

Risk mitigation through offshoring of services

**How to make it a viable solution for
smaller US enterprises**

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1 Introduction

Offshoring of services has become increasingly popular among large US companies over the past decades. Overseas countries, with India in the forefront, have proved that offshoring critical tasks or business processes to them will reduce costs and often improve the quality of deliverables. Good examples of such success stories are companies like Infosys, Wipro and TCS.

What started as cost-leverage has now matured into knowledge-based services. The so-called BPO (business process outsourcing) is now moving towards KPO (knowledge process outsourcing) and Indian companies, for example, are becoming more confident in delivering value-added services with higher skill domains.

For smaller companies, however, there are still some perceived barriers-of-entry to overcome in order to make offshoring of services a seemingly realistic choice. For example, the initial cost of setting up production and the fixed costs to maintain it can be overwhelming. Many smaller companies, even if they sometimes use outsourcing as part of their strategy, do not even consider offshoring of these services because of the perceived high risks associated with it. Hence, what is becoming standard operating procedure for many larger enterprises is still considered much too risky business for smaller firms.

Of course, there are risks associated with all types of offshoring, and these risks can be very different than the typical risks associated with in-house business processes or outsourcing within the US. But could there be risks associated with **not** offshoring some services? If offshoring can be viewed as a potential opportunity, then, if not carefully considered and evaluated in the risk management process, it could logically turn into a threat. So how can smaller US companies decide if offshoring of services is a viable option for them? How can they decide if offshoring is a threat or an opportunity?

2 Offshoring services

Offshoring is the process of moving a business operation to a location overseas, whether through a third party provider (an outsourcer) or through the creation of a company's own subsidiary. Hence, offshoring does not necessarily mean outsourcing to a company overseas; it can mean opening an own office or subsidiary overseas. The term nearshoring, or “nearshore outsourcing” also refers to offshoring but to locations that are geographically nearer the US, such as Mexico and Canada (www.wikipedia.org).

The genesis for white-collar offshoring (eg. offshoring of business processes or tasks) was the availability of telecommunications that allowed workers anywhere in the world to access communications. As the speed, reliability and availability of this worldwide communications has increased more and more tasks are available to offshore as well as the locations that these tasks can be performed from. White-collar offshore outsourcing



started with offline tasks such as transcription that require asynchronous communications and then progressed to IT and business process outsourcing and call centers which required high bandwidth constant communications, and is now moving into other higher-level services like engineering, research, legal, accounting and design. So called knowledge process outsourcing.

2.1 Opportunities

Offshore outsourcing is a politically sensitive topic in the United States. As American job losses now have spread from manufacturing to service-sector jobs and professional fields, opponents argue that even if cheaper imports create a broad welfare gain in the form of lower prices, if a large number of people lose a greater amount in wages due to increased inequality, the net result is broad losses. It does not matter how much cheaper a product is if consumers do not have sufficient income to buy it. The media often highlights offshoring deals that happen to fail. Hence, many people perceive offshore outsourcing as everything from harmful to the US economy, unethical and extremely risky.

Yet, offshoring is increasing at a steady rate and is also expanding and evolving in terms of implementation models and opportunities. Many of the traditional risks associated with offshoring, such as instability of legal framework and intellectual property (IP) protection laws coupled with weak infrastructure, is lessening in many countries overseas, and thereby turning several threats into opportunities.

The main benefits US companies can get from offshoring tends to be reduced cost burden, availability of highly qualitative manpower across multiple domains, and a global service delivery program with high scalability. Companies have benefited particularly on the cost front, but organizations are enabled to go further beyond cost reductions and focus more on generating growth and long-term value from offshoring of services. Hence, besides cost leveraging, the benefits that motivate companies to outsource business processes includes economies of scale, efficiency improvement, and superior skill sets and job execution. The availability of a highly qualified talent pool and faster adoption of well-defined business processes leads to higher productivity gains without necessarily compromising on quality. That is what many large corporations capitalize on today.

Mid-sized and smaller US companies have benefited more on the product front rather than completely outsourcing any of its core functions. To manage their business efficiently and scaling their process from the IT perspective, for example, many of them have greatly benefited by using highly sophisticated and customized software made by overseas programmers. Also, the spread of low-cost technology makes it easier for smaller companies to take advantage of the savings and flexibility, especially in places where big companies have laid the groundwork with labor practices and infrastructure. *IT-director* (November 2006).



