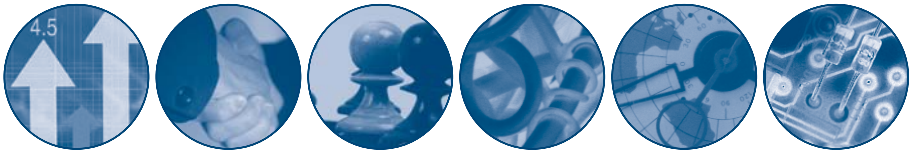

Sourcing and Vendor Relationships
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Update

Outsourcing Insights:

What the Numbers Say

by Michael Mah,
Senior Consultant,
Cutter Consortium

Does outsourcing work? This *Executive Update* seeks to answer that question by examining results from a recent Cutter Consortium survey of 140 companies that have made outsourcing a part of their IT strategy.

BACKGROUND

During the economic downturn, many organizations turned to outsourcing, primarily to cut costs. In some cases, jobs were shipped overseas as work was sent to lower-cost countries. The implications were significant. For the first time, high-wage, developed countries such as Germany and the US were outsourcing more than just blue-collar manufacturing of commodity goods (such as shoes and auto parts) to lower-cost foreign nationals. The shift was now toward white-collar design and service work — the stock of the modern-day knowledge economy. Cost cutting had reached the workers of the information age, not just those of the industrial age.

While many outsourcing service-level agreements outlined targets for "higher productivity," the general interpretation was "lower cost per unit of output." However, that is but one facet of productivity in design work. Some even argue that focusing strictly on this dimension is a bad idea. Other dimensions to consider include faster schedules, higher quality, and more functionality (within a given time frame and budget).

So now that companies have been outsourcing for a few years, are they seeing good results? Is one dimension — cost cutting — being achieved in tandem with, or at the expense of, timeliness and quality? We structured the survey to answer these and other questions. We wanted to know what goals companies are seeking to achieve as well as their priorities. Is cost really the most important factor? We also wanted to understand how satisfied respondents are with what they have received. If they are outsourcing only a percentage of their total IT, how much are they saving after all is said and done?

We also wanted to find out if they plan to stick with their present course. Will they continue as is, bring work back inhouse, or switch vendors? The answers may surprise you.

What about their ability to measure the results of deals? If companies seek cost reduction, productivity gains, or schedule/quality improvements, how satisfied are they in their ability to gather productivity metrics? Who measures and analyzes the results? The clients or the suppliers? If the suppliers measure themselves, isn't that a conflict of interest (i.e., the proverbial fox guarding the henhouse)? Since results might translate directly into contract dollars or penalties, won't companies be hard-pressed to report unfavorable metrics if these measures might hurt them financially?

Lastly, now that the economy seems to be improving, are pure cost-cutting strategies still aligned with present and future goals? What if companies now want to *grow* the business? Is cost cutting still as important? What about increasing top-line revenue and/or improving service? If schedules or quality don't improve as well, is that in a company's strategic interest? These are the kind of questions that this and future *Updates* based on these survey results seek to answer.

ABOUT THE RESPONDENTS

More than 45% of the 140 survey respondents represent companies with more than 1,000 employees. Of the respondents, 70% indicate that their IT staff comprises 50-1,000 or more employees, with approximately 30% representing IT departments with 100-500 people and nearly 15% with IT staffs of 1,000 or more. In short, a large portion of the respondents represented medium-to-large organizations.

TYPE OF OUTSOURCING

First we asked about the kind of work being outsourced. We wanted to know the split between deals in which IT staff were transitioned to outsourcing suppliers, staff augmentation deals, and pure project work. We also wanted to know whether the outsourcing involves primarily new applications, maintenance, operations, or business process outsourcing (BPO).

Seventy-seven percent of respondents say that their companies outsource project work (see Figure 1). Meanwhile, 44% say that their companies augment their staffs through outsourcing, while 29% move staff to outsourcing suppliers. These tend to be larger "megadeals," sometimes in the $100 million-plus range. So while a significant proportion of these deals involve IT staff changing employers from client to the supplier, a larger proportion involve supplier staff going to the client as inhouse contractors.

We also note that this group prefers IT outsourcing over BPO by almost 2 to 1 (see Figure 2). New applications and maintenance dominate, followed by operations and data center outsourcing, and then BPO.

