

Lessons Learnt in Outsourcing

Funded by SME Development Fund



Lessons Learnt in Outsourcing



FOREWORD

The global outsourcing market is fuelled by increasing competition among Asian countries pushing into the market. In order to compete more effectively in the marketplace, it is necessary to promote Hong Kong IT outsourcing services and the profile of Hong Kong IT companies as well as enhancing their capabilities and competitiveness in doing outsourcing business.

In this regard, the Hong Kong Information Technology Federation (HKITF) proposed to carry out a collaborative and promotion campaign to assist Hong Kong IT companies in capitalizing on the outsourcing opportunities. The objectives of the project are:

- To provide a collaborative platform for Hong Kong IT companies to identify their strengths and weaknesses in outsourcing business.
- To team up with the counterparts in mainland China to bid for overseas outsourcing projects.
- To build up the image and profile of Hong Kong IT outsourcing services.
- To share experience and advice in doing outsourcing business.

HKITF was founded in 1980 as a non-profit, non-political trade association to provide a forum in which the IT-related business in Hong Kong can work together for the benefit of the industry and to maintain a high level of business practice amongst the members. It promotes local IT business through activities such as exhibitions, seminars, breakfast and luncheon speaker meetings and networking hours to exchange business ideas and to expand personal network. HKITF also acts as the bridge for international IT companies looking for local partners and works with trade commissions to host trade promotion events.



Lessons Learnt in Outsourcing

Hong Kong Productivity Council (HKPC) was appointed as the implementation agent for this project. HKPC has been assisting the local IT industry through a diverse range of services including running the Software Industry Information Centre and organizing exhibitions, study missions and other marketing events. It has also conducted a series of IT-related studies, including the publication of "Excellence of Hong Kong Software Enterprises 2004", "Expanding Business into Mainland China — Successful Case Studies" and "Business Guidebook for Hong Kong Software Developers". With its deep understanding and well-established connection with Hong Kong's and Mainland's IT industry, HKPC is able to implement this project, accomplish its objectives and promote it effectively.

This report presents an overview of the global outsourcing market, highlights the competitive advantages of Hong Kong IT Industry and reviews the lessons learnt by local IT companies in doing outsourcing business. The intent of this publication is to share the experience and some of the best practices in outsourcing with the industry and facilitate future development in the outsourcing space.



ACKNOWLEDGEMENTS

This project is organized by the Hong Kong Information Technology Federation and funded by the SME Development Fund of the Trade and Industry Department, the Government of the Hong Kong Special Administrative Region.

We wish to acknowledge the support of all industry associations and companies that have offered valuable insights and shared their experience in outsourcing. We also appreciate the effort and commitment of Hong Kong Productivity Council and the project team members in bringing this book to publication. In addition, we are thankful to the companies that have participated in the overseas outsourcing exhibitions under this project. These include, in alphabetical order:

- Arcotect Limited
- Azeus Systems Limited
- COL Limited
- Computer And Technologies Solutions Limited
- ecVision Limited
- EPRO Systems Limited
- Excel Technology International (Hong Kong) Limited
- Future Solutions Laboratory Limited
- iASPEC Services Limited
- Integrated Enterprise Solutions Limited
- International Transport Information Systems Limited
- KBQuest Group Inc.



Lessons Learnt in Outsourcing

- Lifewood Technology Limited
- MillionTech Development Limited
- Outblaze Limited
- Sun Wah Linux Limited
- Sun Wah-PearL Linux Limited
- Unihub Limited
- We Software Limited



Outsourcing
Services

Contents

1. INTRODUCTION	06
2. THE OUTSOURCING LANDSCAPE	08
2.1. Global outsourcing market	08
2.2. Market trends	11
3. THE HONG KONG ADVANTAGES	14
4. LESSONS LEARNT IN OUTSOURCING	17
4.1. Customers' needs and expectations	17
4.2. Critical success factors	22
4.3. Best practices	23
4.4. Industry support	30

Lessons Learnt in Outsourcing

INTRODUCTION

To build up the image and promote the profile of Hong Kong IT outsourcing services, a Hong Kong Pavilion was established in three overseas outsourcing exhibitions, namely 2005 Outsourcing World Summit (US), OutsourceWorld London 2005 and 2006 Outsourcing World Summit (US). These exhibitions are renowned global events and provide a business platform that brings leading executives and IT professionals from all over the world together for sharing the latest trends and developments in outsourcing.

