

The changing face of outsourcing

Outsourcing and especially off-shoring of technology projects has traditionally been associated with the development of low-value, high volume business processes and applications. But a recent report jointly carried out by DataArt and HFIT, indicates that financial services organisations are increasingly on the lookout for outsourcing partners to develop mission-critical platforms to enhance their competitive edge

The use of ‘global talent’ or offshore outsourcing has gained momentum over the last ten years across the financial services industry and financial firms have taken advantage of the benefits of using offshore resources in technology development, operations, processing, helpdesk as well as other tasks, in order to save costs and improve efficiencies. Indeed, some outsourcing initiatives have been so successful in venturing abroad that firms have even expanded their offshore activities to include R&D (research and development).

However, a common misconception is that financial institutions are mostly using offshore talent for low-value, high-volume tasks such as application maintenance, call centre operations and data processing. But as our research clearly indicates, this is not necessarily the case.

DataArt, a New York-based provider of customised, high-end software applications using development resources in Russia, collaborated with HFIT on the survey, which polled a total of 75 financial

technology executives. The research focuses primarily on software vendors in financial markets, producers of software systems, tools and networks for trading, risk management, processing and investor communications.

The targeted groups are providers of technology to those financial institutions that prefer buying, rather than building systems to power mission-critical front and back end office operations. The study sets out to discover just how much of today’s financial technology has been developed using offshore resources.

Findings

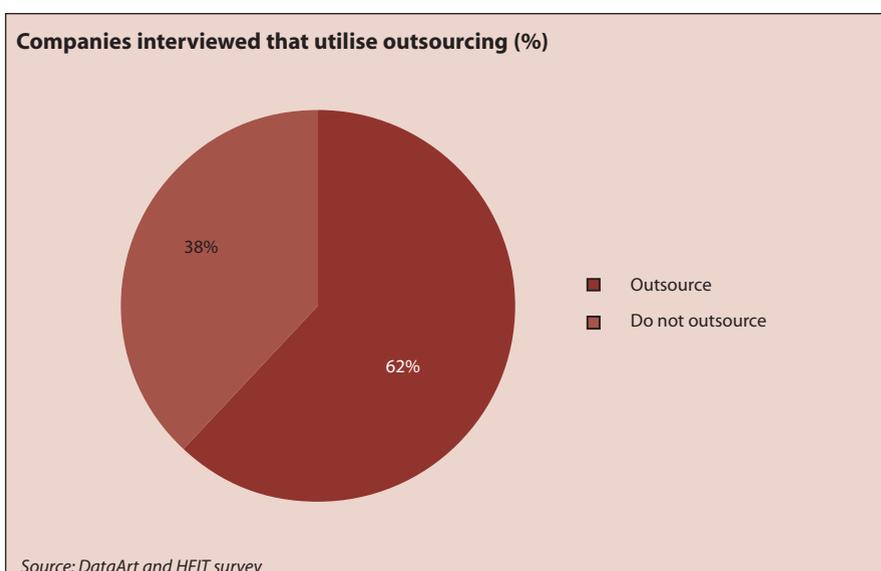
In short, the majority of firms that we polled send projects offshore; 62% of respondents state that they engage offshore talent. Of the remaining 38% that don’t employ offshore talent, a number of these are considering outsourcing.

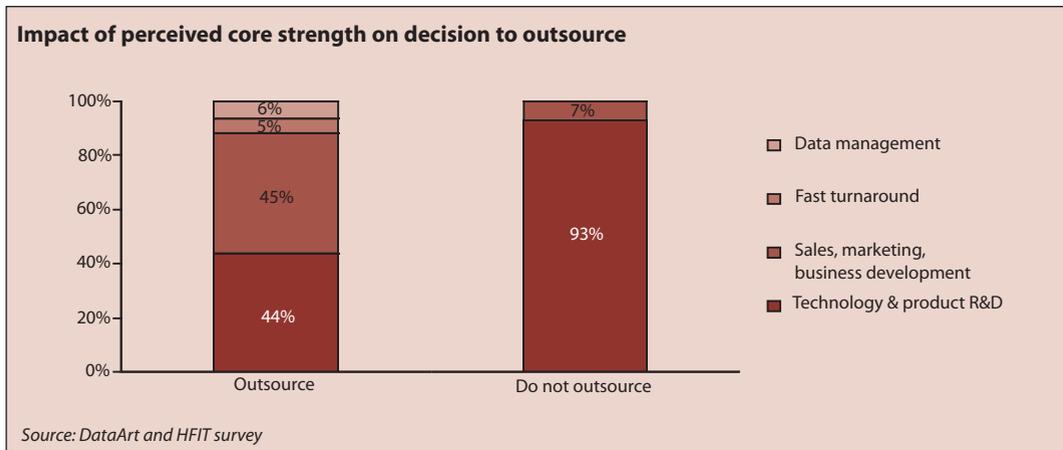
The survey found that of those companies utilising offshore talent, 45% hire a vendor with offshore operations, 26% set up their own operations, and 18% pursue both strategies maintaining their own team for core activities and utilising an outside vendor for less critical tasks.

