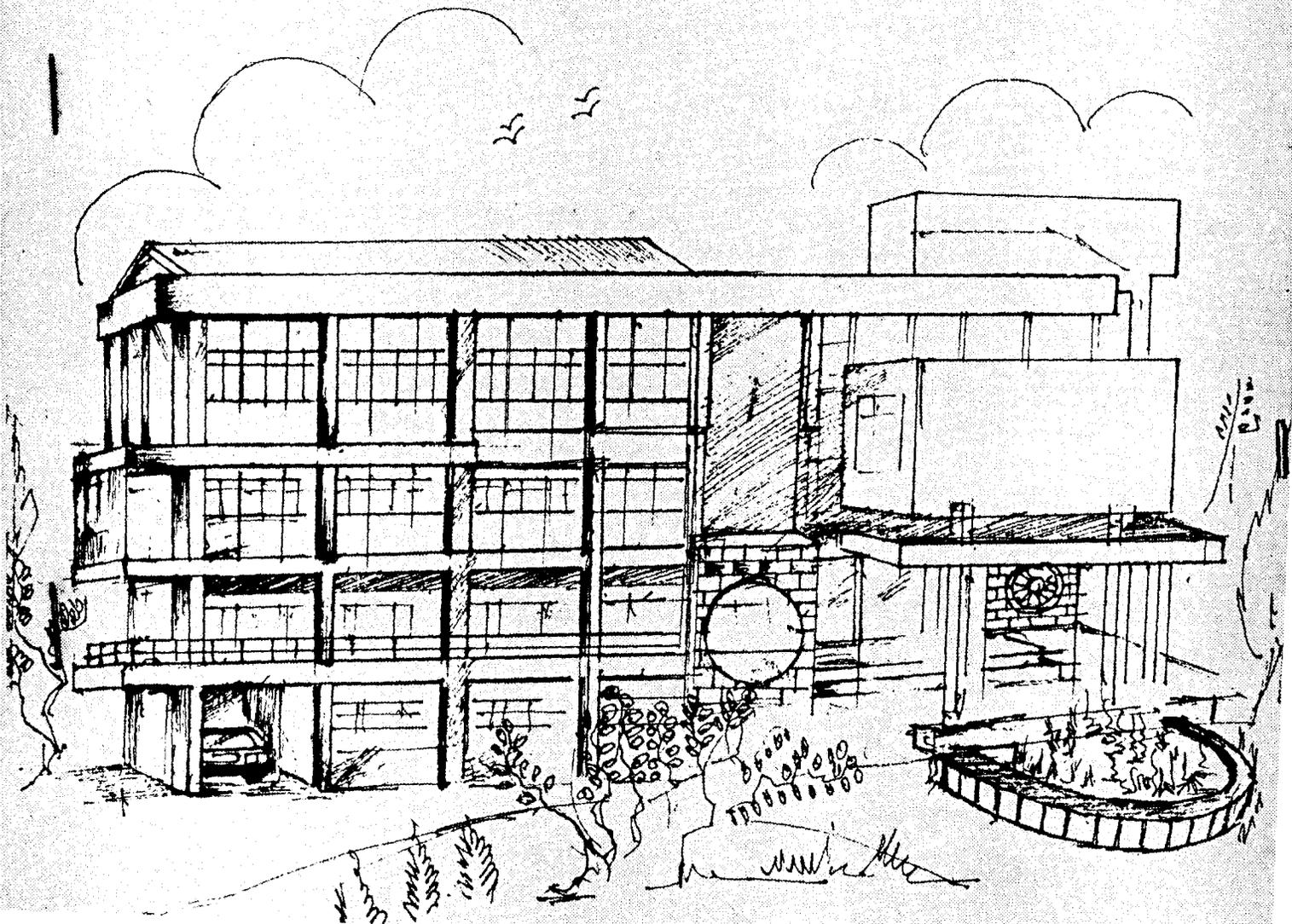




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An Investigation into the Recent  
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**SUCCESS OF OFFSHORE IT OUTSOURCING - AN  
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**T. A. Pai Management Institute  
Manipal –576 104, Udupi Dist., Karnataka**

# **SUCCESS OF OFFSHORE IT OUTSOURCING - AN INVESTIGATION INTO THE RECENT OUTSOURCING ENGAGEMENTS INVOLVING INDIAN SERVICE PROVIDERS**

