Financial Technology Executive Seminar:

How To Make Software Outsourcing Effective

May 22, 2007

Agenda

Introduction

Highlights of the "The Changing Face of Outsourcing" Survey

Improving Communications on Offshore Projects

Success Factors in Software Outsourcing

Q&A

Our Panelists

Marina Kolesnik

Senior VP, DataArt

At DataArt: Kolesnik is in charge of several strategic and marketing initiatives for DataArt's financial technology practice

Prior to DataArt:

❑ Management Consulting McKinsey & Co

❑ M&A and strategy at Acorda Therapeutics

❑ CFO, co-founder of Mail.ru (Russia's leading Internet company)

❑ Technology analyst at NYC-based hedge fund

❑ MBA (Harvard Business School)

Thomas Castriota

Founder and Managing Partner, Work: American Style

Prior to Work: American Style

Castriota held number of various technology and management positions with

❑ Financial Services Firms: Nomura Securities, Deutsche Bank

❑ Startup Software Companies: Alphablox, Red Brick Systems

❑ Large Software Companies: Sterling Software, Information Builders, IBM

Alexei Miller

Executive VP, Head of Financial Technology Practice, DataArt

❑ With DataArt since 1997, Miller has been instrumental in building the company's Financial Technology practice, which he currently leads.

❑ He is in charge of building and managing a framework of outsourced projects for financial clients' mission critical and knowledge intensive systems. These include order management and allocation, portfolio analysis, risk management, CRM, real-time market data access and support for STP infrastructure.

❑ MS, Mathematics (St. Petersburg State University)

Before We Begin

❑ Presentation: 11 AM EST – 12 PM EST

   » Panelists presentations

   » Q&A session

❑ How to ask questions

   » As an attendee, you will be muted throughout the presentation

   » To ask a question, please use Q&A tab on the webinar panel and type in a question

   » Direct question to specific panelist if you wish

   » At the end of presentation we will have 20min Q&A session. We will read out questions we received and panelists will address them one by one

❑ After the presentation

   » Presentation material will be available in our follow up email

   » Please, take 5 minutes to fill out a feedback on this webinar (will be sent out upon completion of the presentation)

About Financial Technology Executive Series

DataArt initiative supporting financial technology executives, with a particular focus on executives in financial software companies

Recent events

❑ *The Changing Face of Outsourcing* - joint survey by DataArt and Hedge Fund & Investment Technology, 2006

❑ *Taking Control of Execution Risks in Software Development* – executive breakfast at Harvard Club of New York, March 14, 2007

❑ *How to Make Software Outsourcing Effective* – *webinar, May 22, 2007*

Upcoming events

❑ *Exhibition at SIFMA conference* – New York, June 20-22

❑ *More events covering other aspects of financial technology executive daily agenda in the second half of 2007*

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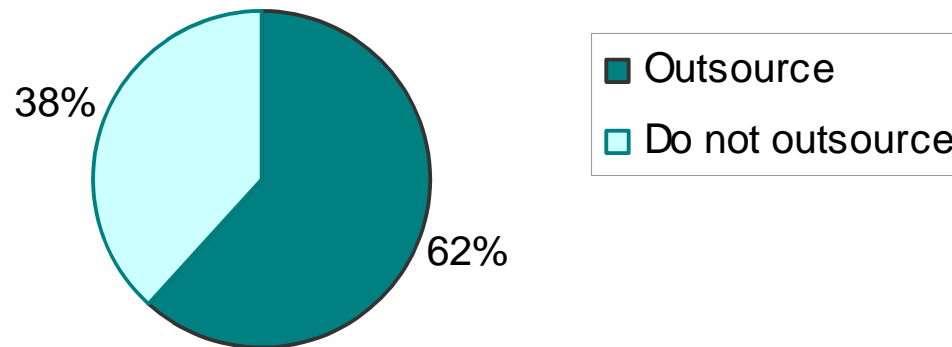Highlights of the "The Changing Face of Outsourcing" Survey

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62% of financial software companies interviewed utilize offshore talent

