

# Win in the flat world

## Outsourcing Models: Aligning Sourcing Strategy to Business Objectives

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### **An Introduction**

*The term 'offshore outsourcing' brings to mind images of work flowing from large corporations to outsourcing service providers halfway across the globe. Perhaps the rapidly growing Indian IT and BPO industry that is recording revenues upwards of \$ 35 billion to \$ 40 billion a year makes it sound like projects are simply sent offshore. The facts of outsourcing, however, are a bit different.*

*Behind each offshored program, initiative or project lies complex decisions that begin with selection of the right models for a particular business need. Organizations must structure their outsourcing relationships with the right sourcing models in order to ensure that desired business outcomes are realized through subsequent sourcing decisions and actions. This paper serves as an introduction to the most common outsourcing models, namely Staff Augmentation, Out-Tasking, Project Based Outsourcing and Managed Services*



## A World of Sourcing Options

After making the decision to initiate outsourcing, there are a number of different sourcing options available to companies. In many ways, these are influenced by desired outcomes and the organization's current levels of Sourcing Maturity

Companies that are looking to maintain complete ownership and control over their IT or business processes, while leveraging low cost resources offshore, seek a very basic model of outsourcing. Cost savings through low cost resources can be realized through the ad hoc **Staff Augmentation** model wherein the service provider agrees to provide specific skilled resources (of identified profiles) to supplement personnel from the client's side. In this model, service providers do not take on any accountability or risk and work as instructed by the client on activities outlined in the agreement. This model is usually adopted by companies that have just begun to outsource/offshore, and represents the beginner level of sourcing maturity.

One notch up the sourcing maturity scale is a model that incorporates accountability from the service providers. When service providers take on responsibility for specific tasks in a project, the sourcing model is called **Out-Tasking**. In this configuration the client keeps overall control, management and oversight in-house while asking service providers to perform some identified functions. Service providers are held responsible for the functions (e.g. programming or testing) that have been assigned to them. Out-Tasking does not assign project ownership to service providers, as it involves only task based responsibilities.

A step-up from the Out-Tasking model is when service providers are given complete responsibility for a project, a **Project Based Outsourcing** model. A company will give away day-to-day operational control of a specific project to a partner service provider. The company restricts itself to regularly monitoring end outcomes of the project. Specific Service Level Agreements (SLAs) and metrics are determined upfront, and progress is determined against these benchmarks. In project outsourcing, service providers are held accountable for project level deliverables, but not business Level outcomes. For instance a service provider who is maintaining a client's portal would be held responsible for the downtime of servers, but not responsible for the loss of business that results.

More experienced outsourcers tend to give even greater accountability to the service provider, leveraging the provider's end-to-end capabilities. This is the **Managed Services** model. In a Managed Services environment, the service provider is completely responsible for delivery of services – including design, building, operating and improving process, applications and infrastructure. Usually, the service provider takes on business level SLAs for the outsourced work. Quite often service providers are involved extensively in drawing up the SLAs with the client, or Operational Level Agreements within other service providers in a multi-vendor environment.

<p><b>1. Ad-Hoc Staff Augmentation</b></p>	<ul style="list-style-type: none"> <li>• Arrangement wherein the vendor agrees to provide specific skilled resources to supplement personnel from the client's side</li> <li>• The vendors do not take on any accountability or risk and work as instructed by the client on activities outlined in the agreement</li> </ul>
<p><b>2. "Strategic" Out-Tasking</b></p>	<ul style="list-style-type: none"> <li>• Out-tasking is where the client keeps control, management, oversight and control in-house while asking vendors to perform certain functions</li> <li>• Vendors are held responsible for the functions (eg programming / testing) that was provided to them- and do not take on end to end SLAs</li> </ul>
<p><b>3. Project Based Outsourcing</b></p>	<ul style="list-style-type: none"> <li>• Here companies give away close operational control of IT to vendor partners while keeping control over business outcomes dependent on IT</li> <li>• SLAs and / or metrics are determined upfront - before projects are outsourced. Vendors are held accountable to these service levels</li> </ul>
<p><b>4. Managed Services</b></p>	<ul style="list-style-type: none"> <li>• In a Managed Services model, one vendor will either (a) take on all aspects of the outsourced work or (b) enter into SLAs with other vendors</li> <li>• Consequently the client gains the benefit of having one of the following: <ul style="list-style-type: none"> <li>• An integrated outsourcing solution provided by 1 vendor or</li> <li>• Operational Level Agreements which are signed on by all vendors on how they will collaborate with each other</li> </ul> </li> </ul>

