

Why Outsourcing Fails - Postmortem Report of Failed Outsourcing Projects

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Leveraging project management for excellence, growth and transformation



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1.1 Abstract

Outsourcing projects are cost-driven and involve lot of risks. India has grown in IT for the past decade due to the outsourcing trend in developed countries. Since US/European countries found India a cost-effective option, they were outsourcing their operations, development and maintenance activities as projects to India to save dollars. Various companies in India are working on these projects for several years and doing it successfully. In recent days the economic growth in India resulted in an increase in cost of various raw materials and resources. This resulted in reduction in margin and thereby increased risks in executing projects within budgets.

Obviously failed projects will teach us great lessons. We have consolidated the list of lessons learnt from all failed projects in this paper. Also, the secret behind the successful projects are listed as key mantras of success. These simple historical data will surely help the project managers' community.

1.2 Introduction

The world is trying to be competitive on a global scale by reducing the operational cost to bring in competitive products and services in their respective industry. In the present scenario, outsourcing has become essential rather than optional to retain the market leadership. In our team, we as project managers worked in this outsourcing business for a few decades. Having worked with multiple customers across different geographies, each project taught us few lessons which are being utilized for the subsequent project. However this will be a continuous cycle.

As our best practice, we are habituated to add the lessons learnt in Projects Asset Library in our company database to serve as input for future projects. This has helped our new projects considerably. We surveyed and found a great trend during our steering committee meetings across all projects. After seeing this trend, we realized that our experience should be shared with our project managers' community. This has triggered the purpose of introducing this post-mortem report as a PMI Conference paper.

This report contains our experience with outsourcing projects. We interviewed several outsourcing managers and observed that most of them agreed that our observations are common across the IT industry.

The analysis reveals that there are seven major fundamental causes for the failure of any outsourcing project. Interestingly they are not directly related to technical attributes of the projects, i.e., Requirements, Scope, etc. It is understood that most of the factors are related to relationship, communication, processes & practices, culture and perceptions. We detailed our findings in this paper.

1.3 How we categorized that a project failed

The main objective in the outsourcing business is to deliver values to the client besides the project requirements. We observed in few cases that though the project requirements are met, still the project / relationship is considered as a failure because of not meeting key stake-holders' expectations/perceptions.

1.4 Reasons for Failure:

We observed that there are seven key reasons which contribute to most of the failed outsourcing projects, despite having sufficient processes and technical capabilities.

- ✦ Lack of outsourcing knowledge
- ✦ Overselling
- ✦ Lack of precision & domain knowledge
- ✦ Expectation mismatch
- ✦ Poor commitment
- ✦ Non controllable challenges
- ✦ Cultural differences

Figure 1 illustrates the percentage of project failure observed due to seven listed reasons for failure

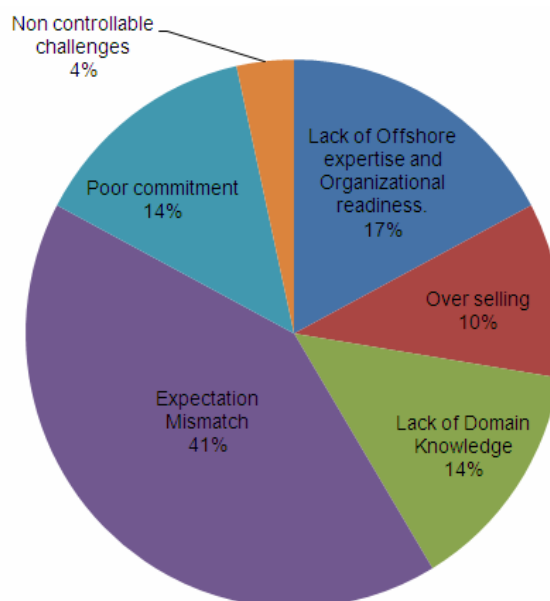


Figure 1: Reasons for outsourcing project failures

1.5 Lack of Outsourcing Knowledge

Most of the project failures are due to the lack of outsourcing knowledge or expertise with the client/outsourcing companies. Before outsourcing the project the client should check whether their organization is ready to outsource the project to partnering companies. Also, both organizations should have patience to wait for the results. The outsourcing benefit cannot be seen in a few projects. Our experience shows each relationship has its own breakeven time to see the intended favorable results. It varies based on the project's complexity and environment. The client organization should be committed to make the outsourcing successful, irrespective of few short term failures, if any.

