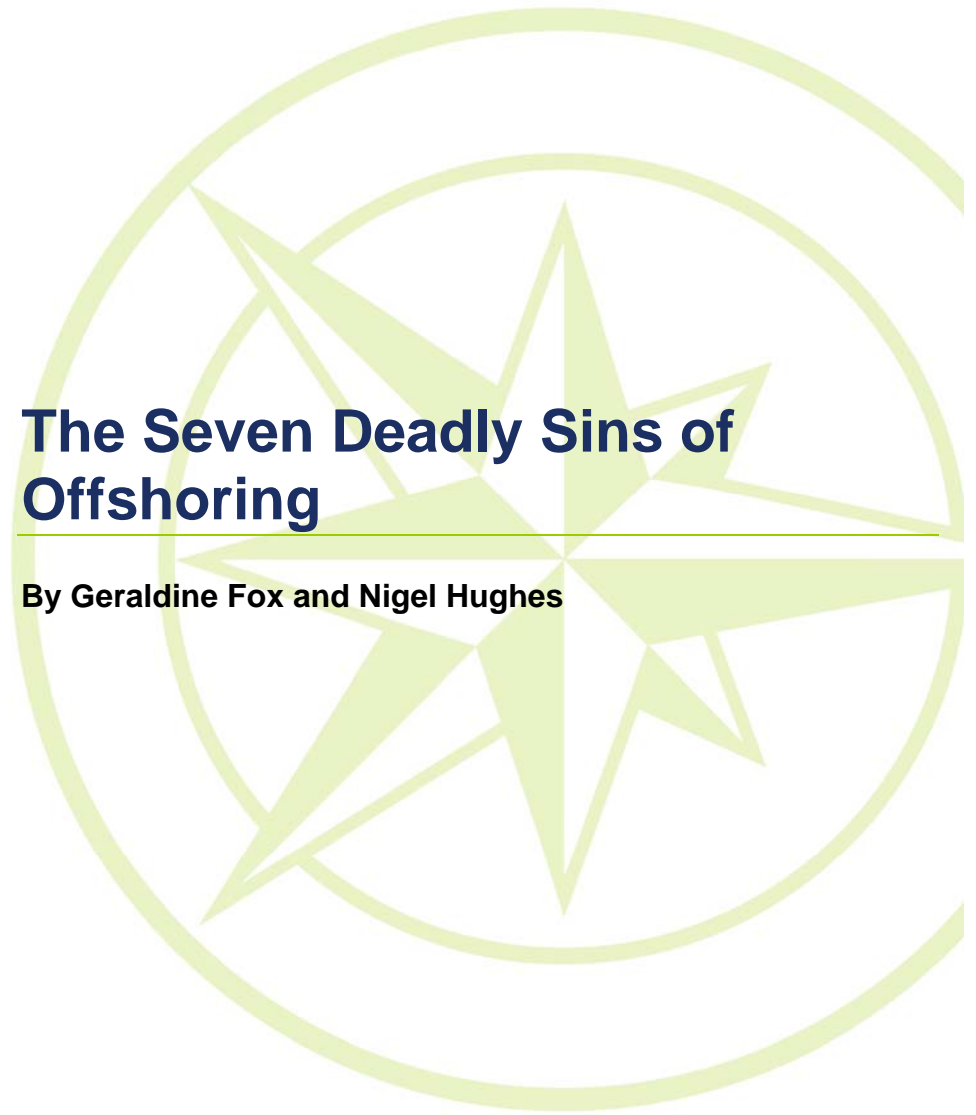


COMPASS



The Seven Deadly Sins of Offshoring

By Geraldine Fox and Nigel Hughes



Introduction

"If history repeats itself, and the unexpected always happens, how incapable must Man be of learning from experience?"
George Bernard Shaw

Offshoring of business operations clearly offers the potential for significant cost savings. However, evidence indicates that organizations are not maximizing the financial benefits of offshoring. While lower labor costs offshore are driving cost savings of 15 percent to 20 percent, Compass analyses suggest that organizations that properly plan and operate offshore initiatives can reap substantially higher rewards.

