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Seven things everyone engaged in offshore outsourcing must know to address budget overruns and frustrations

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By far the most common reason for hiring offshore service providers is to save money--often, a lot of money. Yet surprisingly often those big savings turn into nickels and dimes. "I don't know what happened," one outsourcing manager told me recently, "but we've gone at least 25% over budget for the past six Quarters. This whole program is out of control."

If you're feeling frustrated by hidden costs in your outsourcing services budget, approaches presented in this article will help. I will examine the following issues:

1. Why "low bidders" almost always become a high-cost solution
2. How excessive employee turnover creates cost overruns for you
3. Why lawyers often negotiate defective offshore contracts
4. What to do when offshore vendor escalates all the hard work to your staff
5. Why offshore vendors break promises and miss deadlines
6. How to deal with low offshore productivity
7. How to base your vendor payments on "outcome-based" metrics

Why "low bidders" almost always become a high-cost solution

""I don't know what happened," one outsourcing manager told me recently, "but we've gone at least 25% over budget for the past six Quarters. This whole program is out of control."

Many users of outsourcing are finding that the vendor is not delivering as originally expected – Product schedules begin to slip and Customer satisfaction relative to functions provided by the offshore group starts to decline. Customers feel the product is moving away from their needs or the call center doesn't seem to "understand our needs". Some times this begins to happen right away but quite often it happens when the initial honeymoon period is over. What

this means is that you spend additional time and money from your budget to fix up the problems, recover from projects. It is money you did not plan on spending and hence a hidden cost to you.

Analysis and Recommendations

Why does this happen? This begins with the choice of vendor. Too often companies turn the process of choosing a vendor into a purchasing process. They negotiate the cheapest possible deal. As a result, they almost guarantee poor service. Evaluate your vendor based on your priorities and a set of criteria beyond price. I will list the important ones:

- Size – If your outsourcing contract is for 25 people and you are considering one of the top tier companies in India – you are headed for trouble. They are 100,000 + people and you won't get their best people or best service. Pick a vendor for whom your business matters.

- Culture: Product Development vs IT Services or BPO. Carefully look at this. Management processes and culture are different for each. Which one do you need?

- Expectations: Understand vendor's expectations. What size and by what time? Can you do it? For example, recently I saw a company with an immediate need for 20 people. They promised growth to 50 in 2 quarters and 100 by 1 year. Did not happen. Now the vendor is unhappy. Customer is also unhappy because he is not getting the service he expects.

- Staff: Reason to go offshore. Check – depth of expertise, Number of people, how long, vendor's ability to attract and retain staff.

- Ability to meet your future needs.

"Too often companies turn the process of choosing a vendor into a purchasing process. They negotiate the cheapest possible deal. As a result, they almost guarantee poor service."

How excessive employee turnover creates cost overruns for you

You invest valuable U.S. staff time to train the offshore team and put in a lot of hard work to do trial runs. At this point, several months have passed; you now conclude that they understand your issues, you reassign and/or remove staff at your U.S. location, because you can afford to duplicate staff only for so long. Not much longer after this move, you learn that key developers and/or team leads have left the offshore team. Even though the offshore organization says that they will address it, you realize that there is no way that they can do it, without investing additional resources from head quarters. Another unplanned expense!!

Analysis and Recommendations

- Examine attrition metrics

  When you are in the process of hiring a vendor and ask them what their attrition rate is, they will provide you a number, say X%; this is usually a rate at which their whole organization is losing staff. While this metric is good for you to be aware of, you need to manage additional aspects of attrition:

  Staff rotations planned and unplanned: Many offshore vendors have established rotation for their staff. This will not be included in the X% since the person would not have left your vendor's organization. But, for you, this is still loss of training investment you have made. Rotations of the unplanned variety happen when some one leaves your organization, on their own, but stay within the company; the argument from vendors goes something like "She was going to leave your support center any way; we would rather keep her within our company."

  Attrition from your specific functional area, but within your own Offshore Support Center: If you are the manager in charge of this functional area, this is still attrition for you.

"Turnover metrics about the vendor's company is interesting, but you need go beyond that and understand turnover metrics that affect you directly."

