



Status of Offshore Outsourcing in Australia

A qualitative study

Presented to

Australian Information Industry Association

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Methodology

This document encompasses two research studies.

The first was conducted in April 2004. It took the form of a quantitative-based study in which ITR, with the services of Quantum Market Research in Melbourne, interviewed 100 Australian CIOs and IT Managers on the issue of offshore outsourcing and its impact, or potential impact, on the Information Communications Technology (ICT) industry.

Findings from this study were initially released at CeBIT in Sydney in May, 2004. Some of the slides from this survey are included throughout this document.

The more substantial part of the research takes the form of a qualitative-based study in which 46 interviews were conducted between May and August 2004, on the topic of offshore outsourcing.

For the purposes of this research, the phrase “offshore outsourcing” refers to the availability of services specific to the ICT industry, such as software programming, that can be carried out overseas, and then delivered back to the country of purchase for implementation.

In this study, “offshore outsourcing” is not a term that also includes the equally important and sometimes related topic of Business Process Outsourcing (BPO). This is the practice of companies in developed economies using geographic locations with low-cost labour to conduct a myriad of low-level tasks, such as customer support via call centres, or processing repeatable transactions, such as standard insurance claims.

The phrase “CIO”, or Chief Information Officer, regularly appears in this research. This term has been used to signify not a specific rank of management *per se* but a level of management. Some of the “CIOs” referred to in this survey possess titles such as “Director of Information Technology”, “Chief Technology Officer” or “IT Manager”. The term CIO has been used to cover these and other equivalent titles.

Qualitative Interviews

The 46 qualitative interviews were conducted across a spectrum of interests in the Information Communications Technology (ICT) industry.

The majority of interviews on offshore outsourcing were held with those individuals who have the influence or power to buy offshore ICT services - Chief Information Officers, IT Managers and Chief Executives.

A total 32 CIOs, IT managers or directors / general managers, Chief Executives or Chief Operating Officers (COOs) from separate companies or federal and state government agencies have been interviewed for the purposes of this survey.

Research also embraced the chief executives or senior managers of a range of Australian and multinational companies that specialise in the provision of services that could either benefit from, or be detrimentally affected by, the availability of offshore outsourcing services. A number of executives from Australian software companies that had undertaken an offshore initiative were also interviewed.

Further, interviews were conducted with leading industry figures and influencers in Australia, including government-employed policymakers, industry lobbyists and politicians.

No interview lasted less than 30 minutes.

Names and contacts of the individuals were drawn from either the author's knowledge of the industry, the "Contacts" database of ITR, or the recommendations of the Australian Information Industry Association (AIIA).

All interviews were conducted in confidence. Respondents were guaranteed that neither their identity nor their company's would be revealed.

AIIA does not know whether its recommendations for individuals to be interviewed were acknowledged. At some points in this research, details are deliberately vague as part of best efforts to ensure an individual or a company's anonymity is retained.

Geographic and Industry Segment Representation

Interviews were conducted either in person or over the telephone with individuals in all six states. No interviews were conducted with executives based overseas, thus providing an essentially Australian view of offshore outsourcing.

The majority of respondents represented organisations that were prepared to, or had considered, purchasing IT services offshore, or those who had already done so.

ITR made best efforts to seek out companies that had used offshore services to better understand their experience and perspective. As it turned out, respondents were split equally – 16 each – into those who had undertaken offshore outsourcing, and those that either had not, or had decided they would not.

This is in no way meant to suggest 50 percent of the Australian market conducts offshore outsourcing. The quantitative findings of ITR research conducted in April, 2004, found only a 12 percent incidence of offshore outsourcing among 100 large-size companies that were researched randomly.

No preference has been given to any industry segment, however organisations represented include those in finance and banking, information technology, telecommunications, health and manufacturing, among others. Also covered are state and federal government agencies, collectively a major buying power in the Australian ICT industry.

In the realm of Australian-based service providers, seven interviews were conducted with senior executives of local or multinational companies that provide external ICT services. Some offer Australia-only based services, while others are prepared to send work overseas as part of their offering to clients.

Reportage of Interviews

A set of questions was established for each of the three basic interviewee groups:

- Chief Information Officers / Chief Executives / IT Managers;
- Senior executives of service providers / software companies; and
- Influencers / policy-makers / politicians

The nature of qualitative research is such that the interviews can move in the direction in which the respondents may take them, within reason. Therefore, not all respondents were asked exactly the same questions in the same way and at the same stage of their individual interviews.

Reportage of these interviews focuses on the common themes that emerged from the conversations. The style of questioning was such that the interviewer was careful to not load questions in either a pro- or anti-stance on the topic of offshore outsourcing, or in any way infer that one offshore location was better, worse or more prevalent than another.

This is particularly important as the topic of offshore outsourcing has emerged globally as a debate of substantial passion that is often built on the fear, rightly or wrongly, of significant jobs losses.

The very best endeavours of the report's author have been made to ensure the themes and thoughts of those interviewed are represented as their own, with the appropriate emphasis and prioritisation that the interviewees, not the interviewer, would place on them.

The Objective

THE GOAL of this research is to better understand the status of offshore outsourcing in Australia – a debate that can become remarkably passionate. Unlike other reports that have been undertaken in Australia and overseas, this paper does not seek to pursue a political or an economic point of view. Instead, it seeks to discover and articulate the adoption and intentions of buyers and potential buyers of these services; ascertain whether jobs are threatened, and how much money, if any, are organisations saving by adopting this model.

Not a crystal ball

EQUALLY important is the need to articulate what this document does not purport to do.

This research is not meant to represent a crystal ball of predictions of economic impact, job losses or increases as a result of offshore outsourcing. The research was not designed to be able to articulate a particular point of view – in this case, either a pro- or anti-offshore stance.

The objective is to better understand the attitudes of Australian enterprises today. It does not try to extrapolate the information into some sort of employment data; this has already been attempted in various countries, including Australia. On several occasions, these efforts have drawn a variety of criticisms of each report's fundamental contentions and ensuing accuracy of data and forecasts.

The lack of depth in data of Australian employment for the ICT industry, and more relevantly in the software management and application development sectors, makes it difficult to map trends or come to any specific, fact-based conclusion. The American Electronics Association (AeA) makes a similar suggestion regarding its own domestic debate in the United States.

Not an argument

AS STATED at the outset, this document is not an argument either for, or against, the adoption of offshore outsourcing strategies by Australian enterprises and/or government agencies.

Several industry bodies around the world, including the AeA, the IT Association of America (ITAA) and also the Business Council of Australia, have released documents contributing to the debate in this way. All these organisations articulate strongly in favour of the offshore outsourcing model – a reaction in part to the negative coverage offshore outsourcing has received in the media.

Companies such as Gartner, the world's largest ICT research organisation, have made exhaustive arguments in favour of offshore outsourcing, while Forrester Research has predicted dramatic US job losses over the next decade as a result of offshore outsourcing and Business Process Outsourcing in economies with low-cost labour.

This study's purpose is to represent the views of a wide spectrum of the Australian ICT industry – both on the buy-side and sell-side.

In doing so, it is designed to help the Australian Information Industry Association better reach its own policy position on offshore outsourcing to strengthen the future of Australian ICT goods and services, increasing employment and enhancing the nation's overall economic capabilities.

*Mark Hollands
August, 2004*

Executive Summary

DESPITE its high profile, offshore outsourcing of software development in Australia is taking longer to make an impact than in Western Europe and North America. This study has found senior technology managers – predominantly Chief Information Officers and IT Managers – are cautious of the quality of work being offered in low-cost labour markets that offer offshore outsourcing.

A growing number of organisations – both private enterprise and government – are however, experimenting with offshore options. Research found the majority of these enterprises had been impressed with the professionalism and process of offshore developers, and they were now thinking of expanding their relationships.

CIOs of some of Australia's largest companies indicated they were determined to pursue a global sourcing policy as part of their strategic plan. This would include the use of offshore software development resources, potentially saving them tens of millions of dollars a year in production costs.

Some CIOs said they were now beginning to rethink both their relationships with local development companies and also their in-house hiring priorities, especially if ever faced with a return to an environment of skyrocketing wages for IT skills. These thoughts were only at their earliest stages, but they will undoubtedly have an impact on Australia's software development sector in the medium term.

Every service provider interviewed said an increasing number of customers were now asking about their options offshore. Several vendors said it was becoming routine to provide a "local price" and an "offshore price".

Those who provide services offshore are becoming harder to identify, even in this embryonic market. It would be easy to label the Indian companies, such as Infosys, Wipro and Satyam, the key providers of offshore services. However, a number of multinational companies are now offering services in India as well. The study found they were doing so under some sufferance, as in general, executives of these companies prefer to supply services using lower-cost Australian centres, such as the Gold Coast, Tasmania, Adelaide, and regional Victoria and New South Wales.

Given the substantial cost reduction being offered offshore – between 25 percent to 60 percent, depending on the scope of the work – multinationals were now being forced to provide their own offshore services or risk losing the business, and sometimes a long-term and profitable relationship.

Without doubt, this increasing push by CIOs for an offshore option will put pressure on employment in the domestic outsourcing sector, as programmers' jobs become increasingly seen as a low-value, commodity-type set of skills that can be easily traded because of the volume of global programmers available.

Opportunities for Australia

While there is a threat to Australian jobs, the offshore model also has its opportunities for Australia.

It is at least 25 percent cheaper to run a commercial undertaking in Australia than in the United States or Western Europe. Therefore, many industry executives and commentators believe this nation can also become an offshore destination.

Respondents said the domestic industry boasted world-class skills and experience to be able to provide a higher-level of consultancy than the process-oriented programming that has become the specialty of India, Malaysia and a number of other countries in Central and South America, South-East Asia and Eastern Europe.

The ability of Australian software developers to solve problems, design and implement complex systems should attract business from North America and Western Europe.

Vertical industry or domain expertise in areas such as financial services, government and health, are strong suits for the local software services community.

Some respondents believed that for all the jobs lost due to offshore competition, it was possible for Australia to create an equal number by providing higher value services, thus increasing the value of the software sector of the economy. At a micro level, this is exactly how CIOs think. They want to be able to ship offshore their so-called “code-cutting hackwork” and move their staff on to more strategic and valuable tasks for their organisation.

The ability of Australia to respond to this challenge and create employment as an offshore destination was the subject of intense debate. Many felt the industry lacked sufficient scale and strength to match the success of India in this arena.

Criticism, often harsh, was voiced regarding government policy and its attitudes towards the ICT sector, including the public sector’s propensity to buy overseas goods and services. Many respondents, especially those working in the ICT industry, felt the lack of government support had long hurt the ability of local companies to build sufficient strength to capitalise on global opportunities. According to respondents, many Australian-owned companies had insufficient scale and lacked strategic market reach in the US and Western Europe to attract offshore outsourcing to Australia.

For these local companies to meet the offshore challenge, recommendations from respondents strongly focused on the ability to capture and commercialise intellectual property.

While embracing processes such as the Capability Maturity Model (CMM) and International Organization for Standardization (ISO) were recommended, these were not seen as key points of differentiation. Instead, a unique set of skills and methodologies, often restricted to niche markets or industry sectors, was viewed as crucial to building a strong, locally-owned software development sector.

Among respondents, a high level of support exists for the Federal Government to promote Australia’s software skills and consultancy expertise overseas.

While this might mean offshore work going to locally-located branch operations of multinational companies, many respondents felt strongly that these multinationals represented the best opportunity for Australia to retain jobs and attract business in a global market. The spin-offs from winning offshore work would benefit the local industry, as well as the national economies, respondents said.

Languishing with leadership

To grasp and then conquer the challenge of offshore outsourcing, leadership is required. Often respondents would refer to the pejorative “we” without being able to articulate exactly who they meant.

This leadership void must be filled. Respondents to this survey – except some notable policy advisers – were almost unanimous in their desire to see the Government step forward and devise and execute a strategic plan in partnership with the ICT industry to ensure Australia’s software services industry became globally relevant and continued to be an employer of thousands of Australian jobs.

However, this call for government action has been a common refrain when the ICT industry has faced other challenges. Ultimately, it will be up to the ICT industry to forge its own future and ensure Australia develops a national capability to respond to offshore competition as a coherent and united force.

CIOs’ high-level view of Offshore Outsourcing

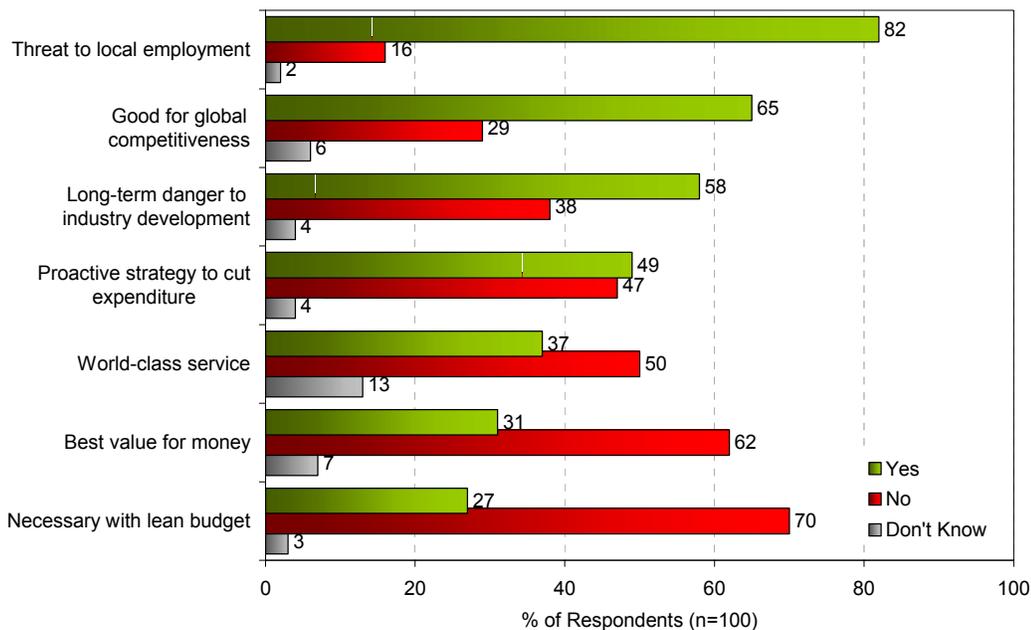


Figure 1 – The high-level view of 100 CIOs interviewed in a quantitative study conducted in April, 2004. Some 83 respondents did not use, or did not intend to use, outsourcing services at this time.

