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WHITE PAPER



Outsourcing: A Decision of trust

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Chapter 1

1.1 Introduction

Outsourcing is becoming an accepted way of functioning for organizations the world over, however companies remain pensive when it comes to entrusting external agencies with critical application and company information.

Outsourcing can be a viable option when executed with adequate safeguards. This white paper examines steps that need to be taken while deciding whether to outsource or not. Outsourcing can encompass a wide range of services, from a particular project to a technical domain to all activities. Each situation requires a different understanding of the priorities, measures, costs, and the benefits involved.

The paper is not intended to encourage or discourage outsourcing. The purpose of the paper is to stress that outsourcing decisions should be based on a solid business case analysis of alternatives. The business case is always unique to the project under consideration and to the organization.

The paper also enumerates the basic elements that need to be considered to move outsourcing agreements beyond transaction based relationships to value-added strategic partnerships. This white paper further contains certain exhibits generated by HSS as a tool for analyzing vendors. This checklist does not assume any responsibility for errors that might result owing to its application.

1.2 Outsourcing: To Do or Not To Do

A successful outsourcing project is only possible if the outsourcing decision has taken into consideration all known costs and benefits associated with the project. It also important that the contract be effectively negotiated and managed.

It is not possible to provide a simple criteria template for an outsourcing versus insourcing cost-benefit analysis. Each organization must determine its priorities, criteria, and weight for each project depending on its individual capabilities. Though an option might seem quantifiably more expensive, it could be the most effective choice for meeting the company's needs.

A successful project would require constant information, true cost and benefit estimates and should also have specific goals to achieve.

1.2.1 Identifying Agency

The first step in the decision-making process is to identify the organizations' needs. These needs lay the framework for projects and activities.

Address the strategic interests and goals of the company - The strategic plan, the information sources and the company's performance measures should all be taken into consideration while identifying the company's needs. The goals of the company serve as a basis for determining a project's success. Core competencies, by and large, should not be outsourced. However, this might change if it is found viable that resources or knowledge from an external source could supplement the available in-house resources.

Specify the service to be provided and identify the rationale behind the outsourcing. The needs could include cutting costs, enhancing service levels, moving to a different technology platform, increasing technical know-how and skills within the organization.

1.2.2 Quantitative Considerations

The costs of outsourcing incurred by the company would include contract management costs, costs incurred due to the lack of understanding of the project objectives and inadequately defined requirements and costs incurred while accessing skills and expertise that are not available internally.

1.2.2.1 Hard Costs

The total dollar cost remains one of the primary drivers behind the management's interest in outsourcing. Cutting costs is not the only reason behind outsourcing as there could be a number of other reasons to go in for outsourcing. For example, while sustaining engineering projects, outsourcing has enabled cost savings, but application development and system integration projects tend to rely heavily on the need of expertise and resources and can be just as expensive, if not more, than the use of internal resources.

Ongoing operational costs that could be avoided though outsourcing should be identified. The type of outsourcing used could help in avoiding these costs. Simple methods to avoid costs would include avoiding the hiring of additional resources to support an application that is already in production, avoiding significant investments in newer technology, etc.

1.2.2.2 Soft Costs

Soft costs would include intangible costs that have an important bearing on the outsourcing decision and are often ignored. An organization must take these qualitative costs into consideration while evaluating the option. These soft costs would include the impact on the staff, on other organizations, the legal environment, security involved, the sensitivity, the planning-time, project time, the operational risk, the technology risk, the relationship-risk, etc.

1.3 Moving Outsourcing Relationships Up the Value Chain

Many outsourcing relationships begin with optimism and mutual amiability. Both sides profess the need for the client to focus on its core-competencies while the outsourcer's commitment should be in leveraging its technical expertise to deliver strategic value. Outsourcing alliances are generally based on certain key business drivers, as exhibited in the following table that details a comparative-grid that should be used while deciding on your outsourcing strategy. While transactional-alliances are dictated with outsourcing motivators for building strategic alliances, a four-step model is detailed in the following paragraphs.

An outsourcing alliance begins with the outsourcer exhibiting its specialized qualities. At the time the contract is signed the outsourcer projects excellent performance capabilities. But, after a year or so problems arise. The client's objectives of becoming more focused are hindered. Cost reductions and efficiency enhancements are not up to the mark. The outsourcer struggles to address the clients obscure business objectives, meet aggressive performance targets and also focus on its own profit margins.

Figure 1: Comparative Grid for deciding transactional outsourcing strategy.

