Offshoring by SMEs

Dr Hugo Velthuijsen
Dr Franz Josef Gellert

KCO College  October 4, 2011
Contents

- The rationale for Offshoring & SMEs
- The Offshoring process
- Partnering & Contracting
- Communication
- The SME Culture
- Trust
SMEs & Offshoring

Motivation

- Expected shortages of IT specialists
  - Estimates between 8800 and 16,000 in the Netherlands once the financial crisis is over*
  - Shortage equals approx 5-10% of available jobs requiring higher IT education
- Small & Medium Enterprises (SMEs) typically do not score top of the list of employers of choice
- IT specialist shortages will hit SMEs hardest
- SMEs need to look abroad for fulfilling IT need
  - Bring the work abroad (offshoring), or
  - Bring foreign IT specialists to the Netherlands
- And possibly: cost, quality & know how!

*Source: IT~Office
SMEs & Offshoring

But …

- Some say: SME’s too small for the business case to work (Delen, 2009)
- Offshoring is hard:
  - 85% of offshoring companies are not satisfied (research Rotterdam School of Management)
  - ‘Backshoring’ as a new trend

- Vision
  - In the end, backshoring solves nothing
  - Problems need to be identified and solved
  - SMEs need to embrace offshoring also.

- Cost, quality & know how may become secondary drivers for offshoring
Contents

- The rationale for Offshoring & SMEs
- The Offshoring process
- Partnering & Contracting
- Communication
- The SME Culture
- Trust
Outsourcing process

- **Strategy**
  - What?, core business?, partners?, ...

- **Operations**
  - Tooling, interfacing, ...

- **Finance**
  - Reporting, risk management, ...

- **Organisation and human resource management**
  - Functions, competences, ...

- **Legal**
  - Intellectual property, Open Source, shaping collaboration, ...

- **Governance**

---

Source: Brown and Wilson (2005); Gonalgo et al. (2005)
Outsourcing process

Topics

- Kraljic model
- Contracts & SLAs
- Trust
- Communication
- HR
Adapted Kraljic model

Tool for classifying systems & processes

- Added value
  - low
  - high
- Specificity
  - standard
  - specific

- I
  - Data centers
  - Communication
  - Workstation management
- II
  - Service management
Sourcing strategy

Example

Source: Confidential
Maturing offshoring relationships

Different systems & processes may be in different phases

Contents

- The rationale for Offshoring & SMEs
- The Offshoring process
- Partnering & Contracting
- Communication
- The SME Culture
- Trust
SMEs & Offshoring partnering
Finding the right (sized) partner

Potential brokers:
- Industry associations
- Experienced IT companies

Broker

Corporate
Large
SME
SOHO

RentACoder
Projectbidz
Freelancer

Real Projects. Expert Freelancers.
Contracting

Different types of contract for different phases

Issues found during analyses of existing offshoring relationships:

- No standard contracts and/or standard contract elements leading to added costs in verifying specific agreements
- Substantial added work costs due to incomplete or ambiguous specifications
- Processes split over multiple providers with client as SPOC leading to additional communication overhead and inaccuracies
- Lack of mechanisms for dealing with poor or excellent performance; risks left with the customer
- Directing on process norms instead of business KPIs leading to unaligned behaviour

Source: Confidential
The rationale for Offshoring & SMEs
The Offshoring process
Partnering & Contracting
Communication
The SME Culture
Trust
Key success factors offshoring

Communication is a key aspect covered by our current research

Key Success Factors for Offshore Outsourcing

**External success factors**
- Continuous controlling of project results
- Continuous communication flows
- Detailed contracting

**Internal success factors**
- Definition of clear project goals
- Detailed project specifications
- Thinking beyond cost savings
- Top management commitment
- Effective risk management

**Generic success factors**
- Good language abilities
- Composition of appropriate project team
- Continuous communication flows
- High quality of offshore employees
- Cultural awareness

**NB:** Cultural awareness is a separate field of study covered within our CoE, cf. theories of Hofstede and Bennett, and has strong relations with communication.