Key Findings

View of the Technology Manager / Buyer

- The Australian market has been slower to adopt offshore outsourcing than markets in North America and Western Europe. However, evidence suggests that interest in the Australian market is increasing, and there will be a growing trend to send software programming work overseas.
- With the exception of a small number of Australia's largest companies, organisations that have used offshore outsourcing have done so as restricted engagements. The majority of projects appear to be limited to small modules of work that are part of a larger project. This is known as the "blended model". A number of respondents say they are trialling the offshore option, supporting the contention that the trend to outsource offshore will increase.
- CIOs possess a pragmatic view of offshore outsourcing. If they believe it is a sensible alternative for their organisation, they will use it. They do not feel they need to consider industry implications, such as loss of work to the Australian ICT industry and subsequent risk to local jobs.
- Several CIOs of leading Australian companies say they can save millions of dollars by adopting offshore strategies for application development over the next five years.
- Long-term hiring strategies in ICT departments of leading Australian companies are now being reviewed as they come to terms with the possibilities of using offshore developers.
- Cost is one motivator for CIOs' decisions to explore offshore options. It is not the main motivating force. Quality of work is the primary consideration. However, if they feel they can gain the same quality but at a cheaper price offshore, then they will take that alternative.
- CIOs expect a minimum saving of 25 percent on any offshore work, or they say this "risk" to established relationships and work practices is too great.
- Australian-based services and outsource vendors – both locally-owned and multinationals – are increasingly providing a price for Australian-based work and an offshore quote, increasing the buyers' options.
- Leading multinational service providers that usually conduct work in Australia are now offering an offshore option, most typically alternatives in India and Malaysia.
- Several of India's leading services companies are now establishing strong local presences, with both local and expatriate staff, to win work by offering both onshore and offshore coverage for a project – thus negating the CIO view that they cannot complete all elements of a project.
- The majority CIOs interviewed who have used offshore service organisations for application development said they were happy with the work completed.

- Reservations were expressed by CIOs, especially in the government and finance sectors, about the ability of offshore companies to manage security issues and protect intellectual property.

View of Industry

- Thousands of jobs are under threat – but new jobs should be created by Australia becoming more aggressive in its efforts to position itself as an offshore destination in its own right.
- With its multi-skilled workforce, respected education system and cultural and language attributes, Australia should be an attractive offshore destination, offering highly qualified and skilled workers who can provide high-level services, such as innovative and problem-solving solutions, design and architecture, business analysis and high-quality implementation solutions.
- Offshoring to countries such as India offers Australian software vendors the opportunity to scale up and down quickly for peak workloads at a cost that would be unattainable by using locally employed agencies.
- A change of business model must be considered for local development houses, possibly forming strategic partnerships with multinational or offshore-specialist providers. Some development houses should not rule out positioning themselves for sale if owners can see their businesses struggling.
- More focus and effort needs to be placed on the creation of intellectual expertise and domain or vertical industry knowledge by local developers.
- IP and domain expertise provides local companies with an essential point of difference from multinational and offshore outsourcers. Local companies cannot beat offshore competitors by simply adopting a “me too” attitude to attain Capability Maturity Model (CMM) qualifications. Offshore companies will still win the business on price. IP creation and commercialisation is the winning formula.
- Greater support of Australian business by governments would give local operators the medium- to long-term opportunity to invest in the creation of intellectual property and vertical industry or domain expertise.
- Industry should explore with the Federal Government programs to assist Australian software development companies develop and capture the intellectual property and/or industry or niche expertise that is required to survive.
- One of the most concrete manners in which governments can support local companies is to buy from them, thereby providing a robust reference site and assisting in the process of promoting Australia as an outsourcing destination.
- A dedicated export fund should be established to promote Australia as an offshore destination – promoting both the Australian-based skills of multinational companies as well as those of locally-owned operations.

- Government-funded training programs should be established in each state to help displaced ICT programmers to re-skill to improve their chances of future employment.
- A medium to long-term threat exists to R&D facilities of multinational companies in Australia. These multinationals are now increasing their presence in emerging markets. The relocation of R&D commitments is one tactic to gain concessions and greater market access in these geographies. It has the additional advantage of tapping the skills of ICT researchers at a much lower cost compared with similar operations in Western countries, including Australia.

Industry influencers

- Heavy criticism of the perceived lack of government policy to help grow the global capabilities of the Australian ICT industry.
- Robust defence of government policy from policymakers in federal and state government, claiming among other things that ICT should stop seeing itself as a special case and it “get its own business model right”.
- Demand for government to increase its spend on local ICT companies’ goods and services to help enhance the strength in the local industry.
- Outside of offshore outsourcing, the careers of programmers will be threatened in the medium term by enterprise decisions to buy package software to reduce technology complexity.
- New software tools are becoming increasingly sophisticated, easing the complexity and skills required for programming, placing further pressure on the jobs and wages of programmers.

Recommendations

The report's findings underline the need for a national strategy of the development of the ICT industry in Australia. The strategy should encompass Commonwealth, State and Territory Governments as well as industry. The strategy should address key issues such as:

- commercialisation of R&D;
- broadband infrastructure;
- intellectual property;
- skills development;
- industry promotion – “branding”;
- capital raising;
- SME market access; and
- Cluster development.

All of these issues have been canvassed before, most recently in the Framework for the Future report, April 2003.

IT IS necessary for industry and government to work together to enhance the marketing of Australian ICT abilities, strengthen capabilities of locally-owned companies and assist professionals who have been displaced and wish to re-enter the workforce with enhanced technology skills.

The over-arching priority of AIIA, both in publishing this research and in its policy deliberations, is to attract investment for both local companies and multinationals to take advantage of the global sourcing phenomenon. In achieving this goal, AIIA believes it will help generate additional jobs and enhance the likelihood of continuous employment for current programmers and other ICT professionals.

AIIA is also keen to encourage increased co-operation with other industry groups to ensure the best outcome for the nation, the ICT industry and the professionals who are confronted with the need to upgrade their skills to remain in the technology workforce.

A major marketing campaign must be undertaken to promote the strengths and skills of Australia's software development sector, and its capacity as a sophisticated offshore destination for North American and West European organisations.

All marketing efforts must focus on the over-arching priority of generating economic activity and employment for Australians.

No one should be concerned about the nationality or home country of companies that will benefit. Multinational companies with an Australian presence, as well as local companies, should be embraced by policy initiatives that respond to the offshore challenge.

Offshore outsourcing represents a significant structural challenge for the Australian ICT industry with potentially profound and far-reaching impacts for both individuals and companies alike. Government now has a role to play if the software sector is to be relevant in the global, multi-billion-dollar technology marketplace. Working in partnership, government and industry can develop programs which can ease the impact on companies and individuals adversely affected by the globalisation of their industries and the commoditisation of goods and even skills.

There is no question of AIIA seeking massive subsidies to allow Australian companies to compete on price with low-cost offshore operators. However, valuable strategic support can come from promoting local capabilities overseas, and creating programs to encourage local companies to increase their capabilities, capturing and commercialising their intellectual property.

A second emotive element must not be ignored: the loss of jobs and the nation's capability to provide low-cost education programs that assist individuals to re-enter the workforce with enhanced skills.

AIIA believes programs are needed to ensure displaced programmers are given every opportunity to attain new skills that are globally relevant, enhancing Australia's overall ability to be an offshore outsourcing centre in its own right.

Furthermore, the recent McKinsey study *How Germany can win from offshoring* shows that a country realises the full benefit of offshore outsourcing only when affected workers are successfully redeployed.

AIIA has also recognised the importance of smaller Australian companies capturing and leveraging intellectual property developed within their organisation and then partnering strategically to commercialise this IP and develop international markets.

The following recommendations have therefore been split into four, representing AIIA's commitment to industry development including IP capture and strategic partnering, and to instituting a new education-based environment in which displaced ICT professionals can improve their skills and re-enter the workforce.

Industry Development

- 1.) There should be a national ICT development strategy, jointly developed by government and industry with elements addressing issues such as:
 - commercialisation of R&D;
 - skills development;
 - industry promotion – “branding”;
 - SME development; and
 - clustering.
- 2.) Build on the Technology Australia brand to further promote Australia as a destination for offshore outsourcing of software development and innovation.

The target market for such promotion should be companies and government agencies in North America and Western Europe. To maximise the opportunities from such an initiative, it is essential industry and government, including agencies such as Austrade / Invest Australia, work together closely. They should:

- Grow the awareness of Australia's high-value software skills in analysis, design and problem-solving – not the process-driven programming capabilities promoted by India, the Philippines and other nations with low-cost labour;
- Promote skills of both multinational companies and Australian-owned companies, providing the North American and West European target markets with evidence of Australia's thought leadership, globally-competitive scale and proven process.

- 3.) Government must apply a dedicated budget and strategy to promote Australia as an offshore destination, including the allocation of staff to work as liaison officers between overseas prospects and locally based service companies. Staff would also provide periodic assessment of achievements of the program. Their role would be financed by government and developed by industry representatives.
- 4.) Encourage Australian-owned software development companies, especially those in the Small to Medium-size Enterprise (SME) category, to take an active part in promotional programs if they are willing to attract work from the North America and Western Europe.
- 5.) Establish an industry cluster to identify the core capabilities and workload capacity of those companies that wish to promote their services offshore, as outlined in recommendation three. This will allow industry to develop appropriate offshore strategies and leverage marketing and promotional programs.

Intellectual Property

- 6.) Provide training, white papers and assistance to help companies understand how to capture and leverage intellectual property so it can be commercialised either locally and/or overseas.

Strategic Partnering

- 7.) AIIA, either alone or in partnerships with other industry bodies and federal government agencies, to offer guidance and advice on best practice for forming strategic partnerships, both locally and overseas, that are designed to generate additional work, revenue and profit for local companies.

Employment Adjustment

As well as building a program to promote and strengthen the ICT industry, AIIA also recognises the threat to the jobs of fellow Australians by offshore outsourcing. While offshoring may generate new opportunities within the Australian economy, there is recognition that many of the individuals who will be displaced will not necessarily have the skills to grasp the newly-created job opportunities.

Significant work must begin to not only provide the next generation of ICT professionals with globally relevant skills, but help ensure the continuation of employment for today's software engineers.

Industry and government must also be sufficiently pragmatic to accept that even continuation of employment is not always possible. Therefore, they should help affected Australians prepare for new futures in the technology workforce. To do this, the following is suggested:

- 8.) Identify and gain agreement between industry and government on the skills required to attract offshore outsourcing to Australia;
 - Marketing programs should be developed to ensure these are the skills Australia promotes as part of its offshore campaign

- Awareness campaigns should also be developed for the local market to educate current professionals and students on career opportunities available with specific skill-sets;
 - Government and industry must liaise with education authorities to ensure the availability of appropriate training to ensure a flow of graduates with desirable skills, and also drive the value of high accomplishment in these skills areas.
- 9.) Identify the job roles and the right training programs to help Australian ICT professionals re-enter the workforce should they be displaced;
- 10.) Subsidise or provide attractive loan-facilities for training programs for displaced ICT professionals, as they will struggle to afford expensive ICT training if they are out of work and have dependents;
- 11.) Encourage and counsel local employers to be pro-active and train their staff for new, higher-value roles, strengthening the capabilities of their company so they can develop an offshore facet of their business.

Chief Information Officers & IT Managers

CRITICAL TO the impact of offshore outsourcing is the attitude of the buyer. Of the 32 CIOs interviewed, 16 had undertaken offshore projects of some description. These projects were either significant in scale, or experiments to see if the savings and quality promised would eventuate.

The remainder of the CIOs interviewed either had no interest in seeking offshore services, or worked for federal and state government agencies and felt the political ramifications of taking application development work overseas was an unwanted burden on their government, minister or department.

CIOs from Queensland and Tasmania – two states that use the word “smart” as part of their own marketing for business investment – felt particularly strongly that offshore outsourcing was politically inappropriate.

However, the study did not find any respondent in state or federal government who had been given an edict, either political or managerial, with regard to the adoption of offshore outsourcing services for software application development.

Platform of Pragmatism

Whether in private enterprise or government, there was an overwhelming sense of pragmatism on the issue of offshore outsourcing among CIOs. This is counter to the attitude of chief executives and senior managers from the vendor-side, who quickly become passionate about the impact of offshoring on the domestic industry.

CIOs, essentially, do not feel they come to work to swing the bat for Australia or the Australian ICT industry. The study found their view, unanimously, was that (internal political considerations aside) if it made sense to use offshore outsourcing, then they should.

Their top four priorities influenced by offshore outsourcing options were:

- Creating value for the business or shareholders;
- Cost containment or avoidance at a departmental level;
- Reducing time to deliver; and
- Providing quality ICT services to the organisation.

