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## Outsource It!

A No-Holds-Barred Look at the Good, the Bad,  
and the Ugly of Offshoring Tech Projects

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*Edited by Kay Keppler*

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## 1.5 Cost Savings: Expectations Versus Reality

I receive monthly emails from one offshore outsourcing sales executive. Here is one of them:

*Dear Nick,*

*I know your schedule is very tight, but I really hope we have an opportunity to share our ideas on how to help you decrease costs by 300 percent in the next twelve months. I thought since you are in Beijing now, it would be a good opportunity to meet. Looking forward to your early reply.*

*[Name withheld to protect the guilty]*

Wow, 300 percent savings!!! Where do I sign? While the tenacity of the sales exec is commendable, his message is ludicrous. Even if you're very good at leveraging outsourcing, realizing more than 30 percent in savings is difficult. Why is that? Three reasons: productivity, overhead, and turnover.

### The Productivity Paradox

How much money can we save by outsourcing? On the surface it seems obvious: even with wage inflation in India, China, and eastern Europe, rates there are still substantially lower than in the United States. For example, a mid-level Java developer in San Francisco earns roughly \$75 per hour, compared to \$25 per hour on average in Bangalore, Shenzhen, or St. Petersburg. At first glance, this lower rate translates to a savings of more than 65 percent, or a 3:1 ratio (for every on-site Java developer you can get three offshore Java developers).

Is it that simple? Will getting three developers for the price of one give you three times the productivity? Unfortunately, no. Not even close. Since I can almost hear the vendors moaning, let's look first at two real-world examples.

Case one: After three months of attempting to improve the quality of an off-shore development project that was led by a team of five, we transferred the project in-house and got it done two months later with one guy.

Case two: Again—offshore project, several senior people, quality and productivity issues. We brought the project back, and a single, mid-level, in-house developer delivered the project in less time than it took us to ramp up the outsourcing team in India.

And there are many more cases like this. In my experience, staff productivity from outsourcing vendors is no more than 75 percent of your in-house employees. In many cases, it's 50 percent or less. For every good local developer, many developers in other countries can offer the same or a higher level

of productivity. The problem is that getting them on your offshore team is practically impossible.

To a large degree that's because the best and the smartest easily find jobs in the best companies around the world. The second-best are grabbed by top-notch firms like Google, Microsoft, or Siemens, which have offices in software hubs like Bangalore, Moscow, and Beijing. And only the rest of the talent pool is available to outsourcing companies.

Moreover, in an effort to stay cost-competitive, many outsourcing firms don't offer the salaries and benefits that keep quality senior people. Most firms constantly bring in entry-level employees through campus recruiting and other "bulk" hiring activities. As a result, these firms end up with a disproportionately high number of junior staff, who get promoted at accelerated rates. Next to US professionals holding the same title, they can't possibly compare in terms of technical skill or breadth of experience.

How much would lower productivity cost us? Let's see. Imagine that you are thinking about outsourcing a five-member team that includes one tech lead, two mid-level Java developers, and two junior. Your cost for the local team would be this:

Role	Level	Experience	Quantity	Rate/hour (US\$)	Cost/month (US\$)
Tech lead	Senior	10+	1	83	13,944
Developer	Mid	3–10	2	59	19,824
Developer	Junior	1–3	2	44	14,784
Total					\$ 48,552

What would it cost if an outsourcing company provided the team? Let's assume a 50 percent productivity rate for junior- and mid-level staff and 100 percent for senior. To compensate for productivity loss, let's double the number of junior- and mid-level developers.

Role	Level	Experience	Quantity	Rate/hour (US\$)	Cost/month (US\$)
Tech lead	Senior	5+	1	32	5,376
Developer	Mid	2–5	4	28	18,816
Developer	Junior	0–1	4	25	16,800

Role	Level	Experience	Quantity	Rate/hour (US\$)	Cost/month (US\$)
Project manager	Mid	5+	1	30	5,040
Total					\$ 46,032

Note that the outsourced team also includes a full-time project manager, which is not surprising for a team of seven. The result is a mere 5 percent cost savings. Your actual savings may vary based on your negotiating skills, but the overall dynamics won't change.

Don't get me wrong. Building a productive team is entirely possible, and we'll cover how to do that in more detail in [Chapter 12, Build and Lead Distributed Teams, on page ?](#). At this point, just note that due to the productivity issues, the difference in hourly rates does not translate directly to cost savings.

Adding a full-time project manager to the team is just one aspect of increasing the overhead; other factors also have a tremendous impact on cost.

