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Offshore Outsourcing: An Overview

By Dep Deol

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The phrase "offshore outsourcing" has become ubiquitous in the Information Technology (IT) industry. It is spread all over in trade publications, and you can hear it in many places ranging from the company boardroom to the water cooler. If you are involved with any facet of the IT industry, it is important to learn more about this latest development in evolution of the industry.

In this article, I will present an overview of the offshore outsourcing scene and the various ways in which companies are involved in offshore outsourcing. At the end, a set of recommendations is listed for business owners, managers, and other stakeholders who are considering offshore outsourcing for their organization. Please be advised this article only addresses IT offshore outsourcing. It does not cover outsourcing in other industries.

Let's start by defining the term "offshore." Offshore in the phrase "offshore outsourcing" refers to any country where wages for IT professionals are substantially lower than in the US, UK, Western Europe, and Japan. The major destination countries for offshore work are India, Russia, and Ireland. Other places to note include countries in Eastern Europe, such as Ukraine and Bulgaria, Brazil, South Africa, Israel, and China. Low wages in these countries are a result of the low cost of living. The wages in these countries can be anywhere from one-third to one-tenth of the wages for similar skills in Western markets. It is worth mentioning that IT skills in these nations translate into 20-50% higher salaries than their respective national average salaries for all professions.

Next, let's define the term "outsourcing." From a business point of view, outsourcing is a situation in which a defined piece of work is performed by an external third party provider. At times the line of authority of an external provider can be blurry – a global company may pass around work among different departments spanning the company's own offices in multiple countries. Generally speaking, however, outsourcing involves two or more independent companies working together. For example, American Company A prepares the specifications for a software application, and then passes it to Ukrainian Company B for actual design and development. After the work is completed, Company A receives the finished product from Company B. Software development is one type of IT work that can be outsourced. Remote system administration and product maintenance are some other types of work

that are routinely outsourced by IT firms.

Putting our definitions of offshore and outsourcing together, we can now effectively define IT offshore outsourcing - it is the outsourcing of IT work to offshore countries. Offshore outsourcing is actually not a recent phenomenon. IT offshore outsourcing has been occurring as early as the 1970's. There were several Indian companies that provided services to American firms at that time. IT offshore outsourcing started to take off in the early 1990's and gained further popularity during the Internet Boom of late 1990's. Then, with the crash of the Internet Boom, offshore outsourcing came into center stage - the biggest driver was the fact that businesses were scrambling to cut costs and offshore outsourcing provided a viable means of lowering cost of operations and new development.

Below are the different categories that can be used to group companies working in the offshore

outsourcing space –

Type I: Fully offshore. These are small companies operating in the offshore countries. They can have anywhere from 1 to 50 employees. A major feature that distinguishes these companies is that they spend very little, if anything, on external marketing. Their business mostly comes from word of mouth promotion and referral from existing clients. Rarely do they have offices in countries where their clients come from. Also, freelancers and informal teams of friends and associates working together are part of the Type I category.

Type II: Fully offshore with own representative office (for marketing, requirements engineering, etc.) in the client countries. Given the representative office in the client countries, Type II companies can more effectively get client leads and market their services. Companies operating in this space are medium to large sized, with an employee pool ranging from 50 to several hundred. On the top rung in this category are a handful of companies like Indian Satyam and Wipro, employing thousands and generating revenues in millions of US dollars.

Type III: Western companies with their own dedicated development centers located in offshore countries. This arrangement is commonly referred to as the hybrid model. Using their offshore centers, Western companies can leverage their local talent in the respective country and use it for a variety of tasks. Most major global IT companies have a presence offshore, and now several medium sized companies are also turning to this alternative.

Type IV: Western companies acting as middlemen for offshore companies. Also known as service brokers, they maintain their own network of offshore firms (mostly Type I). Type IV firms may offer end to end management of projects, including project and financial risk management, or simply introduce a Western company to an offshore provider and charge a commission on the work performed.

Following is a set of recommendations for using offshore resources –

– Identify potential companies by inquiring in your circle of associates and checking online offshore provider directories. Unless your organization is fairly large, it would be ideal to approach only Type I and III companies. Type II companies mostly work with Fortune 1000 caliber clients.

– After identifying some prospects, learn as much as you can about the company. Carefully look through their online case studies and portfolios. If a company looks like a good candidate for partnership, contact them for names, email addresses and, if possible, phone numbers of their existing clients. If their existing clients are established companies themselves, it is a good sign that the company you are considering is reliable.

– Once you have made a decision on partnering with an offshore provider, start by giving them small, non-essential projects or pieces of a project. This will allow you to assess the relationship without jeopardizing any of your own business in case the arrangement does not work the way you had envisioned. In which case, try to resolve the issues. Any reasonable business owner will endeavor to work with his or her clients towards a mutual resolution of any differences or misconceptions.

– Be sure to have risk management mechanisms in place and sign service level (SLAs) agreements with your offshore partners. As the situation requires, non-compete and non-disclosure agreements may also be signed. Before sending off work to an offshore provider, it is well worth the time to lay out formal procedures to respond to events like network crashes (at your site or the provider's site) and

deadline extensions.

Offshore outsourcing has become an integral part of the IT industry. In the next few years, its role will only become more important. Gartner Research predicts that 25% of IT jobs will be "offshored" by year 2010. The question organizations will ask is not whether they should outsource, but which offshore outsourcing strategy best fits their needs.

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Where Are The Facts About Outsourcing

By Jonathon Hardcastle

Outsourcing of jobs to offshore companies has been a hot-button issue since the 1960s when the United States began losing automotive manufacturing jobs to Japan. In recent years, the outsourcing of technical jobs has revived the debate which became one of the top issues in the 2004 presidential campaign. However, actual facts and statistics about the effect of outsourcing on the American economy are hard to come by. Rhetoric, not facts, dominate the discussion of whether outsourcing has an effect on the economy.

There is a serious dichotomy between the beliefs of average Americans and those of economists and other experts. For example, a Zogby International Poll showed that 71% of Americans believe that outsourcing hurts the economy but when the Wall Street Journal asked the same question of economists, only 15% felt that outsourcing had a negative effect.

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Opinions on outsourcing tend to be divided by economic status rather than political persuasion. For example, some Republicans in the House and Senate believe that outsourcing has a terrible effect on the economy and that legislation should be enacted to stop it. However, conservative think tanks like the Heritage Foundation and Republicans with ties to big business believe that the threat of outsourcing has been over exaggerated.

Liberals are also divided about outsourcing. The Democratic party has traditionally been the party of labor in the United States but it was a Democratic president, Bill Clinton, who shepherded the North American Free Trade Agreement through Congress, a treaty which most experts agree facilitated the current outsourcing trend.

For every argument for outsourcing, there is another argument against it. For example, the Heritage Foundation argues that despite outsourcing more Americans are employed than ever before and that jobs continue to be created to compensate for those lost overseas. Anti-outsourcing advocates point out that gross wages are dropping because the jobs that are being created are low-level service sector jobs, not high-tech jobs to replace the ones that are being lost.

The Heritage Foundation, citing the Organization for International Investment also argues that for every job outsourced, another is "insourced" to the United States from another country, often at a higher rate of pay than the job lost. Anti-outsourcing advocates say that those numbers can't be accurately verified.

What is clear is that until the federal government conducts accurate research into the effects of outsourcing on the United States economy, there will be no definitive answer one way or the other.

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