

## White Paper

# Avoid Outsourcing Pitfalls

### INTRODUCTION

You certainly know all the myriad efficiencies that outsourcing promises to offer operations or the larger macro effects. Outsourced operations and the savings and increased efficiencies are a proven fact, if the outsourcing relationship and lifecycle is managed correctly, and that certainly won't change anytime soon.

But if there is anything worth considering, those are the common pitfalls that one has to watch out for. For every redundancy that a smart outsourcing project eliminates and every dollar that it saves, there are also risks in managing operations from a distance, both simple and complex.

Smart outsourcing implies awareness and overcoming potential issues and risks, subjects that we will emphasize in this white paper.

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## Ignoring the risks

Instead of introduction, ignoring the risks and pitfalls is actually the first and most common mistake in outsourcing. Ignoring to prepare for outsourcing, failing to consider and understand the full impact of outsourcing on your company results and the actual expectations and goals in this project is the major pitfall before even engaging into outsourcing.

### Tips that may help:

- Set objectives and strategies for outsourcing
- Find support and build commitment from within your own company for the outsourcing project; make sure you have the right people to drive the outsourcing effort
- Define the requirements, set realistic expectations, make sure your organization understands them
- Estimate risks, costs, and changes from the current business model or be prepared to take them into account
- Thoroughly evaluate vendors
- Have an exit plan before you enter the outsourcing deal

### *DO's*

- *Make sure that, when you start the outsourcing relationship, you dedicate the right people and resources on both ends*
- *Make sure your contact person has very good communication skills*
- *Define as much as possible the expectations, document them and set clear performance metrics, and set clear targets.*
- *Be prepared to change; allow flexibility to your contract. Be prepared to renegotiate the outsourcing contract once the outsource partner better understands your business*

**Don't try to micromanage the outsourcing provider; let it choose the resources, and manage the output, not the input. Set targets and measure results. If you are asking for CVs, people, and general input, you are not managing the right thing.**

## Communication is crucial

### *Care for diversity and culture*

One of the most common pitfalls that you will meet in outsourcing is a poor level of communication. Bad communication between parties is surely a success-killer for your outsourced business.

Often, this is related to the **cultural differences** that appear in an outsourcing process since the inner nature of this process implies working with people from various countries and different cultural and professional backgrounds.

While cultural gaps may seem a soft science, dramatic differences can quickly erode an otherwise successful offshore outsourcing relationship. Assuming the cultural differences do not exist in the business community and that all professionals are the same around the globe is a crucial mistake. This can lead to **misunderstanding of commitments, plans, schedules or status reports** or even soft and sensitive issues like tensions in the outsourced team inflicted through culturally insensitive comments or actions. Explain the requirements and then ask questions that would prove that the requirements have been properly understood. Refrain from using more colloquial English, use simple, business English. Put in charge of the outsourced project someone who has multicultural experience, someone who has successfully worked with people remotely.

Outsourcing introduces misunderstandings during communications and translations between languages, and varied cultures and contract structures. Company executives must see these implications and consciously evaluate mitigation strategies.

### *Setting the scene*

Derived from communication is also setting the **expectations**. Setting the expectations is one of the most important steps to undertake at the beginning of the outsourcing relationship. If the goals are not mutually understood and shared, both parties will demand something else from one another and therefore success can fade between different expectations. This can be mitigated by explaining as much as possible the expectations, documenting them, and measuring some clear targets.

### **Tips that may help**

- **Use a single communications channel.** It's important to establish change information with the provider via one-to-one channel, between the project manager from their side and your dedicated

person from your side. Initial specifications are never perfect and you can overcome the problem with continuous feedback.

- **Listen to them.** If you hire them for expertise you lack, don't pretend you know it all. Listen to what they say.
- **Share your knowledge.** Send over one or two members of your staff to join the development team for a while. This will help everyone better understand your corporate structure and standards.
- **Know the project manager.** The project manager in charge of the outsourced project has to have a very clear understanding of cultural differences. Ideally, he has travelled widely and lived in several countries so he knows why people act as they do.
- **Treat your partner as a long-term partner.** If you plan to use an outsourced team, plan a long-term relationship. You will need to closely review the project and monitor progress often.