CIO priorities influenced by offshore outsourcing

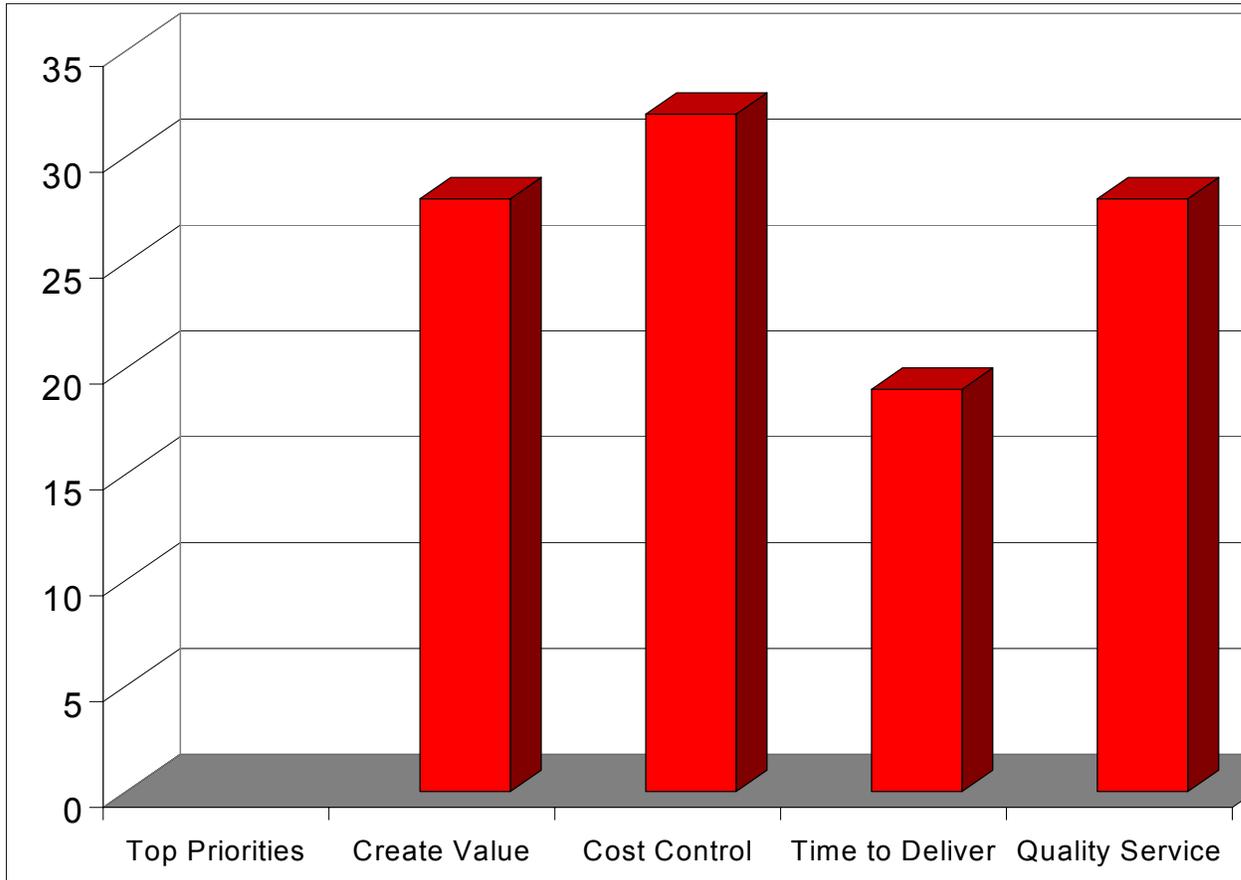


Figure 2 – CIO priorities influenced by offshore outsourcing. 32 respondents.
Multiple answers, top four responses featured.

There is no dogma about using an offshore company, whether it is in India, the Philippines or anywhere else. We do not send code for development offshore because we do not have a need at this point. Currently, we think the business risks are too great for the benefit we would receive. But nothing is sacrosanct. We would never say 'never'.

Group CIO, 'Big Four' Australian bank

Quality is Key

THE commonly held view that Australian organisations will embrace offshore outsourcing for purely reasons of cost is a falsehood, the study found. Not one of the CIOs interviewed – either those who had or had not used offshore services – said they would pursue an overseas strategy to reduce expenditure only.

Their reasoning for going offshore, above all else, was the belief they would gain a better quality product and service. There was strong recognition that processes for software development were superior at companies with CMM-3, CMM-4 and CMM-5 qualifications than Australian software development houses that had not embraced a recognised production regime.

(“CMM” refers to the Carnegie Mellon University software engineering process, the Capability Maturity Model).

A small number of CIOs – four – said they rejected the offshore option for reasons of quality. They did not believe they could operate with overseas software development houses and attain the same level of quality and service as they enjoyed domestically.

Of the 32 CIOs interviewed, six had been to India or had sent a colleague to see for themselves the capabilities of some Indian offshore companies. One had sent a colleague to China and another to the Philippines.

The experience of all CIOs interviewed is largely based on their interaction or knowledge of Indian companies such as Infosys, Satyam, Tata Consulting Services and Wipro. Awareness of alternatives beyond the Indian market was limited. So, the judgment of CIOs in this study is based predominantly on the abilities of Indian companies, rather than other providers in regions such as South America, South-East and North Asia and Eastern Europe.

It blows you away to see the resources, infrastructure and determination of these Indian companies to succeed. We have nothing like it in Australia. These companies are embracing processes such as Six Sigma, CMM and ISO that many local companies do not offer. I was sceptical before I left, but I was quickly converted. The working conditions are magnificent. It was hard to find fault with anything.

CIO, Australian manufacturer

Reasons Why You Would Consider An Offshore Strategy

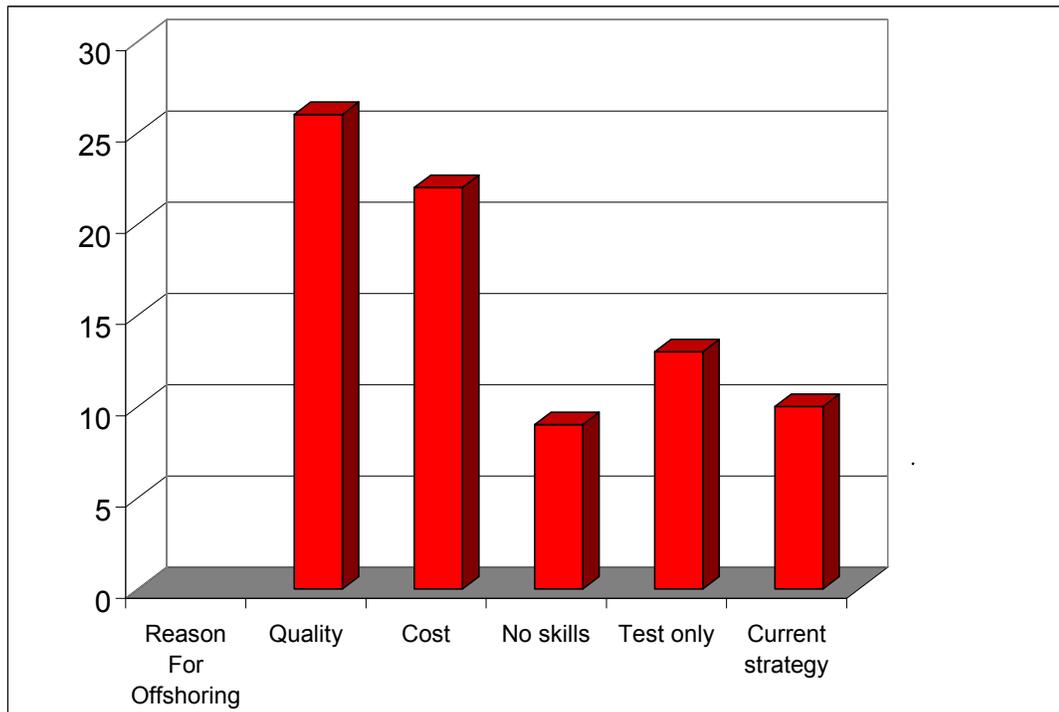


Figure 3 – Reasons Why You Would Consider An Offshore Strategy. 29 CIO respondents in the qualitative survey answered this question. Not all CIOs who responded to this question had outsourcing arrangements in place. Respondents were permitted to give multiple answers.

Outsourcing Selection Criteria

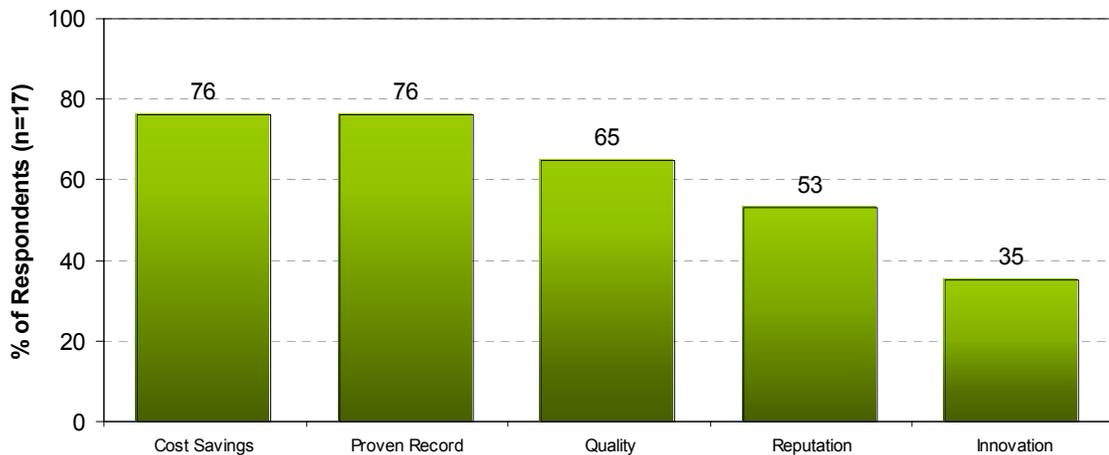


Figure 4 - Outsourcing Selection Criteria: Taken from the quantitative survey of 100 Australian CIOs and IT managers in April, 2004. All respondents – 17 - had offshore outsourcing contracts at the time.

Price, Savings, Value

RESPONDENTS gave varying accounts of the savings they had been offered, as well as those they believed were available or they had actually achieved.

There has been a preponderance of unsolicited calls in the local market place from Indian companies offering savings of up to 50 percent on project costs, according to respondents.

The more realistic level appears to be in the realm of 25 to 40 percent savings, depending on the scale and scope of work. Several respondents said they did not expect to save any money and were working with offshore operators for reasons of quality and vertical industry expertise that was not available in Australia.

Most Australian CIOs were hesitant, even resistant, to give an entire project to an offshore company. Instead, some are embracing a so-called “blended model”, in which more management-based or creative tasks are carried out onsite, and code development is conducted offshore. (see page 28)

Despite the CIOs’ insistence that price is a secondary consideration to quality, it is still a very attractive reason to use offshore outsourcing. When pushed on the topic, the majority of CIOs admitted as much.

For most CIOs, the words “price” and “risk” go hand-in-hand when it comes to offshoring.

CIOs and IT managers in smaller companies felt the potential to be exposed if something went wrong with an offshore outsourcing contract. They believed that, politically, the situation would be worse than if an outsourcing contract with a domestic-based supplier turned sour.

Their reasoning: a decision to move work offshore heightens the “risk” and a project must therefore be managed knowing that from the beginning. If it is a failure, then it portrays not only a bad choice of partner but also poor risk management skills. For the CIO there would be a professional price to pay, such as the loss of peer respect.

Exceptions to the fear-of-failure factor were a small number of CIOs who worked for 25,000+ employee companies and ran substantial IT operations. These individuals expressed a high degree of confidence in offshore outsourcing, especially in India and Malaysia.

Their degree of comfort, however, is enhanced by the fact their in-house resources are so much greater than those supporting the majority of Australian companies. Therefore, their technology groups’ abilities to manage an offshore relationship is significantly greater.

Respondents in private enterprise reported that their management colleagues, thanks to their exposure to media coverage, were aware of the potential cost-savings of offshore outsourcing. Many had expressed a desire to better understand how IT projects could be completed with less expense without realising the potential risks.

However, all respondents said they were not prepared to accept anything less than a 25 percent saving on development costs if work was to be conducted overseas for no other reason than cost. Significantly, slightly more than a third of respondents (35%) did not expect to save any money. Their offshore partners had been selected not for reasons of cost but vertical or niche expertise, they said.

Who Outsources?

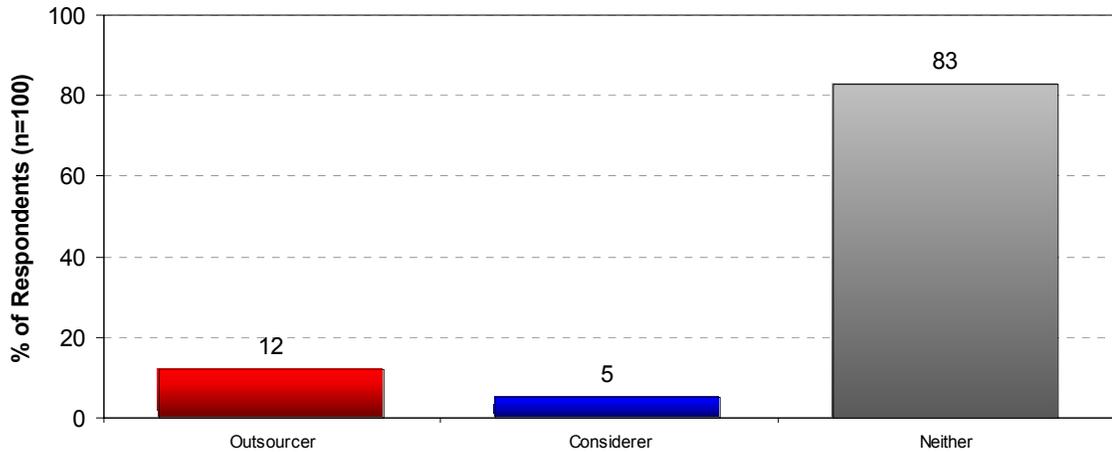


Figure 5 – Do You Outsource Currently, Or Would You Consider Outsourcing? These two questions were asked for the quantitative survey of 100 CIOs held in April. It found only 12 percent had outsourced offshore, and only one in six have used overseas services or would consider doing so. Vendors in the qualitative survey held from May to August, indicate interest in offshoring has increased, and the proportion of outsourcers and considerers will grow

‘Give Me an Indian Price’

CIOs are increasingly asking local services companies to provide two basic quotes – the cost of conducting the work in Australia, and the price if resources were employed overseas to reduce cost.

This is a strategy that at least one telecommunications company, several state government agencies and financial institutions have used as part of their request for price (RFP) processes. Their aim, of course, is to ascertain the cost saving achieved by using offshore services, and then weigh up the benefits and risks of such an action.

One senior ICT executive at a NSW government agency said her department had no specific RFP procedures that dictated where the work should be conducted. Given this, there was no reason to rule out any one organisation, or where the work was conducted. This had resulted in the agency giving two projects to one Indian company on the basis of domain expertise, process qualifications (CMM-5) and a 30 percent reduction in code development costs compared with Australian rates.

Respondents in general said they were not determined to move work offshore but had to make decisions based on merit and common sense. Their priority was to the profitability and performance of their own organisation rather than those of local companies, they said.

Really, this all needs to be put back on the local industry. If they cannot compete on price, then they need to compete on something else. If they don't, they will go out of business.