Prof. Saji K. Mathew<sup>1</sup> & Prof. Rajendra Sahu<sup>2</sup>

## **Abstract:**

Success of IT outsourcing engagements is often difficult to gauge as success carries different meanings to different outsourcing decision contexts. The desired outcome through offshore IT outsourcing varies across client organizations. Previous research has identified a number of such reasons; the major focus has always been cost reduction though. This paper analyses the likelihood of success of three recent major IT outsourcing deals involving Indian IT service providers. A best practices framework for IT outsourcing success was used for analysis. The first organization analyzed had a medium low chance of success, the second had a medium high and the third was having a medium likelihood. The major difference between the first and the second was found to be in the decision scope and decision sponsor-the first one opted a total outsourcing mode with less senior management involvement in the decision process whereas the second one chose selective IT outsourcing with senior management involvement.

**Key words:** IT outsourcing, success, cost reduction, best practices, decision process

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<sup>1</sup> Associate Professor, T A Pai Management Institute, Manipal, Karnataka, South India 576 104

<sup>2</sup> Associate Professor, ABV-Indian Institute of Information technology & Management, Gwalior, India.

## 1. INTRODUCTION

IT outsourcing has received much attention of academia and industry with increasing significance ever since Eastman's Kodak's path breaking IT outsourcing decision in 1989. Globalization and growth of information and communication technologies has mainly driven the offshore IT outsourcing phenomenon where a supplier from another country than that of the client firm makes significant contribution in the physical and/or human resources associated with the entire or specific component of the IT infrastructure in the client organization (Loh & Venkatraman, 1992). The growth of the industry is evidenced by the increasing offshore component of IT labor in the budgets of Fortune 500 organizations (Agarwal & Carmel, 2004). In the Indian context, National Association of Software and Services Companies' (NASSCOM) estimates show that Indian IT & IT enabled Services (ITeS) industry will contribute 4.8% to India's GDP by 2005-2006 (Business Line, 2005). The industry grew at a CAGR of 30% during 2001-2006, and is estimated to grow at 26% CAGR to reach \$60bn by 2010 contributing 7% of GDP. The United States accounts for close to 70% of India's offshore revenues (CRISINFAC, 2005)

Though the major focus of offshore IT outsourcing still remains cost savings through labor arbitrage and economies of- scale, scope and specialization, the industry is maturing towards more partnership based engagements. Carmel & Agrawal's (2004) study of 13 most influential US firms suggests that offshore IT outsourcing follows a stage model, based on increasing maturity and sophistication in the offshore strategy from an offshore bystander, through offshore experimenter to proactive cost focus maturing to a proactive strategic focus. Most of the Fortune 500 firms were in the first

stage in 1990s, where *fear of moving work offshore* was predominant. However many firms overcame this stage by mid-1990's, experimented offshore destinations like India for obvious benefits and matured to more stable cost focused offshore stage. Some of the firms have moved up the maturity curve to view offshore IT outsourcing as an important strategy for achieving a range of strategic objectives like business & technology innovation, new product development, access to new markets etc.

In the present evolutionary context of IT outsourcing there exist no common right definition of success. It is also possible that a client and service provider in an outsourcing relationship could have differing definitions of success. Service providers' perception of success in offshore outsourcing involves continuation of partnership as a major factor (Mathew, Aundhe & Rajagopalan, 2006). Also a definition of success would be largely influenced by the expected outcome of the outsourcing engagement. This will again depend on the stage of maturity at which an outsourcing firm (client) stands. Outsourcing organization have diverse kinds of expectations from the outsourcing engagements. A study of Lacity & Willcocks (1998) identifies 15 different expectations/reasons for outsourcing by organizations. Therefore it is imperative that success should be measured in terms of the 'desired performance' (Domberger *et al.*, 2002). The desired performance here is contextual and would depend on what an organization intends to attain by resorting to IT outsourcing.