When you look at attrition through these lenses, your own attrition rate will be higher than X%. To better manage this, you need to establish agreed upon rotation plans within the vendor's organization, understand why there is attrition from project to project and take corrective

- Examine the type of work offshored

  It makes a critical difference whether you offshore only routine tasks or give your offshore team challenging assignments. One of the motivators for the offshore staff is the type of assignments and opportunity to learn and progress. On the other hand, you do have routine tasks that some one has to do and most likely you have offshored these tasks to begin with; in such a case, establish a planned progression for key performers so that they can see that by staying with you, they will continue to have the opportunity to learn.

- Examine the offshoring model

  This is not intuitively obvious. Some companies have gone offshore and established a subsidiary of their own, without considering minimum size that is necessary for effectiveness. In the current environment where demand for skills is high, if you do not have local branding and your size is less than say 200, it will be hard to retain key personnel; they can see better career opportunities at a larger organization.

- Incentives

    You can set up incentive plans for individuals or groups as part of an overall retention plan; but make sure that this is done in close partnership with the vendor and you are compliant with IRS regulations.

- Overstaffing

    Some vendors allow extra staffing at their cost. Check out this option.

Why lawyers often negotiate defective offshore contracts

Most contracts define rates and legal issues. They are vague about performance metrics (e.g., "best efforts") and allows loopholes.   For example, if the operating manager is not free to specify level of experience for the staff say 3 to 4 years – vendor is free to provide less experienced people. This causes additional cost in training and productivity.

"Lawyers are necessary to negotiate offshore contracts. But to be effective, you need to get operations and business staff involved."

Analysis and Recommendations

- Involve business and operations experts in contract discussions from the beginning.
- Set up explicit metrics – Examples: Staff retention. Planned rotations. Outcomes.
- You may want to consider rewards for good performance and penalties for under performance.

What to do when the service provider escalates all the hard work to your staff

Vendor's staff handles easy calls, but escalates most complex issues (which take more time to resolve) to your in-house team. This issue is applicable to support centers. You need to devote more staff locally. Unplanned expense!!

Analysis and Recommendations

Quite often this behavior is not intentional on the part of the vendor's staff. It is difficult for the vendor's staff to make the right call between making a customer angry by holding on to a call too long vs escalating too soon which will force you to increase staff at head quarters. Here are three steps you can take to address this issue.

- Benchmark

  Compare escalation rates among several outsourced operations or at least outsourced vs in house. Set up a performance metric and hold the vendor responsible.

- Train offshore staff and managers when to escalate

  You need to invest in training offshore managers on how to make the decision between taking too long to escalate vs escalating too quickly.

- Provide objective feedback

  Most offshore staff will respond to objective feedback and coaching. You should make this an on-going part of the operations.

Why offshore vendors break promises and miss deadlines

"Why doesn't the offshore team just say what they really mean – they cannot do it rather than say yes and still not do it?"

Vendor appears to commit to performance targets, deadlines, etc. but routinely ignores these promises. Here are quotes from conversations with user managers:

> "Why doesn't offshore team just say what they really mean – they cannot do it rather than say yes and still not do it?"

> " I had a meeting of all people on both sides of the ocean, went over our project details. No one from the offshore team spoke up. I assumed that there were no further issues. Finding out one day before integration deadline about offshore team not meeting deadline. Very upset. What am I supposed to tell my boss?"

You spend time and money from your budget to recover for late deliverables and poor quality. This is another hidden and unplanned cost.

Analysis and Recommendations

As with other situations, there is no one silver bullet. You need to address multiple issues to resolve this and get your costs under control.

- Management competency: Managers and executives find themselves with the task of managing an offshore effort or initiative due to an organizational need and they have never done it before. Often they do not receive training in the nuances of how to be effective in multicultural environments and manage operations thousands of miles away. Though they will develop this skill over time, you should provide training to help them get up to speed rapidly. If you have done this initially when you launched into offshoring, you need to continue to train new managers.

"Part of the solution lies in you educating your managers in how to function effectively in multi-cultural distributed environments."

- Clearly define management processes for managing in a distributed environment; after all you are dealing with issues 10000 miles away.

- Get a handle on the capability of offshore managers' competencies; you need to make sure that they meet your needs.

How to deal with low offshore productivity

Here is what I heard from a manager recently: "One developer on my staff in the U.S. can do the work of 2 offshore"

He is not alone or unique. I find many managers mention variations of this theme. They complain that low productivity in the offshore operation is eliminating the cost benefits that you justified the movement to offshore in the first place. Added to this, there are costs associated with travel, communications and duplication of equipment, to name a few. The implied conclusion by at least some of the staff is that it is not saving money after all and it was a bad idea to have gone offshore.

