

# **The Black Book of Outsourcing**

***How to Manage the  
Changes, Challenges, and  
Opportunities***

***DOUGLAS BROWN AND SCOTT WILSON***



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# PREFACE

We need to discover the means to enhance the skills of our workforce and to further open markets here and abroad

—Alan Greenspan, Chairman of the U.S. Federal Reserve Board

**O***ffshore outsourcing*, or *offshoring*, refers to the procurement of goods or services by a business or organization from an outside foreign supplier, typically to gain the benefits of labor arbitrage. In the past 10 years, business process outsourcing (BPO) contracts have increasingly been awarded to firms in developing countries, because educated workers in these countries—in particular India and China—are willing to work for a much lower wage than are same-level workers in developed countries, such as Japan. (For offshore outsourcing to be economically feasible, savings from the lower wage rate must surpass the increased costs of management and associated risk.) But, in the mid-to-late 1990s, when high-paying professional jobs, such as those in the computer industry, began to be offshored with greater regularity, many people in developed countries began to object to the practice.

Consequently, offshore outsourcing became a hotly debated issue among workers, corporate executives, and politicians, one widely covered in the international media. When the American economy began to pull out of the recession in 2001 and unemployment failed to decrease as expected, offshore outsourcing was cited as a contributing factor to what was called a “jobless recovery.” In information technology, for example, a particularly “soft” sector, many American programmers lost their jobs to lower paid foreign workers. More recently, however, many economists have conjectured that the higher-than-expected unemployment numbers were not the result of offshore outsourcing, and that offshore outsourcing has had a positive impact on the American economy.

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HISTORICAL PERSPECTIVE

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College instructor Jim Ryan, who teaches the history of outsourcing at Auburn University in Alabama, offers these insights. Ryan, formerly a top business executive, left corporate America to pursue his advanced degrees including his PhD in Management Information Systems, at a time when the IT industry itself started the shift of high-tech jobs offshore. Ryan, now a recognized expert in computer sciences, complex decision support systems, and technology applications, appreciates the evolution of outsourcing and its effects on the global tech workforces. He likens the current fears about outsourcing to similar concerns during the Industrial Revolution and, more recently, the early 1990s. For example, in 1900, 40 percent of the workforce was in agriculture, before advances in technology made it possible to produce more food today with only 2 percent of the workforce.<sup>a</sup> Unquestionably, explains Ryan, that transition was difficult on many farmers, but their descendents live in a better world because of those changes. Initially, the lower costs meant higher profits only for those farmers who stayed in business, but eventually competition forced the distribution of gains across the rest of the country. The result was dramatically cheaper food, which also meant greater availability of more resources to make myriad other products.

Ryan's business and IT students learn quickly that their wages won't depend on their job titles but on their skills and the amount of capital they have to augment those skills. Opening our economy to trade in goods and services enables us to use our skills and capital as productively as possible. There are two ways we get things in life: The first is to make them; the second is to let someone else make them and trade them. When others can make something more cheaply than you can make it for yourself, it makes sense to outsource it. You specialize in what you do most productively and swap for the rest of your needs. That specialization creates wealth.

In the current outsourcing landscape, then, if the economy in India has a low-wage scale, and programmers there can write computer code more cheaply than their American counterparts, it makes sense for us to import that code. How is this different from

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<sup>a</sup> Joseph M. Miller, Daan Joubert, and Marion Butler, "International Trade and Globalization: The Great Outsourcing Scare," *Hoover Digest*, Spring 2004, pp. 1–5.

importing inexpensive televisions from abroad and saving our resources for other work we can do more effectively? Or from finding a new production technology that makes it possible to produce a product at lower cost? It's about getting more from less. That's the true road to wealth, and that's the story of the past 100 years of economic progress in America.

In conclusion, Ryan asks his students to think back to the early 1990s, when people were up in arms about Japan. He reminds them that, in the main, we held to our policy of letting people buy freely from around the world. The alarmists, as it turned out, were wrong. Japan didn't steal our jobs or ruin our country. Employment in the United States grew steadily, as did wages, helped in part by imports from Japan and the rest of the world. Japan, in the meantime, has stagnated. Ryan theorizes that today's alarmists will turn out to be wrong as well. Ryan encourages his Auburn University students to earnestly focus on the changes, challenges, and the opportunities that outsourcing continues to bestow on their business and IT career aspirations. No surprise that Auburn University IT graduates are very highly recruited for their advanced understanding of both complex management information systems as well as the ground-breaking opportunities outsourcing is developing for them to pursue, thanks in part to the visionary approach of Ryan.

## DEBUNKING MYTHS ABOUT OUTSOURCING

Like all controversial topics, myths about outsourcing have begun to circulate, based on fear, conflicting information, or misinformation. Therefore, it is important to begin any discussion on this issue by debunking these myths.

*Myth 1:* Outsourcing means hiring workers from another country to take jobs away from our workers, on a permanent basis.

*Truth:* Outsourcing is the practice of hiring private contractors, which are not necessarily based in another country, to handle projects for a company. Offshoring, a kind of outsourcing, is the term used to distinguish projects that are being outsourced to overseas contractors. Many of the companies based in first-world countries establish a budget for

paying offshore workers. This means the payroll and workload of onshore laborers remain may remain as-is, or even grow; but the type of work onshore laborers are doing will change.