CIO, Federal Government agency

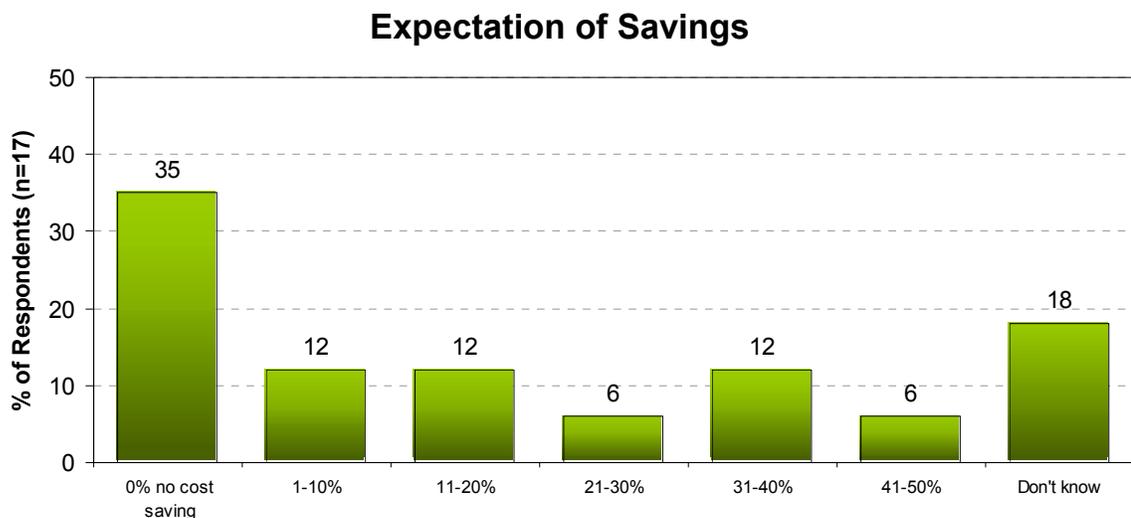


Figure 6 – Expectation of Savings. 17 respondents, quantitative survey in April 2004. All respondents had undertaken or were conducting offshore outsourcing projects.

The Blended Model

ANECDOTAL evidence from multinational vendors suggests Australian technology managers are adopting a more cautious approach to the offshore outsourcing of application development than their counterparts in the United States and Western Europe.

A separate survey by one multinational services specialist with a presence in more than 30 countries found Australian organisations were less inclined than other mature economies to hand over an entire project to an overseas software house. This finding by LogicaCMG is supported by the evidence that has emerged in this study.

With the exception of the two CIOs of multinational companies who expressed total confidence in their offshore relationships, no respondent was prepared to send an entire project offshore, regardless of the savings.

Many respondents said they were still at the formative stages of an outsourcing strategy – three used the phrase “dipping my toe in the water”. Therefore, CIOs were prepared to hand over only code-cutting and testing tasks that they could easily and accurately specify.

At this point in time, however, they were not willing to entrust an offshore company with higher value work, such as requirements gathering and business analysis, architecture and design, implementation and user acceptance trials.

There appears to be a number of reasons for this:

- Offshore outsourcing companies are only now beginning to make their presence felt in the local market. Many of these companies opened sales offices in Australia in the last couple of years and are only now starting to build local project teams, often with a combination of local and expatriate workers to handle projects from start to finish.
- As often stated by offshore providers, Australia is behind the trend of offshore adoption compared with North America and Europe, so its current behaviour is understandably more cautious.
- Culturally, and especially compared with the Americans, Australians are less tolerant of the risk-failure equation. As a result, they may be less trusting of offshore organisations being able to execute a project from cradle to grave.
- Local CIOs are not receiving the degree of savings achieved by those in the US and Europe. The local cost base can be 25 percent less than those in the US and Western Europe. Therefore, the financial incentive for Australian CIOs to offshore projects, either in their entirety or in part, is diminished.

Whatever the reason or reasons, local executives of Indian offshore outsourcing companies interviewed for this survey claim the Australian market has been particularly tough to crack compared with North America and the United Kingdom.

Despite promises of increased quality and significant cost savings, they say local CIOs have been suspicious of, or are reluctant to believe, the pledged financial and quality benefits.

As an anecdotal example, one respondent told the story of how Infosys needed more than 50 meetings over a two-year period before attracting any initial interest from Telstra. Today, the national telecommunications carrier is a client.

When quizzed on this issue, the most common reasons for CIOs' reluctance to hand over a project in its entirety were:

- Want work carried out locally;
- Security, IP risks;
- Need to retain skills in-house;
- Business requirements must be done here;
- Business analysis must be in-house;
- Want own staff to do implementation;
- Still trialling offshore alternative; and
- Struggle to meet outsourcer's specification requirements.

Reluctance to Hand Over Entire Project Offshore

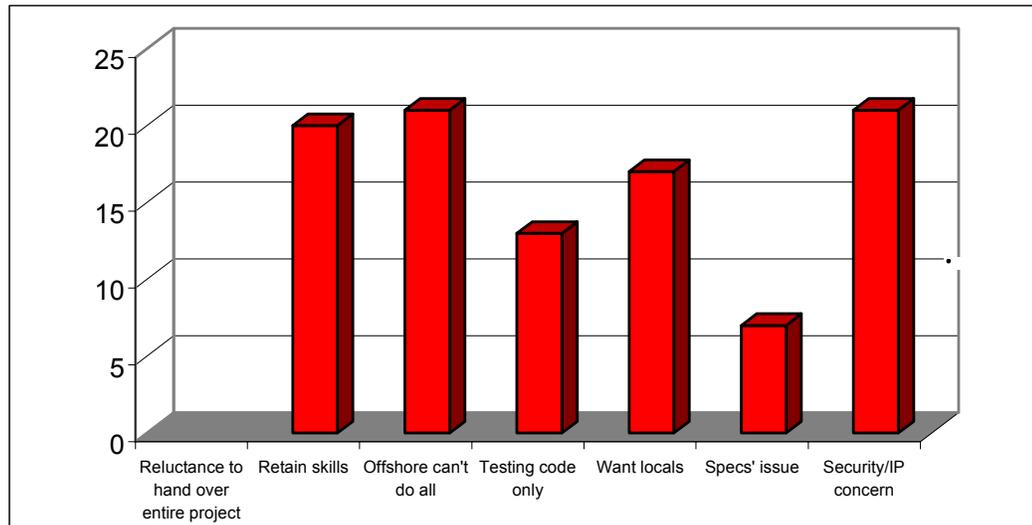


Figure 7 – Reluctance to Hand Over Entire Project: 23 respondents in the qualitative survey gave multiple answers. CIOs ruled out handing over an entire project partly because of the demand for complete accuracy in the business requirements collection phase. Leading Indian offshore players are hiring expatriate and locally-based skills to overcome this issue.

The solution to date has been to conduct “blended projects”, in which the perceived mundane tasks of cutting and testing code are given to an offshore outsourcer, while the higher-value activities, such as design and implementation, are conducted in-house or with local outsource partners.

Clients now ask for an 'Australian' price and an 'offshore' price. Two years ago, the offshore option was not on the radar. There is still a high-degree of caution in Australian organisations. They keep a lot of the project work closer to home. They are prepared to send the code-cutting work offshore because it is easier to define than other aspects of a project. Clients seem to trust near-shore destinations more than offshore, by which I mean India. They are more comfortable with Tasmania or Malaysia than India.

Senior executive, Australian-based sourcing company

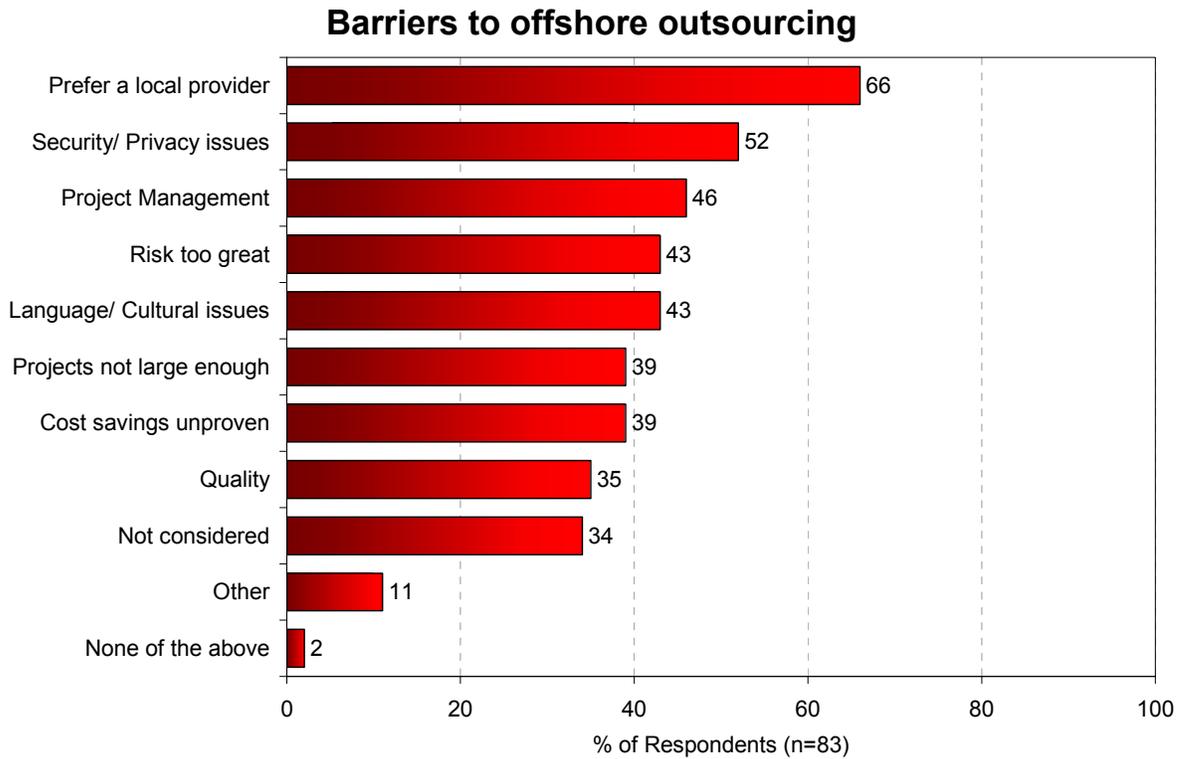


Figure 8 – Barriers to Offshore Outsourcing: 83 respondents from the quantitative survey conducted in April, 2004.

Future of Blended Projects

WHILE the reluctance to outsource entire projects to offshore companies is prevalent today, it may not last forever. Companies such as India's Infosys and Satyam have established local operations. They are now hiring local staff and forming local partnerships to overcome objections that have led to blended projects. Fundamentally, they are offering the same types of service that have been in the market and provided by US-based vendors for years.

The fact many Australian CIOs are still at the exploratory stage of offshore outsourcing suggests that as relationships and processes mature then providers of offshore services will gain a greater share of the projects and the wallet. These providers will not just be India-based but also US firms that offer low-cost operations in emerging economies.

The current caution, particularly compared with the fast-adopting markets of the US and Europe, should not be interpreted as an sort of endorsement for either local abilities or Australian service providers in general.

A number of CIOs recounted with significant bitterness their experiences with local providers. Failure of process, code accuracy and testing and the lack of an ability to implement or keep to timeframes and budgets were all cited as failures in the local market.

I do not use offshore outsourcing because of internal political issues, but I would if it made sense. There is a high-level of skill worldwide, not just in Australia or India. I would be prepared to go to Russia. My motivation is partly driven by my own experience of being let down by local providers. Some are cowboys. It is a real effort to separate the show ponies from the professionals in this country.

CIO, state government agency

Eleven CIOs commented on the fact that despite the protestations of local industry regarding the potential and the reality of job losses, ICT professionals in mature economies had not covered themselves in glory in the past decade.

Business managers, keen on using offshore outsourcing to save money and improve profitability, were certainly not champions of in-house developers or necessarily their regular outsource partner(s).

If you look around the planet, it is not as if we have done a great job of technology implementations. Memories of failed ERP and CRM projects, which cost organisations millions of dollars, are not easily forgotten by the business. From what I have observed, India is the fastest improver in technology implementation in the world. Not only do they have the price right, they have the quality, too. It's pretty compelling if you know how to work with them effectively.

CIO, 'Big Four' Australian bank

The Process Trap

THERE are two assumptions made regarding the prospective employment of offshore services by Australian companies; firstly, the overseas option is cheaper, and secondly, the buyer is only interested in price. Neither is necessarily true.

A number of CIOs have found the offshore option to be more expensive, despite the quoted price sometimes being significantly cheaper than equivalent services available in Australia.

The cost blow-out can occur at the Australian end of the relationship, where poor business requirements gathering at the start of the project requires re-programming work.

A number of CIOs commented that anticipated savings did not eventuate because of their own lack of process at the beginning of a project when it was vital to get the business requirements and software design correct.

All those respondents who have faced this issue had given their work to an Indian offshore outsourcer with no less qualification than CMM-4. They admitted they had fallen foul of the demands that CMM-driven developers put on clients in terms of adherence to accuracy of requirements.

These CIOs said the failure of their projects was a “wake up” call for them, illustrating their own internal structures were not ready for process-oriented Indian companies. All the projects cited, while eventually carried out satisfactorily, represented either no savings or were more expensive than if they had been delivered in Australia.

Each CIO said they were now looking seriously at their own processes to initiate improvements so they could, in the future, be able to handle another offshore project.

The tradition in Australia has been to produce a functional specification for a project, rather than a technology specification. You can do that in Australia because staff understand what is required. You cannot do that when you deal with CMM-type companies because they are process-driven and do things by the numbers. We have seen the pain of that.

Chief executive, services vendor

I would not be keen to send specifications offshore. We are trying to standardise our approach to these projects at home. I do not think we are ready to start sending work to Malaysia or India. I can see that we could feasibly use the option if it was just hack work, but we would have a lot of work to do at our end with specification accuracy, dealing with the business to gain the right requirements and covering governance issues.

Director of Information Management, state government agency

Experience of Offshoring

THIRTEEN of the 16 CIOs who had had trailed offshore outsourcing received favourable experiences. Eight of them could be classified as being immediately converted both by the quality and the cost of the work. They said they would move to a more strategic engagement with their overseas partners.

The majority of respondents had used Indian companies; three had employed organisations in Malaysia, one in Latvia and one in Argentina.