Around 20 Hong Kong IT companies had participated in these exhibitions to demonstrate their capabilities and showcase their solutions. Three guidebooks "Advantages & Profile of Hong Kong IT Outsourcing Services" were



compiled to promote the competitive edges of Hong Kong IT Industry and the excellence of local IT companies.

The combination of exhibition space, speaking slots and many networking events increased the level of visibility, brand awareness and business opportunities for Hong Kong IT companies to raise their exposure at these global events. Moreover, presentation sessions and partnership meetings were hosted to facilitate these companies to establish connection with overseas customers.



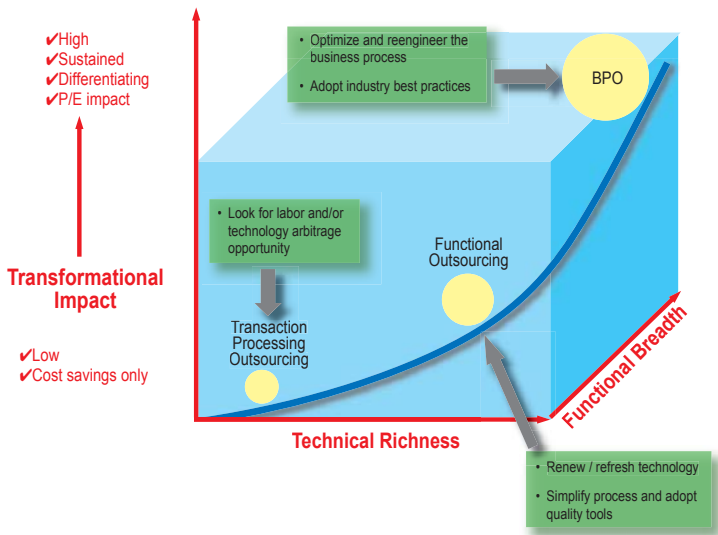
2. THE OUTSOURCING LANDSCAPE

2.1. Global outsourcing market

2.1.1. Stages in outsourcing

The global outsourcing market has witnessed a transformation since the mid 90s and its evolution will continue in future. JDalal Associates, a US consultancy firm specializing in the outsourcing field, points out that the market has been moving from transaction processing outsourcing, functional outsourcing to business process outsourcing (BPO) (see figure 1).

Figure 1: Stages in outsourcing



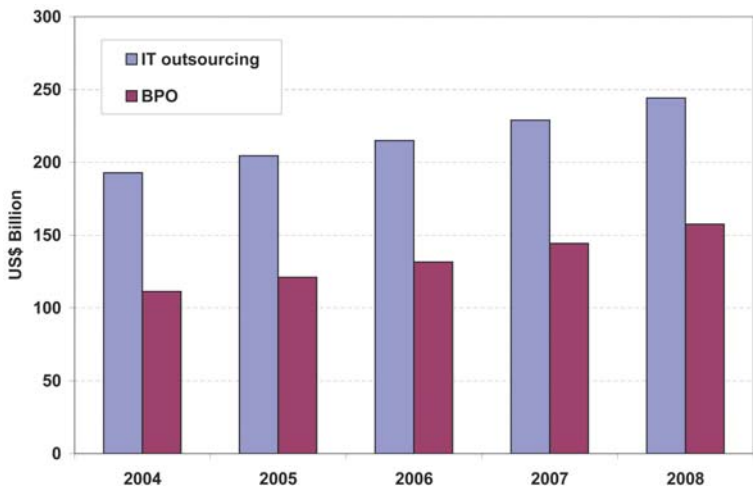
Source: JDalal Associates, LLC, 2005

2.1.2. Worldwide outsourcing spending

Outsourcing has become a vital part of many enterprises' operations today. According to Gartner¹, the worldwide IT outsourcing spending is projected to grow from US\$192.8 billion in 2004 to US\$244.2 billion in 2008, with an estimated growth of 26.7% (see figure 2).