IT'S ALL ABOUT THE MONEY

We then confirmed what we suspected: cost is the primary driver of these arrangements. When asked what the most important objective or justification for IT outsourcing is, cost cutting outranks schedule reduction and quality improvement by about 4 to 1.

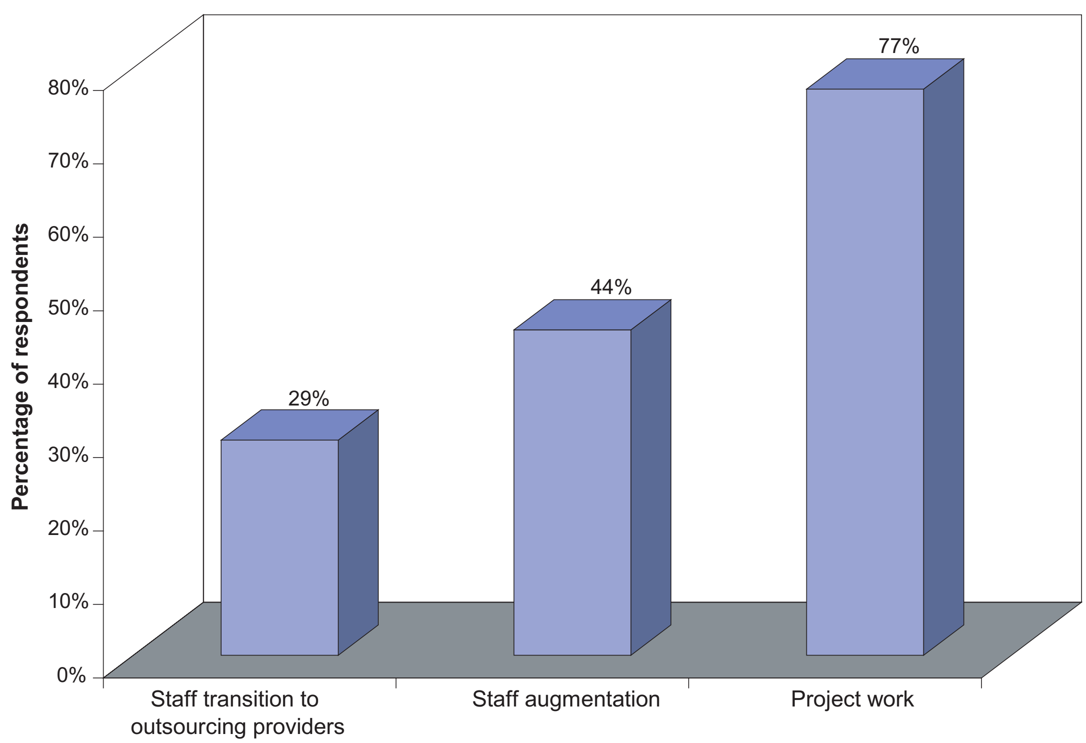

Figure 1 — What kind of outsourcing is your company engaged in? (Respondents able to select more than one response.)