Operational data from offshore initiatives indicates that the manner in which offshore projects are implemented and managed limits their success. Focused on short-term cost reductions, organizations rush projects through without adequate planning, due diligence, or consideration of the long-term implications of inevitable changes in business requirements or of offshore market conditions.

This Compass white paper discusses – in the context of a tongue-in-cheek discourse on the seven deadly sins – common mistakes organizations make when offshoring, whether through creating captive operations or outsourcing to a third party. This discussion will lead us from the heady Bacchanalian feast of early success, allowing us to learn from past errors and transgressions and firmly resolve never to offend again.

Conceit/Hubris

"Pride does not wish to owe and vanity does not wish to pay." Francois de la Rochefoucauld

The sin of pride is considered the original and most serious of the seven deadly sins, and indeed the ultimate source from which the others arise, so beware. Despite clear evidence showing that rushing through an offshoring project to achieve immediate cost savings is counterproductive in the long term, many organizations succumb to the sin of false pride and plunge headlong into an offshoring initiative without performing due diligence, convinced they will succeed where others have failed.

Often out of hubris, many organizations also wrongly assume they have the necessary internal governance resources, and underestimate the management overhead associated with setting up and then running an offshore operation. Inadequate onshore management capabilities contribute to poor productivity and communications, and to missed cost savings and performance improvement targets.

The truth is, it takes *time* to offshore correctly; more specifically, it takes good planning and detailed execution. An organization unwilling to invest time at the outset and do it properly cannot expect to reap the long-term benefits of offshoring.

Compass Advice: *Don't be too proud to learn from the mistakes of others, nor too arrogant to assume you can cut corners in implementation and abdicate the responsibilities associated with the ongoing management of the offshore operation. Acknowledge that your existing internal resources may not be sufficiently skilled or experienced to execute and manage a project of this magnitude. Invest the time to do it right the first time and in the resources to make it successful throughout the life of the initiative.*

Sloth/Laziness in Planning

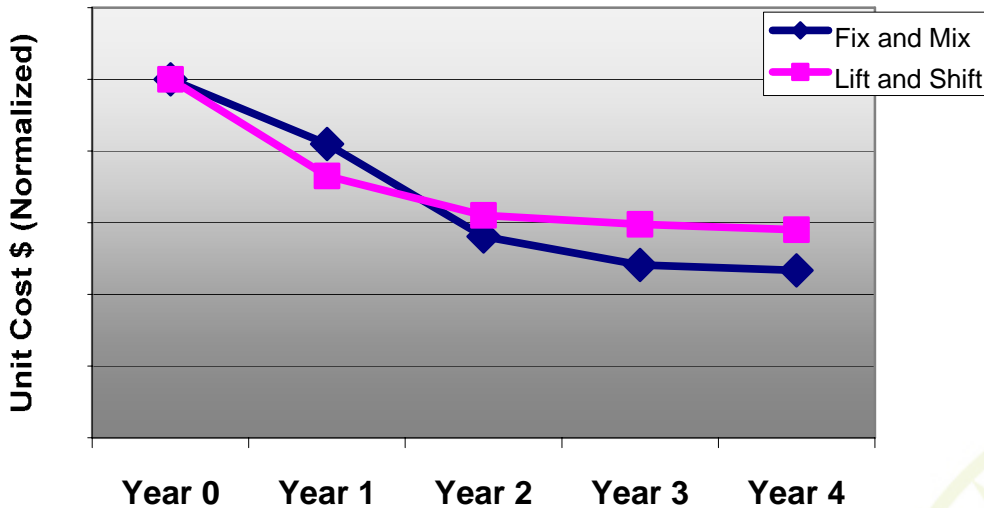
“Laziness is nothing more than the habit of resting before you get tired. Failure is not the only punishment for laziness; there is also the success of others.”
 Jules Renard

The most obvious manifestation of sloth is the unforgivable laziness of abruptly moving an inefficient business process and running the inefficient process more cheaply, thanks to the lower salaries available offshore. What a waste!

Compass analyses indicate that this “lift and shift” strategy is flawed: Although individual salaries may be substantially lower in an offshored environment, the manpower resources required increase by as much as 15 percent.