"One developer on my staff in the U.S. can do the work of 2 offshore!"

Analysis and Recommendations

With time, offshore productivity can begin to suffer; this is especially true when an offshore operation begins to grow. You need to take stock of various possibilities that impact productivity. Here is a checklist:

- Right Offshore Staff

  You need to assure right skills offshore. Initially at least get involved in staff selection. Look at resumes, phone interviews. Over time you and the vendor understand enough so that they can do it on their own.

- Right Projects

  Surprisingly outsourcers are often given assignments that are almost impossible to do well. These include projects that demand specialized domain or cultural knowledge, lots of face-to-face interaction, and fast-changing performance goals. Take an objective look at your offshore portfolio and restructure for success.

- Meaningful Incentives

  Make sure vendor has meaningful incentives for improving productivity (instead of losing revenue by reducing call volume). If you do not provide incentives to improve productivity, you are asking the vendor to unilaterally "reduce" their revenues. Who will do that?

- Offshore Management Processes

  Many managers are comfortable with passing information in "water cooler conversations". But when you are operating in a distributed and multi-cultural environment, management processes must be razor sharp. Make sure that yours are.

- Regular Audits

  Management has plenty to focus on these days. Nothing goes smoothly all the time. The problem du jour can consume a management team and offshore activities are increasingly left to operate in a vacuum. Depending on the nature and severity of the problems that distract management, the situation offshore can get very severe before it hits the radar screen. By then many things are broken. "I didn't hear anything about it and assumed that everything was OK. How did it get broken so fast?" is the comment I hear often.

An initial assessment to get a handle on how well the offshore initiative meets your objectives, coupled with a regimen of regular assessments can avoid big problems. The key is building the mechanism in your operations so that regular assessments to optimize your offshore operation are expected and anticipated by all members of your team.

How to base your vendor payments on "outcome-based" metrics

What you don't measure will generally get neglected. You should identify the critical areas and establish metrics; just the fact that you have communicated your decision to watch these key metrics often improves performance.

Traditional outsourcing models focus on input; for example man hours, person months, emails answered or number of calls processed. On the other hand outcome-based focuses on output i.e. reaching a business goal such as customer satisfaction, customer loyalty, support cost as a percentage of revenues etc.

Analysis and Recommendation

Ultimately, buyers do not want to buy person hours, but you want an outcome -- such as a completed product or a satisfied customer. Reasons to consider outcome-based model:

- This model helps align the business goals of providers and buyers.
- It offers potential for higher eventual savings as labor arbitrage is replaced by productivity and synergies between tasks as key savings drivers.
- It provides the ability to incent more innovative behavior from provider.

But there are challenges:

- Potential lack of transparency into how work is being performed
- Little insight into cost of service (unless visibility into resource consumption is maintained)
- Additional administrative burdens associated with root cause analysis (if service is not being delivered as promised) and evaluation of service delivery
- Resistance from vendors
- Measure of success needs to be tied to the outcome under the vendor's control

On the balance, I recommend the use of outcome-based approach wherever possible.

"Too often, the measures that we use for success are process-based or output-based, instead of outcome-based."

" In driving toward outcome-based metrics where possible, we get to the "heart of the matter"-the essence of what the program is supposed to provide."

Summary and Next steps

While many companies are frustrated with offshore outsourcing, you need not be one of them. By implementing approaches outlined in this article you can avoid budget overruns, operational difficulties and get back in control.

The first step in any implementation is to figure out which of the issues outlined here apply to you. Occasionally, I find that there are issues outside of the most common ones I have outlined. In either case, you need to develop a customized implementation road map unique to your situation.

By customizing and implementing approaches outlined in the article, you can address budget overruns, operational difficulties and get back in control

About Sath Associates LLC

Beginning with pioneering work at a $2 Billion a year Fortune 500 technology company, 25 years ago, we have been advising clients to launch, manage and optimize outsourcing and offshoring. Typical issues addressed – outsourcing strategy, finding the right vendors, negotiating contracts, onboarding vendor staff, establishing operating processes, metrics, setting up the right management structure, optimizing for maximum benefits. Robotic Process Automation (RPA) creates opportunities to optimize outsourcing and in some cases eliminate outsourcing altogether. We advise clients on outsourcing and RPA.

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