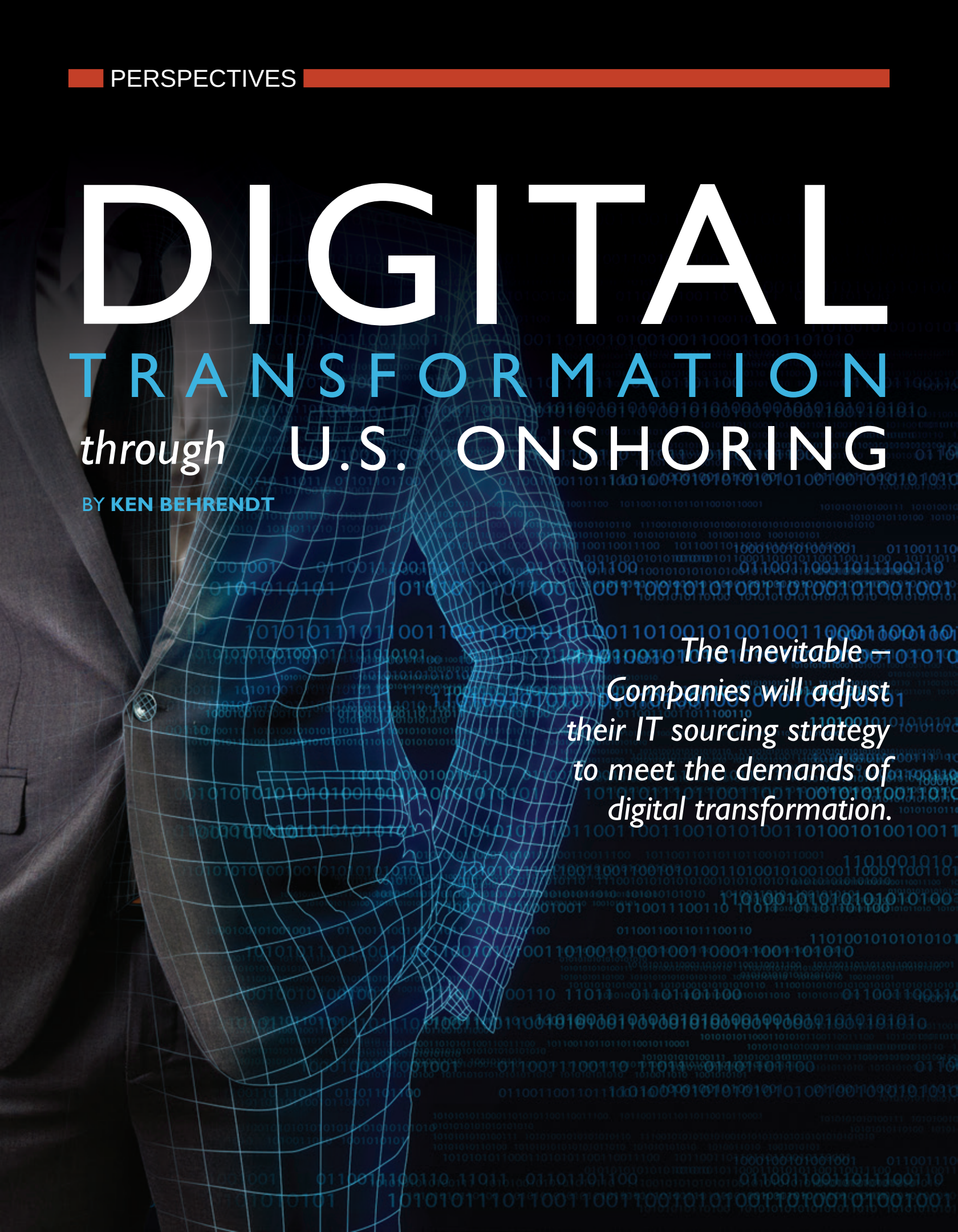
DIGITAL TRANSFORMATION *through* U.S. ONSHORING

BY **KEN BEHRENDT**



The Inevitable – Companies will adjust their IT sourcing strategy to meet the demands of digital transformation.

Businesses are now undergoing a digital transformation significantly more revolutionary than the .com era of the 1990's - and this dynamic is virtually unstoppable.

In simplistic terms new SMAC technologies (Social, Mobile, Analytics and Cloud) are driving businesses to create a new business advantage with its customers and the global market. This transformation is engaging new technologies requiring IT services solutions to utilize specialized, local teams based on speed-to-market delivery (e.g. Agile delivery), where the teams have fluency and intimacy in the customer, customer's culture, business and business' culture. Offshore IT sourcing does not have, nor will it acquire, nor can it evolve to the necessary capabilities to support these new business requirements. This is a bold statement, but easily confirmed by corporate America's IT leadership.