*Myth 2:* Only big companies can afford to outsource. Small business managers won't gain any benefit from this practice.

*Truth:* In the past, it is true, big companies did the bulk of hiring both onshore and offshore contractors, but as more companies become involved in outsourcing, opportunities are opening up to owners of small and medium enterprises. Many contractors now offer specialized services to smaller businesses. Smaller businesses have the same goal as big companies: to earn more while spending less. Without adopting an aggressive attitude and an open attitude toward outsourcing benefits, such businesses stand to lose.

*Myth 3:* There is a third myth, and it is the most widely circulating of them all: *Outsourcing is bad for America.*

*Truth:* To debunk this myth we cite a report sponsored by the Information Technology Association of America (ITAA) and prepared by the research firm Global Insight. It concluded that the practice of outsourcing is good for the U.S. economy and its workers.<sup>1</sup> According to the report, released in March 2004, offshore outsourcing of software and information technology (IT) service tasks not only is boosting the U.S. gross domestic product but also is helping to generate jobs in this country, including positions in the IT sector. ITAA's members, which include tech giants IBM, Electronic Data Systems, and Accenture, are among those locating operations in lower wage countries such as India.

The report goes on to state that although offshore IT software and services outsourcing has displaced, and will continue to displace, workers in IT software and services occupations in this country, improved economic activity will generate a wide range of new jobs—in both the IT and other industries. As the benefits compound over time, the U.S. economy will operate more efficiently, reach a higher level of output, create more than twice the number of jobs than those displaced, and increase the average real wage.

The ITAA-sponsored report also cites these statistics: 2.3 percent of total IT software and services spending by U.S. corporations in 2003 was devoted to offshore outsourcing activities. That figure will rise to 6.2 percent in 2008. During that same time period, total savings from offshoring are expected to climb from \$6.7 billion to \$20.9 billion. The cost savings and use of offshore resources, predicts the report, will lower

inflation, increase productivity, and lower interest rates, thereby boosting business and consumer spending and increasing economic activity. Other notable numbers from the report demonstrate that:

- The benefits of offshore IT outsourcing added \$33.6 billion to real gross domestic product (GDP) in the United States in 2003.
- By 2008, real GDP is expected to be \$124.2 billion higher than it would be in an environment in which offshore IT software and services outsourcing were not a factor.
- U.S. Companies spent over \$16 billion in 2004 to outsource jobs ranging from medical transcription to nanotechnology research. It is predicted companies will spend \$31 billion in 2008.
- The incremental economic activity from offshore IT outsourcing created more than 90,000 net new jobs in 2003, and is expected to create 317,000 net new jobs in 2008.
- Shipping software and IT services work abroad leads to higher real wages for U.S. workers through lower inflation and higher productivity. Real wages were 0.13 percent higher in 2003, and are expected to be 0.44 percent higher in 2008.

The following table projects the rise of business process outsourcing revenues from 2002 to 2008 (in millions of dollars):<sup>2</sup>

	2002	2003	2004	2005	2006	2007	2008
BPO							
Market	\$110,167	\$121,687	\$131,171	\$143,090	\$157,033	\$300,000	\$600,000

## REFRAMING THE OUTSOURCING DEBATE

Just how marked is the shift to outsourcing jobs for the United States, the United Kingdom, Europe, and Japan—more specifically, their workforces and economies? Two decades ago in this country, the loss of jobs in the automotive sector and other high-paying manufacturing fields sparked fears of a hollowing-out of the economy. Yet, painful as the loss of those positions was, strong economic growth and innovation created far more—and better—jobs to replace them.

Now the same process, many economists say, is occurring as a result of outsourcing jobs to other countries. Others, though, argue that today's outsourcing of highly skilled service jobs is fundamentally different—and therefore poses greater risks for the economies of developed countries. Yes, a

number of individuals in the IT industry are losing out to well-educated programmers or engineers in other countries who can do the same job for far lower wages. But as the global economy evolves, innovation will create new high-paying jobs.

Certainly, outsourcing contributes to short-term unemployment trends in developing countries, but those who blame outsourcing for job losses tend to ignore other powerful trends that are currently changing the rules in the business environment, including:

- The shift from domestic to global economy
- The shift from manpower to technopower
- The shift from company-led to consumer-driven market forces
- The shift from an industrial economy to a knowledge economy
- The transformation of the employer/employee relationship
- New relationships and governance structures concerning vendors and suppliers

Critics of outsourcing see it only as the elimination of consumers and the unrealized potential of more productive jobs in new industries. In fact, outsourcing is being touted by several high-level economists and business executives as exactly what advanced countries need to get their economies back on track. Among them is Alan Greenspan, chairman of the U.S. Federal Reserve Board, who has endorsed the potential of outsourcing to

#### WHY INDIA?

For myriad services, India has emerged as the outsource location of choice for both the United States and the United Kingdom. The reasons are not hard to identify. First, India has the second-largest English-speaking population in the world, after the United States, and an educated workforce of more than 270 million workers.<sup>a</sup> In addition, the outsourcing market in India, particularly for information technologies, has had time to mature and gain support from U.S. and U.K. businesses. Moreover, India's 1991 Statement on Industrial Policy facilitated foreign direct investment and technology transfers, thereby ushering in a new era with fewer of the

<sup>a</sup> Government of India, Ministry of Education, [www.education.nic.in](http://www.education.nic.in), December 2004.

regulatory burdens that had previously kept foreign firms from establishing business operations there. In the decade since this policy reform, foreign direct investment in India has increased more than fiftyfold.