**Table 1**

## Comparison of Sourcing Models

Selecting a sourcing model depends on the organization's existing sourcing maturity level and their willingness to improve it. It is not necessary for every organization to operate or aspire to operate at the highest level of sourcing maturity - they may have different business dynamics and different expectations from sourcing. Based on its unique needs, a company should select the sourcing model appropriate to them. The above-mentioned sourcing models have been tried and tested and are widely prevalent in the industry. A brief overview of their pros and cons:

1. Ad-Hoc Staff Augmentation		Prevalence: Medium	2. "Strategic" Out-Tasking		Prevalence: Medium
Pros	Cons	Preference: Decreasing	Pros	Cons	Preference: Decreasing
<ul style="list-style-type: none"> <li>✓ Ensures resource/skills availability</li> <li>✓ Tactical time-to-market gains</li> <li>✓ Some amount of cost flexibility</li> </ul>	<ul style="list-style-type: none"> <li>× Absence of metrics or processes</li> <li>× Uncertainty around vendor quality</li> <li>× Challenges of managing "resources"</li> </ul>		<ul style="list-style-type: none"> <li>✓ Specific "hard to do" resource profiles can be obtained outsourced</li> <li>✓ Leverage unique skills in vendor</li> <li>✓ Possibility of managing spikes in work activity</li> </ul>	<ul style="list-style-type: none"> <li>× Artificially dividing activities to facilitate out-tasking</li> <li>× Potentially sub-optimal manner of undertaking work</li> <li>× Not a true partnership as the vendor takes on limited risks</li> </ul>	
3. Project Based Outsourcing		Prevalence: Medium	4. Managed Services		Prevalence: Medium
Pros	Cons	Preference: Increasing	Pros	Cons	Preference: Increasing
<ul style="list-style-type: none"> <li>✓ Collaborative model - where vendors share the risks and rewards</li> <li>✓ End to end vendor accountability for projects</li> <li>✓ Increased avenues for vendors to apply their best practices</li> <li>✓ Very high client benefits</li> </ul>	<ul style="list-style-type: none"> <li>× Client personnel need to get comfortable relinquishing day to day control</li> <li>× Calls for better understanding and appreciation of the offshore model</li> <li>× Demands better Biz-IT alignment while defining requirements</li> </ul>		<ul style="list-style-type: none"> <li>✓ Enables the client to have an integrated outsourcing solution</li> <li>✓ Obviates the hassles of having separate SLAs with different vendors</li> </ul>	<ul style="list-style-type: none"> <li>× Typically justified only in a very complex outsourcing milieu or at very high levels of offshoring</li> <li>× OLAs are not easily arrived at; the multi-vendor managed service is still a nascent model</li> <li>× The integrated outsourcing model could tend to have a high element of being a 'black box' with low transparency</li> </ul>	

**Table 2**

## Staff Augmentation

Staff Augmentation is usually the first step in a sourcing journey because it is easy to implement. It can rapidly increase resources in a particular area because staff augmentation does not need elaborate effort in setup, oversight or management. Apart from being quick on the ground, staff augmentation does not require much management band width. Staff is added on to an existing organization, so structures related to reporting, performance management or direction setting need not be revised.

In more mature sourcing setups, augmentation is applied to handle spikes at work that call for specialized skills (e.g. phasing out applications earmarked for sunseting). Having 'on-demand' staff helps to lower costs, and minimizes unutilized full time employees. Nevertheless, there are often issues around availability of specific skills for ramp up, which can lead companies into complex service provider arrangements. In other words, there are many companies that face significant issues because they use a few individuals from tens of contractors each.

Staff augmentation is also upwardly scalable. It may work for a few individuals in a few departments, but large scale staff augmentation with expectations of significant productivity gains are simply not feasible. The biggest difficulties of staff augmentation are lack of service provider involvement and underutilization of service provider potential. Lack of responsibility for deliverables, outcomes, or even tasks limits the utility of this model to the most basic requirements. A lot more value can be derived by working closely with service providers.

In summary, this arrangement is generally used when:

- Companies have just begun their sourcing journey i.e. they are at an early stage of sourcing maturity
- These companies want to extend their own team but do not have the ramp up capability
- The service provider –client relationship is relatively new

It is easy, however, to overextend the staffing model. Breakthrough gains in productivity or process reengineering cannot be achieved through augmentation. It is an inflexible model which perpetuates status quo, and has often been seen as a hindrance to further outsourcing

### Strategic Out-Tasking

Out-Tasking addresses the issue of vendor involvement by shifting the responsibility for the accomplishment of identified tasks to the vendor. Unlike the staff augmentation model where the service provider renders the service without responsibility for accomplishment, out-tasking expects the vendor to deliver the completed task. The provider estimates the requirements needed to accomplish a particular task based on the parameters provided by the outsourcer, and then assumes responsibility (through contractual obligations) for satisfactory completion. Simply put: the service provider assumes the risk for completion by committing to a price.