**% of companies
interviewed that utilize outsourcing**
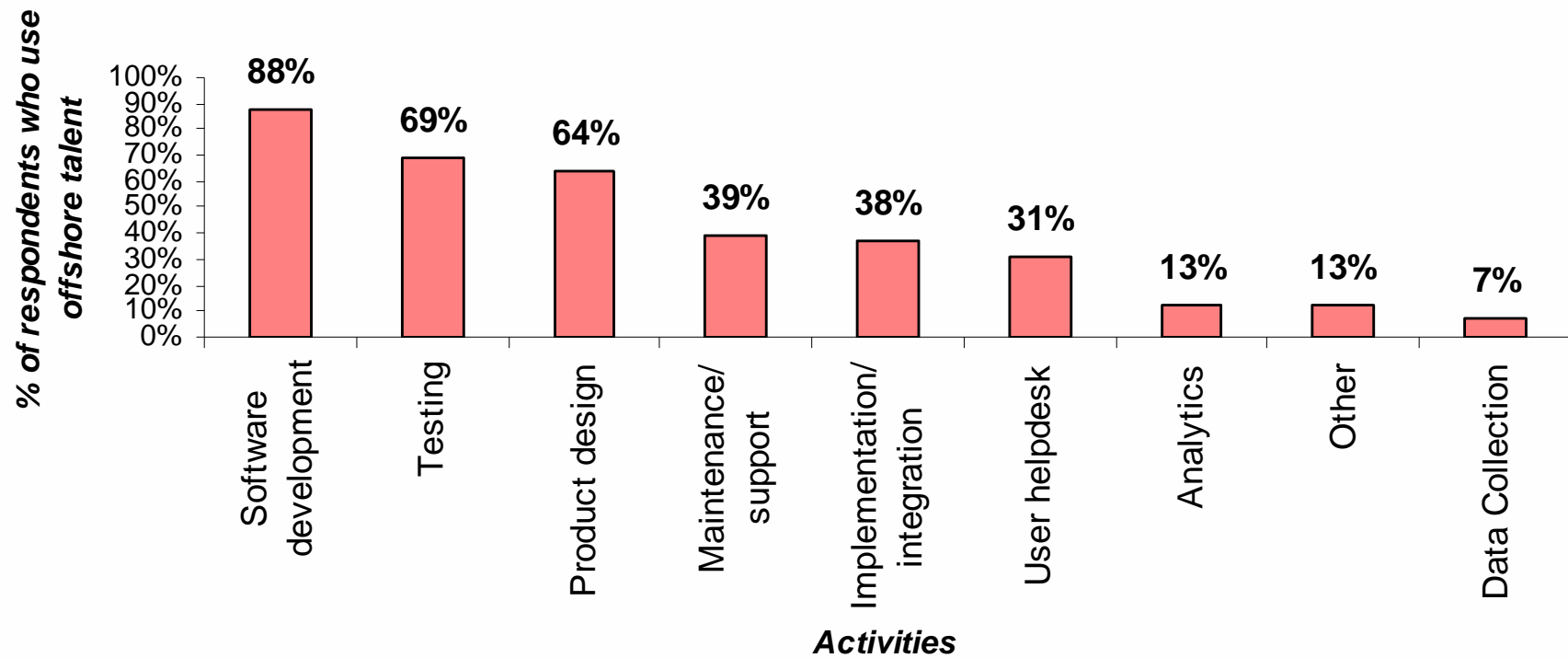
38%

62%

- ■ Outsource
- ☐ Do not outsource

75 financial software vendors were interviewed for the research

Source: *The Changing Face of Outsourcing* - joint survey by DataArt and Hedge Fund & Investment Technology, 2006

How companies leverage offshore talent

Activities to leverage offshore talent

% of respondents who use offshore talent (y-axis)