Business Driver	Outsourcing Motivators	Suggested Outsourcing Model / Strategy to be pursued
Reduce and Control Operating Costs	Free up capacity	Outsource large sustenance assignments that consume a large proportion of resources.
	Reduce Cost	
	Capture benefits quickly	Capitalize on vendors economies of scale to do the job more cost effectively

Lack of employee resources	<p>Increased capacity</p> <p>Speedy ramp up of resources</p> <p>Building knowledge repository</p>	<p>Outsource specific skills (such as systems maintenance which are resource-demanding) that are less critical to future development and value creation</p> <p>Refocus on strategic core-competencies</p>
Technology Expertise	<p>Access to world-class capabilities, best practices, new technology tools etc</p> <p>Shrink product's time-to-market</p>	<p>Outsource major development efforts demanding state-of-the-art technology expertise.</p> <p>Outsource to a vendor specializing in the requisite technology domain, ensuring the availability of 'ready-resources' and capitalizing on 'first-mover' advantage</p>
Share Risk	Share risks in terms of technology transitioning or launching new products	<p>Outsource technology assignments that do not conform to explicitly defined scope, specification and implementation plans.</p> <p>Go in for a time and material execution model for such projects that are difficult to complete in time.</p>

This white paper addresses a four-step model that must be followed for building strategic alliances. Outsourcing is not a typical buying or selling transaction but a case of building long-term relationships, where both the parties are convinced of mutual benefits. From carefully selecting the right-vendor, establishing contract measurements, managing and evaluating the contract, to identifying the outcome measurement criteria, every facet of outsourcing needs planning and diligent execution to make the relationship a successful alliance.

1.3.1 Selecting the Vendor

Outsourcing skeptics believe that an outsider cannot provide the same attention as the in-house team. Therefore, a thorough vendor scrutiny becomes vital before assigning critical technical roadmaps and confidential information to him.

Understanding the emphasis of a vendor's business, or what it is that drives the vendor, is essential while choosing the appropriate vendor to meet the specific needs. A vendor selection team should be developed that would recognize business areas for the project. The vendor selection team should comprise senior management, legal staff with contract expertise, technical staff, end users and financial staff.

HSS proposes a vendor selection checklist. The parameters on which the vendor should be assessed have been carefully chosen, and it is advised that before entering into a relationship, the vendor selection checklist must be completed.

Further, while taking a decision based on our vendor selection checklist, it is advisable to assign weights to the parameters mentioned. According to a survey conducted by The Outsourcing Institute, the three most important factors considered while choosing an outsourcing vendor included price, quality and flexibility.

1	Experience and Expertise	<ul style="list-style-type: none">• Experience with similar projects?• Offering Outsourcing services (in years)?
2	Strong Track Record	<ul style="list-style-type: none">• Past performance history / reputation?• In-house facilities to meet agency's business needs?
3	Ability in handling technology transitions?	
4	Financial Stability	
	Resources	
5		<ul style="list-style-type: none">• Employee Strength• Hiring Process• Employee Demographics• Retaining / Training Polic

- | | |
|---|--|
| 6 | Flexibility <ul style="list-style-type: none">• Business Model Flexibility• Scalability for ramp-up / ramp-down |
| 7 | Confidentiality Comfort <ul style="list-style-type: none">• Well-defined Security Policies• IPR Protection norms• Business Continuity Plan• Quality Standards |

It should be borne in mind that a vendor's business goals are always different from those of the client. The client and the vendor must be prepared to identify and resolve the differences that might arise.

It should be acknowledged that somewhere the external vendors would be making money on the outsourcing agreement, otherwise they would not be willing to enter into an agreement. Signing a contract in haste could lead to working with a vendor who is not responsive to the company's needs and who sticks precisely to the contract letter, charging the agency for any additional services

1.3.2 Establishing Contract Measurements

Measurements are the primary means by which the success or failure of the outsourcing process can be determined. Measurements ensure the accountability of the vendor and also determines the success of the outsourcing effort. If measurements are not in place at the time the program begins, the contract cannot be managed effectively.

Start with measures identified in the cost-benefit analysis. These describe critical success factors where improvement should be seen. Measurements must reflect the specific objectives of the outsourcing effort and must be readily obtainable through business processes and procedures

Metrics should be considered in three different areas: outcome and performance based metrics, quality assurance metrics and work and operational metrics. The objective is to measure the success of the vendor in meeting the business requirements of the agency. These measurements would be the tracking mechanisms for contract. Contracts should include specific clauses about what would happen if the vendor's performance were not up to expectations.

Understand what is being measured to ensure that the appropriate business needs are being met and that an analysis could be performed on the measurements selected. For example, tracking total costs does not allow for a breakdown of why costs increased. It will be important to know whether an increase was due to non-performance or due to an increase in functionality that improved operating efficiency.

Define expectations in the contract. Metrics establish what is expected and what happens if expectations are not met. Use metrics that support business goals. If cost-effectiveness is a major decision driver, include contract provisions to encourage the vendor to reduce costs for the agency. Ensure that measurements can be tracked consistently.