## Adopt a flexible management

The outsourcing relationship does not manage by itself. It must be managed permanently, and adjusted and evaluated regularly. Changes must be applied; contracting terms must be reviewed, etc. And, most important, these activities will carry added costs on your end.

Make sure you avoid this compelling issue: being rigid in the scope of work. Especially when dealing with a project that involves R&D, flexibility is an imperative. You must be ready to change and adjust according to the findings in the process.

You might need extra resources to dedicate to your project, so make sure you have provisions in your budget for this. A way out is available on both ends. Businesses are constantly identifying new strategic initiatives. If a third-party IT provider can't accommodate new goals, the customer company might want out of the contract. However, be prepared to have an exit plan; it might cost more than you estimate, but less than proceeding with an unsuccessful partnership.

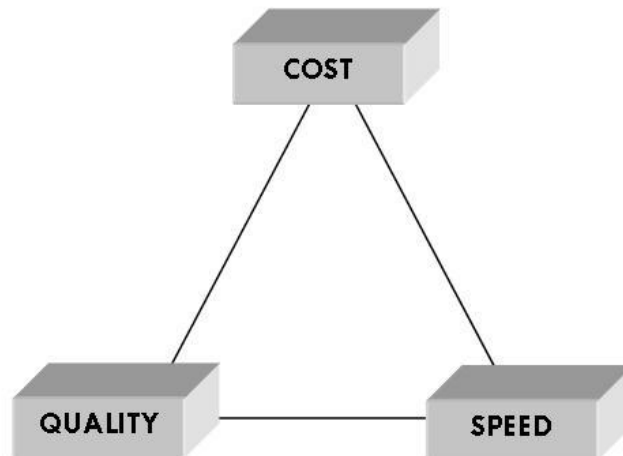
When implementing outsourcing, make sure you're establishing a relationship that has sufficient flexibility to deal with business fluctuations. You must have a realistic timeline for the outsource process and estimate correctly the time required to negotiate a service agreement.

Remember to get the operational issues resolved in the service agreement before moving into legal aspects and financial terms of the agreement.

### ***DON'Ts***

- *Disregard the full impact of an outsourcing agreement on your company's financial condition.*
- *Lack of incentives for provider continuous improvement.*
- *Lack of a contingency plan for major disruptions at the service provider.*
- *Expecting too much from a provider in the early stages of the outsourcing go-live.*
- *Neglecting to "flex" the outsource relationship as outsource requirements evolve.*

## Good quality versus good price



It is well known that one of the benefits of outsourcing is **cost savings**. But more important than this, are the benefits related to improved quality and operational expertise.

This is directly connected to contracting the service with a **Service Level Agreement (SLA)**. In poorly defined contracts there is no measure of quality or SLA defined. Even when an SLA exists it may not be to the same level as previously enjoyed. This may be due to the process of implementing proper objective measurement and reporting which is being done for the first time. But it may also be lower quality through design to match the lower price.

Therefore, if you want good quality **don't negotiate on price** but make sure that quality can be provided given the price. In any moment in time, from price, quality, and development time, you can only have two of them. Even though the price for good quality and rapid development might be lower by outsourcing than the price on your local market, it will still be higher than the price you would get from comparable outsourcers playing on the same market.

Make sure you send the right signals; if you want to squeeze the maximum out of your outsourcing partner don't "nickel and dime" him, reward the right behavior. Rewarding the right behavior is very important as it will align your goals with the goals of the outsourcing partner. If the ultimate goal is to keep the costs low, then reward the partner for not going over the budget and coming up with more cost effective solutions. If your ultimate goal is quality, then set a maximum number of defects that the final product should have and reward the partner based on this goal's achievement. On the other hand if you want speed, then make sure you reward the

completion of tasks in time and bonuses for delivering them ahead of time, know that your outsourcing partner will have to motivate its employees and push them to the max, so make sure you reward him as well.