- Software development: 88%
- Testing: 69%
- Product design: 64%
- Maintenance/support: 39%
- Implementation/integration: 38%
- User helpdesk: 31%
- Analytics: 13%
- Other: 13%
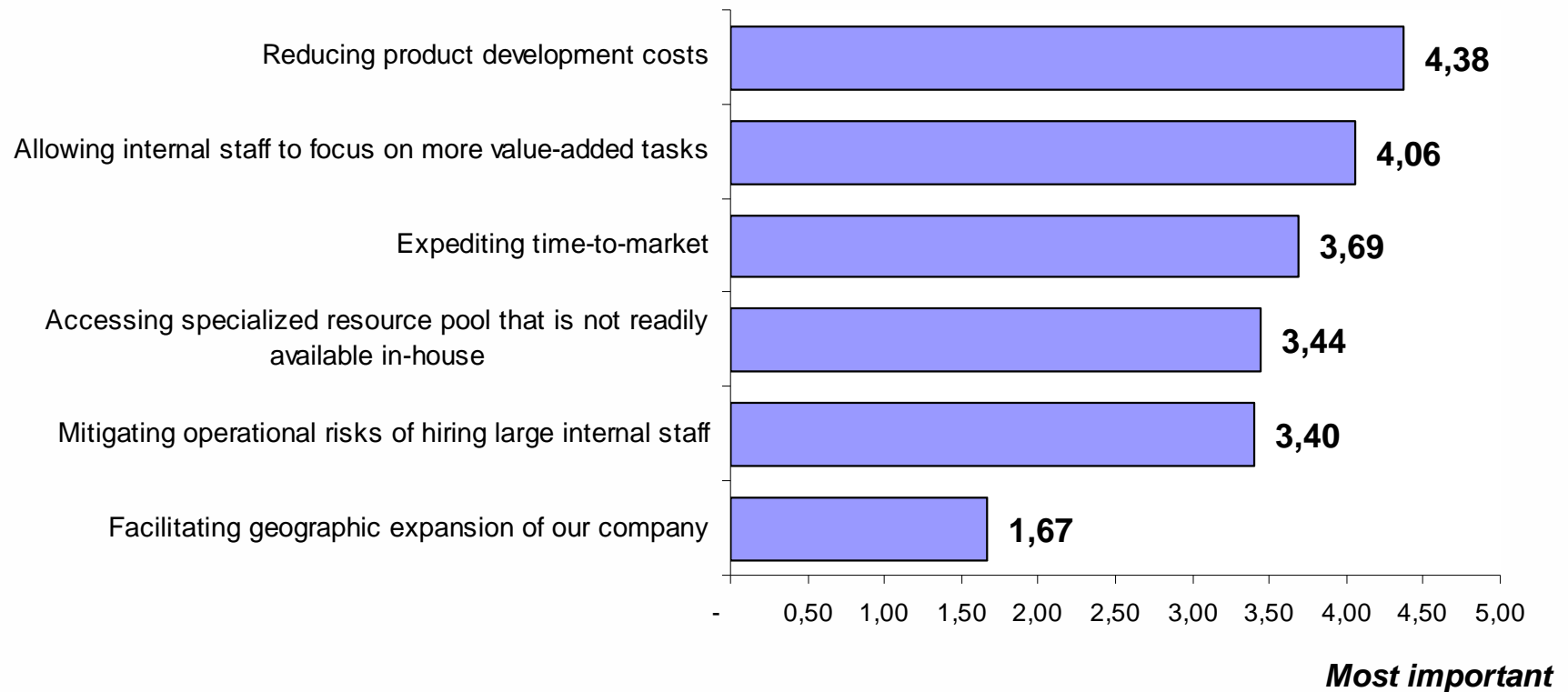- Data Collection: 7%

Activities (x-axis)

Source: **The Changing Face of Outsourcing** - joint survey by DataArt and Hedge Fund & Investment Technology, 2006

Benefits of offshore outsourcing

Benefits from offshore outsourcing on a scale 1 to 5

Benefit	Score
Reducing product development costs	**4,38**
Allowing internal staff to focus on more value-added tasks	**4,06**
Expediting time-to-market	**3,69**
Accessing specialized resource pool that is not readily available in-house	**3,44**
Mitigating operational risks of hiring large internal staff	**3,40**
Facilitating geographic expansion of our company	**1,67**

- 0,50 1,00 1,50 2,00 2,50 3,00 3,50 4,00 4,50 5,00

Most important

Source: **The Changing Face of Outsourcing** - joint survey by DataArt and Hedge Fund & Investment Technology, 2006

