Sourcing and Vendor Relationships
Executive Update
Vol. 5, No. 18

Update

Outsourcing Insights:

Getting Started, Getting Results

by Michael Mah,
Senior Consultant,
Cutter Consortium

According to a recent Cutter Consortium survey of 140 organizations, more than 71% of respondents plan to outsource portions of IT sometime within the next year. Given these numbers, it's important that organizations have realistic expectations of what they can achieve in an outsourcing arrangement.

In Part I (see "Outsourcing Insights: What the Numbers Say," Vol. 5, No. 17), we reported on the types of outsourcing that respondents' organizations are engaged in; their cost/productivity, schedule, and quality goals; and whether IT organizations are able to effectively measure productivity. The results from that *Update* can be summarized as follows:

- Cost reduction is the primary reason for outsourcing, more so than schedule and quality improvement.
- Clients report more satisfaction in achieving cost reduction and less satisfaction in improving schedule and quality.
- Average cost savings in an outsourcing deal is approximately 20%. But when you consider that typically 25% of IT is outsourced, the net savings amounts to only 5% (20% of the 25% of IT being outsourced).
- Organizations are generally dissatisfied with their ability to measure.
- The majority are looking to switch vendors or bring work back inhouse.

In this *Update*, we examine customer satisfaction with IT outsourcing arrangements, how customers evaluate potential suppliers, and how both sides measure customer expectations during outsourcing contracts.

I CAN'T GET NO SATISFACTION

Figure 1 shows respondents' answers to the question "How satisfied are you with the results of your outsourcing arrangements?" (with 1 being extremely negative and 7 being extremely positive).

The most cited response was 4 — "neither" — with 34% of the vote. The next highest response was 3 — slightly negative — with 26%, followed by 5 — slightly positive — with 24%. So nearly 85% of the answers fall into this narrow band. If you look at the net savings being in the single-digit percentage range (5%) and the satisfaction levels rating an average score, you may wonder how such a major IT trend has generated what seems to be