1.3.3 Managing and Evaluating Contracts

Once a project has been outsourced, the agency is not absolved of the responsibility for the service/ process and its success. Many organizations experiencing outsourcing complications have not paid enough attention to managing the contract. Contract management requires the ongoing participation of internal staff in the outsourced project. Areas of involvement include strategic planning, quality assurance, phase containment, change management, and defining and monitoring the measurements.

Consider the following nine factors in the course of managing and evaluating and outsourcing contract.

In-house resources to manage the contract	Regardless of how large or small the outsourcing effort is, internal resources must always be assigned to manage the contract. A larger, more comprehensive contract, such as one for outsourcing development projects or an overall Network Management, requires more in-house oversight because of the specialized measures involved, and the importance of strategic planning to the success of these efforts. The in-house outsourcing project team should be experienced in legal issues, finance, organization processes, and technical domains.
Communication	In managing outsourcing relationships, communication with the vendor is of utmost importance during the life of the contract. Internal staff must be available to identify problems and work with the vendor to resolve them. While selecting a vendor, it should be kept in mind to zero-down on a vendor whose business/ functional culture aligns with that of the organization, so that a communication is fostered and developed to support the effort.
Documentation	All correspondence and communication with the vendor regarding problems, proposed changes, or the implementation of the outsourcing effort should be kept documented in order to resolve disputes or identify areas of strengths and weaknesses that might arise.

Escalation Mechanisms	The vendor should have a well-defined Escalation Process to help customers escalate the problem to next level of management if required. There should be well-framed matrix for critical and non-critical issues with defined escalation-levels based on plan slippage.
An ongoing review process	Reviews of the outsourcing engagement should take place regularly on a scheduled basis to ensure the monitoring of the project and to identify potential problems or issues early. The schedule may be driven by event, date, product, or issue, depending on the needs of the engagement.
Performance Reviews	The performance review process should be kept separate from operational meetings. Performance reviews must focus specifically on success and performance issues, rather than the ongoing operational functions.
Regular Steering Group Interactions	It is always advisable to plan for a platform where a senior management interaction from both sides can be encouraged. The objective for such a forum is to explore further opportunities and discuss other issues.
Manage project requirements	During a project, a vendor could interact with the agency and use resources to identify additional requirements and build a case for increasing the project's scope. In the same way, internal resources could add requirements not identified in the contract and cause price increases.
Plan for an exit strategy	Committing an organization to one firm could result in a loss of negotiating power. Most outsourcing contracts would come to an end at some point in time and the better prepared the organization is to negotiate with other vendors or to take the project back in-house, the better off the organization will be. Planning for unscheduled contract termination is equally as important as managing the scheduled end of an outsourcing arrangement.

1.3.4 Designing and Managing the Management Mechanism

The support and commitment of the senior management is essential while developing a strategic outsourcing alliance. Senior executives who consider sustaining assignments a burden are more likely to view outsourcing solely as a cost-cutting tool or would neglect the relationship altogether. Conversely, the senior management that sees potential value and competitive advantage in their alliance with the vendor are more willing to take ownership of the outsourcing relationship, and would dedicate the resources needed to identify opportunities for enhancing value and scouting for furthering the relationship.

Both clients and outsourcing vendors have incentives to make the alliance work. For clients, the costs of switching vendors or of taking projects in-house are exorbitant; for vendors, being dropped by a client means a loss of revenue, loss of more business and also a blemish on their reputation.

The stakes are even higher with strategic outsourcing partnerships. To make things work, the vendors should have a well-defined internal organizational structure managing the outsourcing relationship. As would be mentioned in detail in the following sections, HSS encourages organizations to go in for a well-defined Partnership Model. HSS has institutionalized a strong relationship model, which has proven itself in our growing business with customers like Nokia and NEC. The model has an amalgamation of all-essential risks, roles and responsibilities of executives driving it - Relationship Owner, Relationship Manager and Program Manager. These are well framed and are shared with the client.

1.4 HSS: A Proven and Mature Outsourcer

HSS, a subsidiary of Hughes Network Systems, USA (GM group company), specializes in providing outsourcing services to Fortune 500 companies. Our reputation in the telecom industry attaches substantial weight and credibility to the outsourcing models and offshore services we provide. Another white paper titled 'HSS: A Proven and Mature Outsourcer' enumerates HSS's experience with executing outsourcing assignments.

The white paper details the key success factors, which has helped HSS establish its credibility as a sought after provider of outsourcing services to the explosive communications industry. The paper also covers the HSS outsourcing process flow from the Contract / SLA Signing stage to the Offshore Project Execution phase.

The white paper is supplemented with the numerous risk-mitigation measures HSS undertakes ensuring the smooth execution of offshore projects. Finally, the paper elicits a case study bringing out how HSS was able to instill faith in its client and thereby transitioned a transactional relationship to a long-term strategic relationship.