CREATING A *Successful Strategy* FOR SOFTWARE DEVELOPMENT OUTSOURCING

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core10

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INTRODUCTION

The strategic goals of outsource software development are changing.

For a while, in the wake of the Great Recession, outsourcing was all about cost savings. Today, though, technology professionals are rediscovering some of the other benefits of working with vendors outside of their companies. Moreover, they're beginning to define value and satisfaction around criteria that aren't just about the lowest price.

As a recent Global Outsourcing Survey attests, today's CIOs increasingly emphasize how outsourcing provides access to new and better talent, accelerates development speed, offers added value through partnerships, improves product quality, and provides companies with the freedom to focus on core competencies.[1]

This evolution in thinking begs the questions: What are the benefits of the various outsourcing strategies? And how does one choose a model that will meet one's strategic goals?

In the analysis that follows, we tackle these questions and weigh the pros and cons of the four main approaches available for outsourcing software development work — onsite, offshore, nearshore, and onshore.

By the end of the read, you should have a framework for choosing the model that best meets your outsource software development goals and working style.

1 *Deloitte, "2016 Global Outsourcing Survey"*

https://www2.deloitte.com/content/dam/Deloitte/nl/Documents/operations/deloitte-nl-s&o-global-outsourcing-survey.pdf

HOW THE GOALS OF OUTSOURCING HAVE CHANGED

Following the Great Recession of 2008, IT budgets were understandably tight as businesses went into survival mode. Outsourcing was mainly viewed as a strategy for reducing software development costs.

Today, though, with a degree of confidence in the economy restored, CIOs are beginning to remember that outsourcing has other benefits that were often talked about pre-recession. As was the case prior to 2008, the emphasis has shifted away from cutting costs to a more expansive consideration of value. According to a recent Global Outsourcing Survey, "Value is being achieved through the impact of innovation, ease of relationship management, and improved strategic flexibility, not just cost savings."[1]

Per the survey, the top four reasons companies outsource are to: 1) cut costs, 2) focus on core business, 3) expand capacity, and 4) enhance service quality.

Figure 1. The Top Four Reasons Companies Outsource per Deloitte

REASON TO OUTSOURCE	PERCENTAGE OF RESPONDENTS
CUT COSTS	59%
FOCUS ON CORE BUSINESS	57%
EXPAND CAPACITY	47%
ENHANCE SERVICE QUALITY	31%

In documenting that CIO's are again diversifying their consideration of outsourcing's benefits, Deloitte's study prompts a reconsideration of how outsourcing was discussed prior to the Great Recession. It's useful, in other words, to return to some of the pre-recession statements about the value of outsourcing to re-establish some of outsourcing's potentials that have been overshadowed by the post-recession drive to prioritize cost reduction above all else.

One of the most concise summaries of the diverse benefits of outsourcing from the pre-recession era is a white paper titled "The Benefits of IT Outsourcing" from global market intelligence firm IDC.[2]

Here are the points that IDC underscores that are still valid today, broken down into three important categories of benefits: cost, strategy, and product.

1 *Ibid.*

2 *IDC, "The Benefits of Outsourcing," http://www.keystoneisit.com/outsource4.pdf*

Cost

Cost, of course, has always been a primary consideration when making a decision about outsourcing, but not always in the same way to every outsourcer. The fact is, outsourcing delivers financial benefits in three different ways: It is less expensive, it enables greater control of costs, and it can be used to preserve capital.

LESS EXPENSIVE

Invariably, outsourcing is less expensive than building an internal team to develop a piece of software. However, as with most things, you typically get what you pay for (i.e., the cheapest option will often deliver the poorest quality).

COST CONTROL

The main advantage of outsourcing when it comes to costs is not necessarily the end sum — it's more about how outsourcing facilitates cost control. With solid contracts based around clear expectations coupled with good management, development costs can be made predictable and even deferred through the skillful negotiation of payment terms in an outsourcing agreement.

CAPITAL PRESERVATION

Through smart outsourcing, capital expenditure on operations can be reduced since the outsource partner assumes the costs for long-term capital investments such as equipment purchases.

Strategy

Outsourcing shouldn't just be an expeditious decision; it can also play an important strategic role in a company's technological evolution. In the first place, it can give a company access to talent and technology that might not otherwise be accessible in its area — due to scarcity or cost. Second, outsourcing is a great way to be nimble when it comes to resourcing. And lastly — and perhaps most importantly — it relieves company employees to focus on core competencies and more strategic initiatives.

FRESH TALENT & TECHNOLOGY

With the right outsourcing partner, a company can benefit from resources that they otherwise couldn't access, such as rare talent and the most current technology.