Let’s examine a real-life example:

Impact of Strategy on Cost per Policy Maintained



The chart above shows that a lift and shift strategy achieves short-term cost savings, but does not address underlying problems. When these problems are offshored, the solution is often to add resources (people). While acceptable when salaries are low, this strategy becomes unsustainable over time as offshore salaries continue to increase, and as traditional offshore locations experience staff shortages and exceptionally high turnover (up to 80 percent a year in certain sectors and regions). A decrease in individual productivity is a common characteristic of offshored environments, even in so-called “mature”

offshore operations. And while offshoring to a captive operation offers the opportunity to solve problems over time, a lift and shift approach with an outsourcer compounds the challenge, as problems must be managed through a third party.

Top-performing companies are adopting a “fix and mix” approach – a concerted analysis and improvement of operations *prior* to offshoring (fix), followed by a selective movement of specific functions to offshore environments where appropriate (mix). This approach ensures that efficiencies are fully realized, and is characterized by investment in process and operational improvement and training, followed by selective offshoring to leverage core

competencies and comparative advantage. The data shows that the initial investment is more than offset over the long term by increased savings.

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Advice: *Don't take the lazy man's path. While lift and*

shift might yield short-term cost savings, this strategy won't pay off in the long term. The days of cheap yet talented labor are numbered; you must be more proactive than your competition. Offshoring process problems compounds issues of distance and culture. At a minimum, develop a performance improvement plan for the offshored operation. Better still, reengineer the operation before offshoring. Invest in building solid processes and an onshore management framework and, offshore, invest in training and orientation to integrate staff into the global organization and create a sense of belonging.

Avarice/Greed

“There is no calamity greater than lavish desires. There is no greater guilt than discontentment. And there is no greater disaster than greed.” Lao-tzu

Avarice desires instant gratification with no regard for the consequences. In offshoring projects, avarice shows itself as a lack of concern for the ultimate fate of the business, as well as in a colonialist disdain for the well-being of offshore development. For those who succumb to avarice, the promise of financial gains resulting from wage reduction and human arbitrage is paramount.

Apart from the dubious morality involved, this approach eventually collides with the reality of staff retention problems offshore (between 40 percent and 80 percent turnover has been documented in various Indian operations), and associated cost and quality problems.

Compass Advice: *Avoid avarice. Take a long-term view. Don't try to maximize savings early on and sacrifice financial and service improvements down the road. Invest in local resources, specifically in staff training, orientation, and retention. Offer a career path – it will pay off in higher productivity and lower attrition. Organizations that invest at the outset in process reengineering and in people will reap the rewards.*

Extravagance/Wastefulness

“I would rather have my people laugh at my economies than weep for my extravagance.” Oscar II, Sweden

Our analyses show that, in general, offshore productivity is considerably lower than that of equivalent onshore operations. Although individual labor rates may well be lower offshore, solving a problem by taking on more, cheaper personnel is wasteful and extravagant and has implications for service quality.

Lower productivity and excessively high turnover in many offshore operations certainly contribute to reduced cost savings. Here's a typical scenario: a problem is offshored, additional “lower-cost” (but highly educated) staff are thrown at the problem, without any effort made to find a solution. After a while, the highly educated employees grow frustrated and depart for more financially and intellectually rewarding jobs, resulting in even more staff being cast into the void. A vicious cycle is created, whereby service quality and cycle times suffer, and error rates increase.

Upward salary pressure in India and elsewhere is forcing organizations to seek new destinations, but the low-cost/low-efficiency model will likely be replicated in these markets as well. Although the salary differential between onshore and offshore workers remains substantial, the combined effects of lower productivity, increasing salaries, hiring/training of replacement staff, and managing problems associated with continuity will close the gap far sooner than originally anticipated. Organizations chasing cheaper talent all over the globe are ignoring a fundamental opportunity to fix the problem *before* offshoring – an approach that would allow them to reap the benefits of both lower salaries and an efficient organization.