Offshore outsourcing challenges
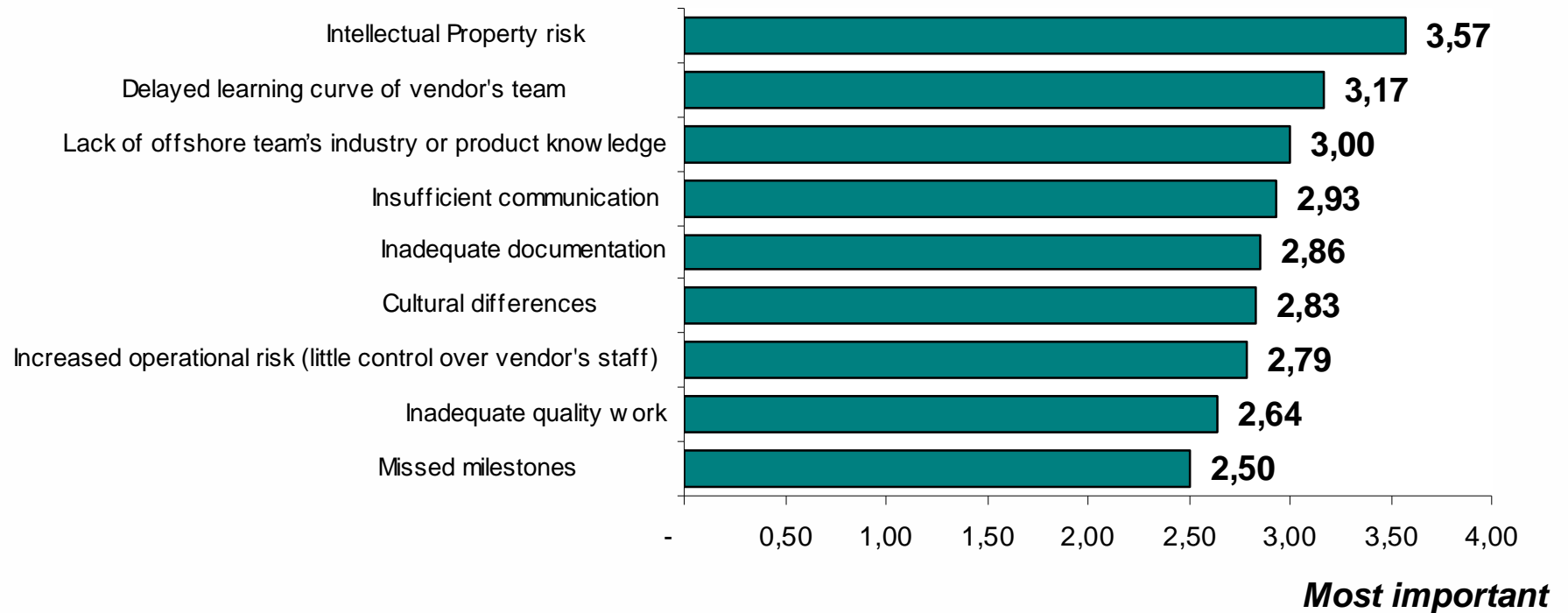
**Offshore outsourcing challenges
on a scale 1 to 5**

Challenge	Score
Intellectual Property risk	3,57
Delayed learning curve of vendor's team	3,17
Lack of offshore team's industry or product knowledge	3,00
Insufficient communication	2,93
Inadequate documentation	2,86
Cultural differences	2,83
Increased operational risk (little control over vendor's staff)	2,79
Inadequate quality work	2,64
Missed milestones	2,50

Most important

Source: **The Changing Face of Outsourcing** - joint survey by DataArt and Hedge Fund & Investment Technology, 2006

How to mitigate potential risks

IP Risk

Risk mitigation strategies

- ❑ Working with offshore vendors with US presence in order to get legal protection under the US law
- ❑ Preventing offshore team from having access to the entire code or to the most critical parts of code
- ❑ Daily backing up code on company's US server
- ❑ Singing non-compete contracts with all individual vendor's developers who work on the project

Delayed learning curve of vendor's team

- ❑ Selecting the right vendor, who:
  - ➤ Has experience with similar technologies and project types
  - ➤ Has overall grasp of the financial industry
  - ➤ Is about the same size and is used to work with same types of clients
- ❑ Interviewing vendor's staff, select dedicated team
- ❑ Establishing from the start collaborative relationship with its vendor to educate and transfer knowledge

How to mitigate potential risks (continued)

Lack of industry or product knowledge

Inadequate quality work

Increased operational risk (staff turn over)

Risk mitigation strategies

- ❑ Selecting a vendor with appropriate experience and confirm vendor's claims via references check are key elements in addressing this
- ❑ Identifying a vendor who has a proven track record of fast learning. One may look at types of projects done by vendor, their diversity and complexity and confirm successful track record with vendor's existing clients

- ❑ Conducting due diligence and references check
- ❑ Starting with a small pilot before launching a large project
- ❑ Ensuring quality design and specifications
- ❑ Defining quality standards upfront