ADDED FLEXIBILITY

Outsourcing provides companies with the ability to command significant resources when they need them. They can surge when demand spikes, pivot quickly in response to changing market conditions, and step up when the competition increases.

RENEWED CORE

Per IDC, outsourcing can be effective as a strategy for "handing over noncore activities to a trusted third party" so that a company can focus on core competencies. Deloitte's most recent study echoes this idea with 57% of respondents citing this freedom to focus as one of outsourcing's main benefits.

Product

With a dedicated, qualified outsource team focused on a single project, development can happen much more rapidly while also producing a better quality product thanks to the expertise and depth accessible through outsourcing, as well as the focus it enables.

IMPROVED EFFICIENCY

If one connects with the right outsource provider, product development can be much faster. In the first place, an outsource software project generally commands a dedicated team and comes with service-level guarantees. Moreover, if a bottleneck is encountered or a surge is required, outsource providers are set up to scale quickly.

BETTER QUALITY

Working with an outsource provider specialized in a certain type of product will yield a better result. They'll be able to apply their experience and expertise to create something that functions on a higher level than a product put together by an in-house team with multiple projects and priorities — or a generic IT outsource provider.

HOW OUTSOURCING CAN GO WRONG

In 2015, NashTech, the technology services arm of Harvey Nash Group, surveyed 3,000 CIOs to get a sense of "the shape of outsourcing."[1] One of the study's key findings was that a third of all CIOs who rely on an offshore approach to outsourcing do not have their expectations met. Common reasons for this discontent — and sometimes outright failure — include:

- Costs
- Management
- Service
- Distances (Geographic, Temporal & Cultural)

Many companies in the outsourcing market have experienced these difficulties with offshore outsourcing, which they may consider their only option. But there are other options — such as onsite and onshore models — that are designed to preempt most of these disappointments. In an evolving outsourcing market focused on value, one should consider the strategic benefits of these other approaches.

Costs

Ironically, while cost is supposed to be one of the main benefits of outsourcing, it is also one of the biggest liabilities since lack of proper planning and management can lead to "surprise" expenditures. Per Stephanie Overby's detailed study of "The Hidden Costs of Offshore Outsourcing," a company can expect to spend an additional 16–65% over the actual development cost — a rather wildly fluctuating range that can quickly eliminate any apparent savings — when taking an offshore approach.[2]

These hidden costs come from factors such as traveling to overseas destinations to vet potential offshore vendors, bringing offshore talent to the U.S. for training, and setting up and maintaining a secure network between U.S. and offshore partners. There are also invariably more hidden costs related to the other issues cited below — ones that not only cost money but that also affect performance and product quality.

So while an overseas option will always look better on paper at the outset, it's wise to heed Gartner's best practices which "consistently advise clients not to simply look at the pure labor rate or rate card . . . [because] a significant variable that swings the total business case is the value that clients place on . . .

1 NashTech, "In or Out? The Shape of IT Outsourcing in 2015," https://www.slideshare.net/NashTech/nash-tech-ciooutsourcingreport2015

2 Overby, Stephanie, "The Hidden Costs of Offshore Outsourcing," http://www.cio.com/article/2442089/offshoring/the-hidden-costs-of-offshore-outsourcing.html

regulatory, compliance, political, time zone and geographic issues."[3] At the end of the day, "going local" and choosing a low-cost-domestic (LCD) option may deliver the best net cost.

Management

Per Deloitte, 64% of companies that use outsourcing are working to improve vendor management, indicating that most CIOs feel their outsourcing arrangements fall short in this area. Classic outsourcing management mistakes include a failure to understand the level of management required, lack of visibility into performance, and the mistaken assumption that management is the vendor's responsibility.[4]

Service

With the demand for outsourcing continuing to rise, more and more companies are born every day to fill the need. Unfortunately, Deloitte's recent survey shows that a significant number of these service providers don't deliver on their promises.[5] Some are not even qualified to do the work they are contracted for, based on feedback from contracting companies.