Communication

Cannot be covered by formal communication alone

Source: Willcocks, Cullen, The outsourcing enterprise, the power of relationships, Logica, 2010
Communication

Avoid intermediaries

- Company
- Outsourcing
- Offshoring

Business department

IT department

Business owner
IT demand
IT supply
IT proc
Acc mgmt
IT proc
Acc mgmt
IT ops

Avoid intermediaries
Communication

Communication attributes

Attributes of communication quality

- Technological factor: Quality medium
- Quantitative factor: Timeliness
- Qualitative factor: Accuracy, Completeness, Consistency, Credibility, Interpretation differences

Common understanding between the Indian vendor and its Western client

Offshore BPO success
- Flexibility
- Price
- Profitability
- Quality

Antecedents

Communication processes

Outcomes

Contents

- The rationale for Offshoring & SMEs
- The Offshoring process
- Partnering & Contracting
- Communication
- The SME Culture
- Trust
<table>
<thead>
<tr>
<th>The most distinctive capabilities:</th>
<th>In practice an ability to:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Offshore readiness</td>
<td>• Understand the shortage in skilled IT personnel in the .</td>
</tr>
<tr>
<td></td>
<td>• Have the mindset to strategically consider offshore outsourcing possibilities.</td>
</tr>
<tr>
<td>Capability to define appropriate strategy</td>
<td>• To build strategy to enable trustworthy relationships where external capabilities are available when necessary.</td>
</tr>
<tr>
<td></td>
<td>• Answer the questions:</td>
</tr>
<tr>
<td></td>
<td>o How can I keep the company competitive?</td>
</tr>
<tr>
<td></td>
<td>o How can I make use of the capabilities available in offshore locations?</td>
</tr>
<tr>
<td>Contract facilitation</td>
<td>• To build transparent and cooperation based partnering contract with the supplier.</td>
</tr>
<tr>
<td>HR management</td>
<td>• Recruit employees who match and complement each other’s personalities and promoting effective team work.</td>
</tr>
</tbody>
</table>

SMEs & Offshoring

Relationship styles

![Diagram showing relationship styles between power-based and partnering-based relationships.](source: Cullen and Willcocks, 2003)
SMEs & Offshoring

Main conclusions multiple case study

- SMEs lack internal capabilities compared to large companies
- SMEs should use partnering-based methods of negotiating and preparation
- SMEs can benefit from the supplier’s personnel by coordinated HR management to minimize consequences of lack of internal skills
- The most distinctive capabilities for SMEs are:
  - Internal offshore readiness
  - Capability to define an appropriate strategy
  - Contract facilitation
  - HR management

Contents

■ The rationale for Offshoring & SMEs
■ The Offshoring process
■ Partnering & Contracting
■ Communication
■ The SME Culture
■ Trust
Issues of Trust

General observations

- There is a high level of quality available in offshoring countries, e.g. India:
  - Amount of students educated is staggering (>300,000 engineering graduate / yr)
  - Level of education is high (top students go to world wide top universities)
- The question is not so much can they do it, but rather can we do it (together)
- High end IT & BPO companies conform to international standards
  - CMM-I level 5
  - Native English speakers
  - Used to multi-cultural collaboration
- Clients needs to build their trust in the capabilities of their providers
- Providers need to build trust with their customers Need to invest in knowledge transfer and relationships
- Clients need to invest in the relevant domain knowledge of providers*
  - For foreign employees to understand the needs and to build better solutions
  - For own employees to exploit capabilities better
  - For manageing employee turnover

* See also J. Rottman, Successful knowledge transfer within offshore supplier networks: a case study exploring social capital in strategic alliances, Journal of Information Technology, 23, 31-43, 2008
Issues of Trust

SME perspective

- When an SME partners with a similar sized provider, the provider’s capabilities may be hard to establish
- When an SME has to provide extensive insight in proprietary business operations, the SME will be anxious wrt confidentiality
Development of Trust

Contract life cycle

Pre-contract phase

Post-contract phase

initial trust

mutual trust
Building trust in the literature

Model derived for SMEs

Key difference in “informal working methods”

Trust in a broader context

- Senior trust
- Adult trust
- Baby-Trust
- Relationships
Relationships

Cognitive (confidence to rely on others competence)

Affective (confidence in a partner based on feelings)

With colleagues, supervisors, managers and partners in Private life and business
A matrix to categorize trust development

<table>
<thead>
<tr>
<th>High Quality</th>
<th>Low Quality</th>
</tr>
</thead>
</table>
| Professionals (cognitive) | Trust Hoppers=???
| Sustainables | Believers (affective) |

Small time frame | Huge time frame

Development
Trust is one of the key elements in successful offshore outsourcing relationship between client SME and service provider.

From client SME’s point of view, building a trustful relationship between the partners reduces the possibility for opportunistic behaviour by offshore service provider.

An SME can actively improve Trust in the relationship with an offshore service provider.

Informal working methods support the building of Trust and SMEs appear to be better at informal working methods than large companies.

Questions?

>>> Just Ask!

Dr Hugo Velthuijsen / Dr Franz Josef Gellert
Professor Business & IT
Leading Professor CARI Entrepreneurship
Institute of Information & Communication Technology
Hanze University Groningen,
University of Applied Sciences

Tel: 0031-50-595 4551
Mail: h.velthuijsen@pl.hanze.nl
Thank you!