On the other hand, the growth in BPO will outpace the growth in IT outsourcing. Worldwide BPO spending is forecast to rise from US\$111.3 billion to US\$157.5 billion over the same period, up by 41.5%.

Figure 2: Worldwide outsourcing spending



Source: Gartner Dataquest, 2005/11

¹ "Top Ten Asia Pacific ICT Trends and Predictions for 2006 and Beyond", Gartner Press Briefing, December 7, 2005.

2.1.3. Drivers for outsourcing

Outsourcing has a critical role to play in creating excellence in business operations and performance. Major drivers that have been propelling the demand for outsourcing services are summarized as follows:

a. Market drivers

- Increasing competitive pressure.
- Changing factors for business success.
- Globalization (global availability/delivery).
- Innovation becoming a key differentiator.

b. Business drivers

- Focusing on core competencies.
- Improving productivity and competitiveness.
- Capitalizing on new business opportunities (e.g. e-commerce).
- Improving service level and quality.
- Establishing world-class processes and practices.

c. IT drivers

- Converting IT investment into expenses.
- Accessing to new technology, specialized skills or IT resources.
- Lowering the total cost of ownership/operation.
- Better managing variable capacity needs.
- Shortening implementation time.
- Enhancing IT effectiveness by leveraging on service providers' expertise.



2.2. Market trends

Key trends and market dynamics that are going to shape the development of the outsourcing industry include:


- Offshore outsourcing will grow in size and importance. The acceptance for offshoring is gaining momentum as enterprises need to keep pace with global competition and develop more sophisticated global supply chain model. These will have a significant impact on IT and multiple business processes.
- India's leadership position in the outsourcing market will remain but emerging countries are catching up fast to capture a larger share of the enormous outsourcing spending. Strong growth is predicted for locations like mainland China, Central and Eastern Europe which are aggressively entering the offshoring space.
- Perspectives on outsourcing rates (both onshore and offshore) will remain relatively stable due to keen competition from local and overseas players. However, the growing demand for IT professionals has been raising the salary and compensation considerably. The increasing manpower cost will exert pressure on service providers' gross margin. Nevertheless, as more enterprises demand specialized services and utilize outsourcing as a strategic lever, they will be willing to pay more for added value.
- Merger and acquisition activities will grow. Scale will become increasingly important, especially for the BPO market. Moreover,



Lessons Learnt in Outsourcing

customers will prefer service providers that have multiple delivery centers for various reasons: disaster recovery, business continuity and creation of a new business model (e.g. "Follow the Sun" model of service delivery). This trend will favor those service providers with multi-country operations.

- The trend of specialization will continue. Service providers will continue differentiating themselves by developing specialized services and skills and deeper domain knowledge to maintain their competitive edges. Besides specialization, some service providers are expanding the breadth of their offerings as they grow in size and seek to strengthen their market position.
- The focus of outsourcing has shifted from cost saving to innovation. Enterprises are expecting their service providers to develop and implement innovative solutions ahead of their competitors. By understanding customers' strategic direction, service providers can assist them in business re-engineering and looking for innovations in those areas.
- In addition to multinational corporations, small and medium-sized enterprises are becoming target segments for outsourcing in view of the competitive pressure and cost concerns. Manufacturing, healthcare and retail sectors are seen to be the next potential markets for outsourcing.
- As the outsourcing agreement is getting more complex, risk management will become a weighty factor in the decision making



process. Service providers need to have a strong governance program in place and governance principles have to be established prior to entering into an outsourcing agreement.

- More regulations will be in place in client markets (e.g. the US market). Service providers need to adhere to standards and meet enterprises' requirements for data security and privacy laws.