Digital transformation is the new demand and for the last fifteen years Offshore has been the supply. The opportunity presented to the United States is the supply will no longer satisfy a demand that is growing exponentially. Eagle Creek estimates this opportunity - the rapid expansion of technology services in the U.S. where technology hubs will be the primary technology services delivery vehicle - will last a minimum of seven to ten years from today. Post this expansion Eagle Creek expects this opportunity to continue, but technology hub destinations will have been established. This is akin to India where the major hubs were determined within the first five years of the rapid expansion phase of Offshore.

THE IT PROBLEM

Today, digital transformation or digital business is an endless journey. We have entered an era where new technologies, new applications and new devices are being released to the market at an accelerated pace. As a result, this journey will create a substantial backlog of IT projects - projects necessary to be completed, projects scheduled to be completed, but projects that can't be completed generally because of budget constraints. Budget is and will remain the fundamental inhibitor to digital transformation. Furthermore, it is not difficult to extrapolate the cost of these projects will outstrip the budget of IT today, tomorrow and for the foreseeable future. This implies IT

will have an ongoing budget problem. There are three possible solutions to a budget problem relative to an IT backlog:

1. Increase the IT budget year-over-year. This may happen, and to some extent we're sure will happen, but the inevitability of an economic downturn or the fear of an economic downturn will prevent this from happening for any extended period of time. Digital transformation is a long-term and ongoing investment with or without economic downturns. (e.g. mobility and handheld devices are not going away.)
2. Reduce technical resource cost to the lowest possible amount. The cost of technical resources is the primary budget issue of digital transformation. It is not the cost of the underlying or supporting technologies.
3. Achieve greater efficiencies from every technical resource. That is, get more productivity from each and every resource in order to maximize the output of these resources, which in turn maximizes the effectiveness of the IT budget.

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THE UNIVERSE OF TECHNICAL RESOURCE SOLUTIONS

IT departments have finite options for technical resources with a universe of possibilities limited to four alternatives. The possible options are:

1. **Employee**. Technical resources hired and employed by the business, typically located in the United States. For digital transformation, these resources range in salary from $75,000 to $150,000 per year plus benefits.

2. **Onsite Contractor ("Onsite")**. Contract technical resources located in the United States, generally engaged at the customer's location, typically paid by an hourly rate, typically reimbursed for travel expenses, and may or may not reside in the geographic location of the business (hence the reimbursement for travel expenses). These resources are historically the most expensive resources IT can engage.

3. **Offshore.** Technical resources located outside the United States, typically residing in lesser developed countries when compared to the U.S., always offering a customer value proposition of lower cost. These resources are historically the lowest cost resources IT can engage.

4. **U.S. Onshore**, also known as rural sourcing, onshore, onshoring or domestic sourcing. Technical resources located in non-urban areas, i.e. areas that are not considered major metropolitan, and always located within the United States. These resources are generally priced equal to or lower than an Employee when the Employee is allocated its fully burdened cost, always priced less than Onsite, and always costing more than Offshore.

Each of the above alternatives have strengths and weaknesses, hence all technical resources are not created equal. The Benjamin Franklin quote remains true, "The bitterness of poor quality remains long after the sweetness of low price is forgotten" and is reflective of how IT departments view Offshore. Regardless, IT Departments still require a low cost / high quality technical resource solution to solve its IT backlog problem.

The above universe of technical resource possibilities are the only alternatives available to an IT department. With this being fact, The Opportunity and The IT Problem must be solved within these confines.

WHY CERTAIN TECHNICAL RESOURCE SOLUTIONS WON'T WORK

Gartner, Inc. a leading technology analyst and consulting company, recently released a grid that defines what technical resource solution should be engaged for a particular type of technology being deployed. Digital transformation is in the upper left and right quadrants. (Note: Nearshore - represents Canada, Caribbean, Central & South America).

Eagle Creek agrees with Gartner (as many of Gartner's conclusions came from Eagle Creek interviews), but takes a more pragmatic view to this conclusion.

Offshore

Eagle Creek asks every IT department the same question - on a scale of 1 to 10, 10 being perfect, how effective are your mid-level managers in managing offshore? (A mid-level manager has responsibility for overseeing the day-to-day activities of technical resources associated with a technical project.) Without hesitation the answer is always the same, "We're a 2 or 3." For most businesses this statement is a reflection of no less than 7 years of Offshore experience and for some as many as 15 years of experience.

On a new scale of 1 to 10, if technologies were measured by complexity, digital transformation will be considered a 9 or 10. This is compared to technologies that have been traditionally sent Offshore for the last decade, technologies generally considered to be at a 2, 3, 4 and 5 level. Most IT departments have concluded if Offshore hasn't been successful with the easier technologies, the more difficult technologies of today will never work.