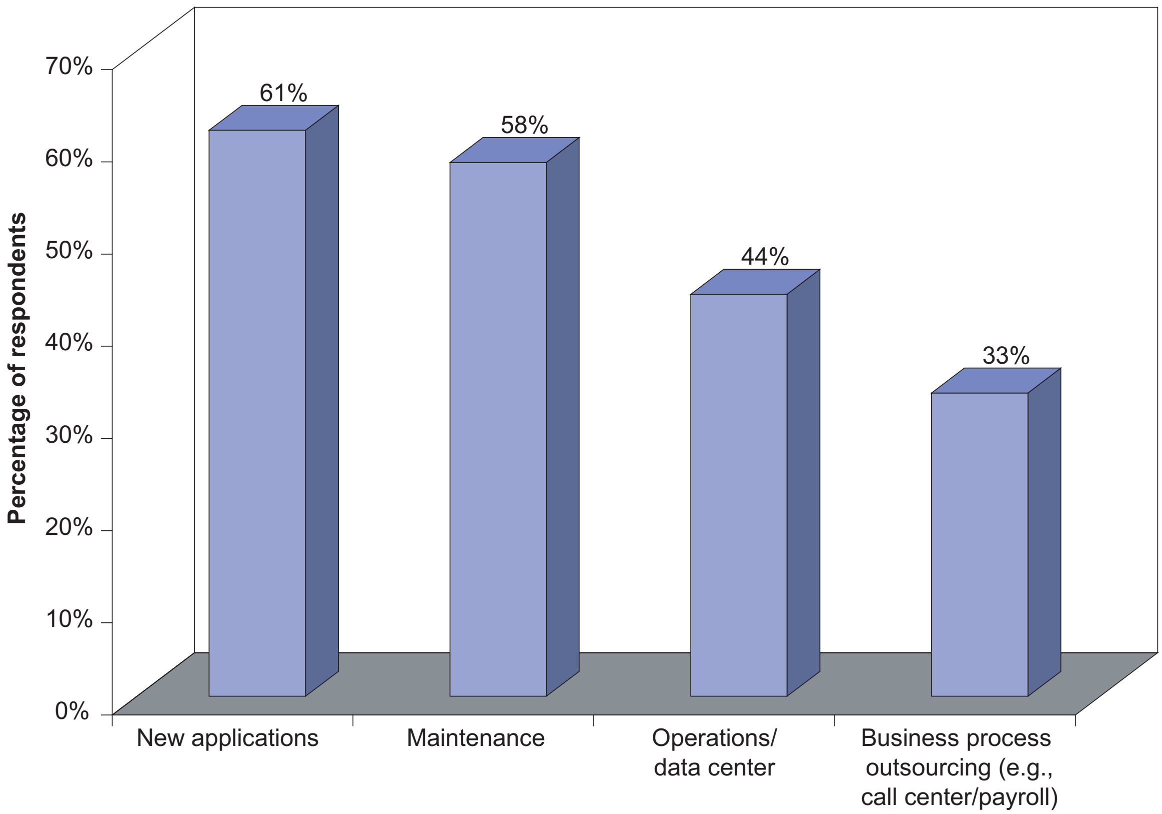

Figure 2 — What categories of outsourcing apply most to what is happening your organization? (Respondents able to select more than one response.)

I find it especially interesting (see Figure 3) that cutting costs outranks increasing revenue by about 6.5 to 1 (26% versus 4%). Ironically, if a company's true desire is to increase profitability at the end of the day, growing the business is largely ignored; cutting costs is what it's all about right now. Only 14% say that outsourcing is about improving service. And though more than half of respondents indicate that they seek a combination of all three, when it comes down to it, clearly it's all about the money.

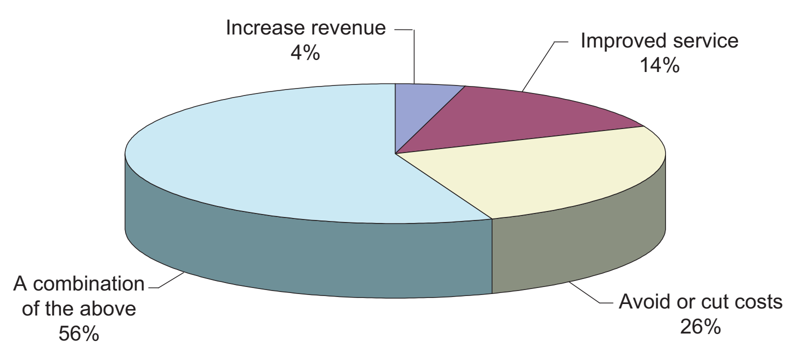

Figure 3 — Indicate the primary goals that you are seeking by outsourcing.

SOME OUTSOURCING RESULTS

Next we asked how successful companies are in achieving their cost and productivity objectives, compared with achieving schedule and quality objectives. Based on 101 responses, the results are surprising: 8% and 5% say that they are "not at all" successful in achieving cost and productivity objectives, respectively; and 6% and 10% reply that they are "not at all" successful in achieving schedule and quality objectives, respectively.

Consistent with this is the finding that 32% of respondents say that they are minimally successful in achieving cost and productivity objectives, while 40% and 36% of respondents report being minimally successful (less than 10% improvement) in achieving their schedule and quality improvement objectives, respectively.

Approximately 47% and 45% of respondents say that their companies are moderately successful (i.e., a 10%-30% improvement) in achieving their cost and productivity goals, respectively, while 30% and 34% believe that their companies are moderately successful in achieving their schedule and quality goals, respectively.