3. THE HONG KONG ADVANTAGES

The competitive advantages of Hong Kong IT Industry lie in strong industry expertise, business knowledge, well-established infrastructures, good understanding of the Chinese and overseas markets as well as high quality IT professionals with good project management skills and rich experience in large-scale projects.


a. Domain and business knowledge

Being a cosmopolitan city, Hong Kong has good understanding of the Chinese and western cultures, strong industry expertise and good business knowledge of the operation of multinational corporations. The highly competitive and complex business environment has made Hong Kong a good test bed for local IT companies to develop innovative and world-class applications.

b. Well-established infrastructures

Hong Kong has well-established infrastructures in terms of telecommunications network, financial structure as well as tax and legal systems. Equipped with excellent information infrastructure, Hong Kong offers a favorable environment for developing web-based applications, e-commerce, enterprise portal, multimedia, online games and mobile applications etc.

In addition, Hong Kong is one of the largest venture capital bases in Asia. The establishment of the Growth Enterprise Market further assists IT



companies in raising funds for product development/commercialization and business expansion. More importantly, intellectual property rights are well protected under the governing laws.

c. Award-winning solutions

Hong Kong IT companies have been developing advanced and sophisticated solutions to address the complex and ever-changing needs of the private and public sectors. Moreover, they have been continuously improving the quality of their software and services to stay competitive in the market. Many award-winning solutions have been developed and are highly recognized in the international market.

d. International exposure and practices

In terms of market exposure and technical standards, Hong Kong IT companies are familiar with international practices, making Hong Kong an ideal link between mainland China and the West. The bilingual capability of local IT professionals in Chinese and English communications, combined with their sensitivities to global market trends, have greatly facilitated Hong Kong IT companies to engage in offshore outsourcing activities.

e. Excellence in project management

Hong Kong IT companies have good project management skills and teamwork methodology as well as rich experience in implementing large-scale projects. There are high quality IT talents in Hong Kong who are creative, efficient, flexible and have strong quality commitment. In terms of



Lessons Learnt in Outsourcing

technical competence, many of them are well versed in high value-added activities such as architecture design, system integration and consultancy services. Consequently, they are able to deliver projects on time, within budget and with high quality standard.

f. Mainland – Hong Kong collaboration

The close relationship between Hong Kong and mainland China has intensively strengthened the partnership between IT companies in the two places. Their combined advantages have further increased their competitiveness in the global outsourcing market.

4. LESSONS LEARNT IN OUTSOURCING

Face-to-face interviews were conducted with a number of Hong Kong IT companies regarding their experience and lessons learnt in doing outsourcing business. Their opinions, combined with advice from overseas experts in this field, were consolidated and presented in the following sections.

4.1. Customers' needs and expectations

4.1.1. Value proposition

Why do enterprises outsource? What do customers buy? Value assessment is an integral part of the outsourcing deal. Basically value proposition can be created in three dimensions:

a. Cost

- Savings (e.g. reduction in processing costs).
- Avoidance/recovery of capital investment.
- Alternative use of invested capital.
- Additional benefits from process redesign and sharing of resources.

b. Time

- Service availability (24x7x365).
- Time zone advantages.
- Reducing cycle/implementation time.
- Shortening the learning curve by leveraging on service provider's technology and experience.

c. Quality


- Meeting new business requirements (e.g. creating new business model, increasing accuracy and security).
- Specialization and enhanced ability to set, measure and monitor quality targets.



4.1.2. Major concerns

In the past, many outsourcing projects had failed to meet customers' expectations and satisfaction with outsourcing services dropped. Consequently, enterprises become prudent in making outsourcing decision, especially in relation to offshore outsourcing. Their major concerns include:

- Increased management complexity. How to manage an outsourcing relationship effectively is a key challenge that enterprises are facing. As



more and more functions are outsourced, enterprises need to integrate and manage a portfolio of service providers. Moreover, new laws and regulations have increased the need for more stringent governance over outsourced operations/services.