CUTTER CONSORTIUM

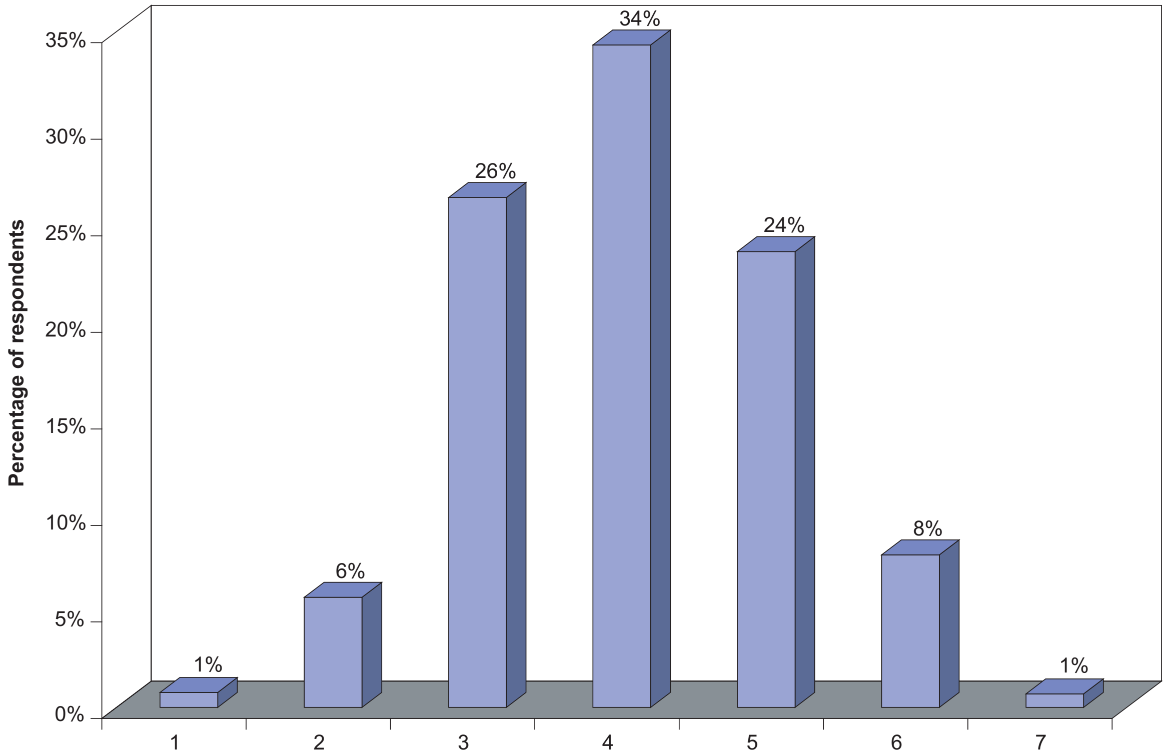

Figure 1 — On a scale of 1-7, with 1 being extremely negative and 7 being extremely positive, how satisfied are you with the results of your outsourcing arrangements?

tepid results. Are we not getting it right?

Generally speaking, it's not surprising that organizations report better success in achieving cost reduction than schedule and quality improvement, since that's the primary goal of most outsourcing contracts. But it's shocking that the actual amount of the cost reduction is so minimal.

My suspicion is that domain knowledge issues (since IT is knowledge work) may be contributing to this problem. One client I spoke with explained that, although labor rates in the organization's offshore arrangement were much lower, the work sometimes took three times as long to complete. This was due to the lack of domain knowledge compounded by communication difficulties across vast time zones.

It is conceivable that if offshoring work costs you 50% less but takes three times longer to finish, it actually costs you more. My sense is that political pressures might make admitting this very difficult, however, since doing so would be to admit failure.

For most organizations, the solution would be to ignore cheaper labor rates for the time being and instead focus on solving domain knowledge problems and optimizing communication with teams on the other side of the globe — no small task. Another client I spoke with in the health insurance field decided against offshore outsourcing. She said that her company would have little chance of solving the domain knowledge problem. Why? Because most people in India don't have health insurance, so they don't understand the business and likely would not for quite some time.

To gain a better understanding of the process of the outsourcing courtship, we looked at the following issues. Do organizations tend to enlist third-party assistance in requests for proposals (RFPs) and source selection? When establishing an outsourcing relationship, what criteria is used to select a partner? Is having an offshore component important? Given the political pressures on the loss of domestic jobs, we were curious about people's stances on these issues.

GOING TO THE CHAPEL AND WE'RE GONNA GET MARRIED

As Figure 2 indicates, 75% of respondents say that it is moderately to very important to use third-party outsourcing advisors, while 25% report that they go it alone. Since most organizations probably don't have long track records of outsourcing, it appears that enlisting experienced help in selecting a partner is important.

And yet something seems amiss here; these marriages are achieving only marginal outcomes, and after all is said and done, a large percentage is expressing a desire to either bring work back inhouse or find another partner. In my mind, this is a rallying cry to the outsourcing industry. Clients aren't as happy with these relationships as they could be. This also suggests that the emerging field of relationship management has significant potential to improve the situation.

THE WAY YOU LOOK TONIGHT

What criteria do organizations use when selecting an outsourcing supplier? As shown in Figure 3, 72% of respondents use metrics when evaluating suppliers, What is remarkable is the fact that 28% do not.

The fact that the majority of respondents are dissatisfied with their ability to acquire and use productivity metrics may partially explain this situation. In Part I, we reported that on a scale of 1 to 7, with 1 being extremely negative and 7 being extremely positive, more than 75% answered 4 or lower to this question.

Clearly, organizations can do better. If productivity improvement and cost reduction are the primary goals of outsourcing, it would behoove organizations to get a better handle on metrics in order to measure whether service-level agreements (SLAs) are being met. (Likewise, they would also need to measure schedule and quality levels, since it appears that many organizations are less than satisfied with results in this area.)

Another view emerges when we consider measurement and benchmarking during due diligence. We asked respondents whether they measure their own historical (pre-outsourcing) productivity, require suppliers to furnish productivity metrics from their historical track records, or if they struggle or don't use metrics.