Interestingly, the decision to outsource had no correlation to the company’s size or stage in development, although that decision was heavily influenced by the company’s perceived core strength.

Over 90% of executives of the companies that haven’t considered outsourcing say that technology and product R&D are their primary focus and that cost savings in product development is not a crucial factor in company decision making. These companies tend to have large IT departments and a technology driven corporate culture that they feel is ill suited for outside collaboration.

Conversely, companies that see their core strengths as domain expertise, sales and marketing, appreciate the cost savings and access to technical expertise that off-shoring provides.





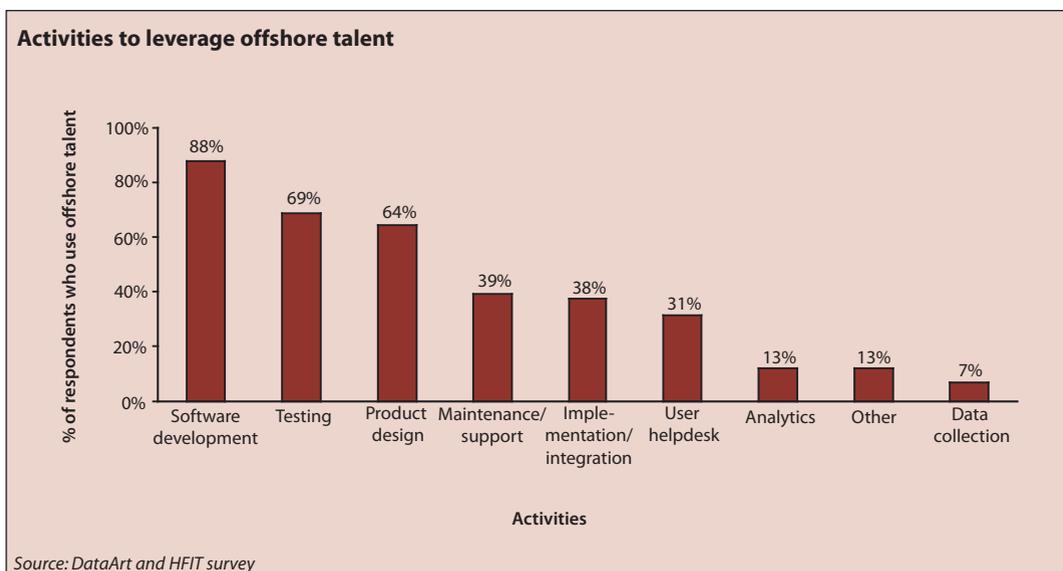
The industry’s wariness towards outsourcing is reflected in a poll taken at the *Gartner Financial Services Summit* in May 2005, where executives of large financial institutions indicated that they favoured using outsourcers for routine tasks like maintenance or call centre operations rather than important projects where strong oversight was essential.