- Poor performance of service providers. Projects are delayed or service levels are not met. In addition, the high staff turnover rate in some locations makes it hard for service providers to keep their staffing commitments to their customers, thus lowering the quality of services delivered.
- Losing direct control over the processes/resources. It is difficult for enterprises to manage the processes/resources, especially in overseas countries. In some cases, this may lead to service disruptions.
- Uncertain return on investment (ROI). Very often enterprises are not able to identify and quantify all the costs and benefits associated with an outsourcing deal. Hidden costs or unanticipated risks will affect the true financial impact of the outsourcing services.
- Uncertain information confidentiality. Data security, privacy issue and intellectual property right protection are major concerns when considering the outsourcing option (particular true for offshore outsourcing).
- Organizational change. The outsourcing decision will likely affect the IT or political landscape of the enterprises. Management needs to handle employees' resistance to change/outsourcing.

- Backlash concerns. The threat of employee backlash over outsourcing, employee severance costs, and backlash from society for sending jobs overseas remain key concerns of enterprises.
- Cultural and language differences. Do enterprises feel comfortable working with overseas service providers with a different cultural background? Can the service providers communicate properly in English (or customers' mother language)? Communication difficulties can result in reduced operational effectiveness or even project failure.

4.1.3. Key selection criteria

According to a study by DiamondCluster² in 2005, the top five criteria that enterprises evaluate the service providers are:

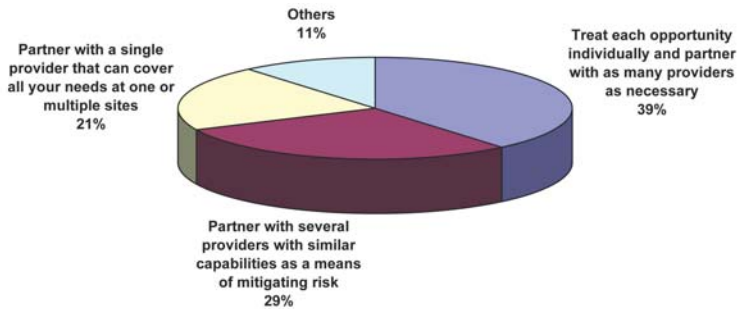
1. Technology expertise.
2. Cost.
3. Flexibility in structuring operating model.
4. Existing or prior relationship.
5. References and reputation.

As more and more service providers emerge in new geographic regions, enterprises are building up their portfolios of service providers that have the capability to address their different needs.

² "2005 Global IT Outsourcing Study", DiamondCluster International, Inc, 2005.

Figure 3 illustrates enterprises' attitude about outsourcing relationships. Close to two-fifths of respondents expressed that they treat each opportunity individually and partner with as many providers as necessary. Many enterprises are more inclined to select multiple providers that can meet their specific needs rather than partnering with a single provider.

Figure 3: Enterprises' attitude about outsourcing relationships



Source: DiamondCluster International, Inc., 2005

4.2. Critical success factors

A number of critical success factors for outsourcing are summarized as follows:

- Brand and good reputation, along with global reference accounts (track records).
- Defined and credible value proposition (clear understanding of your customers' needs).
- Clear business focus and well-defined target markets/segments.
- Key differentiation (competitive edges over your competitors).
- Domain knowledge, back up by expertise and experience in process design, management and technology insertion.
- Process maturity (with well-defined software engineering processes), quality and continuous improvements (e.g. CMMI), and commitment to security environment compliant (e.g. ISO17799).
- Disaster recovery capability (incorporating robust disaster recovery and business continuity plans).
- Proven strategy for recruitment and staff retention, with global/regional workforce access, competence and infrastructure in place.
- Trusted partnership (especially important if you do not have direct presence in overseas markets) and strong relationship management.

4.3. Best practices

4.3.1. Value assessment and propositions

- Strengthen your market position by establishing leadership in industry segments or technology disciplines. Enhance industry expertise to create competitive edges and protect your charging scheme. Focus on core competency.
- Be prepared to talk to customers in terms of business value. Include all tangible and intangible benefits in the value assessment process. Intangible benefits include improved customer services and better managed processes. The key is to identify those specific benefits that are meaningful to your customers.
- Document the formulas and the assumptions used when calculating the ROI. To the Financial Controller, the compelling issues include no up-front investment, fast payback, predictable/uniform spending and revenue gains.
- Strive to understand your customers' needs (what they want to achieve through outsourcing) and, more importantly, exceed their expectations. User demand is always evolving so you have to understand them from the beginning and are ready to satisfy them when they change.
- Build the value propositions on a customer-by-customer basis. Establish win-win propositions where neither the customer nor the service provider feel like they have been taken advantage of. Both parties need to be long-term partners for successful outsourcing.