Also notable is that even though India's basic infrastructure is among the most fragile in the world, businesses there have found ways to compete globally in the IT arena, making the country the world's leader in software exports. The city of Bangalore alone, home to many IT outsourcing firms and global corporations, contributed \$2.5 billion in 2003 to India's total software exports of \$9.5 billion.<sup>b</sup>

Furthermore, promoting IT is one of India's top governmental priorities. The Ministry of Information Technology, established in 1999, plans to accelerate the implementation of IT in government education and the private sector. India also has many universities dedicated to maintaining state-of-the-art IT curricula, and more than 70,000 software engineers graduate annually from these colleges.

The goal of a growing number of American and European companies is to outsource customer-service work to India, to take advantage of India's low wages, thriving high-tech sector, and annual output of 2 million English-speaking college graduates. Of the 3.3 million white-collar service jobs estimated to be outsourced in 2015, more than half will go to India.<sup>c</sup>

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<sup>b</sup> Government of India, Ministry of Industry, [www.smallindustryindia.com/policies/iip.htm#Indus6](http://www.smallindustryindia.com/policies/iip.htm#Indus6) and <http://siadipp.nic.in/publicat/nip0791.htm>, July 1991.

<sup>c</sup> Yale Center for the Study of Globalization, [http://sharif.edu/~maleki/change%20management/article%20&%20strategic/outsourcing percent20Debate.htm](http://sharif.edu/~maleki/change%20management/article%20&%20strategic/outsourcing%20percent20Debate.htm) and [http://money.cnn.com/2003/12/17/pf/q\\_nomorework](http://money.cnn.com/2003/12/17/pf/q_nomorework), February 2004.

revolutionize global business. Similarly, across the “pond,” British High Commissioner Sir Michael Arthur, in response to the pressure from the U.K.’s trade unions to reduce the incidence of offshoring, stated in September 2004 that his government would do nothing to stop offshore outsourcing. British bilateral BPO ties with India were cemented when the prime ministers from both countries met to develop more business alliances.

## WEALTH OF NATIONS

No one is arguing that these are indeed anxious times for workers in the United States and other developed countries; the debate is over the part outsourcing plays in this high anxiety. In 1776, in his still-relevant book *Wealth of Nations*, Adam Smith emphasized that, “It is not from the benevolence of the butcher, the brewer or the baker that we expect our dinner, but from their regard to their own interest.”<sup>3</sup> Following Smith’s ideas, modern companies participate in the international market and pursue their own interests by making the most productive use of their resources. By pursuing profit maximization, firms remain competitive, and the result is cheaper goods and services and a higher standard of living, at lower cost, for consumers.

## NOTES

1. A transcript of the ITAA report is available online at [www.connectlive.com/events/itaa](http://www.connectlive.com/events/itaa).
2. Gartner Research, [www.dataquest.com/press\\_gartner/quickstts/outsourcing.html](http://www.dataquest.com/press_gartner/quickstts/outsourcing.html), August 2003.
3. Stephen Copley, Kathryn Sutherland, eds., *Adam Smith’s Wealth of Nations: New Interdisciplinary Essays*, Manchester, New York: Manchester University Press. Distributed exclusively in the United States and Canada by St. Martin’s Press © 1995.



## INTRODUCTION

# OUTSOURCING: OPPORTUNITIES AND CHALLENGES

Outsourcing is a growing phenomenon, but it's something that we should realize is probably a plus for the economy in the long run. It's just a new way of doing international trade.

—Gregory Mankiw, chairman of the White House  
Council of Economic Advisors, 2004 Economic Report of the President<sup>1</sup>

**P**erhaps like many businesspeople around the world, you're seeking silver-lining solutions to both the opportunities and challenges created by outsourcing, a crucial but admittedly difficult-to-implement business innovation. But as you know, silver linings can be very hard to find. Therefore, our objective in this book is to help with that effort, specifically, to give you a "silver-lining perspective" on outsourcing, by which we mean more than just a bright spot amidst the political and emotional storm clouds of controversy. Generations before us have adapted to revolutionary innovations in technology and business efficiency and we will, too.

We intend to guide you in your personal, corporate, and strategic efforts to take advantage of the opportunities, as well as meet the challenges, of outsourcing, whether you're a corporate manager responsible for an outsourcing initiative; an outsourcing job seeker; an entrepreneur, venture capitalist, or small business owner investigating the bottom-line benefits of this practice. By virtue of the fact that you're reading this book, you're among those who will lead the rest in powerful global economic change.

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*Note:* Web addresses flagged with a (†) are author affiliated sites.

One of the reasons the silver linings of outsourcing remain so elusive is that, despite its growing status as a mainstream business activity, it remains underresearched and poorly understood. There is a shortage of reliable information on outsourcing and business process outsourcing (BPO) markets, vendors and their capabilities, needs of different vertical segments, costs and capability benchmarking of service providers, location evaluation and assessment . . . and so on. Sadly, due to this dearth of good information, many companies are making serious mistakes. For example, all too often an outsourcing relationship is initiated without an evaluation of market alternatives, which can easily lead to a higher price. We're here to help you avoid this and other mistakes.