The relatively nascent field of IT outsourcing area is today characterized by lack of standardization of terminologies. There is no common dictionary of terminologies that everyone agrees upon. For example, based on the survey of 116 organizations in different geographical locations Lacity & Willcocks (2001) employed three factors: objectives

against results, cost reduction and satisfaction to measure success of outsourcing. Lee *et al.*, (2004) used three dimensions: strategic competence, cost efficiency and technology catalyst from CIO's perspective. This further implies that perceptions about what constitutes success will influence the outcome of the search for success (Willcocks, Lacity & Cullen, 2006).

Though the strict definition of success would be difficult in a hazy, evolving domain, it is also important to have a reasonable framework to measure success factors of outsourcing engagements. This need is all the more supported by previous research that substantiates the increasing value that foreign firms find in offshore IT outsourcing to India and also the Indian service providers' perception of relationship continuation with foreign client as a major success factor. In this context, this paper examines the recent major outsourcing contracts of one US firm and two European firms with Indian tier-1 IT service providers. The objective of the study is to understand the desired outcome of these contracts, and the likelihood of attaining the desired outcome. The basis for this analysis is the frameworks for successful outsourcing described by Lacity *et al.*, (1995) and the best practices in outsourcing given by Lacity & Willcocks (1998) based on similar data points.

## **2. BEST PRACTICES FOR IT OUTSOURCING ENGAGEMENTS**

Based on 61 IT outsourcing decisions made in 40 US and UK organizations during 1991-1995, Lacity & Willcocks (1998) derived five best practices and two insightful findings to guide IT outsourcing decisions. The objective of the research was to develop an indicator of success based on client's perceptions of whether the outcome of their IT outsourcing decisions met their expectations. Expected cost savings achieved was

selected as the indicator for success because reduced IT costs was the most cited expectation/reason in the research-in as much as 80% of the cases. The researchers also felt that many other reasons cited by the participants could also be reduced to cost savings. The following best practices were identified by the research:

1. Decision scope:  
Selective outsourcing decisions achieved expected cost savings with a higher relative frequency than total outsourcing or total in-sourcing decisions.
2. Decision sponsorship:  
Senior executives and IT managers who made decisions together achieved expected cost savings with a higher relative frequency than when either stakeholder group acted alone.
3. Evaluation Process:  
Organizations that invited both internal and external bids achieved expected cost savings with a higher relative frequency than organizations that merely compared external bids with current IT costs.
4. Contract duration:  
Short-term contracts achieved expected cost savings with a higher relative frequency than long-term contracts.
5. Contract type:  
Detailed fee-for-service contracts achieved expected cost savings with a higher relative frequency than other types of fee-for-service contracts.\

Total outsourcing involves the decision to transfer the equivalent of more than 80% of the IT budget towards IT assets, leases, staff, and management responsibility to an external IT provider. Total in-sourcing is the decision to retain the management and provision of more than 80% of the IT budget internally after evaluating the IT services

market. Selective outsourcing involves the decision to source selected IT functions from external provider(s) which accounts for provision of services between 20% and 80% of the IT budget which may include single or multiple vendors. Contract duration was classified into three categories: short term-less than four years, medium term-between four and seven years, and long term-more than seven years.

### **3. DATA & METHODS**

We gathered the data required for analyzing best practices followed in recent IT outsourcing engagements from data sources mostly available for public access. This included the Business Line database of news archives, ZDNET database, web sites of the client and service provider organizations and also the Ebsco Business Source Premier database. We opted for this source of data because business sensitive data, carrying contractual information, list of clients/service providers etc. are not generally shared by clients/service providers for research. Further, the data available in public space suffices the input requirements for the analytical framework chosen in this paper (Lacity & Willcocks, 1998). Information Systems research based on sources of data from the public database has also been followed in many previous researches-eg.: Bharadwaj, 2000; Brynjolfsson & Hitt, 1996; Lichtenberg, 1995.

Following a case study based methodology, we have identified three engagements which brought substantial visibility to Indian service provider organizations- General Motors with Wipro Technologies; ABN-Amro with TCS & Infosys Technologies; and DSG International with HCL Technologies. The first client is based in the US and the second and third are based out of the Netherlands and the UK, thereby matching with the

geographies of the best practices framework referred in this paper Lacity & Willcocks (1998).