- Consider your role in the value chain. Continue to differentiate yourself with specialized skills and services. Otherwise your profit margin will erode.

4.3.2. Sales and marketing

- Gather preliminary customer information from sources like annual reports and quarterly filings, company websites, news releases, management appointments and industry portals. It is important to profile the business environment of your customers early in the sales process.
- Find out the key decision makers (c-level executives). Understand the common challenges for their positions and why they will be interested in your services. Deliver the compelling reasons. Sales is about knowing who to call on, when and what the customers' needs are. It is more effective to sell from the top down and from business executives to technical professionals.
- Understand whether the customers have any experience in outsourcing before and where they are in the buying process. This will help you better position your company and services.
- Take time to understand the major business issues that the customers and their industry are facing. Identify their key performance indicators and understand the business problems that the outsourcing services aim to address.
- Be a good listener and place yourself in the customers' shoes. Be prepared to address their concerns and lead them through the



objections.

- Proactively define and explain your edges (your differentiation) to your customers. Take advantage of your edges to ascertain that you can meet their expectations.
- Gain trust by track records and references. Overseas customer references can increase your credibility and allow higher price point. Other references like the profile of the management team, awards granted and quality processes are also important to gain trust.
- Establish direct presence in overseas countries to get in touch with the key decision makers and improve customer relation. It is often necessary to hire direct sales people to develop the market unless your product is mature and easy to sell (e.g. via online distribution).
- Should have a long-term view as return on sales and marketing investment in the near term will be low. It may take 1-2 years before you can get a larger project. Localized sales and marketing effort is necessary to build the understanding for the targeted customers.
- Leverage on the experience and resources of trade associations and industry support organizations (e.g. Hong Kong Trade Development Council). For instance, list your company's information in their portals and join their marketing and business-matching activities.

4.3.3. Project management

- Use a structured approach for implementing offshore outsourcing projects. Adopt proven project management frameworks and




Lessons Learnt in Outsourcing

development methodologies.

- Improve quality continuously. Design a quality management system with well-defined roles and responsibilities. Build a sense of community within your company and instill the goal of quality in your staff.
- Global benchmark is a necessity to be competitive. Follow international/industry standards and overseas regulations.
- Create project transparency to the customers. Communicate with your customers regularly in each development stage to ensure the projects are on the right track.
- Provide detailed requirements and ensure strong development process enforcement when subcontracting the programming tasks to your subcontractors/partners.
- Maintain control over your subcontractors/partners to minimize the risk of losing intellectual property. One way is to break down the programming tasks into different modules and assign different teams to carry out the work.

4.3.4. Partnership and relationship management

- Establish the right partnerships from the beginning. Evaluate the strengths and weaknesses of your local partners, their capabilities and countries thoroughly (e.g. visit their sites, meet their managers and talk with their customers).

- 
- Gain customers' involvement and commitment. Get your customers' key personnel involved in your management meetings when planning how to partner on projects and stay on the path. It is crucial for the customer and the service provider to work together as a team.
 - Build relationship at all levels, from the management to the technical/operation team. Customers buy from people whom they feel comfortable to work with and whom they think have the capability to deliver the services required.
 - Cultivate a long-term, rewarding relationship with customers by strengthening customer services and support. Suggestions include regular communication with customers (e.g. newsletter, alerts), customer satisfaction evaluation (e.g. customer survey and feedback form), giving the best treatment to the best customers, and providing on-line references, enquiry and customer support.