Figure 4 shows the answers to this question. By a 53%-to-44% split, only a slight majority either measure themselves or their suppliers. For those who don't use measures, this poses a problem in two ways. First, it makes SLA negotiations difficult. Establishing cost reductions, productivity gains, and other aspects of SLAs can be a shot in the dark without having a "productivity base-case." How can you agree to improvement goals when you don't know what to use as a baseline? It's like wanting to reduce your cholesterol points without even knowing what your cholesterol levels were to begin with.

Second, it makes renegotiation difficult. Without reliable performance numbers, it's hard to agree on whether the postdeal results are achieving desired levels compared with a baseline. If nearly half the deals out there have no numbers, or have flawed numbers, then whether the relationship is or isn't meeting expectations is simply a matter of opinion. The client may be disappointed, while the supplier thinks everything is fine.

We also wanted to know whether an offshore component was an important consideration in outsourcing arrangements. By a factor of 3 to 1, respondents say they prefer that suppliers achieve productivity increases without using offshore labor.[1] That said, the highest response to this particular question was, "It doesn't matter to me; what's most important are cost reductions using whatever methods available."

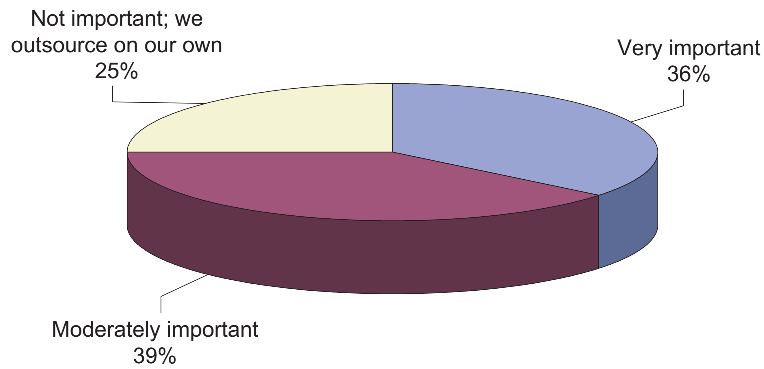

Figure 2 — How important is it to you to utilize the knowledge and resources of a third-party outsourcing advisor when awarding an outsourcing contract?

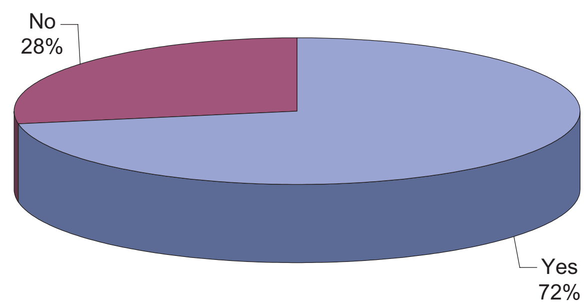

Figure 3 — Do you use metrics criteria when evaluating suppliers?

[1]This finding is based on only 101 responses; 39 responses from those who indicated they are computer consultants were excluded. Including the consultants, the ratio is slightly more than 2 to 1.