Out-tasking is – by its very definition - the outsourcing of identified tasks. It is not the outsourcing of entire projects. For instance, the implementation of an ERP system in a particular department is a project, while testing this system is a task in the project. The key problem is in breaking the project into tasks. This artificial demarcation can be cumbersome especially in the cases of projects which are closely integrated. More pertinently, it can pose severe problems when the outcome and timing of the out-tasking engagement needs to be integrated to the rest of the project. Usually, out-tasking is deployed for tasks that have low interdependencies on the rest of the project – namely programming to closely defined specifications and testing.

Out-tasking is used when:

- There is a strategic decision to not maintain some skills in house – since these can be easily outsourced
- There is comfort that the 'Out tasked' piece of work can be easily disaggregated to send over to the service provider and then seamlessly integrated back into the process later
- An organization is at an early stage of sourcing maturity, and is not ready to relinquish project control

Out-tasking is suitable for short term needs where clients have some identified skill gaps in their sourcing requirements. It may also be practiced by companies who have strategically chosen to

out task specific skills. However it is not the most efficient long term approach to build sourcing maturity because the monitoring and control mechanisms used in out tasking need to be revamped to handle project outsourcing.

## Project Based Outsourcing

In a project based outsourcing model the service provider takes control over an outsourced project and manages all tasks in the project to meet an agreed upon outcome. In such an engagement the vendor will bring to the table all skills that are needed to complete each task in a project, and will provide the project management expertise needed to run the project. The client does not get involved in day to day operational matters and focuses more on the final results of these projects. Vendor management mechanisms are based on end to end project outcomes as well as the quality level in each task; unlike out tasking, where vendor monitoring is limited to a specific task. Therefore, project outsourcing better engages a vendor and provides more opportunities to access vendor capabilities.

Vendor / Outsourcer partnership is the cornerstone of project based outsourcing. Since responsibility for outcomes rests with the vendor. And while the outsourcer can benchmark and monitor outcomes through contractual obligations, the scope for intervention is limited; the entire delivery organization is with the service provider. Even though the service provider runs the entire project risk, it is the outsourcer who retains the business risk for activities that may be dependent on the project. In all, the service provider must be a trusted partner.

Thus model offers the following benefits to the clients:

- End to end service provider accountability for projects (through appropriate SLAs)
- Increased avenues for service providers to apply their best practices
- Sharing of risks and reward (with service providers) – a key ingredient for true partnership

Project outsourcing enables significant productivity and cost benefits. This model provides the basis for engagement with offshore service providers that can provide access to high quality delivery from low cost locations. In the present environment, much or all of the detailed design, programming, testing, quality assurance, documentation and other tasks can be performed in the off-site location, leveraging the lower resource costs there. Moreover, vendors can enable significant productivity improvements through processes and skills that are well advanced when compared to inhouse IT organizations.

In summary, project outsourcing:

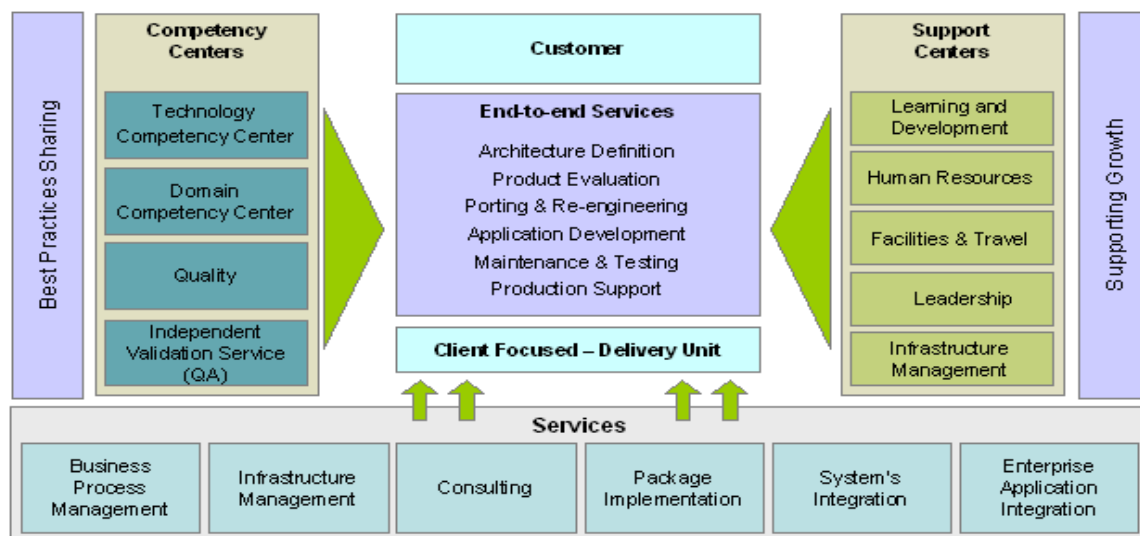
- Requires the client to get comfortable relinquishing day to day control.
- Calls for better understanding and appreciation of the offshore model
- Demands collaboration to define requirements and specifications of the project upfront