As industry becomes more comfortable with the shift in the globalization model toward offshore outsourcing, corporate outsource-buying professionals are charged with the task of being good stewards of their company's resources. This book provides these professionals with a step-by-step guide to the outsourcing process, along with abundant contact information for leading outsourcing firms and career opportunities.

Outsourcing can be a complicated undertaking, for management, job seekers, and entrepreneurs alike, as revealed in a survey of companies and organizations buying outsourcing services:<sup>2</sup>

- Fifty-three percent reported that they have outsourcing challenges because their companies lack project management skills (i.e., they have no experienced outsourcing governance).
- Fifty-eight percent reported they lack a good process for specifying the work.
- Forty-eight percent said they did not have the right metrics for measuring performance.

The most notable trends of the outsourcing phenomenon, as collected by the Global Outsourcing Partnership ([www.outsourcingpartnership.com](http://www.outsourcingpartnership.com)) include:

- Seventeen billion dollars of IT services will go offshore by 2008.<sup>3</sup>
- There are \$2.3 million banking jobs to be offshored. Celent says that offshoring has put a potential 2.3 million jobs in the U.S. banking and securities industries at risk. Celent analysts estimate a potential to shift \$17.5 billion in operational and technical costs overseas by 2010.<sup>4</sup>
- Eighty percent of U.S. companies will outsource something in 2005. Meta Group predicts that 80 percent of organizations will outsource at least one information technology function by the end of 2005. But

the Outsourcing Pricing Guide report also warns that 70 percent of that group will drive a harder bargain when they renew those outsourcing deals, cutting both the scope and duration of the contract.<sup>5</sup>

- Eighty-five percent of current outsourcing contracts to be re-negotiated, Gartner analysts said that 85 percent of all outsourcing contracts signed since 2001 through year-end 2004 will be renegotiated within three years of signing because the original contracts did not serve the enterprise's long-term objectives.<sup>6</sup>
- Business process outsourcing will grow. A final verdict released by research firm Gartner prophesized that by 2005, the number of enterprises that enter into new outsourcing relationships, will increase 30 percent, while the number of IT providers that claim outsourcing relationships, will grow by 40 percent. Through 2004, despite the potential human resource backlash, 80 percent of U.S. executive boards will have discussed global delivery options, both nearshore and offshore. Out of these enterprises using global delivery models, 80 percent will act by increasing their people resources (nearshore and offshore), by as much as 30 percent.
- Gartner predicts strong BPO growth in India, both captive as well as outsourced. The current global BPO market stands at \$173 billion, which is expected to rise to \$27.7 billion by 2007. Indian offshore BPO will grab \$13.8 billion from the total, or approximately 49 percent of the pie. The boom is estimated on a Gartner survey, which reveals that 19 percent of companies in the United States are planning to outsource in the next 24 months, as opposed to a meager 1 percent who are currently outsourcing.<sup>7</sup>
- Europeans will outsource \$9.6 billion in 2008. The take-up of finance and accounting business process outsourcing services by European firms will nearly double from its present size of \$5.1 billion to \$9.6 billion by 2008, market watcher IDC has predicted.<sup>8</sup>
- Outsourcing to hit \$1.2 trillion by 2007. The outsourcing market, riding a healthy 7 percent annual growth toward an estimated \$1.2 trillion in 2007, will be dominated by a few global players in on-demand computing, an industry watcher said at an outsourcing conference in Bangalore.<sup>9</sup>
- By 2015, 3.4 million jobs will move offshore. Forrester Research now says it expects that 830,000 U.S. service jobs will move to low-wage countries such as China, India, and Mexico by the end of 2005. Last year, the firm put that number at 588,000. The new study estimates that 3.4 million jobs will move offshore by 2015, up from 3.3 million predicted last year.<sup>10</sup>

- At least \$75 million of U.S. government contracts goes offshore. At least \$75 million in U.S. state contract work has been captured by 18 companies that specialize in offshore outsourcing.<sup>11</sup>
- Canada loses IT jobs through offshore outsourcing, gains through U.S. contracts. The report by PricewaterhouseCoopers showed that Canada could lose up to 75,000 IT jobs by 2010 to offshore outsourcing, but Canada could also gain some 165,000 jobs through U.S. outsourcing contracts.<sup>12</sup>
- Financial sector to outsource at 34 percent annually. Outsourcing is on the rise in the financial services industry, according to research firm TowerGroup. The researcher estimates that the top 15 global financial services companies will increase their outsourcing of information technology projects from a value of \$1.6 billion this year to \$3.89 billion in 2008, an increase of 34 percent annually.<sup>13</sup>
- The U.S. government can outsource 900,000 jobs. The government's push to open federal jobs to competition could open as much as \$70 billion outsourcing opportunities to private firms, but lingering uncertainties on the final version of the rules make it more difficult to predict, according to a new report from research firm Input. Researchers considered the number of jobs that could be outsourced—officials have estimated that almost 900,000 federal jobs could be suitable for outsourcing—and Bush administration officials have said they want agencies to open half of those to competition by September 2004.<sup>14</sup>
- Forty percent of IT businesses have explored outsourcing in 2004. According to analysis from Gartner, by next year more than 40 percent of IT-related businesses will either be investigating the possibility of offshore outsourcing or will have already started projects overseas.<sup>15</sup>
- Manufacturing firms to increase outsourcing by 9.3 percent in 2005. Manufacturing companies are planning for healthy increases in 2005, led by a projected 9.3 percent increase of outsourcing budgets, according to a report from AMR Research. New IT investments are aimed primarily at supporting supply chain transformation and the profitable acquisition of new customers. Respondents estimate that 25 percent of IT work is currently outsourced, and 53 percent intend to increase that amount. The overall increase planned for 2005 is a robust 9.3 percent.<sup>16</sup>
- India to lose outsourcing market share by 2007. India is likely to lose market share in offshore business process outsourcing (BPO), from its current 80 percent to about 55 percent by 2007.<sup>17</sup>

