Risk Reduction through Semi-Captive Outsourcing

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Abstract. We report on our real world experiences and offer some solutions for common outsourcing problems. Captive outsourcing – and especially the semi-captive approach which encourages independent activities of the subsidiaries – leads to a stable mutually beneficial structure that reduces many risks associated with outsourcing.

1 Introduction

Traditionally, outsourcing means finding a subcontractor for a specific project. The business relationship ends when the project is over. However, there is much to be gained in terms of economic stability and risk reduction by founding subsidiary companies in offshoring countries and outsourcing projects consistently to them. This paper offers real life experience from our own outsourcing projects with different subsidiaries in eastern Europe.

1.1 Company background

pi-consult gmbh was founded in 1999 in Karlsruhe, Germany. We have grown from a pair of computer science students to a company with 135 employees worldwide, including subsidiaries in Bulgaria, Belarus and Russia. We are specialized in optimizing company communications by consulting and implementation of solutions for marketing process optimization (product "BrandMaker", www.brandmaker.com), e-mail response management, translation management and a content management system. Also, pi-consults offers OEM development for individual software projects. Our customers include Arbeiter-Samariter-Bund Deutschland, Boeringer Ingelheim, Commerzbank, DekaBank, EnBW, Gruner+Jahr, Opel, and the confidential OEM clients.

2 Traditional vs. Captive Outsourcing

The other papers in these proceedings contain a wealth of information about different problems with outsourcing and the associated risks, so we will not add long and redundant descriptions here – commonly, outsourcing adds overhead, reduces control over the process, and introduces many new unknowns. Communication is nearly always cited as the most critical issue, which agrees with our own experiences: How can we make sure that the developers understand the problem, ensure project progress and quality? These aspects are worsened by offshoring with different time zones, language and culture.

2.1 Comparison Matrix

In the following table, we compare several key aspects between traditional and captive outsourcing. Most issues are self-explanatory, but there are also some interesting factors which are covered in more depth below.

Table 1. Comparison of different aspects: Traditional vs. Captive Outsourcing

Aspect	Traditional	Captive
Entrepreneur Risk / Commitment	Low-Medium	High
Initial Investment	Medium	High
Operational Costs	Comparable	Comparable
Resource Flexibility	High	Low
Consistency, Availability	Low	High
Control over Assets and Finances	Low	High
Influence on Development Methods and Infrastructure	Low-Medium	High
Team Structure, Company Culture, TRUST	Fragmented	Closer
Common Sense, Understanding, Domain Knowledge	Depends on duration	High
Efficiency (feasibility of short projects)	Low	High

It might be counter-intuitive that we are talking about risk reduction and at the same time list "entrepreneur risk: high" as first aspect of captive outsourcing. The reason is that there is of course a higher financial risk connected with founding (or acquiring) a company in an offshoring country than with performing a single outsourcing operation the traditional way. The point is that the payoff from captive outsourcing is much higher in the long run, and the benefits and associated risk reductions add up.

Also, captive outsourcing offers possibilities where that the traditional approach fails: It is no problem to perform small projects efficiently and with economic success, since the teams are already established and know the end customer's context and requirements. This reduces the setup and introduction to a minimum, making even projects with one man-month efficient and profitable to outsource.

At the same time, control over the tools and methods used for development ensure low frictions between the developers and the project managers, while in traditional

outsourcing it is time-consuming or even impractical to establish own best practices at the developer's side.

And of course there is the political and strategic aspect: Do you want to trust complete strangers with the development of your key product, or do you prefer a tighter control and an environment of trust and mutual relationship?

2.2 Some Risks and Solutions

During our founding of subsidiaries in Eastern Europe, we encountered a number of challenges which are fairly typical for captive outsourcing. This section lists many of them together with our solutions.

Since this is a real life experience report, we cannot guarantee that these approaches will 100% work for any such case, but we have done well with them. Company culture has a large influence here, and the methods needed for more static global players with tens of thousands of employees are certainly different from those for a dynamic company growing towards 200 employees.

- **Founding**: We already had a business relationship with the founders in the offshoring countries or even knew them personally. Trust is a key element here and minimizes the founding risks which are rather large as discussed previously.
- **Mindset**: The communist past of the former East Block is still visible in the behavior and expectations of the employees. Hierarchies are important, and self initiative as well as passion for the work have to be learned. A transfer of company culture helps, e.g. with visits of their team leaders to Germany and vice versa. This also reduces the common risk of cultural differences and is only possible in a longer relationship, not during single offshoring projects.
- **Infrastructure**: Initially, the freshly started capitalist economy in the offshoring countries had several negative side effects, e.g. unreliable infrastructure, but also the necessity to protect the expensive equipment with armed guards at night. These wild west scenarios have become much better during the last years due to the growing maturity of the economy.
- **Competition**: The market for well qualified IT professionals today is a challenge in Eastern Europe, too – it is not trivial to find new team members. We counter this effect with e.g. a cooperation with local universities and offering seminars and courses for graduate students, improving our profile and contacting interesting graduates directly.
- **Fluctuation**: In order to reduce the rate of programmers leaving the company, we offer work benefits that are similar to a German company, but completely non-standard in the offshoring country: Paid vacation, a company sponsored German life insurance and automatic yearly raises to combat inflation are some of these features that create a firmer bond between company and employee.

2.3 Semi-Captive Outsourcing

The classical captive outsourcing model means establishing or buying a local company and leading it like a subdivision of the own company, i.e. direct orders, little room for local decisions, and high financial dependency.

In contrast to this, our approach – which we call Semi-Captive – highlights local responsibility and entrepreneurship. The subsidiaries are encouraged to develop further business of their own, e.g. offer their outsourcing services to other customers and develop as well as market their own applications.

This has several benefits: The self-respect and motivation is much higher, which increases stability, and the subsidiary is less dependent on a constant flow of projects from the mother company – lessening the impact of the common captive outsourcing problem, namely the necessity to keep the job pipeline full at all times because it is not easy to reduce resources quickly (at least not if one wants to increase them again in the foreseeable future…).

On the other hand, the semi-captive approach still offers much more control and business opportunities than traditional outsourcing: it is possible to e.g. order zero profit projects when extra competitiveness is needed, and the mother company can establish its own set of standards and tools as described above. And of course the internal outsourcing costs are lower than the rates the subsidiary officially charges other customers.

3   Conclusion

We have outlined our practical experience with captive outsourcing and highlighted some of the problems encountered and solutions found. In our experience, especially the "semi-captive" approach with high local responsibility and entrepreneurship offers many advantages – the stability for both sides is higher, growth in the subsidiary automatically benefits the mother company, and the long term relationship reduces risks for both sides.

Of course, as with any long term relationship, this approach needs constant work in order to succeed. In traditional outsourcing, if a project goes wrong you select the next outsourcing provider for the next project – with captive outsourcing, you have to make sure that a project problem does not become a relationship problem and damages future cooperation. An open company culture helps a lot, i.e. focusing on solutions and not assigning blame to specific persons.

Thus, a well established semi-captive outsourcing structure offers possibilities that are difficult to obtain in traditional approaches and benefits both sides, leading to mutual growth and success.