Project outsourcing can be scaled up to deal with a large number of discrete modules of work. Increasingly however, IT services delivery requires continuous commitment over prolonged periods. Such IT outsourcing does not depend on particular technical outcomes, rather, it depends on continued excellence in IT delivery in order to drive business level capabilities.

## Managed Services Model

The Managed Services model is typically a large scope, multi-year SLA-based strategic relationship between the service provider and the outsourcer. The service provider takes on end to end business level accountability for outcomes.

Figure 1 shows in detail the services that could potentially be offered to the client through this model for all the services.



**Figure 1**

This model provides a number of benefits which are difficult to build into short term agreements. A well articulated multi-year agreement could, for instance, help realize the following benefits:

- Upfront identification of capabilities needed for client organizations to leverage world-class sourcing
- A predictable (yet flexible) way to build these capabilities – through identified end outcomes and SLAs on various parameters
- Year-on-year improvements in productivity, cost and quality
- Simplification, standardization, re-engineering and transformation of processes /activities that the service provider undertakes on account of the increased scope and responsibility

- Service provider investments and sharing of business risks / rewards – signs of a true partnership

However, the following points must be kept in mind before implementing this model:

- This model calls for high Sourcing Maturity on the part of the client organization. There needs to be a high element of trust in the service provider for this partnership to work
- It is typically prevalent in organizations that have high process maturity and operational rigor to know what SLAs and end outcomes need to be sourced as a managed service. Benefits of this model increase with a greater scale / scope of outsourcing
- The SLAs (and OLAs in a multisourcing environment) required for this to work are not easily arrived at; only the major service providers have well established processes to define these. It is important that the service provider have prior experience in this model
- This integrated outsourcing model could potentially have a high element of being a 'black box' with low transparency. To avoid this, the client and service provider should define efficient governance and communication mechanisms.

## Selecting an Appropriate Sourcing Model

The selection of an appropriate sourcing model is also dependent on the portfolio of activities to be outsourced. Each of the models outlined in this paper support specific advantages that can be utilized to handle specific situations. For instance, applications earmarked for sunset may be best handled through staff augmentation, while business critical applications may be best handled through a managed services approach.

Independent of the nature of activities to be outsourced is the question of the capability of an organization to adopt particular models of outsourcing. For instance, an organization may want to outsource business critical applications through a managed services approach, but it may lack the internal capability or willingness to actually support the managed services model. It is crucial for an organization to assess whether it has the Sourcing Maturity to support the partnership structures that are required for more elaborate sourcing models.

## The Concept of Sourcing Maturity

Sourcing Maturity is a composite indicator that is developed through a review of an organization's sourcing goals, payoff expectations, impact and awareness. If sourcing maturity in any one of these parameters is low and others are high or vice versa, then the organizations need to give weightage to each of these parameters in order to assess their sourcing maturity. These 4 parameters are specific to companies/industries and the table below describes the various levels of sourcing maturity:



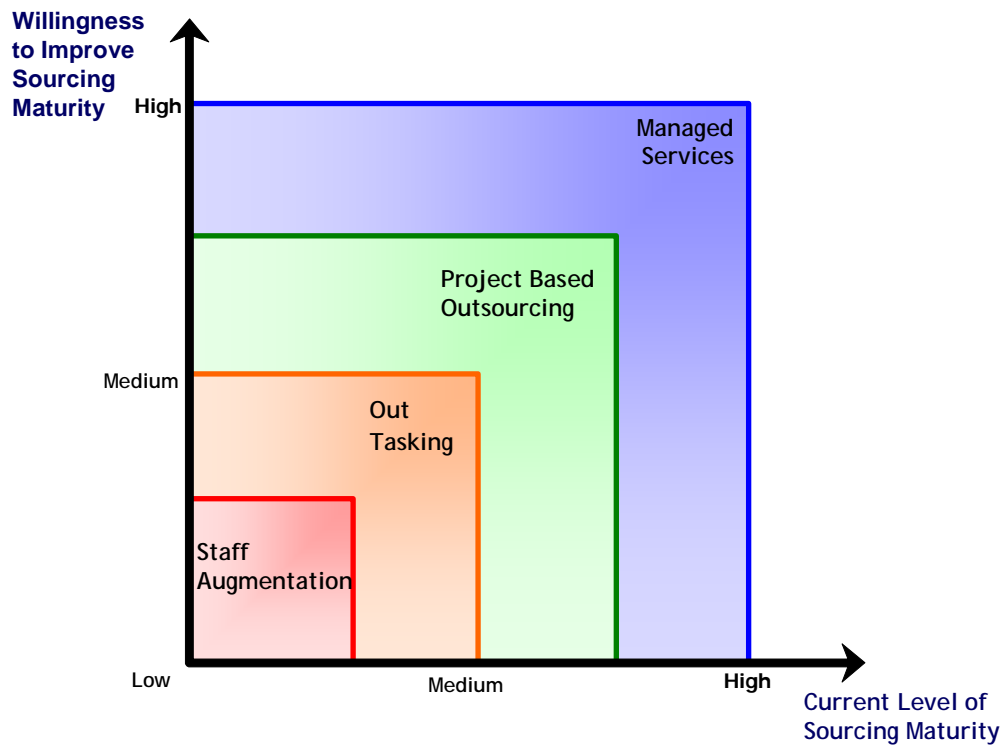
Element	Sourcing Maturity		
	Level 1 - Low	Level 2 - Medium	Level 3 - High
Goals	<ul style="list-style-type: none"> <li>Short to Medium term, tactical focus</li> </ul>	<ul style="list-style-type: none"> <li>Longer-term thinking in some selected areas</li> </ul>	<ul style="list-style-type: none"> <li>Comprehensive, enterprise-wide focus on long-term goals</li> </ul>
Payoff Expectation	<ul style="list-style-type: none"> <li>Immediate - short-term gain</li> </ul>	<ul style="list-style-type: none"> <li>Willing to accept a payoff model that could require initial investment, with returns over a longer horizon</li> </ul>	<ul style="list-style-type: none"> <li>Balanced portfolio approach, with mix of short-term initiatives yielding immediate payoffs and long-term initiatives requiring initial investment</li> </ul>
Impact	<ul style="list-style-type: none"> <li>Localized to individual groups or projects</li> </ul>	<ul style="list-style-type: none"> <li>Starting to realize some benefits</li> <li>Impact at the business unit level</li> <li>Pockets of excellence beginning to emerge</li> </ul>	<ul style="list-style-type: none"> <li>Organization-wide impact</li> <li>Global sourcing incorporated into company's business model, leading to enterprise-wide transformation</li> </ul>
Awareness	<ul style="list-style-type: none"> <li>Low levels of awareness, mostly in "silos" that are "testing the waters" on offshoring</li> </ul>	<ul style="list-style-type: none"> <li>Growing awareness across divisional boundaries</li> <li>Knowledge being managed, organization is learning valuable lessons from previous experiences and improving</li> </ul>	<ul style="list-style-type: none"> <li>Significance of Global Delivery Model well understood across the organization</li> <li>Organization develops sourcing expertise, and is able to adapt sourcing strategy to various situations</li> </ul>

**Table 3**

Organizations at a low level of maturity are limited to tactical outsourcing capabilities, unlike highly mature organizations that can take a strategic, enterprise wide view to outsourcing. Due to this difference in capability a mature sourcing organization has the option of deploying less sophisticated sourcing models (for example staff augmentation), but a low Sourcing Maturity organization does not have the capacity to deploy advanced sourcing models. Naturally, low sourcing maturity limits the options available for outsourcing and caps the benefits that can be derived from outsourcing.

In all, an organization has to develop a conscious strategy for moving up the Sourcing Maturity curve in order to enhance its outsourcing options and improve the benefits it can derive from outsourcing. Thus, it is incumbent on the management to:

- Assess current sourcing maturity
- Develop the willingness to move to the next level of sourcing maturity



**Figure 2**

Figure 2 above represents a simplistic framework to determine the Sourcing Model that would be most appropriate for an organization, based on its level of Sourcing Maturity. Clearly though, selection of a Sourcing model is a much more involved decision dependent on many of the aspects that have been covered in this paper

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