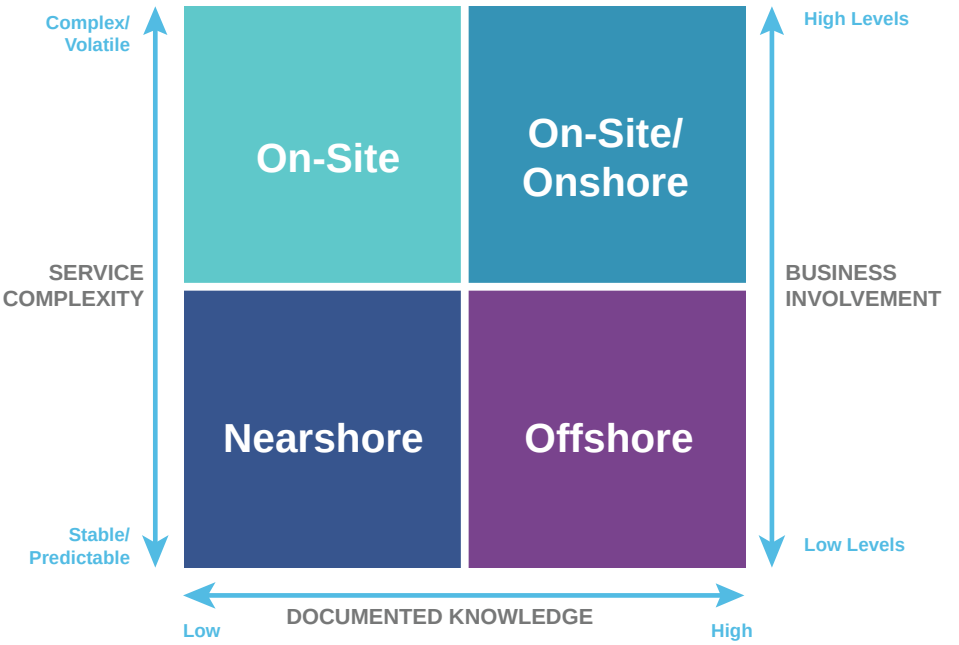
Regardless of why Offshore isn't working, the issue is - it isn't working. Most U.S. businesses have concluded it can't make Offshore work for digital transformation or digital business.

Onsite

Onsite contractors are the most expensive resource an IT department can engage. These resources are approximately 1.5x to 2x the cost of Employees, 3x to 5x the cost of Offshore, and 2x to 3x the cost of Onshore. This differential will only continue to increase because of increased demand issues resulting from digital transformation and the limited new supply of technical resources entering the market. As a result, Onsite cost will only increase further exacerbating the budget problem.

It is mathematically impossible to solve an IT backlog problem, constrained by a budget, with Onsite technical resources. Stating this, Onsite will play a role in digital transformation. It is Eagle Creek's estimation for every four to six remote resources (either Onshore or Offshore) there will be a requirement for one Onsite or Employee resource. Generally, the Onsite technical resource has a greater depth of knowledge of the technical issues associated with a project.

Gartner Market Insights, February 2015



Note: Nearshore represents Canada, Caribbean, Central & South America.

1. Source: Gartner Market Insights: Market Insights: Don't Ignore Onshore Capabilities in Your Global Delivery Strategy, 3 February 2015 by Helen Huntley, Allie Young.

Employee

Every IT department prefers an Employee for a technical resource position, but this isn't practical for the following reasons:

1. There are too many technologies within an IT department to staff all positions internally.
2. Many of these positions require unique to semi unique skillsets.
3. Many times the technical position is engaged for a limited period of time, e.g. an implementation.
4. The positions referenced in the above three points will probably disrupt the pay scale of most IT departments. These positions are generally paying 25% more than a similar grade of Employee.
5. It is unlikely IT departments will revert to training new Employees. The cost of training is too great when all factors are considered.

The above applies to digital transformation - and are the reasons why IT departments cannot internally staff its way to a solution. It's Eagle Creek's expectation that Employees will only make up 25% of digital transformation resource requirements.

WHY ONSHORE

If one accepts the following:

- Digital transformation is driving the need for new skills, an expansive range of skills, and skills deployed in a model that possesses proximity and context in all its affectations
- Budget inadequacy inhibits a company's ability to make the necessary investments then…

The simplest of logic states that if IT projects need a lower cost price point and can't go offshore, then the solution must reside in the U.S. If the solution is in the U.S. then the alternatives are Employee, Onsite and Onshore. Employee and Onsite resources for the most part reside in urban areas. Given there is a supply and demand issue for these resources, it is not difficult to conclude the following will happen to Employee and Onsite resources:

1. The cost of technical resources will only escalate with time.
2. Turnover for these resources will increase, further escalating the cost of these resources.