Figure 2. Top Seven Global Outsource Vendor Shortcomings per Deloitte

VENDOR SHORTCOMING	PERCENTAGE OF RESPONDENTS
REACTIVE	46%
DON'T PROVIDE INNOVATION	33%
HAVE HIGH STAFF ATTRITION	29%
LACK OF LEADING PRACTICES	25%
UNQUALIFIED	23%
LACK OF INTEGRAL INTEGRATION	22%
POOR SERVICE QUALITY	20%

Given that outsourcing isn't just on the rise but that CIOs are again — and increasingly — looking at outsourcing as a strategy to generate value by providing access to innovation, speed, and talent, the prevalence of these shortcomings is

3 *Gartner, "Q&A on Ruralsourcing, Ruralshoring, Farmshoring, Homeshoring and Homesourcing," http://www.cross-usa.com/pdf/qa-on-ruralsourcing.pdf*

4 *BuyIT Best Practice Network, "IT Outsourcing: A BuyIT Supply Chain Guidelines," https://www.cips.org/Documents/Knowledge/Categories-Commodities/IT-and-Telecoms/IT-Services-and-Software/BuyIT%20IT%20Outsourcing.pdf*

5 *Deloitte, "2016 Global Outsourcing Survey" https://www2.deloitte.com/content/dam/Deloitte/nl/Documents/operations/deloitte-nl-s&o-global-outsourcing-survey.pdf*

alarming and suggests that outsourcing strategies other than the cost-minded offshore models are sorely needed.

Rather than focusing on process issues such as the need to develop robust qualifying mechanisms and stronger vendor management — both of which put more of a burden on the company looking to outsource — it's more fruitful (and easier on the outsourcer) to take a closer look at the conditions that have produced failures in the areas of quality and management. From there, one can select an outsourcing model that either eliminates or mitigates these factors, leading to greater satisfaction, as well as enhanced productivity and value.

In other words, by working with a partner whose business model doesn't include all the conditions that can make outsourcing seem so difficult and prone to disappointment, one can get more out of the arrangement, as well as make it fundamentally easier. For U.S.-based companies, this means taking a closer look at **onshore, LCD options which** remove the geographic, temporal, and cultural differences that so often lead to complications.

Distances — Geographic, Temporal, Culture

Outsource resources are, by definition, outside of a company. There's bound to be some distance, then — both in terms of physical miles, working hours, and mutual understanding — in any outsourcing relationship.

In this day and age, though, geographic distance isn't such a barrier. Employees are used to working with remote vendors and even distributed co-workers. But it's still important to meet from time to time, especially during project kickoffs or when working on key project milestones. The only real negatives here are when long trips and extended stays result in unanticipated travel expenses or when dampened employee morale affects productivity (e.g., due to separation from family and home).

Temporal distance between outsource vendor and company client is a big factor in determining project success as it can become difficult to coordinate mutual working hours. But the real rub is between differing attitudes about time itself. "Some of the biggest frustrations, delays and spiralling costs have stemmed from a clash in working cultures where notions of time (not time zones) and accountability are mismatched," writes NashTech.[6]

6 *NashTech, "In or Out? The Shape of IT Outsourcing in 2015"*

https://www.slideshare.net/NashTech/nash-tech-ciooutsourcingreport2015?from_action=save

This idea that time can be experienced differently points to the most daunting distances one can encounter in an outsource relationship — the cultural ones. There is a whole body of literature on the subject that echoes the conclusion of Gartner's study of LCD options: "Cultural affinity, or lack of it, will directly affect the overall productivity levels of success for these important interactions. Consequently, high cultural affinity between the service provider and service recipients serves as an important advantage."[7]

7 Gartner, *"Q&A on Ruralsourcing, Ruralshoring, Farmshoring, Homeshoring and Homesourcing"*

http://www.cross-usa.com/pdf/qa-on-ruralsourcing.pdf

HOW OUTSOURCING
MODELS STACK UP

So how does one choose an outsourcing model that will stand the best chance of delivering the benefits one wants while avoiding the pitfalls one doesn't?

Let's look at the models that are available, which include: onsite, offshore, nearshore, and onshore (which encompasses the colloquialisms "ruralsourcing," "ruralshoring," "farmshoring," "homeshoring," "homesourcing" and "hereshoring™").[1] Below we note some basic definitions for these categories and outline the benefits and risks specific to each.

Onsite

As the name indicates, onsite outsourcing involves contracting with outside experts who can work at a company's office on a regular basis. Basically, it is a form of temporary work.

BENEFITS

- Proximity for collaboration
- Greater oversight
- Cultural compatibility

RISKS

- Little to no cost benefit
    - Need to supply workspace and potentially equipment
    - Providers have commensurate costs of living
- Draws on same local talent pool

Offshore

Offshore outsourcing involves hiring an external vendor in a country other than then one where the hiring business is located. For U.S. companies, this often involves vendors in India, Southeast Asia, or Eastern Europe.

BENEFITS

- Lower costs

RISKS

- Lack of oversight
- Geographic distance
- Temporal distance
- Cultural distance

1 *Ibid.*

Nearshore

Nearshoring is a variation on offshore outsourcing that utilizes providers in adjacent or nearby countries in an attempt to eliminate some of the temporal and cultural barriers that can often lead offshoring initiatives to go awry. From the U.S., this most often involves IT vendors in Central and South America.

