
The Giant Awakens: Sheen Software Systems Considers China for Offshore I.T. Outsourcing.

Part A

Mr. Frank Xin and Mr. Zhang Chang were ordering dinner at *M on the Bund*, the stylish eatery overlooking the dazzling Shanghai riverfront. "I'm bullish on China and particularly on Shanghai, said Xin. His friend, Chang, a vice president of IS at a major Shanghai bank, was more careful. "Look, Xin, as a friend, I think you're taking some major risks in setting up shop across the ocean. And this stuff about lightweight methodologies seems lightweight to me."

The case was developed by Prof. Carmel as a foundation for class discussions and learning. It is based on actual companies and events, though some details have been disguised or stylized. This case is about a small American firm exploring the possibility of setting up offshore IT outsourcing in China. The case takes place in 2003. Part B is planned for 2004.

This case may be used for educational purposes without explicit permission. Any other use must receive permission from the author.

This version was created on November 20, 2003.

A Teaching Note is available from Prof. Erran Carmel of the Kogod School of Business at American University. Please e-mail with a request.

Frank Xin Goes to China

Xin made up his mind that China was where his offshore outsourcing unit would be. He had followed the recent emergence of the offshore outsourcing industry in China. His deliberation was only on where and what form his Chinese operations would take. He considered Shanghai because of the “buzz” and because he had some family ties in the city. "Shanghai is a good strategic point to grow," he said. And in answer to his own hesitations, he continued: "If Shanghai itself continues to get expensive, I can move to one of the nearby cities with tech parks such as Suzhou or Hangzhou (each of which is 1-2 hours by train from Shanghai).

Operations

Xin still wasn't sure how to set up China operations. He saw two options, the first was to set up his own "captive" office that would be a subsidiary of "Sheen - USA." The second, which he was still exploring, was to partner with an existing firm. In that arrangement he would sign an agreement with a Shanghai firm whereby the Shanghai firm would allocate some of its staff to Sheen. Xin saw advantages to each.

If he decided to lease an office, he had a number of choices. His first interest was in the Software Park in Pudang - a newly built area in eastern Shanghai. But, the facility has been full for years. Pudang rates are very low for Shanghai at 55 cents per square meter versus about 70-80 cents in the rest of the city. Being a member of the software park, even if he did not reside there, would give Sheen other financial benefits: a tax holiday in the 1st three years (on profits); and a 50% reduction on taxes in the subsequent 5 years. Xin was not sure what profits would be allocated to his Shanghai office, though.

Xin began planning his offshore strategy by attending the Global IT outsourcing summit¹ at a fancy hotel in downtown Shanghai a few minutes walk from the riverfront (the “Bund”). The two day conference was one of the first in China that focused on offshore outsourcing. It was organized by the Shanghai Municipal Foreign Economic Relations and Trade Commission, the Shanghai Municipal And Formalization Commission, the Shanghai Software Industry Association, and several other organizations.

At the conference, the vice mayor of Shanghai welcomed the attendees with a well-prepared speech that was targeted at the forum. About 200 people attended the conference, most of whom were from Chinese software companies. Several foreign firms sent their representatives, including ADP-Asia and Siemens. Conference speeches included those by the heads of Microsoft - China, Shanda (a leading computer game maker based in Shanghai), and the CTO of Webex, an American firm with R&D in

¹ Link to conference site: <http://www.cnoutsourcing.com/English/index.asp>

Shanghai. The summit was covered on the next day's English language "Shanghai Daily" opening with the headline. "China's software outsourcing industry is expected to shorten its gap with India in about 3 years."

By 2003, the China software market had been growing at a very fast rate for several years. Unlike the Indian industry, which most see as its main competitor, China's industry enjoyed strong demand domestically from an economy that was growing over the last decade at double digits CAGR. Beginning roughly 2000, Chinese firms began to set their sights on augmenting the domestic demand with foreign markets. In 2003 China is expected to export roughly \$1 billion in software and software services (commonly called outsourcing). The Shanghai metro area accounts for roughly 12% of the total software exports. Shanghai is home to software R&D centers for HP and Ericsson as well as support centers and localization centers for Microsoft and other multinationals.