Conclusion: cost for Onsite and Employee resources will only increase with time. Consequently, Onshore must work.

There is a second argument. Corporate America has spent the last fifteen years investing in remote resources, primarily Offshore resources. As much as it has had limited success, it has learned many things with the most obvious being - remote resources have advantages, specifically in cost. As an example, there are less IT infrastructure costs such as facility costs, benefits costs and salary costs. And as important, IT no longer must deal with recruitment and retention of people. Most companies have learned that remote resources are and will be a lower cost alternative to Onsite or Employee regardless of the position of the supply and demand curves.

This is why Gartner Inc., in February of this year, made the declaration that "onshore delivery is no longer just an offshore alternative. The onshore/on-site delivery option has become an imperative within a provider's global delivery strategy"[1]

For any type of resource there are two variables to consider: cost and quality. Offshore doesn't work from corporate America's perspective primarily due to quality. Quality stems from "understanding the business" or the lack of understanding the business in the case of Offshore. Corporate IT's history demonstrates that U.S. based consultants possess inherent contextual familiarity and can learn "the business", thus drive quality. Include the quality variable with lower cost and the only answer is Onshore.

The market has enough experience to realize this new model - Onshore - must play a significant role in digital transformation. This is why the Gartner Inc., in February of this year, made the declaration that "onshore delivery is no longer just an offshore alternative. The onshore/on-site delivery option has become an imperative within a provider's global delivery strategy"[1].

KEY COMPONENTS TO A SUCCESSFUL ONSHORE SOURCING MODEL

The key components to Onshore success can be divided into three categories: resources, environment, and financial assistance.

Resources

The technology hub must be located in a non-urban environment, i.e. not a major metropolitan area. It is unlikely that a successful investment model can be developed for an urban environment. Stating this, the non-urban location must become a destination for the millennial. It is this age group that will make up the majority of resources located with any hub and graduates from the better schools produces a more reliable and better Onshore consultant. In addition technology centers must become importers of people from outside the state.

Environment

For the foreseeable future technology hubs must reside in non-urban areas for the simple reason of Resource Return on Investment ("RROI").

RROI is the driver for a non-urban environment. In a non-urban environment for the cost of the first year's employment it is possible to train a raw untrained person to become a marginally productive technical resource, and by the third year of employment the RROI becomes positive.

In an urban environment the RROI is quite different. The cost of a new employee is at least 20% greater. The cost of training this employee is greater. The probability of a new employee leaving the organization within the first two years is at least 40% greater. These numbers generate a risk/reward model that most IT organizations find unbearable, which is reflective of why these same organizations will not hire and train newly graduated IT students.

It is near impossible to make a financial argument how an urban technology hub can be cost effective

Financial Assistance

A resource technology hub is built on three key processes, namely, recruiting, relocation and training

There are no shortcuts to the process of recruiting, relocating and training. No cost cutting techniques. No volume reductions. All other costs associated within a technology hub are relatively insignificant including rent abatement, tax abatement and capital expenditure financing.

Economic development must be directed at subsidizing the recruitment, relocation and training of the individual. Consequently, there is an educational adjustment process that needs to take place between the economic development community and the organization building the technology hub.

CONCLUSION

As new circumstances are evolving and giving rise to new forces and needs in the market it is clear that there are a finite set of choices as to how to solve the services issues emerging from the adoption of promising digital technologies and strategies. Companies have to adapt to these changes. Frameworks exist to help guide these changes and provide a template to help achieve balance in services and sourcing models – balance that reflects consideration to these new pressures and drives a rational and diverse services formula to support the modern enterprise.

Harnessing the opportunity presented by Digital Transformation is about technology AND expertise as well as the formula you use to balance the deployment of such expertise. Developing mobile applications, deploying purchased solutions, integrating and supporting them requires a new balance of in house and partner resources. The demands of digital are such that the type and breadth of skills combined with the economic considerations require a balanced approach. One that reflects the needs of the business and accommodates the nature of new technologies.

"US Onshoring allows an organization to best manage price, quality and risk in software development, deployment and support."

U.S. businesses have engaged Offshore for the last fifteen years. In this period of time, these organizations have concluded Offshore cannot and will not provide 100% of the required technology services solution for the future. This is for various reasons but principally a result of a lack in quality, where quality has multiple facets.

US Onshoring allows an organization to best manage price, quality and risk in software development, deployment and support. It enables the advancement of digital initiatives while accommodating a static budget, permitting reduction in the backlog, and the application of the right skills using the most effective methods.

MEET THE AUTHOR

Ken Behrendt is CEO of Eagle Creek Software Services, a provider of consulting & technical expertise to the Enterprise. The company focuses on consulting services from CRM to Application Development to Mobility, helping clients deploy the right skills, at the right location at the right price to succeed in Digital Business.

Learn more at www.eaglecrk.com