It has been demonstrated by the research of Lee *et al.* (2004) that the same best practices could give conflicting results if applied to a different geographical location. For example their empirical study covering 311 client organizations in South Korea found no support for short term contracts as better designs for success than short term contracts. The researchers attribute this to the cultural context of South Korea where people prefer long term relationships as compared to short term engagements. Hence we use the best practices described in Section 2 due to its similar geographical coverage, large sample size and time spread operating in the offshore mode of IT outsourcing. In our analysis, when a given data aligns with a best practices factor, we assign the ‘best practices alignment’ a *high* value, a partial alignment is assigned *medium* and no alignment is given *low*. Success is calculated as the average of the five best practices alignment values.

#### **4. DECISION ANALYSIS**

In this Section we analyze the three outsourcing contracts announced in the recent past. These announcements appeared in the trade press and news columns several times. The clients involved in these contracts are General Motors (GM), ABN Amro, and DSG International. The available data on the three engagements showed that the desired outcome in all the three decisions was *cost reduction*. Therefore we define success here as attaining expected cost reduction and use our analytical framework to arrive at the likelihood of attaining cost reduction in the three cases. Contract type, terms and

conditions etc. being business sensitive information is not accessible in all the three cases.

**Table 1: Data of three IT outsourcing decisions**

S. No	Client, country	Service Providers	Deal size	Decision scope	Decision sponsor	Evaln process	Contract duration	Contract type
1	GM, USA	EDS, Hewlett Packard, Capgemini, IBM, Compuware Covisint, Wipro	\$15 Billion	Total outsourcing	CIO, who is also the vice president of the firm	only external bids	Medium (5 years)	not known
2	DSG International, UK	HCL Tech	\$330 million	Total Outsourcing +cosourcing	senior management	Only external bids	Medium (5 years)	not known
3	ABN Amro, Netherlands	IBM, TCS, Infosys, Accenture, Patni	\$2.2 Billion	Selective Outsourcing	senior management	only external bids	Medium (5 years)	not known

#### 4.1 General Motors

General Motors Corporation, also known as GM, is the world's largest auto manufacturer. Founded in 1908, GM today employs about 326,999 people around the world. GM manufactures its cars and trucks in 33 countries. GM bought Electronic Data Systems (EDS) in the mid-'80s. GM bought EDS with the notion of EDS becoming not only the internal IT department for GM but also continuing its business on the outside. In '96 they spun EDS off as a separate company but entered into this 10-year master services agreement (Dignan, 2005).

GM announced separate contracts with EDS, HP, Capgemini, IBM, Compuware Covisint and Wipro for its future information technology program. This initiative was

driven by the ending of a 10-year split-off of ‘master service agreement’ with EDS that expired in June 2006. As per the press release announcing GM’s sourcing decision, of the five-year contracts being awarded, EDS will continue to have the most business at GM but somewhat less than earlier, while HP and Capgemini will increase their existing business while IBM, Compuware Covisint and Wipro will be strategic IT partners to GM (GM Media Online, 2006). The announcement of the deal was done by Ralph Szygenda, CIO and vice president of GM who is also the architect behind the present IT sourcing strategy (Hamm, 2005). Since he is CIO acting as a senior management representative, with no clear involvement of other senior management functional representatives visible in the decision process, a partial decision sponsorship by senior management is evident here. There are also media reports of Szygenda’s single handed but well intended IT strategy, exhibited well during the bidding process (Hamm, 2005).

**Table 2: Best Practices Alignment of Decisions**

<b>Organization</b>	<b>Decision scope</b>	<b>Decision sponsor</b>	<b>Evaluation process</b>	<b>Contract duration</b>	<b>Contract type</b>	<b>Success</b>
GM	low	medium	low	medium	-	<i>medium-low</i>
ABN- Amro	high	high	low	medium	-	<i>medium-high</i>
DSG International	medium	high	low	medium	-	<i>medium</i>

Table 2 shows GM's IT outsourcing decision with respect to the best practices framework. As per the available data given in the table, GM's decision doesn't align with the decision scope and evaluation process but partially aligns with decision sponsor factor. Qualitative scores have been assigned to the factors with equal weights and likelihood of success has been arrived at based on the procedure discussed in Section 3. GM's outsourcing decision has thus a *medium low* likelihood of success.