Xin and Sheen

Frank Xin² is reflective of many global software entrepreneurs: as an "overseas Chinese," he is able to bridge East and West. Xin has been living in Los Angeles for 15 years where he still makes his home. Having grown up in Taiwan, he is able to speak Mandarin and can be understood in Shanghai, though he is still trying to master the local Chinese dialect, he says. Prior to founding Sheen he was at Peoplesoft.

Xin founded Sheen in 2000 to provide customized solutions for the business and entertainment industries. His large clients include Disney and 20th Century Fox, but most of his clients are SMEs. In all cases, the development teams assigned to projects are small and nimble, 3-6 technical staff, usually. Most of his clients are regional - in metropolitan Los Angeles, but some have been based elsewhere in California and the United States.

Sheen has four permanent employees and a dozen regular consultants/contractors brought in when needed. He runs a small lean shop that relies on the combined technical abilities and sales abilities of the principals.

² In accordance with English transliteration norms -- Xin is pronounced Sheen.

Sheen Strategy

“My strategy is to grow,” said Xin, “... to capitalize on our strengths and the strengths of the Chinese.

In Sheen’s client engagements, the firm uses its own adaptation of Agile methodologies³. Agile methodologies are also known as “lightweight methodologies”; the most famous of which is Extreme Programming, or XP. The “agile movement” is a reaction to the “heavy” methodologies exemplified by the Software Engineering Institute’s CMM (Capability Maturity Model), which emphasizes controls and documentation, both of which are anathema to independent-minded programmers.

“We've found that most clients don't have the bandwidth to do full-blown systems analysis and design, so Agile methodologies are better suited. Agile approaches are much better suited to more and better communication between client and developers with lots of end-user participation and small, nimble teams of developers. By working closer with the developer, the client gets over the xenophobia of working with the foreigner, the unknown.”

The other part of Xin’s strategy is to utilize the strength of the Chinese. While the Indian outsourcing industry has mastered the factory approach of software production, the Chinese software industry is only slowly following that lead-- and perhaps reluctantly. About 20 Indian firms have attained the highest process standards of software development, the CMM Level 5. India's success is all the more noteworthy because its firms represent roughly 50% of all global firms who have attained this standard.

"When we bid against CMM Level 5 Indian firms how do we beat them? We have to offer something different."

Chinese programmers, on the other hand, are educated in computer science programs with a tradition of theory and algorithm development. Students coming out of this educational system are not interested in working in factory environments in which they are handed specifications. They want to work with the customer to solve problems.

"Agile programming is a much better fit to Chinese work culture than the stifling procedures embedded in the CMM," said Xin.

³ For more on the strange marriage of “Agile Methods” and software development over distance (distributed development) see the following links: Bridging the Distance. Software Development Magazine. Dispersed and distributed development teams may span the globe, but they can be linked through the agile movement's main principle: communication.

<http://www.sdmagazine.com/documents/s=7556/sdm0209i/sdm0209i.htm?temp=snsjALft4Q>

One of the cornerstones of agile methodologies is very tight teamwork and very tight interactions between client and developer. Sheen's approach to teamwork is to place people at the client site as much as possible. Sometimes this can reach half of project duration. When the client wants the team at their site for longer periods of time, this adds to the project cost. Sheen passes the cost to the client.

"In China, everyone wants to be their own boss, people are less conformative, so when you use Agile methods, you allow everyone on the team to give feedback."

Sheen web page, late 2003.

Sheen: Our focus is on Systems Integration services

Sheen's core areas of competencies are:

- Object oriented analysis/design and programming using UML and J2EE
- Relational database design using Microsoft SQL Server, Oracle, and Sybase
- Managing architectural design using XML and related technologies

We provide the following services:

- Systems integration
- Software architectural design
- Custom programming
- Technical training
- Best practices consulting

Our clients are in these categories:

- Fortune 100 entertainment corporations
 - Major software providers
 - Online retailers
-