## Overhead

Overhead expenses can eat away what you save in low hourly rates. The biggest increases come from these sources:

- *Management.* If you outsource a small QA team, for example, you'll probably need both local and offshore QA leads. Without outsourcing, a single lead is enough.
- *Communications.* Distributing teams across multiple time zones, languages, and cultures significantly increases the volume of communications required to minimize misunderstandings.
- *Risk Mitigation.* Protecting your intellectual property and countering internal risks will increase costs.

In addition to productivity and overhead, the vendor's ability to retain team members is a critical factor when calculating the overall cost of personnel.

## Turnover Ratio

Losing a member of a technology team can be very expensive—as much as three to twelve months of employee salary. The turnover costs come from loss of productivity, hiring fees, training ramp-up, and other factors.

The degree of turnover is typically measured by “turnover ratio”—the number of lost employees over the team size over the course of the engagement. For example, a loss of two developers from a team of ten over the course of the engagement would be a 20 percent turnover ratio.

But there’s always a catch. Welcome to the murky world of turnover ratios.

On a recent engagement with a reputable company in India, the stated turnover ratio was 18 percent, but during the course of one year with a team of ten, we saw more than twenty people come and go; only one stayed on for the duration of the project. No matter what formula I applied to the situation, I came up with a ratio closer to 100 percent rather than 18! Yet every time we had an account review, the vendor claimed that the turnover ratio was in line with the originally stated ratio. Huh?

Clearly, my valued (and reputable) partner had a different definition of “turnover ratio.” A vendor looks at turnover from a companywide perspective. Internal transfers are common to improve staff allocation, appease a larger customer, or keep employees motivated. While that kind of shifting helps the vendor, it can hurt you.

Reducing turnover is a complex task, which we’ll cover more in [Section 12.4, \*Maintaining Your Team\*, on page ?](#). In the meantime, it’s important to remember that your organization probably won’t save as much money by outsourcing as managers think they will.

Now that we’ve looked at cost savings from several angles, let’s discuss two other points in our “fine print” review: the vendor’s ability to scale or meet staffing demands and the overall quality of deliverables.

## 1.6 Ability to Scale

Many organizations face the challenge of adding personnel for increased work loads and ramping down when demand reduces. Outsourcing seems to be the perfect solution for this problem. Still, some issues are inevitable:

- Finding qualified people—even in countries that produce a huge number of IT graduates— isn’t easy. Every vendor faces strong competition and is limited by factors such as commute proximity to the vendor’s office.
- For vendors in countries with small populations, ramping teams up is a big challenge. A lead time of two to three months to bring on a mid-level developer is common.
- Many countries legally require employees to remain at the job for a certain amount of time after they’ve submitted their resignations. If you’re



recruiting employees working for other companies rather than recent graduates, the lead time can be more than two months.

- A vendor helping you address swings in resourcing requirements needs to find a place to put the people coming off your project. Large vendors can reassign them to other clients or even afford bench time, but smaller vendors could be forced to do layoffs.
- Finding staff with specific skills—especially for cutting-edge technologies—can be extremely time-consuming, even for a top-tier vendor in India. I had to abandon the idea of using my large vendor for sourcing a specialist after three months of intensive searching.

Many outsourcing vendors, especially large ones, will market their ability to scale. In some cases they can, in some they can't. Remember, staffing miracles are rare. Don't count on them.

## 1.7 Quality of Deliverables

There is a strong perception in the industry that the quality of deliverables produced by offshore personnel is inferior to the quality of work of local staff. This perception is deeply flawed.

Outsourcing partners can deliver poorer—or better—quality products and services than those of local employees. The challenge in getting quality deliverables is in (1) understanding all aspects of the deliverables and the quality associated with them, (2) communicating quality expectations to your partner, and (3) controlling the quality on an ongoing basis. That task is difficult, and we'll talk more about how to maintain control over the quality of your deliverables in [Section 11.4, \*Accepting Deliverables\*, on page ?](#).

What is important to understand now is that you have to pay the price to achieve the quality you demand. We've all heard that the best things in life are free, but the quality of deliverables is not one of them. At the end of the day, you get what you pay for, but if you don't control the process, you get much less.

We've covered a lot of ground, and by now you probably understand why I didn't jump on the airplane to Buenos Aires right after receiving the invitation from my friend. Even if you're feeling swamped, you probably have a better grip on the risks and rewards of outsourcing and understand what it can or can't do for your organization.

You've seen how using the SMART technique will help us to refine our objectives and give us something concrete to shoot for. And you've seen how

important it is to understand the details—the fine print—of what we're getting into, from the potential (not-that-great) cost savings and the vendor's (in)ability to scale, to the difficulty of maintaining quality deliverables.

The next step is far more complex and involves making decisions on what and how to outsource. We've got the basics and know what we want to get done and what to watch out for. Now let's take a deeper dive into work distribution, engagement models, and outsourcing strategies to see what might work for your organization.