With the growth of offshoring capabilities into business process outsourcing (BPO) and knowledge process outsourcing (KPO), more and more industries in the US can take advantage of these services. Integrated packaged product developments, application maintenance, call center operations, research and engineering services are all examples of tasks and processes suitable for offshoring. Many larger companies in verticals such as insurance, credit card processing, pharmaceuticals, airlines, telecom and IT have benefited from both BPO and KPO.

Another huge potential benefit is the access to the enormous and fast growing markets overseas, particularly in Asia. This opportunity alone could create the competitive advantage needed for long-term success for US companies in any industry or market.

2.2 Threats

Of course, all ventures have risks associated with them and setting up production in another country is riskier than setting up in your own country. Risks involved in offshore outsourcing often lead organizations to shy away from conducting business overseas.

There is a perception among many smaller companies that the size of their business is too small to justify offshoring. It is a deeply held notion but it has no basis in fact. While it is true that the more work is performed offshore, the more money is likely to be saved, most of the application development and call-center work is priced by headcount. For that reason, even if a company offshore the work of only one employee, they are still likely to save. *Infosys* (May 2006).

However, smaller companies going offshore are making a bigger bet than large corporations since they have fewer resources to invest in an offshore venture. Also, because some costs are fixed, it can cost small firms more per worker to shift a job overseas. Monitoring and managing workers far away for the head office takes time away from a smaller group of executives based in the US; retention and work-quality problems can wreak more havoc on a small company than a large one. The cost and benefits of offshore compared to investing that time in expanding their business locally must be considered.

Major risk categories to consider include:

- Misuse of data and/or intellectual property
- Legal infrastructure of offshore country
- Proximity to home office
- Communications
- Cultural compatibility
- Workforce ethics
- Geo-political environment



A commonly perceived risk within smaller companies is also the loss of control that could be associated with offshoring. “However,” says Ashok Syal, Managing Director of Sumpraxis, a facilitator company for Knowledge Process Outsourcing, “there is no direct evidence that this is a real risk; with good risk management and a strong management team in place, the risk of loss of control is no greater in offshoring than in outsourcing or even in-house processes.”

3 Strategic Risk Management and Offshoring

As many US companies are painfully aware of, it is becoming more and more difficult to find a viable edge in today’s competitive marketplace. A lot of emphasis is put on results and bottom-line profits.

Cost-cutting, better inventory control and strong customer service are all ways to try to gain a competitive edge, almost no matter what industry you are operating in. But this is not always enough. How well a corporation handles its risk management is often the determining factor of how well they are doing competitively nowadays.

So what is risk management? Most Project Management textbooks define risk management as “the art and science of identifying, quantifying, responding and controlling project risk. It includes maximizing the results of positive events and minimizing the consequences of adverse events.” (Kanabar, 2006). These activities, if performed effectively, can help determine the outcome and level of success of any project.

However, risks to the success or even the survival of the entire company are more significant in the long-term than any single project. Therefore, we need to go one step further up and look at strategic risk management, also sometimes called enterprise risk management (Lewis 2001). The risk management used to support the strategic planning of an organization is fundamentally the same as for project risk management but the perspective and the provisions in which the process is conducted has to reflect the timescale and span of strategic concerns. The risk management processes are the same, but the process should include long-term strategic business opportunities and threats and bring the process we use for risk identification into the early part of strategic planning.

US companies, big or small, that are concerned about their competitiveness should consider whether or not offshoring can improve their performance and help them achieve their strategic goals. If not, this long-term strategic opportunity could easily turn into a competitive threat. As the economies of the world grow, the advantage to be in the overseas markets grows. India and China combined have 10 times the population of the US and are growing 2 to 3 times faster than the US economy (www.offshoreitoutsourcing.com).

4 Strategic Risk Management Model for Offshoring

The better a company is at managing overall risk, the better it can position itself in the global marketplace. Therefore, it is very important to identify offshoring as a potential opportunity in the strategic business planning. The *strategic risk management model for offshoring*, which is presented below, can be a valuable tool when trying to determine whether or not the strategic business model should include offshoring of any of the company's services. It closely follows the steps used in the project risk management process; risk management planning, risk identification, risk analysis, risk response planning, and risk monitoring and control.