BENEFITS

- Lower costs
- Temporal proximity

RISKS

- Lack of oversight
- Geographic distance
- Cultural distance

Onshore

Onshore outsourcing, also known as "lower-cost-domestic" (LCD) outsourcing, comes in a couple of different flavors: ruralshoring and hereshoring. What they have in common is that the workers they use reside in the same country as the contracting organization. This proximity cuts down on the pitfalls of geographic, temporal, and cultural distances that often plague offshore and nearshore outsourcing arrangements.

Ruralshoring

Ruralshoring makes use of distributed workers in non-urban areas (e.g., large sections of Colorado and Montana). These workers work from home in a virtual capacity with one another, as well as with the companies they service. The emphasis on staying home — rather than reporting to a central company office — has also led some to call ruralshoring "homeshoring" or "homesourcing."

BENEFITS

- Lower costs (lesser)
- Temporal proximity
- Cultural compatibility

RISKS

- Lack of oversight (lesser)
- Geographic distance (lesser)
- Security issues due to reliance on home networks

It's important to note that the term "ruralsourcing" has also been applied to offshore outsourcing models, which can produce some confusion. There are companies in Australia and India, for example, that pool together home-based workers in non-urban areas and market their services as "ruralsourcing" solutions.[2]

Hereshoring™

In contrast to ruralshoring, hereshoring describes an outsourcing relationship involving two companies with central offices in the same country. Hereshore service providers in the U.S. are based in second- and third-tier cities within striking distance of major tech centers such as Boston, Chicago, Dallas, New York, and San Francisco. Costs of living are comparatively low in these smaller metropolitan areas but quality of life is high, as are the levels of available talent.

BENEFITS

- Lower costs (lesser)
- Temporal proximity
- Cultural compatibility
- Proximity for collaboration
- Greater oversight
- Security

RISKS

- Geographic distance (least)

2 *Ibid.*

OTHER CONSIDERATIONS
TO KEEP IN MIND

Cultural compatibility isn't just about speaking the same language and having similar attitudes about time. And while it might be nice to feel a sense of affinity with an outsource provider born of watching the same television shows or following the same football team, it's a stretch to translate those sorts of commonalities into business advantages.

There are, however, a number of specific cultural factors that can have very tangible effects on the success of the outsourcing relationship. These include common legal jurisdictions, shared values that can support partnerships, and similar attitudes about authority in the face of a collective commitment to creating the best solution possible, as well as factors local to the providers such as access to talent and their level of community involvement.

Legal Protection

On the legal front, any outsourcing arrangement should take into account two factors underscored by Gartner:

1. Regulatory requirements that may preclude options that involve using foreign contractors (i.e., offshore or nearshore models).

2. Protection afforded by working with a vendor subject to the same legal jurisdictions. (For U.S. companies, this makes onshoring appealing.)[1]

Partner or Vendor?

Will the outsourcing agreement be a one-off or will it be part of a larger strategic initiative to find a partner that will allow for in-house workers to focus on core competencies and higher-level functions? If the latter, it's important to find a vendor that is easy to work with and shares company values.

Deloitte's study notes that companies are trending toward repeat outsourcing arrangements with 89% leveraging existing providers to varying degrees.[2]

Meanwhile, BuyIT writes that "IT outsourcing strategies are more likely to misfire if executives view the IT outsourcing agreement as a one-off, performance-based contract[.]"[3] These analyses suggests that "one-and-done" thinking is one of the root causes of companies' historical dissatisfaction with outsource providers.

1 *Ibid.*

2 *Deloitte, "2016 Global Outsourcing Survey"*
https://www2.deloitte.com/content/dam/Deloitte/nl/Documents/operations/deloitte-nl-s&o-global-outsourcing-survey.pdf

3 *BuyIT Best Practice Network, "IT Outsourcing: A BuyIT Supply Chain Guidelines," https://www.cips.org/Documents/Knowledge/Categories-Commodities/IT-and-Telecoms/IT-Services-and-Software/BuyIT%20IT%20Outsourcing.pdf*

Willingness to Challenge

Better results usually come from workers who are committed to finding a solution, rather than simply doing what they are told. As NashTech writes, "An outsourcing provider unafraid to disagree with you from a basis of expertise and thorough assessment is more likely to become a partner in your solution."[4]

Outsourcing partners who exhibit this level of independence and who feel that they can question direction based on expertise in order to reach the best solution aren't widely available outside of the U.S. or Europe.