In a nutshell, since outsourcing deals are making cost cutting a priority, it appears that results are tilting in this fashion, with schedule and quality results being lower, as we might expect.

THE BOTTOM LINE

With all this emphasis on cost cutting, it is surprising to see how it affects IT. We asked participants how much of their IT their company plans to outsource: 42% report they will outsource 11%-25%, while another 28% say 26%-50%.

Let's assume then that, on average, 25% of IT will be outsourced. Now let's assume that the typical cost savings is roughly 20% in a given outsourcing deal. This translates to a total savings of 20% of that 25% portion of the total IT spending pie, which is 5% (.20 x .25 = .05). So out of an IT budget of, say, $1 million, your cost savings would be $50,000.

HOW WELL DO COMPANIES MEASURE?

In examining the data, I was particularly struck by the fact that most respondents find it difficult to acquire and use metrics to govern their outsourcing deals. I suspect that an inability to effectively measure is to the detriment of these contracts and the results subsequently achieved. We asked respondents to rate on a scale of 1 to 7 (with 1 being extremely negative and 7 being extremely positive) how satisfied they are in their ability to acquire and use productivity metrics.

As Figure 4 indicates, 77% of respondents give a rating of 4 or lower. Clearly, organizations are establishing multimillion-dollar (if not multibillion-dollar) deals, yet achieving less than satisfactory results when it comes to measuring the productivity gains of these arrangements.

The good news here is that there is room for improvement in measuring IT productivity and project estimation, especially in applications development. Given the methods that are currently available, the potential benefits are within reach for many companies today.

SO ARE THEY HAPPY?

Putting all this in perspective, survey results show the following:

- Cost is the primary reason for outsourcing — more so than schedule and quality.

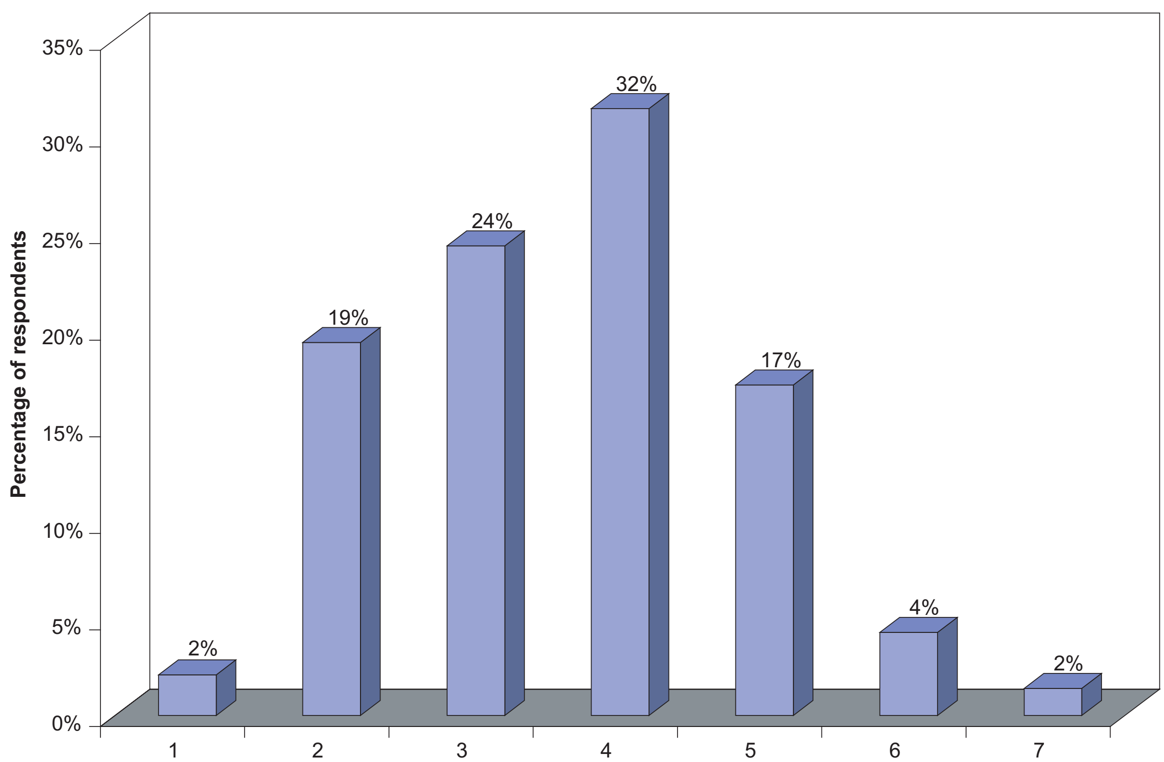

Figure 4 — How satisfied are you with your ability to acquire and use productivity metrics?