1.5.1 Case Study #1:

Company A decided to outsource. The top management team approached major companies in India and evaluated them in terms of capabilities, cost, and expertise and then decided to outsource a project to Company Y. The T&M contract model was chosen. Offsite team went onsite for a requirements study; client provided the marketing specification and asked them to design the requirements for one of the major systems. The team collected the requirements for that subsystem (line card) and started working on it. The project was well planned and executed. Requirement, Design, Implementation was done and stand-alone testing was performed as per the plan and requirement. The product was delivered. Once the customer's product qualification team started testing in integrated environment, several bugs were logged in the bug tracker. As a result of this new requirements and features were added. The team fixed the issues in the last stages and this caused dissatisfaction to the client.

The top management team reviewed this project and found that the offsite team struggled to implement the project and this resulted in schedule and costs overrun. They decided that outsourcing did not make any sense.

Later, Company Y analyzed and shared the following findings with Company A to make the outsourcing successful:


1. The client team shall adopt collaborative approach and proactively plan for necessary support to the offsite team.
2. Offsite team shall be treated as client's extended team rather than adopting the vendor approach.
3. Relationship evaluation model shall not be limited only to short term goals but also oriented towards long term benefits.
4. The process mapping shall be done at organization level to ensure synergy.

1.6 Overselling

Client's top management wanted to outsource everything to save cost to stay in the competition. Sometimes the outsourcing companies need to take the project in order not to allow another vendor to work for the client. Once the project is kicked off and starts moving, client expectation mismatch is observed. This creates turbulence in the relationship. The client organization should be mature enough to judge capabilities of the partnering company and also account for the risk mitigation before outsourcing. It is always safe and worthy to take calculated risks in execution.

1.6.1 Case study #2:

Company "A" started outsourcing few projects to company Y. Around six projects were running well without any issue. This triggered the other division in Company A to outsource a large program almost equivalent to that of the present total team strength of six projects. Company Y found this as a great opportunity. Though there was no team available offsite, it decided to take the project and ramp up fast. Due to market conditions the team could not ramp up and show the resources to the client team. Onsite team developed the perception and decided that this program cannot be started.



Then Company A's other division awarded that project to another outsourcing company in Australia. The sales guy's overselling caused the larger program to be lost. If the sales/offsite team had openly explained the problem to the client and requested for time to ramp up the team in a phased manner, this project might have been awarded to Company Y. The overselling and expectation mismatch killed this opportunity.

1.7 Lack of precision and domain knowledge

Generally, client always assumes that everyone in the offsite team has domain experts and tries to measure them with the same yard stick they use for their engineers, who are working in that specific domain for several decades. Also, if the ramp-up is fast the domain knowledge cannot be developed in weeks/months. It takes at-least one or two projects for acquiring product specific knowledge.

In India, the number of companies engaged in end-to-end product development are very few. The international standards and compliances for technologies are the main body of knowledge. So we have usually very few engineers specialized in various domains required for different product segments. However, if managed properly, we have people with the aptitude and attitude to learn and develop those skills quickly. If the team is provided with infrastructure and time, it is observed that within few months the offsite team acquired competency to handle the domain level requirements and problems.

1.7.1 Case study #3:

Company Y approached Company A for a new outsourcing opportunity. At that time, Company A had an immediate problem and was looking for a solution for one of its upcoming projects in a three months deadline with sizeable portion of activity left. The project had immense revenue potential whereas company A had already spent more than six months to complete just requirement and architecture design activity. As usual, the sales team promised the solution before three months. Since it was the breeder project, company Y picked up its best resources and formed the team in a week's time. The team planned aggressively and proactively to complete the project in all areas like design, implementation, procurement, manufacturing, shipping, etc.

