

## Chapter 1.4

# Information Technology/ Systems Offshore Outsourcing: Key Risks and Success Factors

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### **ABSTRACT**

The offshore outsourcing of information technology and information systems (IT/IS) is being increasingly practiced among firms that are focusing on core competencies and cost-effectiveness. With the increase in offshore IT/IS operations, a growing number of companies are encountering negative experiences and unpredicted results. The analysis performed in this chapter reveals the possible risks and perceived success factors of

companies outsourcing IT/IS operations offshore. The major points of interest are operational and strategic risks; legal contracts; cultural, security, and financial issues; and noted success factors by companies that participate in offshore outsourcing. The research indicates the importance of risk identification and the formulation of strategic plans that include preventive, detective, and corrective control methods of implementation and evaluation. Effective methods and metrics for measuring the success or failure of IT/IS offshore

outsourcing operations is expected to be a continuing development with the increasing growth of this phenomenon.

*It is not the strongest of the species that survives, or the most intelligent, but the one most responsive to change.*

—Charles Darwin

## **INTRODUCTION**

Offshore outsourcing with respect to information technology and information systems (IT/IS) or business processes is a key commercial phenomenon. IT/IS offshore outsourcing is the focus of this chapter and is defined as a process undertaken by an organization to subcontract or to sell the organization's IT/IS assets, staff, and/or activities to a foreign supplier, rather than develop IT/IS resources internally. The contractual relationship requires the vendor to assume responsibility for the client firm's IT/IS requirements. IT/IS services include software development and maintenance; network and computer operations; and research and development (see Table 3.1) (Dolan, 2006). An extensive report by the National Academy of Public Administration prepared for the United States Congress and the Bureau of Economic Analysis defines offshoring as follows: "United States' firms shifting service and manufacturing activities abroad to unaffiliated firms or their own affiliates" (Norwood et al., 2006).

In offshore outsourcing work is outsourced to foreign countries that have cost advantages in various tasks such as application development, product manufacturing, and/or call center and back office operations. It involves complexity and risk not found in typical domestic outsourcing due to factors such as cost (i.e., labor, infrastructure, real estate, and corporate taxes); availability of highly skilled workers; market potential; country risk profile (i.e., disruptive events, security, regulatory

risk, macroeconomic risk such as cost inflation, currency fluctuation, and capital freedom), and intellectual property risk; environment (i.e., government support, business and living environment, accessibility of location such as travel time, flight frequency, and time difference); quality of infrastructure (i.e., telecom and IT, real estate, transportation, and reliability of power supply); improved customer service by way of 24X7 call centers and/or fewer environmental regulations (Farrell, 2005, 2006; Kraemer & Dedrick, 2004). Table 3.1 lists the common IT/IS outsourced services.

## **Industry Analysis**

IT/IS offshore outsourcing is one of the fastest growing businesses in the world due to technological advances including the Internet and mobile services. The advances have changed markets by decreasing communication costs and increasing specialization of service production. Given that the Indian software services account for about \$9.9 billion, this does not seem like a huge market share until one looks at the exponential growth rate of this sector. This sector managed to grow by 26% in 2005 and Michael Corbett of the International Outsourcing Professionals postulates a 40% compounded annual growth rate over the next decade (Barrett, 2006).

Pressures from dynamic market conditions and market uncertainty have caused business organizations to focus on core competencies and outsource functions in which they lack expertise in order to show profitability maintain effective cost structures and improve the bottom line. There are increased pressures on management to remain cost effective by accomplishing more with fewer resources at a faster pace. Outsourcing goals and objectives include competitiveness, time to market, round the clock customer service, agility, and access to world class technology. As illustrated in Figure 1, countries and regions with the most outsourced IT professionals are India,

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