Compass Advice: *Don't fall into the trap of compensating for low productivity with more bodies – it is wasteful, extravagant, and a false economy. Apply the same continuous performance improvement mind-set to the offshore operation as has been applied for years to onshore operations. Consider that companies that have invested in technology, infrastructure, and processes in their offshore operation continue to show improvements in productivity and cost savings, reaping the long-term rewards. Don't skimp on governance, either. Account for the management overhead associated with running an offshore operation from the outset and build the necessary governance framework.*

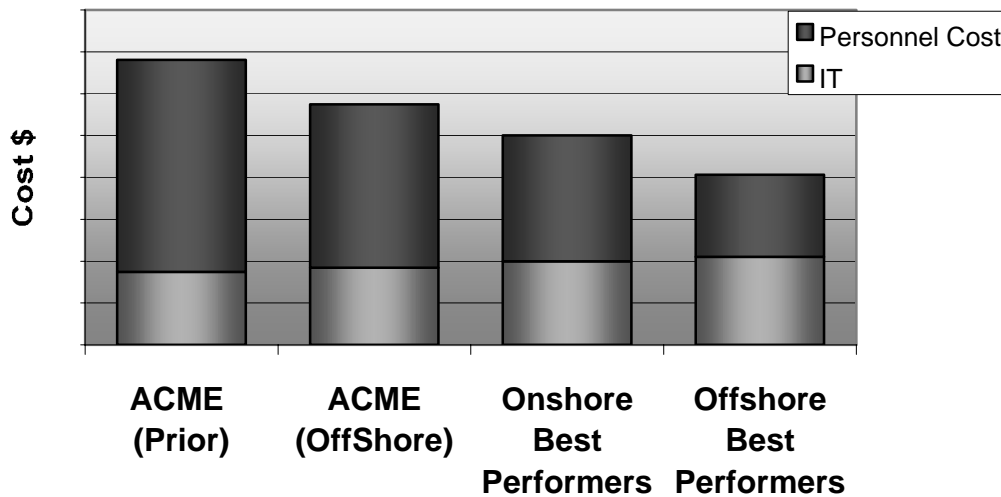
Envy

"Do not overrate what you have received, nor envy others. He who envies others does not obtain peace of mind."
Buddha

Don't offshore because everyone else is doing it. Although you may be envious of the potential discounts, offshoring

investment required to realize the potential efficiency. Such an assessment makes it possible to understand what's needed to reach the desired end state, and whether offshoring is the best way to get there.

Total Cost per Application Processed



The chart at left, based on a recent Compass analysis of a global banking organization, illustrates the point. "ACME Prior" shows the bank's performance prior to lift and shift offshoring. "ACME Offshore" shows performance post-offshoring (16 percent better). "Onshore Best" and "Offshore Best" show top performance among, respectively, onshore

may not be right for your operation. Also, recognize that the discounts are not nearly as deep as touted; claims of cost savings in the region of 40 percent don't accurately account for the impact of lower productivity offshore, higher communications costs, and the additional overhead for onshore governance.

Compass analyses of *onshore* operations frequently identify cost saving opportunities of 20 percent to 25 percent, attainable through the application of technology or improvements in business processes. In other words, offshoring may not be necessary to realize cost saving targets, particularly when considering the costs associated with finding and transitioning to an offshore partner, building new capabilities and processes, and training staff.

Before embarking on an offshoring strategy, an organization should gauge the current and potential efficiency of its onshore operations, as well as the

and offshore operations. The bottom line: lift and shift delivered savings of 16 percent – which is below what top performers achieve onshore and well below optimized offshore operations. Fix and mix would have been a better strategy here.

While offshoring continues to grow, some service operations are being brought back onshore, as organizations weigh the risks that losing direct contact can have on customer relations. This trend is driven mainly by a change in strategy, particularly within call centers involved in both product advice and direct sales. Organizations are discovering real business advantages to running these operations locally, and having their customer interface closer to home. Companies currently repatriating some of their services apparently believe that maintaining a client-facing operation onshore (and /or a customer segmentation strategy) can offer a competitive advantage in the home market.

“Value based routing” is an example of this broader trend. Basically, this approach uses CRM systems to route callers to different locations, based on their propensity to spend money. Callers identified as likely prospects to make a purchase are routed to a home-office center, while relatively low-value calls and routine inquiries are directed to an offshore facility.