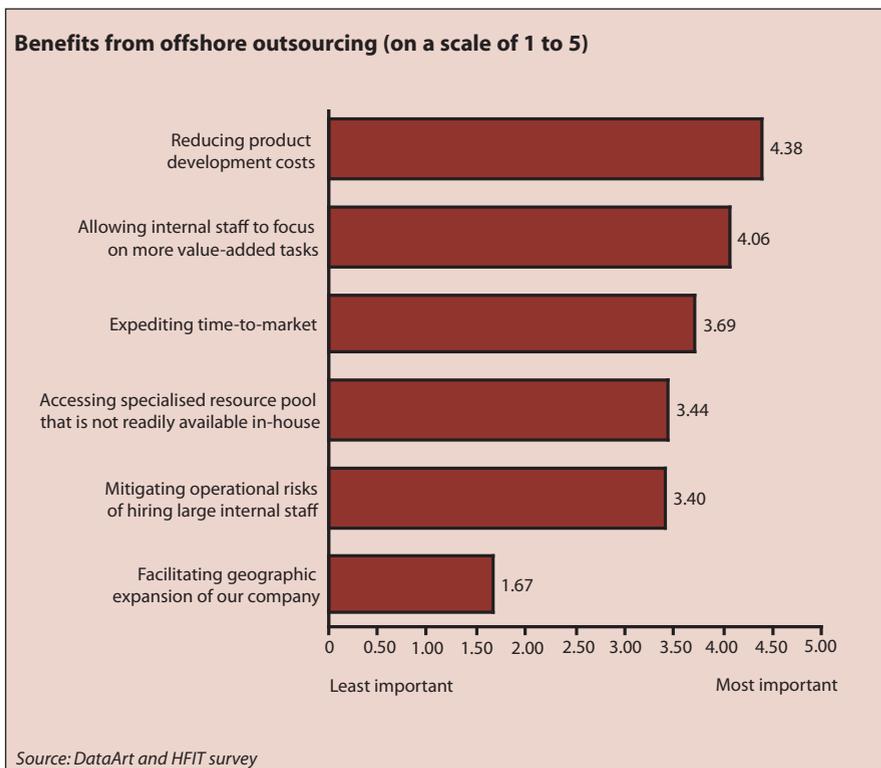
In one of its most interesting findings, the DataArt/HFIT survey challenges assumptions that companies are mostly sending routine tasks offshore and guarding complex projects for their in-house teams. Among those financial software vendors polled, over half (64%) of the companies that outsource said that they trust offshore teams with their product design and architecture. Application development was a task that executives felt confident in conducting offshore (88% of respondents) as well as product testing (69%) and design (64%). Helpdesk support (leveraged by 31% of respondents) did not appear as prominently among the activities outsourced by financial independent software vendors (ISVs) as it did in other industries, where it remains one of the most popularly outsourced functions. This can be explained by the relatively small size of support and maintenance operations at many ISVs.

Moreover, there is a correlation between the degree of involvement with offshore teams and the company’s overall satisfaction with the outsourced projects. It is common to hear executives say: “Yes, we use developers offshore for minor projects because they’re cheap, but it’s not great. We wish we had people offshore who were able to handle real work.”

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Those who succeeded in finding the right resources offshore for their most pressing tasks are more satisfied with their experience than those just looking to save money. In the long run, companies that take outsourcing seriously find that they are able to delegate more complex tasks to their partners offshore and reap the rewards of their investment.





Benefits of outsourcing

As you would expect, the most common reason for outsourcing is cost reduction. Forty one percent of the executives interviewed said that cutting back on costs is their main reason for outsourcing and 88% of executives ranked it among their top reasons for outsourcing. Large organisations estimate their savings from offshoring to be anywhere between 20-40%. Some financial software companies, however, report seeing 50% or more of savings in their product development budget.

Aside from the obvious benefits of outsourcing, the executives that we interviewed highlighted the increasing importance of additional benefits taken into account when weighing their decision. The second most frequently cited reason for sending projects offshore is the ability to focus more company resources on the core aspects of operations. Eighty one percent

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of respondents use outsourcing to allow their staff to focus on the activities that distinguish their company's competitive advantage, improving the company's ability to leverage its most valuable resources.

Closely following those advantages were the ability to expedite time to market (63%), access skills not available internally (61%) and reduce the need for new capital (59%).

Finally, 25% of executives emphasised the ability to utilise outsourcing in facilitating their geographic expansion. American companies found that their offshore vendors were better located to service their European and Asian clients. Depending on the vendor's capabilities and the strength of the vendor relationship, offshore providers were commissioned for more client related tasks such as help desk, maintenance and support, and product implementation.