Even the three CIOs who did not have a good experience – they all used Indian companies - said they had no regrets despite some anguish at the time. Each struggled with gathering business requirements and, as a result, were unhappy with the result of the output from India.

If you 'spec out' a black box, then you had better expect a black box to come back – it won't be any other shape or colour. So if you or the business don't know what you want, then you're going to be in trouble later on. All those savings you thought you would get will be wasted on re-programming.

CIO, Australian-based FMCG

Several CIOs, especially those who were testing the water, said the work they had sent offshore was basic coding and the task had been completed without need for time-consuming management action. Others were delighted with the outcome, especially one CTO who found his Argentinian offshore partner in a chatroom.

I gave them a small project and they did a great job. So, I gave them a bigger contract, and the relationship has continued to grow. The relationship has been built entirely via the Internet and e-mail. I have used them for tactical solutions, nothing strategic. Their price is \$US10 an hour. You cannot do much better than that. I gave them one project that they quoted \$US10,000 to do. For interest's sake, I went to my own organisation's consulting group and asked them to quote on the same work. It came back at \$A200,000. That's a joke, isn't it?

CTO, international consulting group

CIOs' Strategic View

A SMALL number of CIOs in Australia's largest companies, interviewed for this survey, have adopted a much more strategic view of offshore outsourcing. It is apparent these executives will no longer hire or will reduce their in-take of programmers, either on staff or contract, and instead despatch their workload offshore at cheaper rates.

Each of these CIOs believed they would save tens of millions of dollars by using offshore outsourcers over the next five years. They have not opted for one supplier but a minimum two and are also looking at further diversification, using cheaper Australian locations as well as centres in India, South-East Asia and potentially North Asia.

They said their Australian-based suppliers would also need to have a cheaper offshore option to offer their organisation to stand any chance of winning future business.

One CIO explained that his choice of oursourcers - Infosys and Satyam - was based around the fact they also cut code for two of his company's most prevalent software vendor partners. This was seen to be an important synergy.

The occurrence of Indian offshore companies working for American packaged software vendors revealed itself to another leading CIO, too. When this CIO's company began a large-scale implementation of Oracle software, local staff were required to liaise with the developers. Instead of going to Redwood Shores, California – the home of Oracle – staff flew to Bangalore. The situation provoked this comment ...

It's all a bit of a nonsense really, isn't it? Everyone is concerned about jobs going to India but no one seems worried about buying packaged American business applications, which threatens the existance of local developers more than anything else. And now we are seeing the American software being developed in India. This is gloablisation and there's no denying its future.

CIO, Australian multinational services company

The large Australian organisations cited above are in the minority. Few Australian companies have yet to develop substantial and strategic relationships, the survey found.

The view expressed by executives of services vendors - that Australian organisations are slow out of the blocks on offshore outsourcing compared with North America and Western Europe – is supported by the findings of this survey.

Nevertheless, there are a lot of small projects being sent overseas and, given the largely positive experience of respondents, this trend is not only likely to continue but to accelerate.

Key Concerns – IP, Security and Privacy

THE most common reservations cited by CIO in terms of employing offshore outsourcers in emerging economies focused on attitudes and processes surrounding the protection of intellectual property (IP) and, for government agencies, the issue of national security and privacy.

A number of suppliers in Asia and South America were poorly perceived in their ability to respect the value of a client's intellectual property. For many CIOs surveyed, this will continue to be a big issue until they see improvement in respect to the adoption of copyright laws and other forms of IP protection, such as Digital Rights Management.

One local manager of an Indian offshore vendor said their sales team had never sold a deal to an Australian organisation without the client demanding to meet the CEO and have a conversation about IP protection.

A telecommunications executive, who spent four years in India, said the issue of IP protection needed to be addressed.

"With the best will in the world, a lot of people in India do not understand the concept of IP. That is not true of the big companies, like Tata or Infosys. But it certainly is true about the medium-size and smaller firms. Australian organisations need to choose their partners very carefully, otherwise they could find their applications being copied by their outsourcer and deployed for a competitor. And no one, except the outsourcer, would have a clue what has happened."

Senior executive, multinational telco supplier

A Federal Government CIO said he had pulled out of an offshore relationship because of issues surrounding security.

We tested a small component in India – a \$50,000 module as part of a \$1 million project. The specific issue was the security provisions. This ended up being an added cost to us that negated any savings we were supposed to have made. It was a worthwhile exercise, a toe in the water, but not something I would do again in the current situation.

CIO, Federal Government agency

Importance of CMM and ISO

THERE is no clear trend in how respondents select their offshore partners. One CTO found his sourcing partner on Google, another in a technologists' chatroom.

Some were cold-called by Indian companies with the refrain, "when you do your next project, we can cut your costs by 50 percent". Others said they undertook a thorough investigation but still relied to a large degree on the recommendation of their peers.

One Indian vendor claimed that up to 20 percent of CIOs of large Australian companies had visited India in the last two years to see for themselves what the fuss was all about. The survey found six out of the 32 respondents had made the trip, or sent colleagues.

One of the greatest selling points for Indian outsourcers has been their adherence to the process-oriented Capability Maturity Model (CMM). India has the most organisations (more than 70) with the highest rating of Level 5. By comparison the United States has fewer than 40 and Australia only three.

The degree of trust in CMM qualifications varied greatly between CIOs – it came down to more of personal perception than a professional judgement.

A number of technology managers in large companies believed CMM was an important facet, even a guarantee of quality. Others said they could not care less and would simply judge a company on the quality of its code, its time to deliver and the price.

Many of these CMM sceptics said they were far more influenced by the recommendations of their peers, either those in Australia or overseas. The views of American counterparts were particularly highly rated.

View of Capability Maturity Model

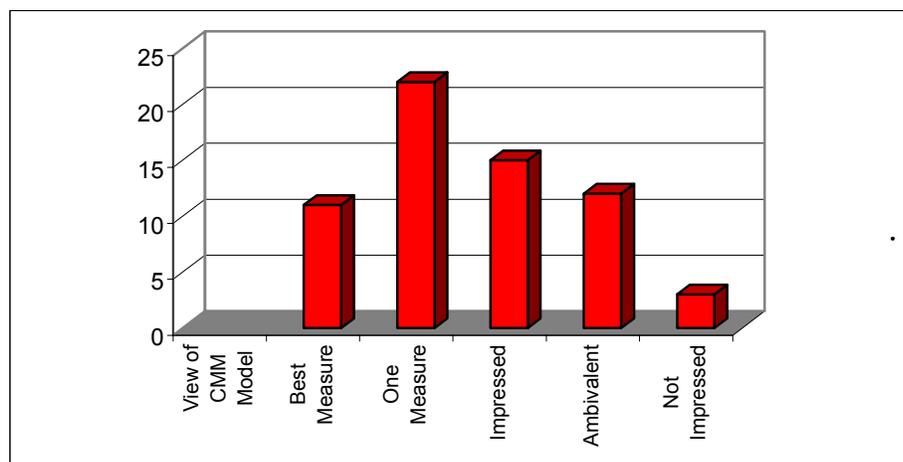


Figure 9 – The view of the Capability Maturity Model. 33 respondents. Multiple answers accepted. The question was answered by CIOs, software vendor executives and suppliers of outsourced services.

Wanted: Innovation, not Code

THE survey found a strong belief that the strength of Australian ICT professional was not based around code writing but the higher value skills of requirements gathering and business analysis, design and implementation.

CIOs clearly believe offshore organisations offer a strict process but little in the way of business-based technology skills that they perceive as being much more important to their enterprise.

CMM qualifications are seen, at least by some, as a baseline qualification that proves the ability to adhere to process. However, it does not provide evidence that employees of CMM-styled companies can think laterally to find solutions to business problems or needs. For this reason, many CIOs have to date restricted their relationships with offshore outsourcing agencies to basic cookie-cutter projects that do not require a unique solution.

CIOs are also deeply resistant to losing or surrendering their intellectual property to an outsourcer, much less one that operates offshore.

I won't give away anything strategic. In fact, all the projects given away so far have been low-level – ones that my own staff do not have any interest in doing. They want to learn and do new things. The work we have been sending to Argentina has been largely maintenance work and quite boring.

CTO, Sydney-based multinational consultancy

It is impossible to say whether this determination to ensure that perceived high-value work stays in Australia will remain for long.

As stated earlier, the strategy of companies such as Infosys and Satyam to establish a substantial presence in the local market indicates their determination to win higher-value work. They aim to take business from established local or multinational companies, and persuade user organisations to release in-house work for the first time.

Even if Indian companies with a local presence are successful in Australia, there should be no assumption that all the work will be automatically sent offshore. These companies are currently hiring local project managers and business analysts to start to capture whole-of-project deals, using skills in Australia as well as those available at reduced rates in India.

Staff Reaction When Work Goes Offshore

RESPONDENTS who have sent development work offshore all expressed their initial concern about the impact the decision would have on their staff.

No CIO admitted to implementing redundancies as a result of an offshore relationship. In fact, many said they were now starting to hire more staff or contractors in reaction to an increasing number of projects that were about to begin.

Each said their departmental management team had taken time to explain the reasons for offshoring code development and what it would mean in terms of their future employment.

Reaction had been varied, according to CIO respondents. For the most part, staff had accepted the decision but wanted to know if their own jobs were under threat. However, each CIO said they had received protests, both openly and privately, from an individual or a small number staff in their department.

My guys did not have a problem with it. There were a couple who were unhappy, more at a political level than anything else. But the rest were glad to get some of the mundane jobs off their plates. Not only that, we have been faced with the challenge of reduced resources over the last couple of years, and everyone has been working very hard. But I do have to be careful. One senior person was very pissed off. His skills were like hen's teeth in the dotcom days, and now everyone seems to have them. That is not only putting pressure on his job, but also the contract rates he would have to accept if he took that path later in his career. He's not a happy man about all this.

CTO, Multinational Consultancy

There have been a lot of questions since we announced our intention to send application development to India. I understand the anxiety. There is no intention in our organisation to make staff redundant because of the India decision. We have made this very clear to them. Also, we have ensured they have the right career paths and training. We sent some staff to a course held by Infosys and they came back saying it was the best training they had had for years.

CIO, Australian company

Intentions to Hire – Overall & Programmers Only

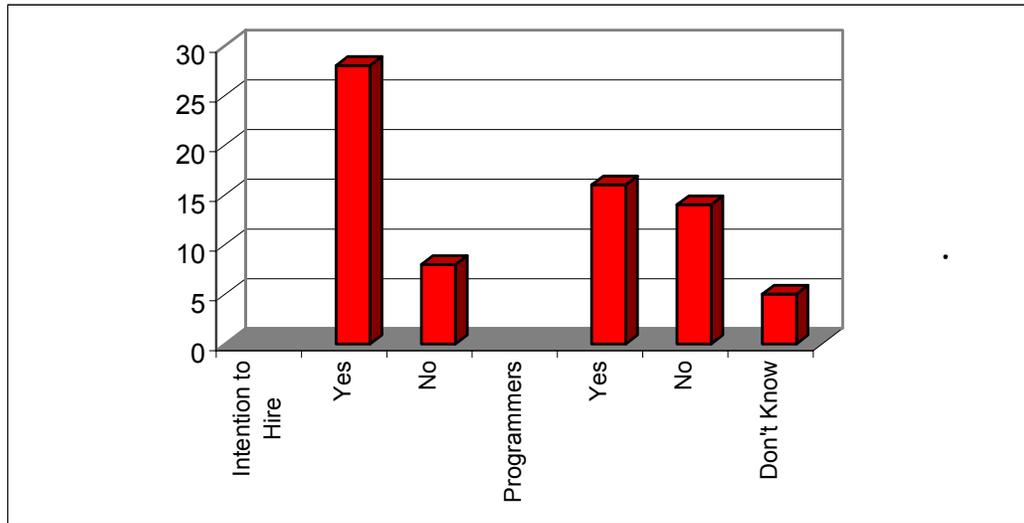


Figure 10 – Intentions to hire over the next 12-24 months. 35 respondents from private enterprise and government agencies, including those in services companies and software vendor companies.

What is Being Outsourced?

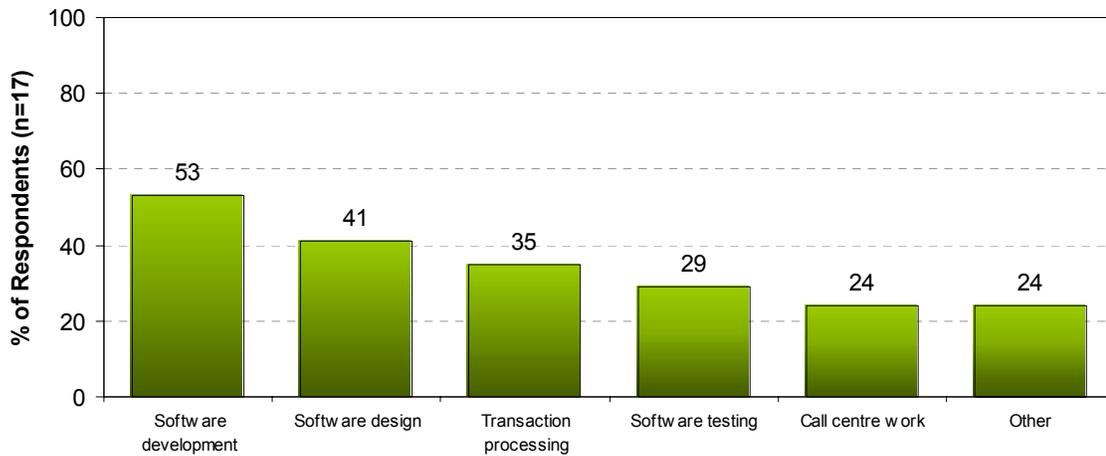


Figure 11 – What Is Being Outsourced? 17 CIO respondents from the quantitative survey conducted in April, 2004. These answers support the qualitative study that says Australian organisations are not giving away strategic and high-value work currently.

CIO demand to staff: Remain Relevant

SOME 24 CIOs - two-thirds of those interviewed – said the impact of offshore outsourcing would mean staff programmers would have to improve their skills to remain relevant to their organisation and industry.

Three CIOs expressed concern their staff were not keeping up with technology. One said their department had an average age of 48, and a renewal of staff and technology skills was essential. The availability of the offshore outsourcing option permitted their organisation to seek higher-value business and project management skills, and rely on offshore partners to “do the hack work”.

