Offshore Outsourcing: Strategies, Processes, and Responsibilities

(Part II in a Series)

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The use of outsourcing has increased over the past decade, with offshore outsourcing in particular experiencing accelerated growth as of late. Organizations in developed countries are outsourcing all kinds of functions — including software projects, finance and accounting, contact centers, Web design, animation art, and R&D — to foreign countries.

The decision of whether to go offshore depends on several factors including determining which functions would be good candidates for offshoring; planning the what, how, when, and by whom for the evaluation and selection process; gaining senior management's commitment and the support of key stakeholders; identifying and mitigating the inevitable risks; asking the right questions; and finding the appropriate answers along the way.

The accompanying *Executive Report* offers you insight and advice on offshore outsourcing strategies, the processes that culminate in an offshore contract, and the responsibilities of both sides in making the arrangement work.

ALTERNATIVE OFFSHORE SUPPLIER STRATEGIES

Because of the relentless cost pressures of the global economy, companies are continuously searching for new and better ways to make their value chains more efficient and to compete more effectively. There are four basic viable offshore supplier strategies:

1. **Alliance, partnership, or joint venture.** Relatively few supplier relationships work well as partnerships or alliances because the costs and potential risks of supplier partnerships are usually high and considerable communication and integration activities must take place between the two companies.
2. **Vertical integration.** This is a traditional strategy that has been used for decades. It extends a firm's competitive scope backward and/or forward within the same industry. It involves expanding the firm's range of activities backward into sources of supply and/or forward toward end users of the final product or service.
3. **Merger and acquisition.** Acquiring an offshore supplier could strengthen a company's market position and open market opportunities in a new region or country, and combining operations might fill resource gaps and allow the new company to do things that two separate companies could not do individually. However, this strategy rarely achieves the intended benefits because of inflated expectations and because capturing the intended benefits proves much more elusive than anticipated.
4. **Outsourcing with an offshore supplier.** Compared to other supplier strategies, offshoring is almost always a better alternative for a typical business. It makes the most sense when the activity is not crucial to the

firm's ability to achieve sustainable competitive advantage and when the outsourced function will not hollow out the company's capabilities over time.

Offshore suppliers can offer a company several advantages, including:

1. **Quality** — obtaining higher-quality services or components than what internal units can provide.
2. **Cost savings** — obtaining services at lower cost.
3. **Business agility** — enhancing the firm's strategic flexibility by finding suppliers with the needed capabilities already in place is often cheaper and faster than hurriedly retooling internal operations.
4. **Innovation** — improving the company's ability to innovate by interacting with "best-in-the-world" suppliers who should have considerable intellectual depth, experience with a number of other companies, and innovative capabilities of their own.
5. **Expertise** — gaining access to expertise faster than finding and hiring people with the skills and experience and building the internal capabilities.
6. **Market expansion** — expanding outside the domestic market usually requires an infrastructure; doing business with a company in the foreign country targeted for expansion may make it easier to compete successfully in that country's market.

PLANNING AND FEASIBILITY ANALYSIS

A major challenge in analyzing the feasibility of offshoring is to estimate potential cost savings. Although offshore suppliers have substantially lower labor rates, it is important to quantify this advantage in the context of total costs. Develop a baseline of current costs to be compared with supplier proposals for the function(s) to be outsourced.

In deciding which suppliers to consider, research and identify the offshore service suppliers that are the strongest in various service offerings. Companies that have previously taken services offshore can provide useful information about which suppliers are best at both providing the services and building an excellent relationship.

Encourage supplier competition throughout the selection process, evaluate supplier responses to your request for proposal (RFP), consider tradeoffs, decide whether offshore outsourcing is still desirable, and, if it is, proceed to contract negotiations with one or more suppliers.

OFFSHORE CONTRACTING

Follow some important contracting principles, including:

- Develop a negotiation strategy before sitting down at the table with suppliers. A term sheet can be used to define the essential issues for negotiation.
- Along with the RFP, provide a complete contract to which the suppliers must respond in their proposals.
- Don't allow a supplier to begin work before a contract is completed and signed.
- Maintain a win-win attitude, foster open communications, pay attention to detail, and enforce a realistic but firm schedule.

MANAGING THE RELATIONSHIP

Managing outsourcing is different from managing an inhouse function, and it requires a different mix of skills. The team members in charge of any outsourcing arrangement need negotiation, technical, financial, operational, and contract management skills specific to managing a supplier. If possible, colocate the offshore outsourcing managers from both organizations so that person-to-person communication is easy and spontaneous. Frequent face-to-face communication is the most effective.

Necessary skills for relationship managers include operations oversight abilities in monitoring requirements; approving changes and handling disputes; technical oversight abilities in planning technology architectures and setting standards; financial oversight abilities in monitoring costs and paying bills; contract administration ability in negotiation to adjust the client-supplier relationship in response to changing conditions.

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