#### **4.2 ABN Amro**

ABN Amro on 1st September 2005 announced 5 vendors for outsourcing business of 1.8 billion Euros, after a global competitive tender (Steve, 2005). The largest chunk of this business– 1.5 billion Euro for infrastructure management – went to IBM. While TCS bagged a five year 200m Euro (\$260m) contract, Infosys' share works out to Euro 108m (\$140m), also for a similar term. Also figuring in the list is Patni Computer, which along with Accenture, has been named by ABN Amro as a preferred partner for application development. With this deal, ABN Amro reduces its IT staff substantially. The bank expects the total estimated IT staff reduction will be 1,500 people in the following 18 months. The bank also expects savings of Euro 258m (\$335m) per year by 2007.

The contracts with Infosys and TCS are for application support and enhancements to the bank. Both companies will be allocated the maintenance of selected applications across ABN Amro's business units. The implementation of the agreements will be phased over 18 months.

The announcement of the deal was done by Ron Teerlink, the CEO of the company's shared services unit, Tom de Swaan, Amro's CFO, and Lars Gustavsson, the CIO (Steve, 2005), thus evidencing the presence of the company's technical and senior management team in the decision process. Table 2 maps ABN Amro's outsourcing decision to the best practices framework. Based on the data available ABN Amro's likelihood of success (achieving cost reduction) in this deal is *medium high*.

### **4.3 DSG International**

DSG is Europe's leading electrical retailer. The IT outsourcing deal of DSG follows the break-up of talks between DSG and Logica CMG to whom DSG was planning to outsource IT last year (ZDNet, 2005). According to its present deal with HCL, spread over a 5-year period, HCL will take over DSG's entire Information Systems division. HCL will provide system development, application delivery, infrastructure support and maintenance services to DSG (Business Line, 2006). About 350 employees will move on to HCL's rolls at its onsite center in London from DSG site at Armagh, Northern Ireland.

As per DSG personnel, the selection of HCL was on the basis of its breadth of experience, partnership approach and the transparency in its cost models. This co-sourcing partnership is expected to enhance DSG's capabilities, drive innovation and improve agility as they build their position as Europe's leading electrical retailer. Further HCL would gradually shift the service to an offshore delivery model over the next 12 months, and expects to manage 60% of the project from offshore locations, with 40% being delivered onsite.

The details of the deal were announced by Kevin O'Byrne, the group's finance director which provides evidence for senior management participation in the decision process. Table 2 describes the details of the deal based on the best practices frame work. The decision scope here is total outsourcing, which involves turning over complete IT services to the external service provider. Although this is a very risky proposition prima facie, DSG has mitigated part of this risk by resorting to co sourcing-an outsourcing arrangement in which the client organization retains some of its key IT manpower to work with the service provider. This will enable DSG to back source in case of partnership failure. Therefore though the decision scope factor should be low by virtue of total outsourcing, it has been marked medium based on the co sourcing strategy. The analysis shows DSG has a medium chance of attaining cost reduction through this outsourcing deal.

## **5. Conclusion**

The analysis of the three major IT outsourcing deals using the best practices framework gives some assessment of the likelihood of success as envisaged by the client organizations. Of the three deals analyzed, ABN Amro's IT outsourcing deal is most promising as it gives a medium high likelihood of attaining cost reduction-the dominant strategy behind the outsourcing decision. This is because ABN Amro has adopted a selective outsourcing strategy whereby it has retained some critical IT services (eg. Information security function) in house. This selective mode of outsourcing is also an evidence of the prior evaluation of its internal capabilities, identification of criticality, strategic value etc. of different IT services. On counts such as evaluation process, and contract duration, all the three organizations score the same. GM scores the lowest in

success because of its total outsourcing decision with no services retained in house. It also depends on one person (CIO) for the entire decision making process.

One limitation of this study lies in the very validation of the predictions made on the success of the sourcing decisions. A comparison against the actual outcome will require financial data of the firm performance to be monitored against the IT investments. Though the present figures show immediate reduction in the IT budgets of the client organizations, the consequences of under performance of the partnership could lead to financial loss. Therefore firm performance against the new IT strategy needs to be monitored over the outsourcing duration and overall cost due to IT needs to be used for evaluating the success of the outsourcing strategy. In the absence of such a monitoring mechanism which is difficult the study is entirely dependent on the validity of the best practices framework. However the predictions gives a confidence to the extent the best practices have been established on a fairly large sample size in similar geographical locations.

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