All respondents expressed a desire to see more business skills in their department and less focus on technology and what it could do for technology’s sake.

This, of course, is a common refrain but appears to be no less prevalent today than five years ago.

The survey found 15 CIOs now intended to use the availability of offshoring to be able to move their own staff to their next level of technology management or execution.

The industry will go through a skills refresh that will be encouraged by the offshore option. The kids coming out of university are not interested in working on bespoke projects, or with PL1 and Cobol programming languages. Those with Baby-boomer profiles are the ones affected most by offshore outsourcers. These offshore companies are turning their skills into a commodity. Without skills for today’s technologies, you are dead. Yes, I am changing staff. I want new staff with a far better understanding of the importance of technology integration into the business.

CIO, Australian icon company

The bottom line for Australian ICT professionals is that CIOs are seeking staff with skills in business and communication, as well as technology.

There was large-scale agreement with the proposition that code writers and testers had a limited lifespan in the Australian industry because offshore outsourcing companies were effectively commoditising those skills.

Even government CIOs acknowledged the fact that at sometime in the future, when the political debate had eased and offshoring was better accepted as an economic reality, agencies would move to reduce their costs by using overseas partners and refocusing internal operations on higher-value activities.

Labour arbitrage is a fact of life. The sooner everyone accepts that, the sooner this issue will be dealt with. Those individuals who think their jobs might be threatened by an Indian outsourcing deal had better do something for themselves. There is no point complaining, because this is the way it is. To a point I sympathise, but this not an end-game. People can learn new skills and move along the skills base. As a CIO, I would really like my staff to be thinking in this way.

CIO, state government agency

The reality is that our industry is changing rapidly. We have seen similar changes in the manufacturing of textiles, footwear and vehicles. Why are we surprised that it is our turn? Now the economics are against us when we are compared with Bangalore. Next it will be China, then maybe Vietnam. We need our local talent to add value to our organisations and create intellectual property, not cut code that could be cut anywhere in the world. This is the challenge - not trying to somehow manipulate a market in an anti-competitive fashion to save jobs that cannot be saved.

CIO, Australian icon company

So-called “hot” skills in the local industry, as cited by CIO respondents, included:

- Business analysis;
- Integration skills;
- Vendor relationship management;
- Business intelligence and data mining skills;
- Networking engineering and architecture;
- Web and systems architecture;
- Web Services; and
- Linux experience and skills

The Sourcing & Software Vendors

THE DEGREE of alarm at the emergence of offshore outsourcing is significantly greater on the vendor side of the industry, the survey found.

A smaller sample of seven individuals in the software and consulting sector were interviewed for this report.

Three of them are involved in the creation and selling of packaged software applications or research and development. The remainder focus their business activities on the provision of application development services to their clients.

This group expressed considerably more passion and concern for the future of Australia's ICT industry than the 32-strong group of CIOs, who by comparison approach the offshore outsourcing trend much more as an opportunity rather than a threat.

Staying Globally Competitive

Chief executives of some of Australia's leading software companies also view offshore outsourcing as an opportunity. While they are undoubtedly committed to the wellbeing of their industry, each respondent said they had used offshore outsourcing of some code-writing to remain globally competitive.

Their basic reasoning for taking work overseas was three-fold:

- Lower cost
- Ability to scale for peaks in workload; and
- Faster time to market.

It is publicly known that two of Australia's leading software vendors, Mincom and TechnologyOne, both have offshore operations.

Mincom established its own development house in Bali four years ago, and has recently established a relationship in India. In more recent times, TechnologyOne has set its sights on using programmers in Kuala Lumpur, Malaysia. Smaller vendors that did not wish to be named in this report are using or conducting trials with offshore outsourcers in South-East Asia and India.

No employees had been made redundant as a result of the move, these respondents said.

Like the CIOs, software vendor chief executives said the onset of offshore outsourcing did not mean Australians would necessarily lose their jobs at home. However, they stressed the decision to employ partners offshore was an essential, pro-active step to protect their companies and their employees by remaining globally competitive.

Vendor Savings Made Offshore

SOME Australian software companies have established their own presence offshore. They claim they can reduce their long-term costs by between 40 percent to 60 percent for functions such as support, coding and testing.

However, the strategy is largely savings-neutral in the early stages due to the implementation of management, process and work practices.

Those companies that have established relationships with offshore organisations – the survey found respondents who send work to South-East Asia and / or India – reported savings on overall project costs were between 25 percent and 35 percent.

Like the CIOs of user organisations, these software companies are not using offshore suppliers for strategic, IP-creation or problem-solving tasks. Instead, they are capitalising on low-priced labour for programming.

Two CEOs of software companies said they were more than satisfied with their experience of working offshore. Offshore staff were were meticulous at following instructions and processes, but they lacked the creativity that could be found in Australia and other mature ICT markets.

The final quality of programming work is as good as you might receive here. However, it is twice the effort to get there, but there are twice the people working on the project at a quarter of the price. In the end, you get the quality you want. Australians are very good project managers and analysts, and overseas I have found IT people to be unable to think outside of the box. Their processes are much better, however. And if you lock them into those, then you will be able to find creativity and innovation in countries such as America and Australia.

Chairman, Australian software vendor

A Software Vendor's Experience

ONE large Australian vendor has recently started a relationship with Infosys in response to pressure on the business to expand its product and code development performance.

After being initially cautious about how well they would work together, Infosys now receives 10 percent of the company's development work, and the likelihood is that the relationship will expand.

The vendor did not seek out Infosys, or any offshore supplier, for the work. It issued an RFP to which four companies responded – two from India and two from Australia. Below, the company's chief executive describes his experience . . .

We were not looking for the cheapest price – let's make that clear. We needed a good quality product first and foremost. And we needed to be able to scale up quickly to handle the peaks in our workload.

The approach, experience and quality of processes were stand-out features of the Indian bids. The Australian responses paled by comparison. And we particularly liked the capacity of the Indian companies to scale up because our work is always of a pressing nature.

However, we would never give up our code capability in Australia. The life and death of a software product is in the design and the integration of development code. That does not mean Australian programmers have to cut every line of code. But some clients do insist on the work being conducted in Australia. The Department of Defence is a good example of this. We could not win any contract from them without guaranteeing the work would not leave these shores.

Chief Executive, Australian software vendor

Not everyone was infatuated with the Indian experience, however. Like several CIOs, some vendor executives expressed scepticism about the way certain offshore suppliers were using the CMM (Capability Maturity Model), claiming it was treated more as a marketing tool than a process of substance.

The Indians hype CMM-5 in an effort to get work from the US Defense Department. We have seen them program and we had to impose our standards on them. They now have process control sheets that meet our specifications. So it is a case of 'black box spec in, black box out'. CMM is a very simplistic view. We are an ISO-certified organisation and that is much more involved.

Chairman, Australian software vendor

Reaction of Staff

NOT surprisingly, all the software vendors said they were concerned about how their staff would react when informed of the decision to use offshore services. The survey found there was a greater sense of apprehension on their part than expressed by CIOs when faced with a similar situation.

It is clear from the strategy of those vendors interviewed that their offshore relationships at least in part curtail the need to employ more local programmers, either permanent or on contract, in the future.

Instead, their hiring activities will focus on those who have a mix of technical skills and business or vertical industry knowledge. Software vendors are looking for those who can gather business requirements, provide and communicate business analysis, as well as designers and implementation experts who can work with clients.

Respondents agreed staff needed to understand the global pressures facing an ICT company as a context for moving work offshore. To remain competitive, they said, they were required to leverage cheaper labour in the same ways as their global competitors.

Staff reaction was not too bad. All the members of the team have been very busy. They see this (offshoring) as a sensible alternative. We went to great pains to explain this situation to them and help them understand the bigger picture. No one is losing their job. By and large, they accepted it.

CEO, Australian vendor

I do the right thing by our staff. I don't care what the press, politicians, unions, or anyone else thinks. Offshore outsourcing is just a natural progression of where we started years ago with IT, and it is not going to stop now.

Chairman, Australian vendor

Staff Reaction

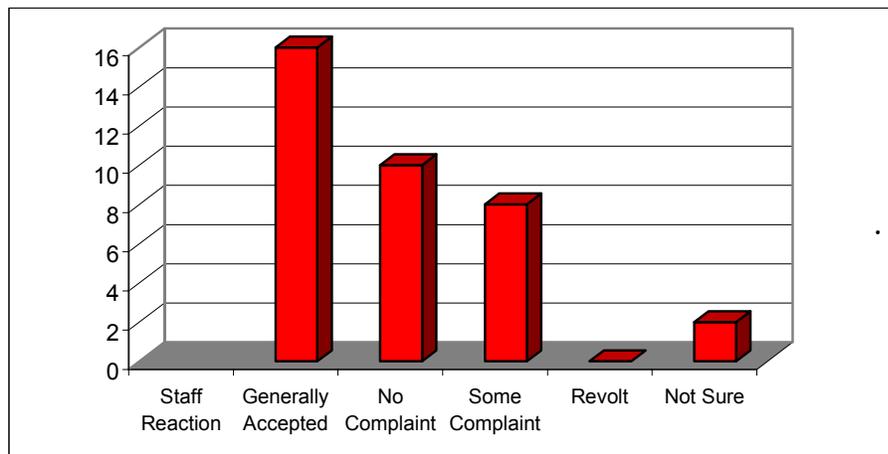


Figure 12 – Staff Reaction. 20 respondents, from private enterprise, government agencies and software vendors and service providers.

Public Reaction

ESPECIALLY for public companies or those with a high profile in the domestic ICT industry, the media coverage of their decision to use offshore outsourcing can create a negative perception of Australian jobs being shipped overseas for corporate profit. With one exception, each respondent admitted they were concerned about an adverse media reaction.

The public's perception of what we were doing did worry us quite a lot. It was important to state to our staff that no jobs would be lost. The intention is to grow the company faster than we could if we used Australian workers only. As long as we explained that properly, then I thought we would be OK. I did fear the local (metropolitan) newspaper would turn up on our doorstep, but it never happened. However, we also had to give a very good explanation of what we were doing - and why - to the Department of Defence. (Note: Defence does not outsource offshore but wanted to know in detail why one of its suppliers was moving in that direction, and any potential impact on Defence work.)

CEO, Australian vendor

View from an R&D centre

SEVERAL hundred Australians are currently employed at R&D centres of major multinational companies around the country.

By reputation, each centre has made a significant contribution to their company and Australia. Their presence is treasured not just for their contribution to employment and the local and national economies, but also as a testimony to the expertise that is available to investors in Australia.

The closure of Ericsson's R&D centre in 2002-03 was a significant blow to the industry. Interviews with senior executives of multinational companies on the future of their own local R&D centres raised concerns.

Some saw the emerging economies and ICT sectors of India and China as a potential threat. They said the growing number of technology graduates and PhDs in Asia put Australian R&D operations at the risk of being seen as expensive, lacking scale, or irrelevant.

Complaints were also voiced about the comparative role of government compared with nations such as Singapore, India and Malaysia, whose ICT sectors were cited as having significant government commitment.

Multinational companies that employed respondents to this survey had either recently established, or were investigating, opportunities for R&D operations in a range of countries, such as Russia, Latvia, Vietnam and China.

One executive said that by establishing R&D centres in emerging economies, his company would increase its negotiating power with the relevant domestic government on issues such as market access, taxation and repatriation of profits.

The wave of change created by globalisation is potentially a stark reality for Australians working in R&D facilities of multinational companies.

The comment below from one respondent was the most extreme solicited by the study, yet it encapsulated the degree of change under way in the global economy. And while it might be extreme, it is nonetheless a reality for the 150 Australians who are employed in the R&D facility of this multinational corporation.

We all feel a definite threat to our jobs. Global management is looking at whether it should put more work into India, and we are watching resources being switched from Hong Kong to China for cost-saving reasons. A lot of our R&D in North America is going to China. Options have even been floated for Ireland and Newfoundland – all these are cheaper than America. In China, we have a 55,000sqm facility being built for 1,000 staff, and we have a JV with a manufacturer there, too. We have a slight advantage in that the Australian operation has been going 10 years. We have done great work and continue to be competitive. But I am not sure that will save us in the medium term.

Senior R&D executive, multinational ICT corporation

View of the Future

SERIOUS concerns for the future of the Australian ICT industry were expressed by the senior executives of local software companies. One commented that “offshore outsourcing is just another nail in the coffin”.

They said local application development companies faced significant threats from offshore and would have to change their business models to survive. The most common recommendations for local application development businesses were:

- Create your own intellectual property
- Gain domain or vertical expertise
- Form a strategic alliance with an Indian offshore supplier; and
- Orchestrate your own purchase by a larger player

They unanimously agreed offshoring could cost thousands of jobs in the medium to long-term, and that affected ICT professionals needed to retrain to provide higher-value skills than programming.

Several executives also expressed optimism that individuals with the right skills would always find employment; and local companies that created their own IP and had domain expertise would continue to be successful.

Everyone says Australians can do the value-add and innovative work. If you have no IP, you end up competing with the Australian subsidiary of an India company, or an American company that is also prepared to ship the work to India. If that is the best we can do, then we can kiss the local industry goodbye. But before we do, we should remember that hundreds of companies who developed their own IP have been forced out of business over the years through lack of local support programs. My company is one of the lucky ones to survive.

Chairman, software vendor

Role of Government

THE support of Federal Government was seen as critical to the future health of the domestic ICT industry and the generation of new employment opportunities. There was a unanimous view that it could do much more for the local technology industry simply by buying its products – perhaps a predictable statement from senior executives of domestic software companies.

No one favoured any government action in terms of legislating against the use of offshore outsourcing by departments and agencies. Instead, they felt policy needed to be far more proactive in terms of encouraging local ICT companies to create and commercialise intellectual property.

Expansion of Austrade’s Export Market Development Grant was suggested as one avenue to help local software developers promote their services overseas. A similar fund, dedicated to local application developers, should be established, the respondent said.

However, respondents were generally dismayed at the Government’s attitude to the ICT industry and lacked faith in the Government providing any significant response to the challenge of offshore outsourcing.