Do not consider outsourcing only for labor arbitrage. In the long run, greater benefits of outsourcing reside in economies of scale and specialization beyond cost savings with the right mature partner for outsourcing.

## Don't forget security

Before outsourcing, an organization is responsible for the actions of all their staff and liable for their actions. When these same people are transferred to an outsourcer they may not change desks but their legal status has changed. They no longer are directly employed or responsible to the organization. This causes legal, security, and compliance issues that need to be addressed through the contract between the client and the suppliers. This is one of the most complex areas of outsourcing and usually requires a specialist third party adviser. One of the first things you have to make sure of is whether the employees of the outsourcer have a non-compete, non-disclosure agreement signed with the outsourcer.

### ***DO's***

- *Initiate an agreement with a service provider that allows flexibility for the future*
- *Have a realistic timeline for any of the steps of the outsource process, including start-up*
- *Fully define an employee transition plan*
- *Do proper planning concerning information systems and interfacing with the service provider*
- *Do enough technology development before implementation*

For instance, standards of privacy are often looser in some countries than in others. This more relaxed attitude toward privacy could have serious consequences when it comes to protecting corporate data, experts on the panel warned. Companies that outsource operations overseas are advised to train local staff to adhere to the company's global privacy standards and to check into the risk of government interception of sensitive confidential information.

There are a few questions you should ask in order to evaluate the risks in terms of security, such as: What is the infrastructure for security of the outsourcer? Do they have an administration/security specialist? Are they PCI compatible? Maybe. The outsourcer can be the weakest link if you need to be either PCI or SOX compliant. How is your and your customers' data protected?

You must put security issues at the top of the talking points list when you begin negotiating with offshore outsourcers. This might even require information security staff to be at the table in both operations and strategic

planning functions. The most significant security issues revolve around the protection of data in one manner or another.

### Tips that may help

- 1. Get Your House in Order** - Before going outside, make sure your own house is in order. Have a realistic security policy that includes data classification and that distinguishes common from sensitive data, as well as how each type of data should be handled.
- 2. Choose Vendors Carefully - Make** sure the service provider you use has strict security policies too, starting with the hiring process. This rule applies to all types of vendors, but especially to offshore companies.
- 3. Understand the Privacy and Intellectual Property Mindset** - Many countries have very lax intellectual property protection laws. Make sure that the vendor you chose is willing to abide by your privacy and intellectual property policies since a misunderstanding can be costly.
- 4. Use Protection** - You can address the two issues above with a combination of database monitoring gateways and application layer firewalls. These devices have the ability to enforce usage policies as well as prevent privilege abuse and vulnerability exploitation.
- 5. Monitor Traffic** - Make sure the service provider monitors outbound Internet traffic and emails for potential information leaks.

## Keep in mind the geopolitical and economic issues

In connection with the previously mentioned cultural gap and security factors, there are some other risks you should observe before getting into an outsourcing business relation.

### Geopolitical risks

It is related to the host country. Most important factor is political stability and legal environment. Managers should carefully examine the latest political situation of the host country before making their decision. The political situation of most of the host countries is stable nowadays. That is why pre-outsourcing analysis first includes the **legal** factor. Here the main factors that have to be evaluated are intellectual assets privileges enforcement, industry laws, customs regime, license, and "trade exit" conditions. While analyzing geopolitical

risks, one should remember such things as – level of political stability in the host country, legal environment, level of government regulations and support, requirements for vendors, etc.

### **Intellectual Property Protection (IPP)**

IPP is a very important question as offshore outsourcing almost always means the creation and/or maintenance of intellectual property. Often, developing countries do not have the best reputations for protecting intellectual property. It is very important to learn about the IPP law in the target country before the start of an offshore outsourcing operation.

## Conclusion

The majority of problems with outsourcing deals are caused by poor communication and lack of effort early in the process.

As with any relationship, communication and understanding of mutual expectations is key to the ongoing health of the relationship.

Customer executives considering an outsourcing need to understand what they are trying to achieve and be willing to put the effort in up front to increase the likelihood of getting what they want.