Talent Pool

While stories abound of savant coders cropping up all over the world, no one disputes that talented people tend to congregate together, preferring locations where they can encounter like-minded individuals who stimulate their thinking and creativity. This is why we have tech centers such as Boston, New York, and San Francisco.

The same is true for outsourcing partners and the locations where they choose to set up their businesses. There are smaller cities around the U.S., for instance, where critical masses of talent have emerged and can be accessed at a value. Typically, these locations have a college or university dedicated to technical fields and a strong surrounding community.

Community Improvement

Contracting with an outsource partner means injecting money into its local economy, whether that be Bangalore, Warsaw, Martin, Tennessee or Huntington, West Virginia. While everyone deserves to thrive, U.S.-based companies looking to outsource will derive a certain supplementary value from being able to say that they support U.S. companies and U.S. communities — especially those main streets in what was once the industrial heartland.

4 NashTech, "In or Out? The Shape of IT Outsourcing in 2015," https://www.slideshare.net/NashTech/nash-tech-ciooutsourcingreport2015?from_action=save

MAKING THE RIGHT CHOICE

As the tech sector swings back to a value-driven approach to outsourcing, selecting the best approach to outsourcing has become much more complicated than simply looking at costs. Finding the right outsourcing model involves questions about strategic priorities, quality of work, access to talent, levels of service, and whether or not companies are trying to find a partner rather than just a mere vendor.

Each of the outsourcing models reviewed above has its advantages, depending on which factors are most important to the company outsourcing. For example, if temporal, geographic, and cultural distance don't matter so much and are still outweighed by the lowest price on paper, an offshore or nearshore approach may be the best fit.

But for companies that want to reap the most benefits from outsourcing and/or avoid most of the risks (including unanticipated costs), one of the low-cost-domestic approaches will inevitably be better. Both ruralshoring and hereshoring eliminate two of the major factors that have traditionally frustrated outsourcing initiatives (i.e., temporal and cultural distances) and offer the supplemental benefit of tighter and more enforceable legal protection.

Figure 3. How Outsourcing Models Stack Up

MODEL	COST	MANAGEMENT BURDEN	GEOGRAPHIC DISTANCE	TEMPORAL DISTANCE	CULTURAL DISTANCE
ONSITE	HIGH	LOW	NONE	NONE	NONE
OFFSHORE	LOW	HIGH	HIGH	MID TO HIGH	HIGH
NEARSHORE	LOW	HIGH	MID	LOW	MID
RURALSHORE	MID	MID	LOW	LOW	LOW
HERESHORE	MID	LOW	LOW	LOW	NONE

And in contrast to its LCD cousin ruralshoring, hereshoring has many other benefits that are exclusive to it. For one, it's a model that makes outside resources more accessible in person than any other option besides hiring local talent to work in house. And it offers greater IT security than a distributed workforce. Plus, there's the satisfaction of working with a group of talented people who make a real economic and social difference to their communities. It's this last idea that really excites us here at Core10, a Hereshore software development firm with thriving development centers in Huntington, West Virginia and Martin, Tennessee. We're part of a vibrant, young innovation community that's grown up around Marshall University and University of Tennessee Martin and their well-respected computer science departments. Every time we double in size, it's cause for celebration in these cities — and across the states. This imbues us with a sense of pride, but also responsibility to our supporters and fellow citizens in the Volunteer and Mountain States.

Honestly, we can't think of a greater motivator when it comes to doing our absolute best for our clients. We want the world to know that West Virginia and rural Tennessee are great places to go for outsourced software development. And we'll be happy to prove it, again and again.

So besides presenting you with a strategic framework for finding the best outsourcing model that fits your needs, we hope this piece has persuaded you that there's real value in a Hereshore approach. Not just because it's what we do, but because it's a cause we believe in.

ABOUT CORE10

Core10 is a 100% U.S.-based software development company that provides a full suite of fintech development services and support resources. We connect talent with opportunity through our technical consulting work for innovative banks, credit unions, and financial services companies. Our hereshore development centers employ driven, dedicated technologists with a desire to learn. The result is professional, knowledgeable, and capable resources, located in areas that are significantly less expensive.

ABOUT LEE FARABAUGH

Lee Farabaugh is a senior technology design, operations, and innovation expert with over a decade of experience in financial technology (fintech) and health care IT. In 2016, she co-founded Core10, an innovative software development company with locations in Huntington, W. Va., Martin, and Nashville, Tenn., pioneering the Hereshore™ movement. She is dedicated to building tomorrow's financial infrastructure while restoring local communities in the United States. Prior to Core10, Lee co-founded the Nashville health care software development firm PointClear Solutions, where she served as chief experience officer, chief innovation officer, and executive vice president of professional services.