

GLOBAL OUTSOURCING COST MODELS

Clients and Outsourcing companies may use several engagement models both for delivery of the outsourced work and thereby arrive at the costing for the model. Choosing of the model depends on several factors both from the client perspective, the nature of work/project involved, risks to be shared and as well the capabilities/competencies of the outsourcing company.

STAFFING/CONTRACTING

The easiest model to understand is the Staffing or Contracting of resources by the outsourced company to the Client company. The driver for this model is that the client may not have the sufficient resources for the project or competent resources and would like to lease the resources for a period of time from the outsourcing company. The outsourcing company provides resources on an hourly rate or a monthly rate for the duration of the project or as need basis. The requirements for the resource, usage and the work involved can be outlined in a detailed requirement document by the client. The outsourcing may prepare a contract for providing resources with necessary skill sets and experience capturing various clauses and conditions, financial terms and termination etc.

Client may interview resources being hired from the outsourcing company and check if they are satisfied with the experience, skill sets and competencies for the work, before approving them to start on the work. Outsourcing Company usually prepares a daily/weekly time sheet for the resource utilization and gets it approved by the Client manager. The outsourcing may bill the client for the services on the set billing period in the contract. Time spent per week or month has to be established with the client prior to the beginning of the project and also working extra hours is billable to client or not. Typically 160 to 176 hours per month or 40 hours per week is considered as the time spent on work.

The resource has to fill up the time sheet every week at the end of the week and get the approval from the client manager and send it across to his company for processing.

Client may periodically review the progress and productivity of the outsourcing company resources and may request a replacement if the work is unsatisfactory.

Usually the outsourcing company resources work at the client site. And hence the costing model would assume that client would provide the necessary infrastructure for the resources to work at their site. The infrastructure would include access to the work place, cafeteria and such facilities as deemed acceptable. The client would also provide a desktop/laptop, network access and access to any project related servers/workstations, an email address etc.

The advantage with this model is that the project control is always with the client, the outsourced resources work under direct supervision of the client at client site and hence closer monitoring of the work and productivity of the resources. Clients can add on resources easily and as well ramp down quickly by releasing the resources back to outsourcer, thereby maintaining higher business agility and cost control.

The model even though a tactical advantage, but may not be strategic to the client to build long term competencies, and capabilities.

COST AND MATERIALS

Cost and Materials is also referred to as Time and Materials, a popularly used model for IT application development and maintenance projects that usually span a long time (typically 1 year plus). Outsourcers bid for the project from the client based on project requirements, amount of work involved (both enhancements and number of support issues to be resolved per month) and coverage hours.

Usually the work gets executed at the Outsourcing company premises. Client or client project team would be responsible for providing requirements for the project upfront, oversee project execution and review project deliverables during the project schedule. Hence a greater definition of project requirements, project execution methodology, Project deliverables verification and validation, Project oversight and tracking, communication and escalation have been clearly defined in the contract and agreed upon.

Outsourcing company may agree upon a monthly rate (or an hourly rate) for the resources engaged on the project based on experience and skill sets or use a blend rate (one rate) for all the resources engaged on the project. If a blend rate is used, the outsourcing company may use some standard model of what kind of resources it has to engage on the project and decide on the team decomposition. Clients also have to understand the team decomposition and mix of right resources needed for the project.

Any materials used for the project outside of standard materials will be expensed to the Client. Standard materials are desktop/laptop, generally used software like office automation and operating system etc that are already included in the rate contract. Non standard and project specific hardware and software can be discussed as exempt items with client and expenses for procuring and using them can be billed to Client.

Client or Client teams would need strong project management and project execution methodologies to monitor and track the outsourcing teams for work deliverables on schedule, quality and productivity. The client teams have to continuously engage the outsourcing team on any change in plans, deliverables, requirement changes etc. Else the resources would be waiting for work and will be non-productive. Dependencies have to be tightly managed as there will no resources waiting for their work to begin.

If the client and outsourcing teams are working in geographical locations, an overlap in time for several hours has to be maintained for the teams to interact on project discussions. Else very good communication processes has to be setup in place and clear documentation and expectation has to be setup.