With the team's dedication and hard work the project got completed just around the deadline. Obviously the client was amazed, however during the product qualification testing the product exhibited lots of manufacturing and reliability issues, and soon the client was unhappy about extremely poor yield and a few missing requirements. The client with their vast domain knowledge felt that the unstated requirements were obvious for the product to qualify in that market segment whereas the outsourcing companies were taking them for the first time. The manufacturing was subcontracted to an Indian vendor whose manufacturing capabilities were way behind its US counterpart.

Though the project was a failure from the scope, time and cost definition, and there were quite a few night-mares in the relationship immediately after the project completion phase, yet there was a silver lining. The client got convinced about company Y's design skills and decided to continue with design outsourcing but retaining the manufacturing work with them. Eventually the design outsourcing business with the client grew to over a million dollars per month.



1.8 Expectation Mismatch

Most of the project manager's time was spent in communication management to correct the expectation between client and team. But sometimes the relationship is getting affected due to wrong expectations. The observed reasons are mainly due to no proper understanding with the client execution team, unclear communication, implicit requirements, and unrealistic yard stick for performance measurement.

Also, while starting the project with offsite team, both parties should create an environment to openly discuss and understand the expectations and have mutual concurrence in their expectations.

The expectation mismatch is highly dynamic, and has significant impact even in some matured relationships because of inability to show long term continuous and consistent value additions.

1.8.1 Case study #4:

Company A wanted to do outsourcing due to business requirement and approached Company X. The project was awarded to company X with a budget of \$1million. The requirements were provided and the client expected that the project will be completed as per schedule. T&M model was chosen. There was no review planned by the top management team. Company X ramped up the team and started billing. Since, more resources were available company X decided to put more people in the team initially.

Everyone started understanding the project and the study phase, design phase was in progress. One fine day, before the scheduled time, the accounts department of Client Company refused the invoice because of budget overrun. The client's top management team asked for the status, it was 30% as per the planned schedule but the budget was overrun. Client showed dissatisfaction and the relationship ended.

Since the bills are paid as per the T&M and the progress is as per the schedule, company X expected that company A was happy. But Company A expected that the schedule was fine and the project will run as per the expected plan. Unfortunately here the project failed because of expectation mismatch due to communication gap.

1.8.2 Case study #5:

Company B outsourced a project to company Y as a pilot project. Company Y started the project and design was in progress. The client team asked for status, offsite team sent the intermediate design where the designer was trying to experiment the best possible design. Since it was an intermediate status, offsite team named the design file as initial draft and sent it to client to show the status.

Offsite team expected that since the design file is named as initial draft client will not check the correctness. But client team reviewed it and found the design was totally wrong. This issue was escalated to client's top management team and commented that the offsite team is technically incapable. Next day the design team got a shock. Finally the design team traveled onsite and explained the issue and illustrated their capabilities to the customer.

The expectation mismatch could happen due to communication issues like wrong wording during communication, one way communication where client confirmation was not immediately taken, and poor communication planning.



1.9 Poor commitment

No support and non collaborative approach from client team will always result in outsourcing failure. In most of the cases where we see poor commitment from client team, was due to the fact that the outsourcing was seen valuable at corporate management level but it was not valued by the execution teams. For successful outsourcing, the corporate management should get the buy-in from the execution team with organizational motivating factors.

Also, the offsite team project manager should facilitate the team to have self commitment on its part of work and relationships to make it successful.

1.9.1 Case study #6:

Company A has good outsourcing relationship with Company B and has executed a few projects successfully. Director of Engineering recommended one for his project team to use outsourcing and get benefited by it. Since the Director asked, the PM gave a chunk of activities to the offsite team for execution. The offsite team came up with requirement clarifications and asked for more documentation. The PM clarified the point at a very high level saying details should be developed by vendor. Project team completed the work as per their understanding and shared the deliverable for client review. Client pointed out several reworks and tried to fail the offsite team. In this environment the team failed after several attempts in multiple fragment of work and clearly the culprit was “no support from client team”.