- ❑ Selecting an established vendor with a large resource pool
- ❑ Singing a detailed contract that locks in the lead team members serving the client
- ❑ Budgeting for 5-10% cost increase as a result of possible turnover at the vendor's end to help manage their financial projections
- ❑ For companies working with dedicated vendor teams it is customary to design a bonus structure for the team or leading team members in order to provide incentives to stay
- ❑ Internally - securing senior management buy in, creating right publicity for bringing a vendor in and getting a right people on the client team who will manage vendor

Why some companies do not engage offshore talent

Limiting factors preventing companies from engaging offshore talent
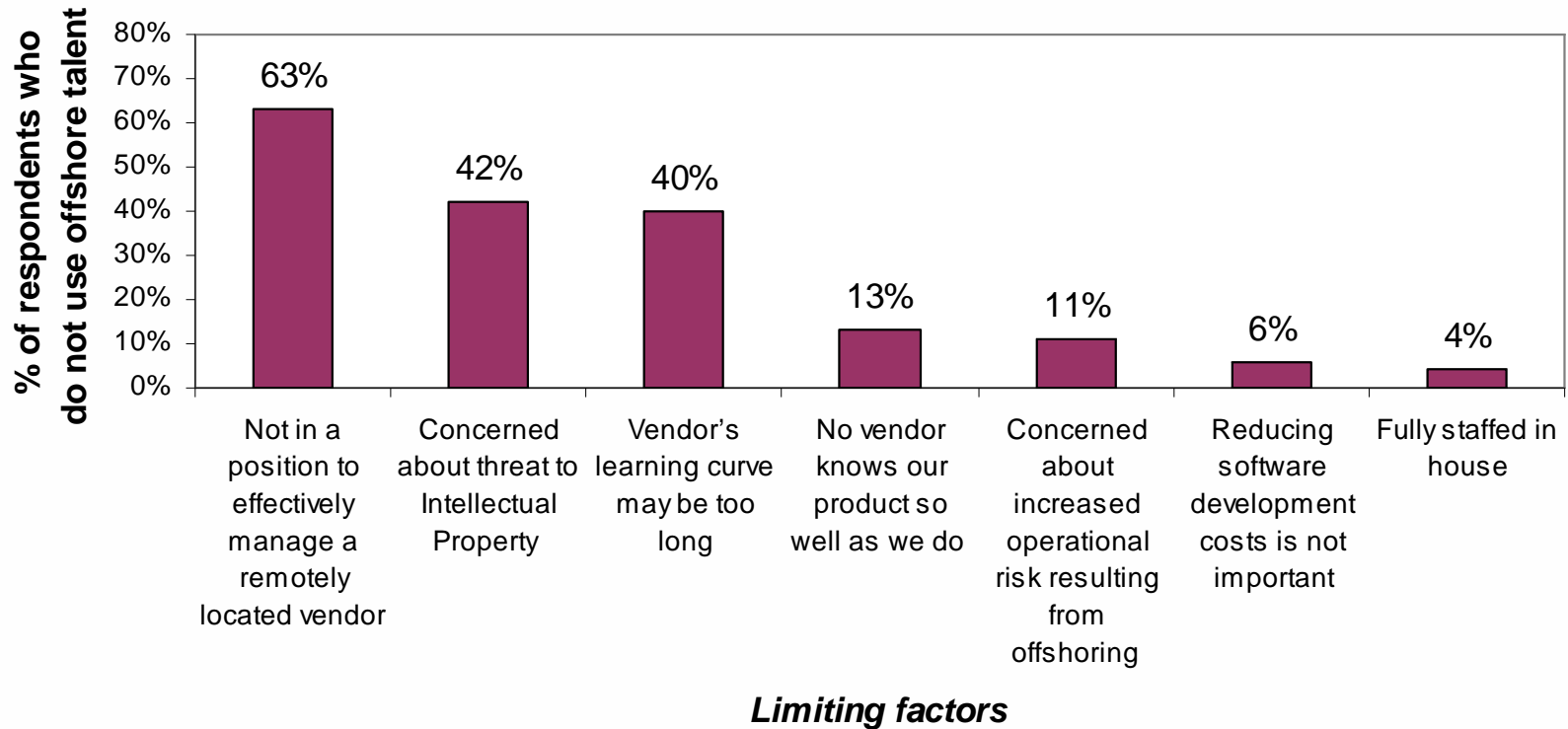
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Improving Communications on Offshore Projects