Once a company completes the *strategic risk management model for offshoring*, offshoring might be put on the list of risks to be monitored and re-evaluated on a regular basis, or it might get integrated into the overall business model.

4.1 Risk Management Planning

First of all, the company should carefully identify and evaluate what its strategic goals and core competencies are. No matter what industry a company operates in, the strategic goals are likely to include attributes that are perceived as giving the company a competitive edge. And, as mentioned earlier, with the inevitable emergence of a global sourcing and marketplace, the competitive edge will have to come from attributes associated with such factors as superior risk management, cost leverage, adaptability, flexibility and/or access to global markets.

The core competencies will be more dependent on the particular industry. The core competencies, whatever they might be, should stay in-house, but anything that is not core to the company's business, and has a high labor cost and requires a staff, can and should be considered for some form of outsourcing.

Normally, risk tolerance is an important factor to take into consideration in the risk management process. Whether a company is risk adverse, risk neutral or risk tolerant can have a significant impact on its risk management decisions. However, in the case of offshoring versus not offshoring, it is hard to say which decision suits which risk profile the best. Once a decision is made to offshore some of the company's services, risk tolerance will play a part in deciding what and how much to offshore, what model to use, and which location to choose. But when it comes to making the decision to offshore or not, it is hard to say which is more risky – to offshore or to “stay home”.

4.2 Risk Identification

In this step, the corporate strengths (opportunities) and weaknesses (threats) are identified. These attributes should represent long-term value (or loss) to the company, and they should be applicable to its relevant industry. For example, a printing and document services company might see its top corporate strengths as commitment to excellence (quality), ability to adapt to emerging technologies (adaptability), and a strong financial position. The same company might list its major weaknesses as inefficient (schedule delays or high labor costs), poor infrastructure (lack of flexibility), and poor internal communications.

4.2.1 Risk Analysis (Qualitative)

In the qualitative risk analysis process, the company should rank its business abilities as objectively as possible against the specific industry they operate in. The list in Figure 1 below shows a list of twelve attributes which could potentially be improved by offshoring some business services that are not core to the company. The attributes are ranked on a scale of one to ten with one being the lowest (worst) score, and ten being the highest (best) score.

	1-10
Competitiveness	3
Productivity	8
On-time projects	5
Flexibility	2
Access to global markets	2
Scalability	5
Risk management	6
Communication	7
Training	9
On-demand service model	3
Quality	5
Profit margin	3
Total:	58

Figure 1. An example of a list of corporate attributes to be evaluated in respect to the specific industry the company is operating in.

If a company gets less than 60 point total in this assessment, then offshoring should definitely be considered.

4.4 Risk Response Planning

Once the major corporate strengths and weaknesses have been identified (in the risk identification process), these attributes need to be evaluated against the known benefits and risks of offshoring services. An example of how this process can be accomplished is shown in Figure 1 below.

In the example matrix below, the corporate weaknesses have been identified as lack of competitive edge, tight profit margins, project schedule delays, lack of scalability, and lack of access to global markets. However, as shown in the matrix, these corporate weaknesses can be mitigated by one or more of the identified offshoring benefits, which in turn show us that offshoring is worth considering as a risk mitigation strategy for this particular company's situation.

Offshoring Benefits	Redundancy	Cost Savings	Flexible Capacity	Accelerated Delivery	Handling of competitive pressure
Corporate weaknesses					
Lack of competitive edge				✓	✓
Tight profit margin		✓			
Schedule delays	✓			✓	
Lack of scalability			✓		✓
Lack of access to global markets					✓

Figure 2. The major corporate weaknesses (that were identified in the risk identification process) should be cross-matched with the main benefits of offshoring.

Likewise, if each of the top risks associated with offshoring can be mitigated by at least one of our corporate strengths, then offshoring might be suitable as a risk mitigation strategy for the same company. In the matrix in Figure 3 (below) the corporate strengths have been identified as communication, internal training, risk management, on-demand service model (which gives low inventory costs), and quality control. These strengths are then cross-matched with the risks that are associated with offshoring: loss of control, increased fixed costs, misuse of data, more time to manage operations, and cultural

differences. As a result, in this example, each corporate strength can mitigate several of the risks of offshoring. The conclusion that can be drawn from this is that offshoring should be at least considered as a viable option for this company, since the offshoring risks are offset by the corporate strengths (see Figure 3).