4.3.5. Communication

- Use technology to improve communication, the flow of information and management control (e.g. instant messaging, access to project status via the Internet). By lowering the management cost, this can help improve the outsourcing ROI.
- Ensure an open communication channel. Have a clearly defined and measurable service level agreement in place so that both the customer and service provider agree to the objectives set and understand clearly their responsibilities and accountabilities.

Lessons Learnt in Outsourcing

- Recognize the language differences. Write in American English when communicating with the US customers as they may not be used to wordings in British style. Another advice is to adopt unified modeling language (UML) for system design so as to minimize ambiguity in communication since not all programmers are good at English.
- Understand different cultures. For example, Asian customers are less receptive to the concept of outsourcing so more time is needed to "educate" them about the value of outsourcing, gain their trust and build up the relations.

4.3.6. Risk mitigation

Risk management has to be an integral part of the outsourcing process. There are different risks associated with outsourcing, including risks about the technology adopted, transition process, service provider's capability and relationship management. These risks have to be identified and quantified. Figure 4 illustrates how to address the outsourcing risks.

Figure 4: Addressing the outsourcing risks



Source: JDalal Associates, LLC, 2005




Points to note:

- Evaluate customers' perceptions of risks by understanding why they would not buy the outsourcing services.
- Explain why/how your company can address these risks point by point and in a specific way.
- Establish a mutual understanding about the governance structure, service level agreement and performance expectations.

4.4. Industry support

The global outsourcing scene is witnessing a multitude of changes and business transformations. Together with heightening competition, the pressure to excel is becoming increasingly intense. To assist Hong Kong IT companies to compete more effectively in the global market, various supportive initiatives have been suggested by the companies interviewed:

- Raise the image and profile of the Hong Kong IT Industry. Promote the success cases of local IT companies and their outsourcing capabilities and advantages in international magazines and well-known portals (e.g. advertisements).
- Increase the awareness and build up the brand name for Hong Kong IT outsourcing services. One way is to leverage on Hong Kong Trade Development Council's expertise in brand building. Another suggestion is to place a large advertisement in an eye-catching location in the airport and deliver a message that Hong Kong is a regional outsourcing hub.
- Form an outsourcing consortium with the support from industry associations and the Hong Kong Government. The consortium can help promote the image of the Hong Kong IT Industry. It can also act as a representative of local IT companies when developing the overseas markets as well as voicing their views to the government.
- Organize more overseas trade missions and business-matching activities to build up connections and business networks in new



markets. Also organize outsourcing exhibitions or investment forums in Hong Kong to create new business opportunities.

- Provide more information about the overseas markets (e.g. market trends and opportunities, customers' needs, competition, regulations and standards adopted in different industries) via industry portals or market studies.
- Formulate more preferential policies to support local IT companies. For example, offer more financial support for local IT companies to participate in overseas tradeshows and provide sponsorship for public relation activities (e.g. media briefing).

Last but not least, consistent and recurrent industry support efforts by the Hong Kong Government and the IT industry are important to build a brand recognition and acknowledgement and appreciation for the value brought by "Hong Kong, China".

This project is organised by Hong Kong Information Technology Federation and funded by the SME Development Fund of the Trade and Industry Department, the Government of the Hong Kong Special Administrative Region.

Any opinions, findings, conclusions or recommendations expressed in this material/event (or by members of the Project team) do not reflect the views of the Government of the Hong Kong Special Administrative Region, Trade and Industry Department or the Vetting Committee for the SME Development Fund.

© 2006 by HKITF. All rights reserved. Reproduction of this publication in any form without prior written permission is forbidden. The information contained in this book has been obtained from sources generally available to the public or released by responsible individuals in the subject companies but is not guaranteed as to accuracy or completeness. HKITF and HKPC will not be liable for errors, omissions or inadequacies in the information contained here or for interpretations thereof. The readers assume sole responsibility for selecting the information to achieve their own purposes.

HONG KONG

Outsourcing
Services



Enquiries:

Hong Kong Software Industry Information Centre

Tel: (852) 2788 5858

Fax: (852) 2788 5860

E-mail: siic@hkpc.org

Website: www.siic.org.hk