The advantages with this model are the resources are locked for the duration of the project and hence competencies and skills can be built over the time. Additional resources can be brought over time or decreased over time to adjust to the changing demands of the projects. Good working relations can develop over time between outsourcing and client teams with good interaction and communication. With good project management and processes, this model can deliver better results. Management by metrics during all phases of development, maintenance and support can provide better insights to client management to understand the costs and returns of using this model.

The disadvantage of this model is that requires a good understanding of the management and delivery of the projects and a tighter monitoring of the outsourcing company resources. Most of the project and business risks still lie with the client.

COST AND MATERIALS WITH A CAP

This costing model for outsourcing is an extension of the Cost and Materials model, but with an upper limit or cap on the costs of resources and materials. This is to prevent an escalation in the overall costs of the outsourced project. It would be useful to put such restraints on the costs as it helps to oversee the project execution within budgeted costs without any cost escalations.

It is advised that the costs of resources and other materials are to be tracked on a regular basis, usually aligning with the billing cycle, on how the project being progressing vis-à-vis the costs and if they are on track against plan.

This model would be useful when there is a risk that the project costs may shoot up overtime for need of more resources and materials.

RESOURCE USAGE

This is an extension of the Time and Resource model. The resources allocated to the project (people, equipment, network, phones, etc.) are monitored and their usage is measured. The rates for each resource per hour or other suitable basis are setup and the usage is billed at the end of the month. Clients would be charged a setup fee for initial setup costs for provisioning the services of any resource.

The benefits would be that clients need to pay only for the proportionate use of the resources and pay as the resources are used.

FIXED PRICE

Fixed price model would be ideal for projects that have a clear scope of requirements and the execution methodology. Both Client and Outsourcing vendor have a good understanding of the requirements of the project, execution methodology, resources required for the project, timelines, risks in the project, dependencies etc. Hence the outsourcing vendor can bid on the project by providing sufficient details on how the project be executed, detail the deliverables in the project, provide timelines, set intermediate milestones and provide a costing model.

Client can request proposals from different vendors for the same project and may evaluate based on several factors before choosing the vendors to whom they can shortlist and enter into detailed negotiation on reducing timelines or costs etc. After the negotiations, Client can award the project to the vendor.

The Fixed price projects have to be executed lot more professionally as the project risks are owned by the outsourcer. Overall project monitoring including schedule control, quality of deliverables and cost control are prime importance in executing fixed price projects.

Period status reports, interaction with Client, managing dependencies and follow up are very essential.

Vendor may setup payment terms with the client at periodic intervals or on delivery of intermediate deliverables. A percentage of the total cost is paid at each interval or upon delivery of intermediate deliverables or milestone events in the project life cycle.

This model is advantageous to both the Client and Outsourcing vendor as there is a motivation for both of them to perform to the success of the project. From Client perspective, it calls for a good definition of the project requirements, periodic monitoring and course correction if any requirement changes, managing dependencies in the project, reviewing and accepting deliverables. From outsourcing vendor perspective, the project has to be better managed for schedule, cost and quality and to client expectations and satisfaction. Project risks have to be better managed. Good communication and escalation mechanisms have to be setup.

Any requirement that is stated in the project if changed or additional requirements has to be managed through a change control process that is defined between the client and the vendor at the beginning of the project and managed as such. Client may ask for analyzing the change and request for a proposal or a contract for change in project terms (schedule, costs, etc.). Upon approval by client, vendor will start executing such changes.

This model is well suited for matured organizations that have executed such projects in the past and have better processes and practices for managing projects.

REVENUE SHARING

This is a model for much matured businesses where the outsourcing vendor is also an expert in the Client's business and may partner with Client in jointly developing a product or a solution. The revenues generated by the product or solution in its life term may be shared by both the vendor and the Client on agreed terms set forth in the contract.

The Client and Vendor both understand the opportunities, market for the product/solution to be developed. The percentage of revenue sharing depends on what each partner brings to the project, effort and cost spent on the project for building the product/solution and support during the revenue generation period. Transparency should be maintained during the Revenue generation phase for both the parties and such information should be built into the product or solution so that the information is available for revenue sharing.