Thomas J. Castriota

Founder and Managing Partner

Work: American Style

About Mr. Castriota

❑ Mr. Castriota is has served in a variety of leadership roles for companies for nearly 20 years including:
  ❑ Financial Services Firms
    ❑ Nomura Securities, Deutsche Bank
  ❑ Startup Software Companies
    ❑ Alphablox, Red Brick Systems
  ❑ Large Software Companies
    ❑ Sterling Software, Information Builders, IBM
❑ Founded <u>Work: American Style</u> to help good people stop making career limiting mistakes at work
❑ Provide Employee and Management Training and Consulting for an ever increasing <u>Flat World</u>

Risks to Outsourcing Projects

- ❑ Loss of control
  - ➤ Real and emotional
- ❑ Complexities of distance monitoring
- ❑ Cost savings not realized
  - ➤ Complex conversion
  - ➤ Complex coordination
  - ➤ Inflation in costs
- ❑ Contract inflexibility
- ❑ Complicated divorce
- ❑ Security and privacy issues

- ❑ Cultural and Process differences
- ❑ Knowledge Transfer
- ❑ Local inflation
- ❑ Sovereign risk and international vulnerabilities
- ❑ Vendor stability/inadequate skill
- ❑ Vendor staff attrition

Common Reasons for Project Failure

❑ Poorly defined user requirements

❑ Lack of real "buy-in" from the user community

❑ Unrealistic timelines for project delivery

❑ Change management not implemented well

❑ Poorly managed scope

❑ Much of this boils down to one thing:

A FAILURE TO COMMUNICATE

The Communication Plan Will Help

❑ Have One. Seriously.
❑ Identify and address the key groups
  » Customers, Staff, Management, Suppliers
❑ Set sober expectations
  » What are the benefits? The risks? The incentives?
❑ The <u>means</u> and the <u>message</u> must be targeted
  » Think Benefits NOT Features
❑ Prepare an "FAQ" and make the message consistent
❑ The word will get out
  ❑ Be prepared and control the message

Consider the Impact of Change

- ❑ Give the team time to accept the message
- ❑ Allow for time to adjust to the change
- ❑ Private conversations will occur
    - ⁂ Encourage the team to do so
- ❑ Monitor the key players closely
    - ❑ Consider the alternatives without them

Remember the Basics

❑ Communicate issues early and escalate as needed
❑ Do NOT rely on email communication alone
  ▪ Remember the value of M.B.W.A.
❑ Do NOT use email to communicate conflict
❑ When you agree, write it down and publish it
❑ Assign a resource to record and publish minutes
  ▫ Distribute draft for feedback

The Mechanics of Good Project Communication

- ❑ PMO should facilitate, organize and record meetings
- ❑ All teams must provide consistent status reporting
    - » Use measures that have the same meaning to all parties
    - » Align the measures across the teams
- ❑ Hold regular team meetings
    - » Both inside specialized teams and cross-team
    - » Create "Focus Groups" on specific topics like UAT, Reference Data, Infrastructure, etc.
- ❑ Limit the number of management meetings
    - » Report status and decisions – not a forum for Debates
- ❑ Communicate issues, decisions, and plans beforehand
- ❑ Turn major milestones into a team wide event

Thank you.

❑ Contact information:
- » Email: tc@workamericanstyle.com
- » http://www.workamericanstyle.com
- » Office: 914- 613-3501
- » Cell: 914-393-8033

❑ Services include programs for Managers and Employees to improve performance, manage change, and create an overall better place to work

❑ We've recently added a program to Score interview candidates on "softer" skills including communication

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Success Factors in Outsourcing

Key Moments in Outsourcing Relationship Lifecycle:

1. Selecting Right Vendor
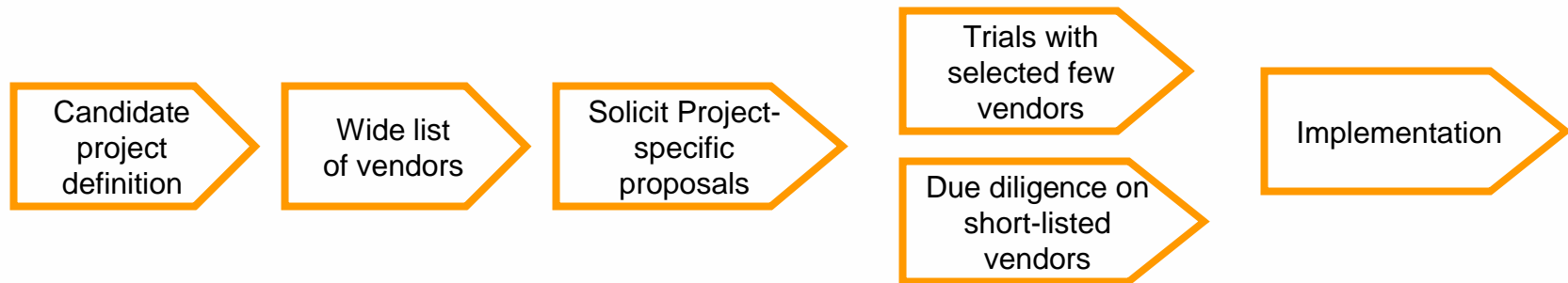
2. Choosing Right Outsourcing Engagement Model

Vendor Selection Process

Traditional Approach:

| Location Analysis | RFI | RFP | Trial | Implementation |

Major Risk: Companies that look good on paper may not be good for the job.

Suggested Approach: Involve real work earlier in the process

| Candidate project definition | Wide list of vendors | Solicit Project-specific proposals | Trials with selected few vendors / Due diligence on short-listed vendors | Implementation |

Key Factors in Vendor Selection

- Do the client-side Application Portfolio Analysis before the engagement and evaluate vendor's compatibility against specific objectives
- Industry-specific expertise (solution vs. process)
- Process compatibility
  - Pace of work - performance
  - Reporting
  - Cultural issues and communications
  - Quality standards
- Scale match – engagement must be important for the vendor to solicit best resources and management attention
- Security, confidentiality, IP rights practices
- Expertise in selected Engagement Model

Engagement Models

Three major types of outsourcing engagements:

1. Team-based (staff augmentation) – vendor provides on-demand or permanent resources for the client organization; with the qualifications and cost structure agreed in advance. It's all about the resources.
2. Project-based – fixed-scope, fixed-budget engagements focused on delivering a well-defined scope of work on a specified schedule. It's all about the deliverables (and hoping they don't become obsolete while the project is running)
3. Application-based – contracting a vendor to perform specific technology or business function on a regular basis, measured by business outcome. May include development, maintenance and enhancement of custom or packaged systems. Focus shifts from *Product* to *System in Production*. It's about the business functions.

Existing outsourcing relationships are often misunderstood:
According to Gartner, more than 50% of contracts that Clients call AO are actually staff augmentation in nature.

Which model is right for you?

Engagement Models

	Vendor's Responsibility	Client's Responsibility	Contract and Pricing	Risk for outcomes
Team-based	• Quality of resources • Staff turnover • Ability to comply with Client's processes	• Task definition • Project and risk management • Quality standards and processes • Productivity evaluation	T&M – labor rates	All on Client side
Project-based	• Fixed set of defined deliverables • Scope management • Compliance with schedule and quality level	• Business case • Change management • Risk management	Fixed-price, result-oriented; with performance-based incentives and penalties	Shared between Client and Vendor
Application-based	• Success is measured in business outcomes • Predictable level of service	• Application Portfolio Analysis • Outcomes definition: metrics, SLAs, standards	Unit-based, with performance and penalties tied to application metrics	Mostly on Vendor side

Key Factors in Choosing the Right Model

- Client's business objectives: need to focus on core functions vs. saving money on labor
- Cost factor: reducing cost vs. cost-efficiency and predictability
- Management style: fear of letting go vs. demand on internal project management
- Systems and tasks – some applications lend themselves more naturally to AO than others. Critical analysis: how good are we at a given function?
- Information security and confidentiality (AO leaves little room for non-trusting engagements)
- Maturity level: improve requirements management process internally, use expertise available on the market. Formal measurement program.
- Short-term vs. long-term benefits. Team- and project-based contracts usually address more immediate problems, while AO provides the foundation for long-term success

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Contact information

Marina Kolesnik   mkolesnik@dataart.com

SVP, DataArt   www.dataart.com

212-378-4108 x 12

Thomas Castriota   tc@workamericanstyle.com

Founder and Managing Partner,   www.workamericanstyle.com

   Work: American Style   914- 613-3501

Alexei Miller   Alexei.Miller@dataart.com

EVP, DataArt   www.dataart.com

212-378-4108 x 10