- Only 2.5 percent of U.S. jobs are lost due to outsourcing. Labor Department said moving jobs overseas accounted for about 2.5 percent of the 182,456 workers who lost their jobs for longer than a month for nonseasonal factors in Q1 2004. Moving jobs within the United States accounted for 9,985 layoffs, or 5.5 percent of nonseasonal mass layoffs. About two-thirds of the jobs moved were in the manufacturing sector. Manufacturing accounted for about 25 percent of all mass layoffs. Seventy-six percent of the jobs moved stayed in the same company, although 36 percent of jobs moved overseas were with a different company.<sup>18</sup>
- Financial sector to outsource at 34 percent annually. Outsourcing is on the rise in the financial services industry, according to research firm TowerGroup. The researcher estimates that the top 15 global financial services companies will increase their outsourcing of information technology projects from a value of \$1.6 billion this year to \$3.89 billion in 2008, an increase of 34 percent annually.<sup>19</sup>
- Deloitte projects that by 2008, 275,000 of the telecom industry's 5.5 million positions will have been sent overseas. The telecommunications industry is set to save \$14.5 billion in the next four years through offshoring 5 percent of its workforce to countries such as India, Estonia, and Argentina.<sup>20</sup>
- Eighty-six percent of U.S. companies will increase offshoring. About 86 percent of U.S. companies plan to increase the use of offshore outsourcing firms, according to a poll by Chicago-based management consulting firm DiamondCluster International. They expect outsourcing to save only 10 percent to 20 percent of their costs, down sharply from 50 percent two years ago. About 85 percent of customers and 81 percent of providers are concerned that legislation or political pressure may prevent them from shifting jobs offshore.<sup>21</sup>
- The next wave of outsourcing will be research and development (R&D) functions, according to the latest Santa Clara University Business Index. The monthly business indicator tracks business conditions and jobs by polling executives and managers in a wide range of companies. While R&D hasn't been moving offshore at the rate of manufacturing and customer support, SCU finance professor Robert Henderschott told Internetnews.com says a trend is developing.<sup>22</sup>

As these numbers indicate, companies that fail to manage their outsourcing relationships will not only spend more money than is necessary, they will also obtain fewer benefits. Customer satisfaction will be impacted, which will increase the risk of outsourcing failure.

## WHAT'S DIFFERENT ABOUT OUTSOURCING

To implement outsourcing successfully, it's first necessary to understand that it is fundamentally different from other recent business trends and, therefore, poses greater risks for industrialized economies. We have to face facts: Most of the white-collar and executive jobs downsized in the last few years in the United States and the United Kingdom are gone forever. And as this "new economy" evolves, the pursuit of the lowest-cost source is going to be happening on a global scale. The old regional trade agreements of the past, like North American Free Trade Agreement (NAFTA), are becoming obsolete. If you doubt this, consider these results of a survey of 20 large European firms: for 75 percent, offshore/near-shore outsourcing spending will increase between now and 2005; and outsourcing's share of Europe's IT services spending is expected to grow from 29 percent in 2002 to 43 percent in 2008.<sup>23</sup> From 2004, BPO is expected to grow faster than all other categories of IT services. Demands for technology innovation and best-of-breed transition skills will drive provider choice.

The hard truth is that the rules that used to guide us in shaping a career, starting a new business, or leading an established company no longer apply. The complexities of outsourcing are forcing drastic managerial and professional career changes, and those professionals who do not update their skill sets to successfully administer outsourcing initiatives will be replaced by those who do.

If you still doubt that business process outsourcing is changing the way the world does business, and that this trend is likely to accelerate, these statistics should convince you:

- By 2007, offshore BPO is expected to account for 14 percent of the total BPO market, compared with only 1 percent in 2003.<sup>24</sup>
- Global market for outsourcing is estimated to grow at an annual rate of 7 percent, to 1.2 trillion dollars by 2007.<sup>25</sup>

Seventy-three percent of U.S. executives interviewed said their companies presently outsource one or more business processes to external service providers. As released by PricewaterhouseCoopers, top U.S. companies are turning to business process outsourcing based on interviews with senior executives at more than 100 U.S. companies averaging about \$4.4 billion in yearly revenue.