Expectations of Federal Government Action

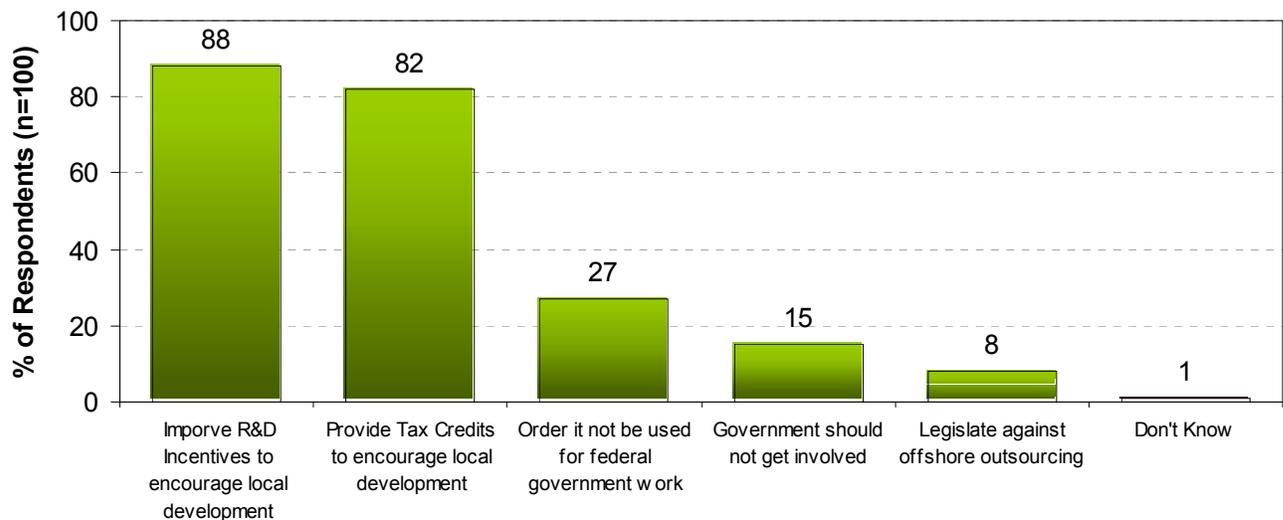


Figure13 – Expectations of Federal Government Action. 100 respondents. Taken from the quantitative survey conducted in April, 2004. All respondents were CIOs or senior technology managers.

Several executives observed that the Government saw ICT as an “enabling industry for other industries” rather than an industry in its own right.

Regardless of the result of the 2004 election called in late August, they did not see this attitude towards the Australian ICT industry changing.

In Canberra, you have to ask why there are not more Australian products being bought. If there were, then local companies would be in a position to develop more IP. But even our own market is not ready for our products.

Business development manager, Australian vendor

There is a commonly held view that it is harder for local companies to win government business because of the ‘cultural cringe’ factor. If that is the case, and Indian companies start taking all the work based on the fact our government simply doesn’t buy local products, then I would have a big problem. The Government needs to have a balanced approach. For companies, the offshore option gives them a chance to increase capacity. In government, it is simply a transfer of work from Australian workers to overseas workers.

Chief executive, Australian software vendor

The Applications Developers

Local & Multinational

IT IS in the domain of the application developer that the largest opportunities and greatest threats exist.

The survey found significant diversity of views among three groups: senior executives of locally-owned, dedicated application development enterprises; those from multinational corporations that provided this service as part of a greater ICT offering, and the leaders of the local office of Indian outsourcers.

Their perspectives, perhaps naturally, were largely a reflection of their different business needs and models. Yet, they were united in the belief that offshore outsourcing in Australia was a growing trend that was here to stay.

The lack of industry leadership and government direction for the domestic ICT industry were criticisms commonly voiced by senior executives of local and multinational companies.

Their suggestions on what should be done in the face of offshore outsourcing had some common ground, and was a mix of national interest and, to a degree, self-interest.

More than any other group of respondents in this survey, there was enthusiasm for a dedicated government program to attract high-level software consulting work into Australia from North America and Western Europe, exploiting the nation's strengths of innovation and world-class technical design skills, together with a comparatively lower cost base.

There was common recognition that the offshore model was quickly turning code-writing skills into a commodity that risked disenfranchising thousands of Australian programmers who were not able, or were unwilling, to update their skills.

Respondents agreed smaller Australian companies had to change their business models to stave off the challenge of offshore outsourcing, or they risked medium- to long-term failure.

The creation of intellectual property and the need to create vertical or domain expertise in a particular market, or market segment, was essential if local development companies were to remain relevant. As outlined earlier in this document, this view was stated by senior executives of software vendor companies, too.

A senior executive of one of the largest multinational ICT companies in Australia complained about the level of debate on offshore outsourcing.

It is being portrayed as a problem, when we really should treat this as an opportunity – we need an international industry attraction strategy.

Senior executive, multinational ICT corporation

How Can Government Help Local Developers Combat the Competitive Threat of Offshore Outsourcing?

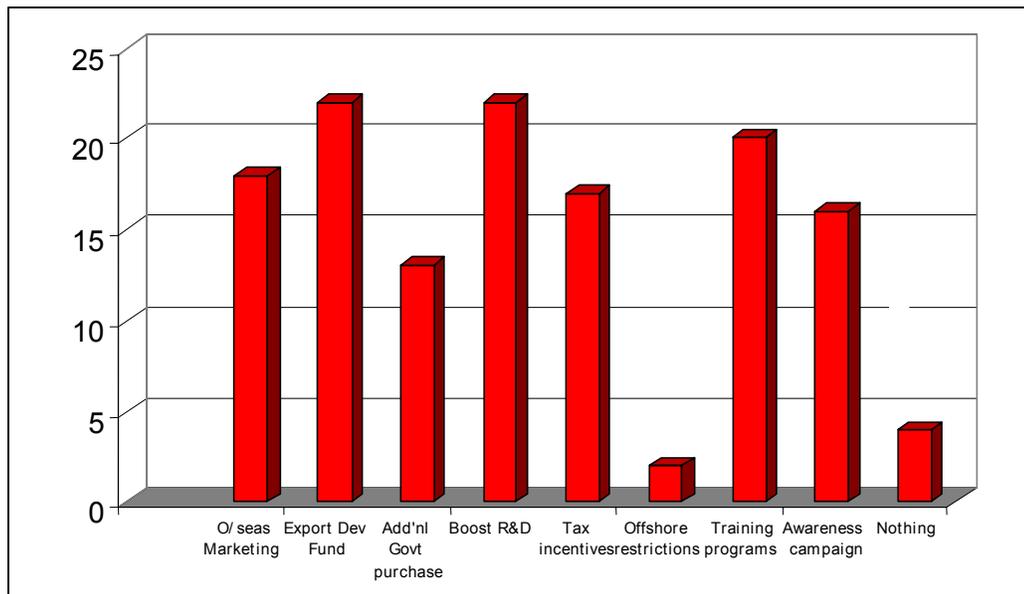


Figure 14 – How Can Government Help Local Development Companies Combat the Competitive Threat of Offshore Outsourcing? 28 respondents, multiple answers – a mixture of all respondents in the qualitative survey.

The Opportunity

IT IS hard to understand the concept of offshore outsourcing as an opportunity when an Australian company has to compete with an overseas labour model that can under-cut prices by up to 60 percent.

Yet, opportunity does exist for those who seek it out. Here are three examples:

- The decision of Australian development house Expert Information Systems to sell to the Indian sourcing leader, Infosys Technologies – a deal finalised on December 18, 2003.

Expert, now Infosys Technologies Australia, is currently growing its business at more than 300 percent as it leverages a combination of the offshore model and local, on-site expertise. Globally, Infosys is currently reporting quarterly growth of 45 percent on its respective performance 12 months ago.

Some might say Expert owner Gary Ebeyan saw the writing on the wall. However, his own company had achieved the status of CMM-4 and was using offshore partners in Eastern Europe, specifically Poland and Macedonia, immediately before the Infosys purchase.

Infosys Australia is now hiring local staff to keep up with demand for its services. It is building its Australian-based skills to offer on-site services to overcome the objections of the “offshore-only” model, and they will take on other multinational companies with an established reputation in Australia.

- The Sydney-based internal ICT operation of Deutsche Bank is hiring IT staff to handle high-level requirements gathering and design work for its commercial centres in London and New York. This is a classic example of how a motivated Sydney-based CIO of a multinational organisation can attract work and jobs to Australia. Her work in this area is widely known and acknowledged by her CIO peers in the domestic banking community.
- Access Testing Centre, which operates in Melbourne and Sydney, is now hiring staff following its alliance in July 2004 with Indian outsourcer Satyam. Up to 20 new jobs will be created over the next 12 months, according to business plans. The centre will check code written in India for Satyam's Australian and overseas clients.

. . . and the Cost

But it is not all good news. One example is Adacel Technologies, which closed its Australian operations with the loss of 70 jobs. It felt it could not compete in the local market against offshore outsourcers.

Some of its clients, including Telstra and Coles Myer, opted to move providers for cost reasons. Adacel had not ignored the threat. It opened facilities in rural areas of Australia but these facilities failed to attract interest from Australian-based clients. Skills were also hard to locate in, or transfer to, rural areas. Now, the company is focusing its future in the United States.

Not all jobs will go offshore. A large proportion of business must stay onshore. Software projects cannot be done by robots or automated software. Scoping and requirements must be completed onshore. Development, documentation and testing can go offshore. All acceptance testing has to be done onshore. We will never be in a situation where everything is done offshore.

Local manager, Indian offshore outsourcer

Tapping the Anxiety of Risk

DESPITE long-term fears for the Australian software sector, respondents in locally-based development companies said many of their Australian clients had demonstrated nervousness about the offshore option. Several were trialling the concept but had mixed results, they said.

The jury is out on the success of offshore outsourcing. We are not seeing a lot of it, to be honest; not as much as you might think from the press coverage it gets. There are concerns among the clients about exactly how far up the food chain of skills you can go with offshoring. Clients are also showing a great deal of nervousness about the risk of sending their projects north. It comes down to the economic equation, of course. If the cost-savings are worth the risk, they'll do it. I'm not sure that it will be as successful as everyone assumes it will be.

Senior executive, Australian-based US services company

Respondents who worked for Indian companies refuted the suggestion that there was a high degree of risk with offshoring projects. One executive stated:

Our process involves a virtual team of local staff and colleagues in India. It is not a case of picking up the 'spec', cutting the code and then throwing it back over the fence. Working with any offshore company that does not have a presence in Australia is risky, but that is not how we work. It's not our model. Increasingly Australian companies will be able to leverage the offshore model by combining it with locally-based skills. They will be able to do that with companies from India, America and even Australia.

CEO, Sydney office of Indian services company

Some of Australia's biggest ICT spenders have shown little fear of sending work to India. Executives of local software development companies said the market was not moving *en masse* to offshore outsourcing. However, a number of them said they were now being asked to provide an offshore price, or at least state they had the ability to conduct work offshore if required.

Several executives from Australian development houses expressed the view that their clients remained sceptical of the benefits, despite the promise of huge savings.

Belief in the "Chicken Little" scenario – that the local industry's sky would fall in – has eased in the minds of some local executives in the last 12 months. Adoption of outsourcing had not only been slower than feared, but clients were also limiting the type of work they were prepared to release offshore.

A significant concern to executives of Australian-owned companies was the growing local presence of Indian companies in Australia, as well as the preparedness (albeit reluctantly) of multinationals to send work to India rather than use low-cost local options, such as Ballarat, Adelaide and Tasmania.

I have come back from my doom and gloom position of a year ago. Things are not as dramatic or as straight forward as I had feared they would be. In fact, I have just had my best quarter for a long time. But that doesn't mean I am very happy about the trend towards offshore outsourcing. It may be quite small now but it will grow and grow.

Chairman, Australian services provider

The Way Forward

RESPONDENTS were united in their desire to see the Australian Government promote the skills of local developers overseas. There was recognition and praise for the work of Invest Australia, which recently placed a series of advertisements in *The Economist*. Overwhelmingly, the mood was that more had to be done.

There was optimism the new Minister for Communications and Information Technology would provide a greater demonstration of leadership than those who held the position previously. However, respondents were aware of the low political profile of ICT and the overwhelming focus of the new minister on orchestrating the sale of the Government's 51 percent share of Telstra.

The issue of promoting Australian software engineering skills may mean supporting the future growth in jobs among multinational companies.

Their local operations are the only ones of sufficient scale to handle large offshore contracts. At the time of writing, the largest services firm, Telstra (including Kaz), was in the formative stages of developing its strategy following Telstra's purchase of Kaz. It was unclear whether the company would seek to be an offshore provider of high-value services as part of its strategy. However, the Asia-Pacific market would be a target for Kaz's services, it is believed.

Concern was expressed by local operators that the Government would spend taxpayers money to promote the so-called "big end of town", and Australian companies, because of their lack of size and scalability, might receive only meagre benefit, if anything at all.

This contention was disputed by executives of multinationals, one of whom said . . .

A job is a job. We need to be concerned about generating economic activity rather than worry about who owns the company.

Spokesman, multinational ICT company

Two respondents from multinational companies observed that few Australian services companies had shown any desire to operate internationally, claiming a focus on helping local firms ahead of multinationals to win offshore work from North America or Western Europe would not work.

The Government should have a policy to encourage SMEs to go overseas. You cannot expect them (SMEs) to do it own their own. They need support. But we should be supporting all Australian-based organisations. The multinationals make up 50 percent of the industry. At the end of the day, it is important that Australia meets the offshore challenge and is net winner on the jobs front. Who actually employs staff for those jobs is largely irrelevant from an economic standpoint.

Senior spokesman, Australian offices of US IT company

Level of Debate

CONCERN was expressed about the level of debate, which a number of respondents said gave the impression that some form of government or industry action could be implemented to automatically ease the pressure, ignoring the reality of global competition.

Those representing Indian companies were particularly concerned, feeling they had been given a difficult time politically as they tried to establish their businesses. Others said the debate was timely and reflected the concerns of thousands of Australian programmers. Here are two opposing views:

Without realising it, some leaders of this debate are doing this industry damage. The complaints about offshoring are creating bad vibes for the public, which does not understand the issues. I understand the emotional and even nationalistic sentiment, but it is not helping.

CEO, Sydney office of Indian services company

I have been on speaking engagements and received a hostile reaction from developers to the offshore debate. There is great anxiety out there about the future and their job security. The multinationals are largely mute on the issue because they have started sending work to India, as large user organisations are now dabbling in offshore. People have a right to be concerned.