- Outsourcing saves companies approximately 20% of one-quarter of the IT spending pie, resulting in a 5% savings in the IT budget.
- We are unable to measure as well as we'd like.
- We're looking to switch vendors or bring work back inhouse (see Figure 5).

I was quite surprised by this last point. When asked whether they plan to continue with their current plan or change course, only 44% of respondents report that they will keep things as is, while 56% plan to switch. Of the 56%, the majority (41%) say that they plan to seek alternative bids from potential suppliers, while the remaining 15% are considering bringing work back inhouse.

There could be a number of reasons for seeking another supplier rather than bringing work back inhouse. First, on staff transition arrangements, it's too late to bring people back on the payroll — they're already gone. Second, it wouldn't be as politically suicidal to say that outsourcing failed to create satisfaction altogether. Some may seek to blame the first supplier they went with instead, possibly believing that the problem isn't with the outsourcing per se, but rather with the partners they chose.

In upcoming *Updates*, we'll further examine how companies choose their suppliers as well as oversight and governance practices, including how companies measure and estimate IT work.

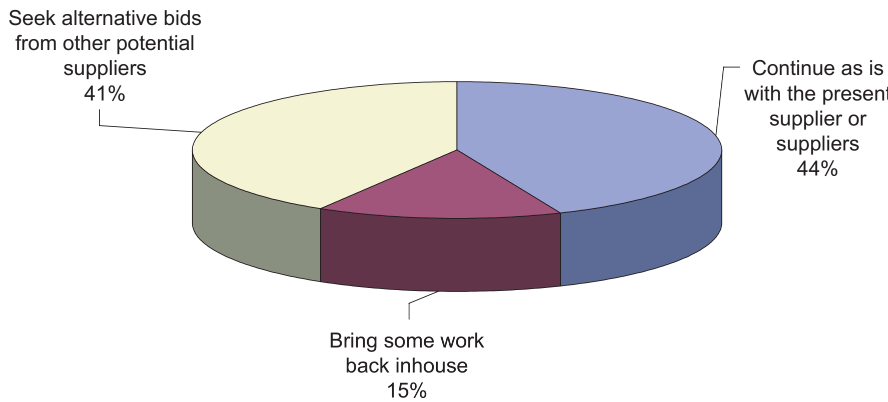

Figure 5 — If you are outsourcing now, do you plan to continue as is or change course?

ABOUT THE AUTHOR

Michael C. Mah is a Senior Consultant with Cutter Consortium's Measurement and Benchmarking Practice and the Sourcing and Vendor Relationships Practice. He is owner/partner at QSM Associates, Inc. Mr. Mah is a recognized expert on practical applications of software metrics, project estimation/control, and IT productivity benchmarking. Over the past 10 years, he has published numerous articles on these and other management topics. His recent work merges concepts in software measurement and benchmarking with negotiation and dispute resolution techniques for IT outsourcing and relationship management. Mr. Mah's particular interest is in people dynamics, such as the complex interactions between people, groups, divisions, and partnered companies working on the technology revolution at "Internet speed." He is also focused on the latest research and theory on negotiation, including the use of game theory, role playing, and training to increase corporate and personal effectiveness. Mr. Mah is a frequent speaker at major trade conferences, including the Cutter Consortium Summit *series,* Applications of Software Measurement/Software Management*, the* Software Engineering Process Group, Practical Software Quality Techniques*, the* Technology Partners International Outsourcing Conferences*, the* Sourcing Interests Group*, and others. Mr. Mah has a degree in engineering from Tufts University. His training on dispute resolution, mediation, and participatory processes is from the Program on Negotiation at Harvard Law School and the Radcliffe Institute for Advanced Study. He can be reached at mmah@cutter.com.*

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Cutter Consortium
37 Broadway, Suite 1
Arlington, MA 02474-5552, USA

Tel: +1 781 648 8700
Fax: +1 781 648 1950
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