A PricewaterhouseCoopers Global Top Decision-Makers Study is a landmark study—the first to focus exclusively on BPO at billion-dollar

multinationals.<sup>26</sup> Conducted by Yankelovich Partners for PricewaterhouseCoopers, the study provides an in-depth report of the attitudes and behavior of senior executives and their companies toward BPO in general, and Finance & Accounting Services (F&A Services) specifically.

Interviews were conducted with 304 top decision-making executives in 14 countries: CEOs, Presidents, CFOs, COOs and CIOs. Among this group, 192 companies (63 percent) report outsourcing one or more business processes. And, of these companies (41 percent) report outsourcing Finance & Accounting Services which includes General F&A, Internal Audit, and Tax Compliance. Over 300 companies participated in the study—covering the Americas, Europe, Asia Pacific, and South America. The findings of the study reflect an increasing interest in, and usage of, BPO as a strategic initiative:

<i>Business Processes</i>	<i>Currently Outsourcing (%)</i>	<i>Best Candidate for BPO (All Companies ) (%)</i>
Human resources	42	59
Finance and accounting	41	70
Payroll	37	70
Real estate	32	65
Procurement	15	33

Top executives increasingly recognize the need to manage their company’s growth with less infrastructure. Thus, they are considering outsourcing processes that are essential, but not core to the growth of their business, including Finance & Accounting functions:

<i>Attitudes toward BPO</i>	<i>Companies Outsourcing Finance and Accounting (%)</i>	<i>All Companies (%)</i>
BPO allows companies to focus on core competencies	94	86
BPO allows companies greater efficiencies without having to invest in people and technology	85	76
BPO helps companies become more profitable, leading to increase in shareholder value	77	66
BPO will lead to better service levels than internal service departments can provide	63	48

<i>Satisfaction with BPO</i>	<i>Companies Outsourcing Finance and Accounting (%)</i>	<i>All Outsourcers (%)</i>
Satisfied	84	84
Dissatisfied	13	10

More than 8 out of 10 executives (84 percent) outsourcing Finance and Accounting services are satisfied with their initiatives. One third of these executives report that BPO initiatives are in their company's current business plans:

<i>Top Three Strategic Benefits of BPO</i>	<i>Companies Outsourcing Finance and Accounting (%)</i>	<i>All Companies (%)</i>
Maintain competitive edge	80	67
Focus on company's core business	79	75
Improve service quality	77	70

The Yankelovich research suggests that the bottom-line benefits of BPO are beginning to be recognized and appreciated. Forward thinking CEOs and CFOs are increasingly utilizing BPO as a new strategic tool to improve their competitive stance, their profitability and ultimately, helping to build shareholder value:

- Eighty-four percent of large-company CEOs are satisfied with their outsourcing experience.<sup>27</sup>
- Market perception of outsourcing has shifted from a way for companies to meet short-term financial objectives to a technique for strong companies to improve competitive positions.<sup>28</sup>

## **Empowering Executives to Outsource**

Michael F. Corbett & Associates, Ltd. conducted research with more than 500 executives and found that:<sup>29</sup>

- One in four organizations plan to increase their outsourcing spending by 25 percent or more.
- Outsourcing will represent 19.5 percent of the typical executive's budget, up from 16.4 percent today.
- Firms in dynamic markets such as telecommunications, high-tech products, and professional services, already source more than 40 percent of their operations outside.
- Innovation is now seen as the key strategic benefit of outsourcing.

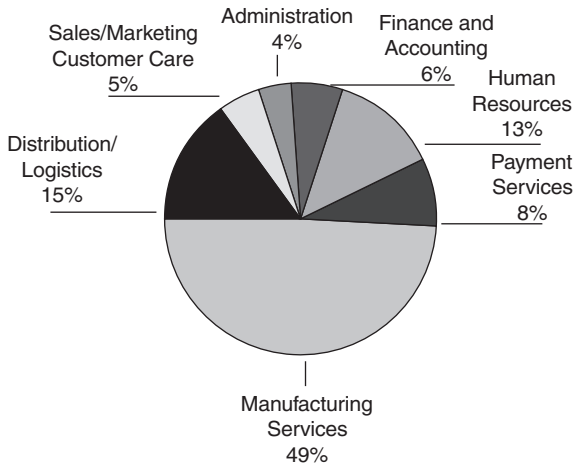


The business process outsourcing market continues to show healthy growth despite the economic slowdown. Worldwide, BPO services are predicted to expand by a 9.5 percent compound annual growth rate by 2007.

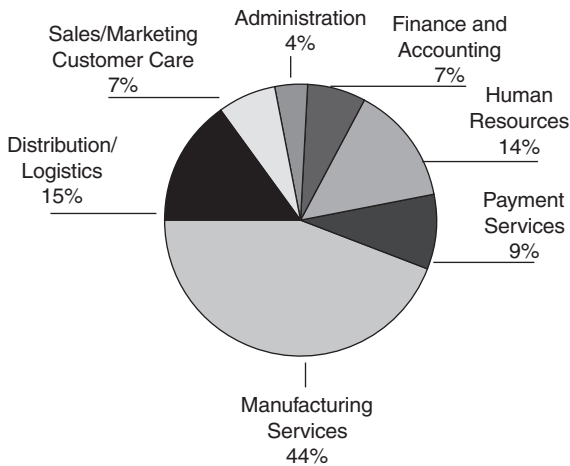
The following illustration compares the Worldwide BPO Market, 1999 versus 2004.<sup>30</sup>