Chairman, Australian services company

Respondents, regardless of their view, felt the level of debate was unlikely to change until leadership from within the industry and/or by government provided some strategic direction to help local application developers.

Should Any Government Support for Local Software Developers Include Multinational Companies?

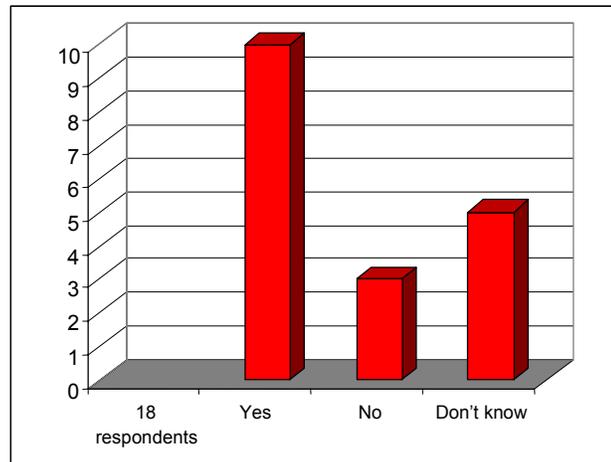


Figure 15 –Should any government help for local developers include multinational companies. 18 respondents. Responses came from a mix of those interviewed for the qualitative survey.

Shift the Strategy

WHILE a national marketing program to promote the capabilities of the Australian software industry is high on their agenda, many respondents said such an initiative would work only if the sector truly acknowledged the challenge of the offshore model and was prepared to undergo a cultural and commercial shift.

Respondents felt local companies should be able to exploit the advantage in business costs structure – estimated at 25 per cent – that Australia has over the United States and Western Europe.

The fact Australia was economically stable, had English as a first language, an excellent education system and was a mature ICT market were significant pluses for local companies seeking offshore work.

Several executives warned against chasing CMM qualifications, which were expensive to attain and did not represent a competitive advantage over Indian or other offshore outsourcers that had achieved CMM Level-4 or Level-5 status.

No Australian company will beat an Indian supplier in a tender situation because they also have CMM Level-5. The client will simply focus on the cost differential and the Indian company will surely be cheaper. So Australian developers must focus on promoting the availability of higher-level skills, domain expertise and their own IP.

CEO, Sydney office of Indian services company

Infosys was cited by one respondent as a model that Australian companies should study. It was named among the top 10 knowledge companies in the world last year and currently has 13 competency areas, claiming to provide world-class domain expertise.

Strategic initiatives suggested for Australian development companies included:

- Focus on IP creation;
- Create frameworks and opportunity for staff to capture IP, such as unique processes;
- Leverage IP in partnership with multinational companies;
- Form strategic partnerships to leverage lowest-cost infrastructure;
- Ensure all staff keep up to date with the latest technologies and methodologies;
- Build (an) in-house specialist practice(s) or knowledge base; and
- Support education programs that teach IP creation and innovation.

How Should Small Development Companies Respond to Offshore Competition?

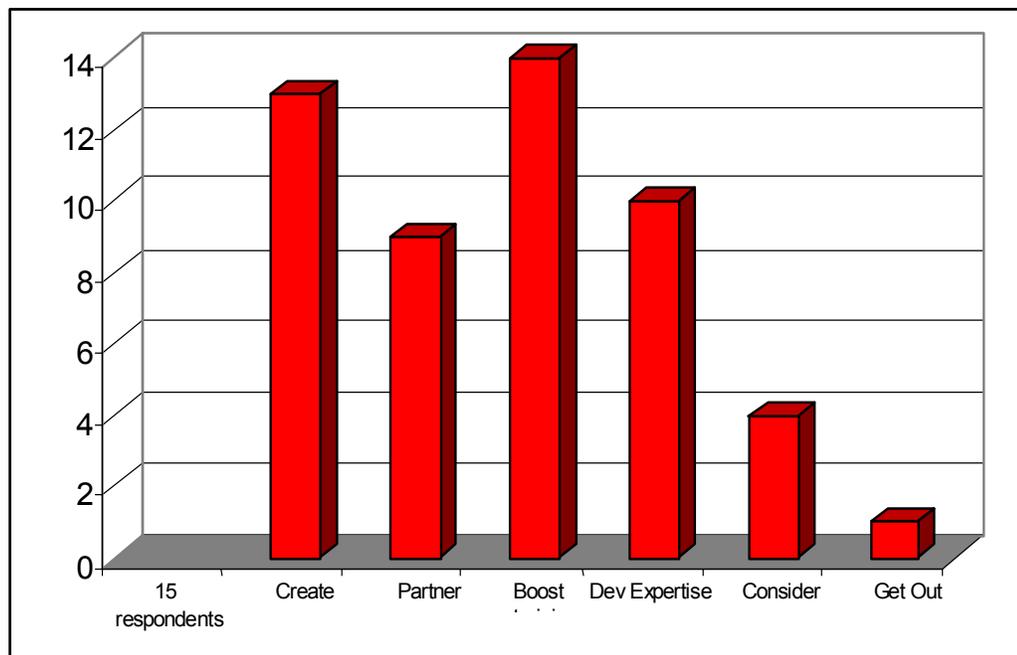


Figure 16 - How Should Small Development Companies Respond to Offshore Competition? 15 respondents were from the vendor-side, developer service companies, plus a small number of CIOs who held a view.

Capabilities Growing Offshore

ONE respondent in particular warned developers of fooling themselves into thinking that offshore services companies in India, China or Eastern Europe were only good for code-cutting, and that Australians could survive by providing what they perceived to be higher-value skills.

In this country, we are taking a very simplistic view of code-cutting. We seem to have convinced ourselves that suppliers offshore are not capable of requirements gathering, architecture, project design, or even implementation. This is wrong. I know the Indian companies to be very good at the clever stuff. This model of the hack-work being conducted offshore, and Australian developers doing the clever stuff at home, is promoting a dangerous false sense of security.

Chairman, Australian services company

The Influencers

Politicians, Public Servants, Lobbyists & Analysts

PASSION rises as quickly among the influencers within the ICT industry as any other group when discussing the rights, wrongs, opportunities and dangers of offshore outsourcing.

Accusations of poor industry leadership and business management, the lack of government support, hand-out mentalities and surrendering to the “worst elements” of globalisation were all raised by respondents to this survey.

There were points of agreement, too. Most accepted and talked about the reality of “labour arbitrage” in the global services industry. Respondents acknowledged this had first emerged in its modern form for the IT department as Business Process Outsourcing (BPO), and now it had moved into the arena of software development.

Frustration was voiced at the lack of government data on the prevalence of offshore outsourcing in Australia.

Independent assessments from Gartner suggest 2 percent of all Australian software development is conducted offshore, although the research company says the trend is growing.

Respondents in the “Influencer” category of this study said small businesses were unlikely to send any development requirements offshore and the real threat to jobs would come from Australia’s large enterprises and, to a lesser extent, government agencies as they began to send programming offshore.

‘For Every Job Lost, Another is Gained’

THE belief offshore outsourcing would be at least a jobs-neutral experience for Australia was expressed by analysts and government officials.

There were already plenty of examples of this nation attracting offshore outsourcing, they said. There was also praise for Garry Draffin, the CEO of Invest Australia who was “prepared to talk up Australian ICT”.

One respondent remarked that arguing for the benefits of offshore outsourcing was a difficult task because . . .

You are discussing the higher-value jobs that will be created in the future, rather than the low-value jobs that will be lost today. Arguing that this is good for our economy in the medium term is a very hard point to put across, especially to those whose jobs are at risk.

State government policy adviser

Others did not buy into this pro-offshore argument at all.

There is no evidence to show benefit or any real return to Australia from offshore outsourcing. When IT companies came from overseas, we gained jobs and corporate tax income - albeit minimised. We saw a rise in local employment but a repatriation of profits. Even most optimistically, there was a small residual of research and development from these multinationals. But with offshoring, we get nothing. It is the next evolution in corporate globalisation. And CIOs are just listening to the voices of their masters in following this trend.

Politician

Indications from CIOs make either of the above statements difficult to support in the short-term. There is evidence of some job generation on the back of offshore outsourcing. Some CIOs said the lower cost structure was giving them the opportunity to conduct more projects, which in turn generated employment.

However, such anecdotal evidence is always talked-up by those who are hiring. On the other hand, job losses are less easy to uncover, as most companies try to avoid public scrutiny or industry knowledge of these events.

No CIO has admitted to laying off staff as a result of their strategy for, or trials of, offshore outsourcing. However, it is hard to believe they will not adopt a pragmatic view towards the global value of local jobs when provided with increasing opportunities to use cheaper labour overseas.

Offshoring 'is Inevitable'

ALL respondents in the "Influencer" category, some more reluctantly than others, accepted the notion that offshoring was inevitable and the Australian ICT industry must learn to adapt to the new competitive environment.

Local software developers had been fortunate the Australian market had not taken to the idea of offshoring at the same speed as North America or Western Europe, according to one respondent. This, he said, should give local companies more time to develop new strategies to stay competitive.

Software engineering will be termed 'software manufacturing' in the next few years. The words 'engineering' and 'development' will die, as it becomes obvious these skills have been turned into a commodity – either by a plethora of low-cost labour markets or new software tools that make code writing easier. And software in general will follow the trends of manufacturing, it will become cheaper but lower in quality.

Industry lobbyist

As much as I don't like to admit it, offshore outsourcing cannot be stopped. And I do not favour a ban, or any action on the part of government to outlaw it. But you can offset its impact with a variety of policies ranging from immigration to training. Today, there is a high unemployment rate in the ICT industry – higher than the national average. And some of the skills gaps are being filled with temporary migrants with no pressure to employ or nurture local talent. Government departments and agencies should be made to look at all local alternatives before taking the offshore option. And we should audit those decisions to ensure they are legitimate and provide the quality, unique service and savings that are supposed to come from using offshore services.

Politician

Role of Government

NO topic generated as much heat as the role of government in response to the emergence of offshore outsourcing. Inevitably, those on the government side were defensive of their position, while everyone else metaphorically took aim and fired, often repeatedly.

The view from policy-makers and advisers on the government side bordered on exasperation. There was a high degree of frustration that no matter how much the ICT industry and multinational companies lobbied for and received, it was never enough.

One policymaker commented the industry was giving the impression to government colleagues that it wanted to be "bailed out" now it was confronted with the challenge of offshore outsourcing.

ICT is like a lot of other industries. In the boom times, they all want to be left alone, but they want a free macro-economic policy so they can get business done profitably. In the late 90s, the Australian Information Industry Association (AIIA) called for cuts in taxes and levies to improve the situation for venture capital. Now they want more. This is a cop-out. Instead, the industry should be getting its own business model right. The centre of government believes it has put resources into ICT, (and now) it falls over and wants to be saved. Many agencies are less supportive of ICT. They see there has been an over-investment; (and ICT) promised more than it could deliver.

Political adviser

Those federal departments that are said to be less supportive of ICT include Finance and Treasury, according to one adviser.

Other respondents expressed a strong desire to see the Government buy more locally-made ICT products and services to help grow the domestic industry.

One said the weaknesses of the local industry were a fatal flaw, claiming that 85 percent of ICT turnover was sucked up by either multinational companies or Telstra, the national telecommunications carrier.

There is no escaping the fact we need to build ICT products to be globally competitive. But the success of doing this comes back to the fact that with the exclusion of Telstra, the Government is the only truly big buyer of ICT products in this country. Another challenge is the lack of corporate leadership. There is none. No one rises to the top. Corporate policy, of course, is not about Australia but the interests of the multinational companies. I get frustrated that the leaders who run these debates are working for companies that do not have Australia's interests at heart.

Politician

We need to ensure we have the right measures in place to encourage innovation and government procurement of local goods and services. We have no choice but to produce IP. We also require a public purchasing policy to test local capabilities first, including labour hiring practices.

Politician

'Government should buy Australian'

A NUMBER of respondents outside of the public service said the lack of government purchasing of local goods and services was a significant reason why the domestic ICT industry had not grown as quickly as it might otherwise have done.

That weaknesses could now be exploited by emerging economies through offshore outsourcing. Many said they were concerned that even though Australia had a lower-cost environment than North America or Western Europe, the software services sector was not in a strong position to attract high volumes of work to these shores.

References were made on two occasions to Canberra being an “SAP town”, referring to the success of the German software company in the federal government. Others cited, without substantiation, the cliched reference to government agencies being afflicted with the “cultural cringe” that determined overseas products were automatically better than those produced locally.

Other complaints were made around the complexity and severity of government contracts that sometimes required local players to bet their business to gain government work. However, others justified the bureaucrats’ approach, saying local companies often did not have the scale or capacity to handle the demands of a large government or industry contract.

If you look across to America, you will see that despite all the talk of free trade between our two countries, a number of their States have policies that are weighted to promote and protect local jobs. This can cut out Australian companies from having any chance to win their business. You have to ask how pure we must be in our trade practices before it starts to hurt the national interest.

Politician

However, one policymaker discounted the complaints regarding the demands for government to buy more locally produced goods and services. The respondent said such actions would require government to implement a form of preference into their purchasing policies. This would not happen under a Coalition government, and it would be hard to understand how a “Labor government could do something like that, either”.

People need to understand that these calls (for more purchases of local products and services) are just another way of small businesses demanding preferential treatment from government. They must learn government must make purchases around requirements and guarantees that are seen to be necessary. The best way to win government business is to be competitive, not receive preferential treatment.

Policy adviser

Second Wave of Offshoring

Respondents also noted that while Australian companies needed to adapt, there was increasing evidence that Indian offshore suppliers could see dangers to their own business models from a second-wave of offshoring from countries such as China, the Czech Republic, Russia, Vietnam, Malaysia and the Philippines.

One respondent reported that Infosys now had 200 staff in Shanghai and there were “56 flights from Dalian to Tokyo each week with Chinese developers chasing Japanese business”.

The prevalence of packaged software purchases was also an issue that undermined the future role of the software developer.

This was raised by a number of analysts. They believed the increasing disposition of organisations to reduce complexity in their business by purchasing packaged software, rather than writing applications in-house, to increase technology functionality was also a significant medium-term threat to developer jobs.

One respondent said that, at least in the Australian market, the move to adopt business applications produced by companies such as PeopleSoft, Oracle and SAP would significantly hurt career opportunities as enterprises became shy of building their own modules because of the upfront expense and ongoing maintenance costs.