Challenges of outsourcing

The respondents of the survey quoted several challenges that they faced when outsourcing projects offshore. The following is a list of their concerns in descending order:

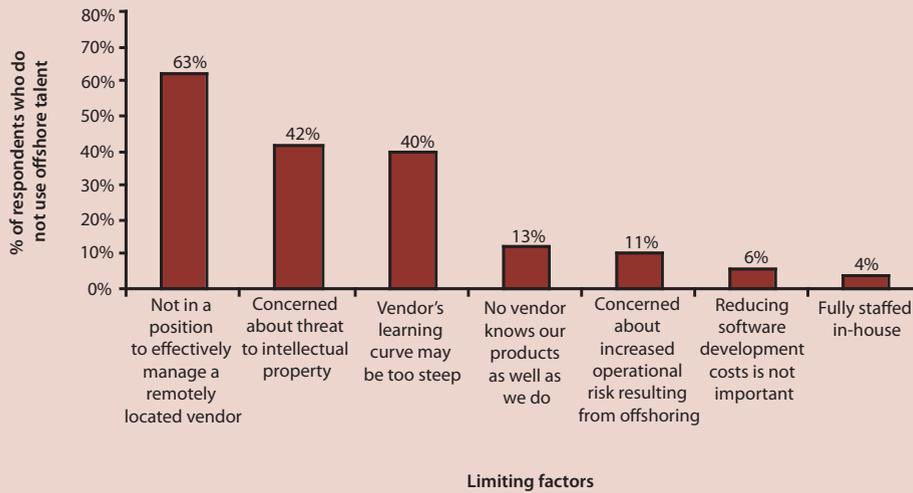
- Intellectual property risk (quoted by over 50% of respondents)
- Delayed vendor team learning curve
- Insufficient communication
- Lack of offshore team's industry or product knowledge
- Poor quality work
- Increased operational risk
- Inadequate documentation
- Missed milestones
- Cultural differences

Executives that we surveyed found these risks manageable, some sharing their strategies for addressing them. No single solution would address every issue for each company, but we found that respondents from various companies had some strategies in common.

The following is a list of suggestions from experienced executives in the field:

- Work with US or UK based entities operating under US or UK governed contracts
- Go the extra mile in picking the right vendor, making sure that they are of the right size and have relevant experience. "The process is not unlike hiring your own IT staff," says one executive of a financial software start up. "You want people with the most appropriate experience and skill set to work for you, so that they can hit the ground running."
- Invest in communication processes and infrastructure, encourage personal interactions and make the offshore staff a part of the team. "One should not overlook the basic human factor," says the CTO of a financial software company with over ten years of experience with offshore vendors. "If the project takes more than six months, we have our team travel to the vendor's site and meet them. Nothing facilitates communication like putting a face to the voice over the phone."
- Trust your own people; having Indian, Russian or Chinese engineers on the in-house team helps a great deal in establishing a productive communications framework, testing the people and transferring knowledge.

Limiting factors preventing companies from engaging offshore talent



Source: DataArt and HFIT survey

Our final question to executives who didn't outsource was, "Why not?" It appears that the main issue preventing companies from outsourcing is management perception. They don't feel that their company is well positioned for managing an offshore vendor. Wariness of the challenges of outsourcing coupled with the internal staff's lack of outsourcing experience leaves companies hesitant to explore the advantages of outsourcing.

Vision for the future

The financial technology industry is at a peculiar stage at which a large number of companies are aware of the potential benefits of outsourcing and at the same time, sceptical about the offshore team's abilities to handle complex, industry specific software. Companies are looking over their shoulders, unsure of the extent to which industry leaders and competitors are managing projects abroad. Those who incorporate the right mix of engineering talent, business domain education and security measures into their offshore management strategies are getting ahead in leveraging outside resources to their advantage. More and more, clients are starting to recognise the opportunities in using offshore solutions while seeing that it is still possible to maintain reasonable costs.

The survey highlighted the growing role of offshore resources in developing financial technologies. Currently, a large amount of software used by buy- and sell-side traders, risk managers and back-office administrators is bought from reputable US and European vendors, yet developed partially by engineers in India, Russia or China. Considering the growing number of outsourcing initiatives currently under way, we expect to see a dramatic increase in the number of projects delegated to offshore vendors.

Hybrid approach

As a result of the research, we predict the evolution of a hybrid approach (to product development/engineering) in which companies will use local resources for business analysis and project coordination, while depending on engineering talent from various locations around the globe. The adoption of remote communication tools, such as video conferencing, secure data distribution and distributed project management, will enable what analysts call 'best-sourcing', whereby companies can select and efficiently manage the ideal resources for their projects, regardless of geographic location. Ultimately, end users will be the ones who benefit most from the collaboration of resources and creative abilities in the global village.

Salient points

- A company's size does not have any bearing on its decision to outsource its software technology development.
- The primary driver for outsourcing development work is cost reduction.
- The second most important reason cited for outsourcing is to allow the organisation to focus its resources on its core competencies.