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**Worldwide BPO Market (Total US @208bn)  
Breakout by Process Area 1999**



**Worldwide BPO Market (Total US @543bn)  
Breakout by Process Area 2004**



Since the Industrial Revolution, outsourcing (previously called “sub-contracting”) has helped thousands of companies achieve profitability through increased efficiency. Nearly every U.S. and European company outsources some part of their business—although not even their own employees may realize it. Companies rarely build manufacturing plants in the United States or United Kingdom anymore, for example. Instead, China, Eastern Europe, India, the Philippines, South Korea, and Taiwan are the locations of choice for this purpose. And with the advent of the Internet and satellite and transoceanic communications, businesses require fewer people to do more work; these technologies can also shorten the learning curve for new skills. Perhaps most notable is that specialized tasks such as software development, financial research, and customer service can be accomplished anywhere in the world at a fraction of U.S. or most European labor costs—as much as 30 to 50 percent net.

Clearly, then, it is often in a firm’s best interest to outsource certain tasks and use the abilities of its remaining in-house workers in other, more productive activities.

Over the next decade, a fundamental shift will cause the migration of transactional, technology, and administrative processes offshore. In the 1980s, the physical supply chain moved to cheaper locations in the 1980s; in the 1990s, the information supply chain, including IT and software application development and maintenance, moved offshore. Now it’s the administrative supply chain. In the next wave, many knowledge-based positions will likely go offshore, too, including human resources administration, distant medicine, high-level CPAs and accountants, and high-end IT architecture and design engineers.

My members (Link to ITAA Membership List: <http://www.itaa.org/about/members.cfm>) believe outsourcing—rather than trying to build and retain a substantial in-house capability—remains the most effective strategy for conducting a wide variety of operations. Outsourcing is not necessarily offshoring. Rather, offshore development and maintenance is a subset of outsourcing. The outsourcing provider may perform services on shore, offshore, or in some combination of the two. The decision is based on a variety of factors, not the least of which is customer preference.

—Harris Miller, president of the Information Technology Association of America (ITAA), representing 400 companies involved in every aspect of the IT industry. Source: Senate Democratic Policy Committee Hearing, March 5, 2004.

## DEBATING THE ISSUE

From a purely capitalist perspective, these market forces bring good news. Companies that focus on cost, quality, and performance will be the most competitive and profitable, and will lower the cost of goods and services for people around the world, while raising standards of living in low-wage countries. The bad news is, high-wage countries must face the upheaval caused by the resultant job losses.

### The Dollar Value

Hard experience has demonstrated that, in procurement alone, outsourcing can help reduce:

- Supply and service pricing by 10 to 25 percent through strategic sourcing.
- Administrative costs by 50 to 75 percent.
- Consumption and spending by 10 to 20 percent.

On the human resources side, outsourcing has the potential to drive HR-to-employee ratios to anywhere from 1:500 to 1:200, and help reduce overall customer care agent costs by as much as 25 percent.<sup>31</sup>

As we've said, in the United Kingdom and across Europe, many workers have lost their jobs, and more layoffs are announced every day, the consequence of outsourcing. In the United States, according to Forrester Research, the total number of jobs lost to outsourcing overseas will reach 791,000 by 2010, and 3,300,000 by 2015.<sup>32</sup> Chances are, you or someone you know has been affected by outsourcing, in one of the areas listed below:<sup>33</sup>

<i>Job Category</i>	<i>2000</i>	<i>2005</i>	<i>2010</i>	<i>2015</i>
Management	0	37,477	117,835	288,281
Business	10,787	61,252	161,722	348,028
Computer	27,171	108,991	276,954	472,632
Architecture	3,498	32,302	83,237	184,347
Life sciences	0	3,677	14,478	36,770
Legal	1,793	14,220	34,673	74,642
Art, design	818	5,576	13,846	29,639
Sales	4,619	29,064	97,321	226,564
Office	53,987	295,034	791,034	1,659,310
<b>Total</b>	102,674	587,592	1,591,101	3,320,213

Critics of outsourcing accuse businesspeople of being unconcerned or indifferent to the working and middle classes of developed countries, including those in the United States and the United Kingdom, the two

### INSOURCING: THE OTHER SIDE OF THE COIN

As the avalanche of work from the United States, United Kingdom, and Europe continues to flow toward foreign shores, some analysts are watching a trickle of jobs starting to move back in the direction of their source.

These analysts are starting to speculate if these incoming jobs actually could help compensate for the high-paying, high-tech jobs that are being offshored, leaving behind a troubled white-collar workforce and a diminished technology industry.

"Outsourcing has crowded out the globalization topic," says Matthew Slaughter, associate professor of business at Dartmouth College's Tuck School of Business. "It is important to understand the contribution of these [foreign] companies to the U.S. economy."