1.10 Non controllable challenges

It was seen that the outsourcing failed with few customers due to non controllable project factors like inflation, market boom and unjustifiable salary hike demands / attrition, new emerging competitors and pressure to reduce margins, mass resignations, political instabilities, government policies, new taxes, and natural calamities. This could be overcome by risk management best practices and produce less impact.

1.10.1 Case study #7:

Company A decided to outsource product development and supply to the existing outsourcing partner Company X. The company X was asked to provide their capabilities on that domain. Since Company X doesn't have the capability to develop, it recommended the partnering company Y to deliver this project. The company Y provided an estimate and the client asked for fixed price contract to mitigate the risks.

Since this was a first project to Company Y from Company A, it decided to take up this contract and started development. During execution, external factors changed. The dollar got depreciated, market was booming, attrition was high, expenses increased, increased tax hit the raw material costs. This hit the project badly and resulted in loss. Because of the team change the project schedule got delayed.

This delay has impacted the product delivery of end client and client (Company A) ended up in paying a huge penalty. The relationship was hit miserably and ended prematurely.



1.11 Cultural differences

In outsourcing, multi cultural team is unavoidable. Even though it appears to be trivial, considerable amount of client dissatisfaction has been observed due to cultural differences.

The cultural training should be provided to both teams involved in execution. The outsourcing organization should educate the client and offsite team with well known cultural issues and best practices.

Periodical onsite visits to client team and inviting client team offsite has shown considerable improvement in the relationship. Team outings, commonly interested activities (like games, celebrations, cooking, etc) apart from work will always bring down the cultural differences.

1.11.1 Case study #8:

The Company A from Japan decided to outsource some of its projects to Company X in India after several stages of evaluation. Japanese manager was appointed as the outsourcing manager to handle the offsite team. He had never stayed outside Japan, and hence didn't prove to be efficient in handling a multi cultural team.

Though the team was formed with proven team members at offsite, the project schedule slipped due to repeated rework on the modules with lot of cosmetic changes. The cultural barrier with executing team and client led this project to failure because of schedule slippage.

In general, the outsourcing aware organizations would always provide sufficient training to the teams involved from different geographies and culture to cross the cultural barrier.

1.12 Lessons learnt – Best Practices

1. For new relationships, always educate the client about outsourcing processes, lessons learnt, and best practices.
2. Proactive gap analysis (process, organization structure, reporting, etc.,) and expected impact/suggestions to be provided to avoid repeating the lessons.
3. Top management of both the companies should follow-up closely and review the project at least once every month until the relationship is stabilized. This creates commitment among execution team for success.
4. The PgM/PM processes and best practices should be used as required for the project.
5. Exhaustive risk analysis and mitigation mechanisms should be in place during overselling. Educate the client as much as possible during sudden ramp up and have daily updates to keep him updated.
6. Conduct exhaustive trainings and workshops to train the team on customer specific domain/skill, including client actively for knowledge transfers on key domains Get buy-in from client by explaining the usefulness of developing expertise at offshore.
7. Check for all possible gaps in communication plan to avoid expectation mismatch.

8. The client organization should be educated to understand the importance of openness and facilitate the offsite team to come forward and explain issues.
9. The client organization should plan outsourcing at organization level and educate the importance/outcome of outsourcing to execution teams and ensure the buy-in from execution team before starting the outsourcing.
10. The client organization should be mature enough to have realistic expectation on any value additions and commitments, irrespective of offsite team promises.
11. Exhaustive risk analysis and mitigation mechanisms should be in place for the uncontrollable factors. Some of the factors could be easily overcome by client awareness, right contracting model and best practices.
12. Cultural awareness and training should be provided to both the organizations to deal with multi cultural teams.

1.13 References

Previously executed projects of all three authors for the past 15 years.

1.14 Conclusion

To conclude, any outsourcing organization could use this paper to understand the commonly observed causes for failure and the best practices to overcome them.

1.15 About authors



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