Corporate strengths / Offshoring risks	Communication	Training	Risk management	On-demand service model	Quality control
Loss of control	✓	✓	✓		✓
Increased fixed costs				✓	✓
Misuse of data	✓		✓	✓	
More time to manage operations		✓	✓	✓	✓
Cultural differences		✓	✓		

Figure 3. The top corporate strengths (that were identified in the risk identification process) should be cross-matched with the major risks of offshoring.

If the corporate attributes exercise above (Figure 1) gives us a number below sixty (if all twelve attributes are evaluated as in the example above), and the two matrixes also indicate that our corporate weaknesses can be mitigated by offshoring and our corporate strengths can help offset the risks of offshoring, then we can feel quite certain that offshoring is a viable risk mitigation strategy for our company.

4.5 Risk Monitoring and Control

The risk monitoring and control phase should choosing alternative strategies, and to monitor for changes in both opportunities and threats as it relates to the offshoring arena. Global outsourcing, offshoring and nearshoring are concepts that are not going to go away; they are constantly evolving and should therefore be carefully monitored so that new opportunities are not overlooked.

As part of this process, industry competition's activities should also be closely monitored. If other major players in the industry choose to offshore some of its services before you do, then your list of opportunities might have to be treated as threats instead.



5 Offshoring implementation tips for smaller companies

If the decision is made to offshore some of our business services, then there are, of course, many implementation models available to us. As mentioned earlier, offshoring can mean outsourcing or it can mean opening an own subsidiary or office overseas. For the IT industry, for example, there are also so called offshoring development centers (ODC) available that can assist in offshoring efforts of both small and larger US companies. Naturally, a lot of research has to go into finding the best offshoring model and location for each individual company.

It is important to deal with concerns about loss of control. Small businesses have understandable concerns about the potential loss of control, the distance from their supplier's delivery center, and challenges with intellectual property protection, data security and software piracy. These concerns are no different from those expressed by larger companies when they took their first steps toward offshore sourcing. Because the issues are the same, the answer is ultimately the same: Establish a comprehensive statement of work with clear, detailed roles and responsibilities, and train in-house staff to manage the offshore service providers. Consider offering consistent company-wide training so all workers use similar processes.

Also, determine the right provider for your size and needs. Choose a Tier 2 provider (or credible niche provider) if you are concerned about being a "small fish in a big pond." Small and mid-size businesses should seek out Tier 2 providers that have a country and local presence in their industry domains and a strong niche focus on the small and mid-sized marketplace. To deliver a strong value proposition, the selected provider must demonstrate an understanding of the challenges facing small businesses in their industry domains. Locate overseas offices in regions that are home to bigger, multi-national companies. Ensure that key employees visit frequently, and plan for those travel costs.

If still in doubt, a pilot project can be executed. For small businesses, a pilot project with 10 to 15 full-time equivalents for six months is suitable (www.globalservicesmedia.com). A detailed implementation plan for proceeding with the global sourcing should be created. For businesses doing this for the first time, a consultant may be useful.

6 Conclusion

Every US company, big or small, should consider offshore outsourcing in their strategic risk management process. We have become a global market, and not considering the opportunity of offshoring in the overall business model could be damaging to a US company's viability. Ultimately, a business strategy – with or without offshoring services – should lead to overall growth of the company. Whether or not offshoring should be part of the business model can be evaluated and decided upon by using the proposed *strategic risk management model for offshoring*.



The move to global sourcing seems inevitable. It has been happening for years and the trend is that it is growing and expanding in possibilities and options. As consumers in every industry demand cheaper goods yet better service, outsourcing is becoming an opportunity (or a threat) for mid-sized and smaller companies, too.

With good strategic planning and with the right expectations, offshoring can yield significant business benefits; improved processes and increased operational competitiveness - and can serve as much more than a means to save money. For smaller businesses it can yield access to the same low cost resources their larger competitors have been accessing for years. This helps to level the playing field. It can also help gain access to scarce resources. However, if offshoring is not considered in the strategic business planning, it can easily turn into a threat. The *strategic risk management model for offshoring* can help a company decide whether offshoring of services is a strategic preference for them or not.

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