Slaughter recently released a study, *Insourcing Jobs: Making the Global Economy Work for America*, which describes the impact of foreign companies hiring workers here in the United States—in all industries, including IT. It also states that these companies employ nearly five percent of those working in the private sector and have paid American workers \$307 billion.<sup>a</sup>

Many people in this country are unaware that offshore companies also are sending jobs *to* the United States and Great Britain, and have been for decades. Job losses from offshore outsourcing are, to some degree, offset by insourcing. And according to Matthew Slaughter, insourcing activity has been increasing steadily over the last decade.<sup>b</sup> Slaughter says, "Over the past generation the number of U.S. jobs at these subsidiaries has more than doubled." Slaughter also notes that insourcing companies also contribute to U.S. economic growth by spurring investments in research and development, physical capital, and international trade. Moreover, insourcing companies pay better than their domestic competitors, Slaughter found.

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<sup>a</sup> "Insourcing Jobs: Making the Global Economy Work for America," study sponsored by the Organization for International Investment, 2004; available online at [www.ofii.org/disputes](http://www.ofii.org/disputes).

<sup>b</sup> Matthew Slaughter, author of the report in note a named above, [http://www.ofii.org/insourcing/insourcing\\_study.pdf](http://www.ofii.org/insourcing/insourcing_study.pdf); Professor Matthew J. Slaughter, *Insourcing Jobs: Making the Global Economy Work for America*; November 2004 also Citation: Matthew Slaughter. *Enterprise Systems Journals*, full article at <http://www.esj.com/enterprise/article.aspx?EditorialsID=1170> (Stephen Swoyer, *Outsourcing in Reverse: Foreign Companies Send Jobs to the United States: Not all outsourcing activity is a net loss for American workers*, October 26, 2004).

Several statistics highlight the importance of insourcing. U.S. subsidiaries of foreign companies employ more than 5.4 million U.S. workers—roughly 5 percent of overall private sector employment, an increase from 3 percent in 1987. As for research and development, insourcing companies now account for a sizeable share—nearly 15 percent, or \$27.5 billion—of private sector R&D activity in the United States, up from 9 percent in 1992. Similarly, U.S. subsidiaries of foreign companies accounted for 10 percent (\$111.9 billion) of private sector capital investments, up from 8 percent in 1992. Most surprising is that insourcing companies also account for a sizeable share (20 percent, \$137 billion) of U.S. exports. And on the payroll front, subsidiaries of foreign companies paid U.S. workers more than \$307 billion—6 percent more than overall U.S. private sector labor compensation. The average annual compensation at insourcing companies was \$56,667—nearly one-third more than in the nonsubsidiary U.S. private sector. This tally has increased sharply from 20 percent in 1992.

According to Slaughter, insourcing helps the U.S. economy in other ways as well. “The other channel by which insourcing companies contribute to the U.S. economy is their interactions with other domestic U.S. firms.” For starters, insourcing companies typically purchase a majority of their supplies from domestic firms—to the tune of 80 cents out of every dollar, or \$1.26 trillion.

countries most affected by the shift in jobs overseas. The resultant hullabaloo has alternately infuriated, confused, and shamed some business leaders to the point at which they have chosen to avoid sensible, progressive outsourcing in their organizations. Unemployed workers likewise are furious and confused. Both groups need to educate themselves about the opportunities created by outsourcing. The *Black Book of Outsourcing* will help launch that effort.

## WHO THIS BOOK IS FOR

This book has been written for the three largest groups of individuals affected by outsourcing:

1. *Corporate managers buying and leading outsourcing services.* If you fall into this category, you will learn what is necessary to manage a successful outsourcing initiative at your “buyer” business and how to work with outsourcing vendors.

2. *Job seekers (particularly those displaced by outsourcing).* You will learn how to launch a new career and find a job in the new global economy.
3. *Outsourcing entrepreneurs.* Ambitious start-up business owners will learn the basics of establishing your own outsourcing firm (increasingly known as “outventures”).

The *Black Book of Outsourcing* addresses the needs of each of these groups, while diffusing the debates and disputes that turn up the heat on outsourcing discussions. We help you focus on industry-specific situations and challenges. We help buyers, vendors, and entrepreneurs manage the problems they encounter daily, buoyed by sound outsourcing management principles, inspiration to succeed, and innovative solutions.

At the heart of this book are the processes that we recommend you follow to conduct your outsourcing program successfully. We’ve developed these proven approaches in our role as consultants to Fortune 500 companies as well as to one-person outventuring start-ups. We’ve seen these success factors work again and again; and in this book we’ll share with you how you can customize these approaches to fit your situation.

We’re almost ready to get started now, but before you read on, take the time to make a list of your goals, and keep them in mind as we proceed. Your list might include how to:

- Use outsourcing to meet today’s business challenges.
- Make the right sourcing decisions—the first time.
- Achieve operational excellence within and across outsourcing relationships.
- Communicate outsourcing to your employees, customers, and the public.
- Build new revenue streams through outsourcing.
- Use outsourcing to reduce corporate risk.
- Successfully outsource offshore.
- Craft value-creating outsourcing contracts.
- Recover from a troubled outsourcing relationship.
- Enhance your career as an outsourcing professional.

Until now, pro-outsourcing zealots have neglected to mention why outsourcing deals fail, the occasionally staggering costs of attorneys versed in international contracts, the cross-infrastructure problems including cultural clashes, the widespread corruption in many foreign governments, and other factors that wipe out the wage savings involved in outsourcing.

We recommend that you do a little research and you’ll find out that one in three outsourcing projects fail because most are not heading into out-