Compass Advice: *Don't succumb to envy and follow the herd chasing the newest, hottest craze. Offshoring is a good news and bad news proposition, so consider all your options before taking the plunge. Don't assume that cost savings are automatic, particularly if you want to retain the same level of customer service. Consider your opportunities for onshore performance improvement and, more importantly, consider the implications for your customers and your business model.*

Gluttony

“A fashion is nothing but an induced epidemic.”
George Bernard Shaw

Given the potential cost-savings involved, some organizations succumb to gluttony and offshore as much as possible as quickly as possible, believing this will maximize benefits.

The result of this approach: picture a python swallowing a pig. The corporate body has a limited ability to digest change, and an even smaller capacity to digest offshore change. A Bacchanalian offshoring feast generally leads to indigestion. Organizations that indulge in gluttony find their entire management focus will be directed toward fire-fighting – wasted energy.

The experience of IT outsourcing offers some lessons. Early ITO deals were characterized by a “soup to nuts” mega-deal approach, which was considered the best way to achieve substantial savings and value-add. Over the past few years however, this strategy has failed to deliver, and selective sourcing has emerged as an alternative. In other words, outsourcing has worked for companies that

took a measured approach, designed an optimal mix of outsourced/insourced/offshored service delivery, adopted a “best of breed” strategy regarding service provider selection, and built internal governance capabilities to manage their operation.

Compass Advice: *Gluttony is always a bad strategy; resist the urge. Don't try to offshore everything at once; rather, test your management capabilities in bite size pieces, process by process. Monitor success – identify what works and what the management team can handle. Build confidence and experience by gradually moving the operations. Establish a track record, gain experience, and develop the necessary governance capabilities to maximize potential benefits.*

Wrath/Anger

“Lawyers are men who hire out their words and anger.”
Horace

If a business offshores through outsourcing and the outsourcer fails to deliver on expectations, the business might be tempted to be angry and blame the outsourcer. In reality, both parties are responsible for the result, and the client organization must contemplate its contribution to the failure. A common misconception on the client side is the belief that problems can be successfully outsourced; this view amounts to an abdication of management responsibility.

Clients also often have unrealistic expectations about end results, particularly the extent of the cost savings achievable through outsourcing. Compass analyses indicate that offshore outsourcing achieves lower cost savings than offshoring in a captive environment. This simply reflects the additional charges the outsourcers incur over and above those of an internal service provider, and does not necessarily indicate that vendors are doing a bad job. The higher charges may also indicate that client organizations are outsourcing problems they have failed to solve themselves. As a result, the outsourcers face a greater challenge to begin with.

The fact is, problems can't be offshored or outsourced. They tend to get worse when geographically remote and when third parties are involved.

Compass advice: *If you offshored through outsourcing and find that your service provider has failed to deliver on expectations, don't get angry. Remain calm. Acknowledge your contribution to missed goals and objectives. Channel your energies in a positive manner, work with your outsourcing partner to discover the source of the problems, and chart a path to success.*



The Seven Deadly Sins: Hieronymus Bosch

Summary: The Seven Deadly Sins

- ◆ **Pride:** Don't be too proud to learn from the mistakes of others
- ◆ **Sloth:** Don't take the lazy path – fix, then mix
- ◆ **Greed:** Balance cost-saving and investment to reap sustainable benefits
- ◆ **Extravagance:** Accepting low productivity and compensating with more bodies is wasteful, extravagant, and a false economy
- ◆ **Envy:** Mature operations are identifying and leveraging comparative advantage from onshore, near-shore, and offshore
- ◆ **Gluttony:** Resist the urge to offshore as much as possible, as quickly as possible
- ◆ **Anger:** Don't outsource a problem and then blame the outsourcer

Learn from others' offshoring experiences, avoid the seven deadly sins, lest you be forced through the gates of offshoring hell:

*"Through me you pass into the city of woe:
Through me you pass into eternal pain:
Through me among the people lost for aye...
Abandon hope all ye who enter here"*
Dante, *Divine Comedy*

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Compass is an independent global management consulting firm that helps Fortune 1000 organizations achieve positive and lasting change in business and IT operations.

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Compass' unique approach is powered by comprehensive operational models and a global performance database that are harnessed by highly experienced consultants to target and achieve demonstrable results – results you can count on.

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