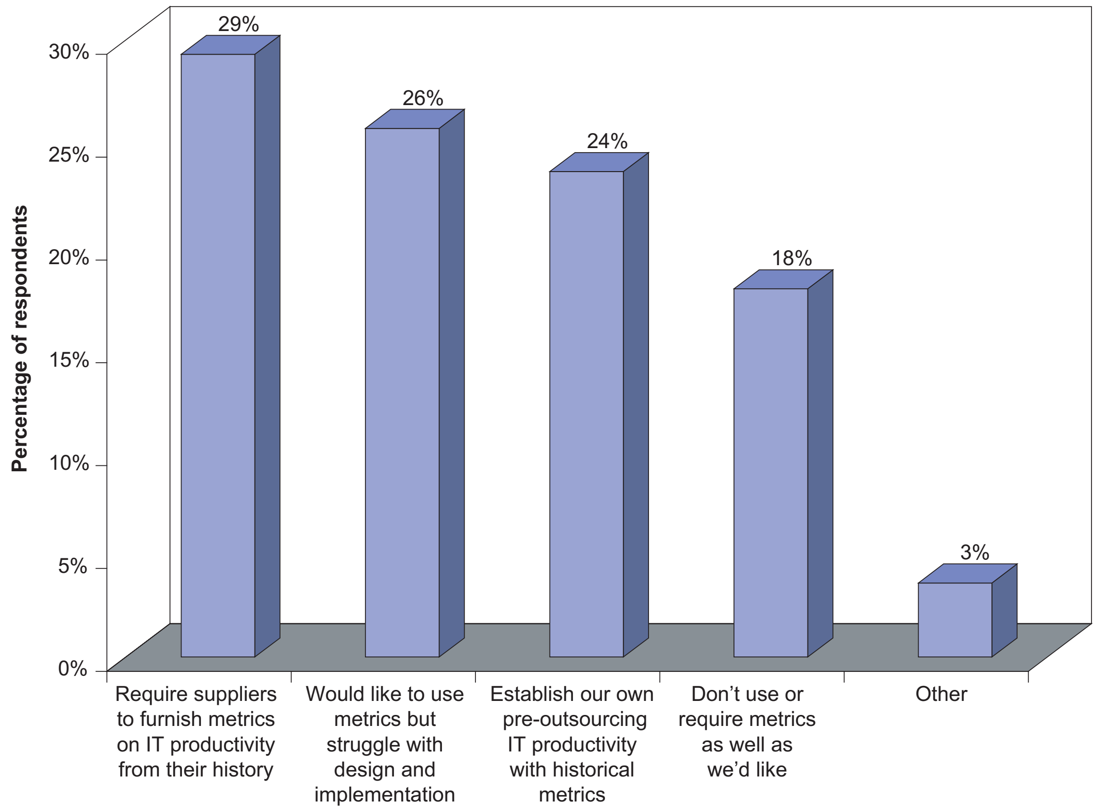

Figure 4 — Please complete this sentence: During the due diligence phase, we … .

Implicitly, this relentless drive to lower costs will undoubtedly push more software projects offshore. But the dirty little secret here is that worldwide IT benchmarking data from QSM shows defects being 35%-40% higher for offshore projects compared with those done in North America. Yet no one talks about the long-term costs of higher defects. This seems consistent with the domain knowledge and communication complexities cited earlier.

WHERE DO WE GO FROM HERE?

How deals are set up and the expectations and contract alignments that result tell us a lot about how to move forward once an outsourcing arrangement is signed.

Clearly, the lessons learned from these responses can serve to guide us when it comes to setting expectations for future outsourcing scenarios. Many of these deals are under tremendous time pressure; just like in IT projects, deadlines rule. It seems easy to simply mandate cost reductions as a service-level goal and establish what can sometimes be arbitrary targets. The tough part is measuring whether these targets (i.e., cost reduction) are being achieved at the expense of other dimensions.

Even with the best of intentions, relationships sometimes fall short. The trick is learning how to handle these situations and the challenges that are posed on governance and relationship management.

In Part III of this series, we'll explore what people do after a deal is signed. If organizations are getting what they asked for but remain dissatisfied, perhaps it's time to get realistic. It wouldn't surprise us to discover that the courtship and romance phase is the easy part — the challenge comes after the couple returns from the honeymoon.

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.*

Workshops

In these times of intense pressure to make every development dollar and every development minute count, the maxim *you are only as strong as your weakest link* has never rung truer.

Moving your development organization up the productivity curve will improve the ROI of every one of your projects. Just trace this back and you'll discover the ROI in training is immense. And with training and workshops designed and delivered by Cutter Consortium's Senior Consultants, you can add to that equation the peace of mind you get from being trained by the best of the best.

Cutter Consortium offers inhouse training solutions from IT project management techniques to software development methodologies, improving data quality, architecting Web services applications, aligning business and IT objectives and more.

Workshop Topics

- Agile Development Methodologies
- Business-IT Alignment
- Data Quality
- Data Warehousing
- Enterprise Architecture
- Estimation Techniques
- Extreme Programming
- IT Strategic Planning
- Knowledge Management
- Metrics/Benchmarking
- Outsourcing
- Project Management
- Requirements Management
- Risk Management
- Software Development Practices
- Testing
- Web Services

For details about the courses offered in each of these areas, contact Dennis Crowley at +1 781 641 5125 or dcrowley@cutter.com, or visit www.cutter.com/workshops.

Workshop Developers/ Presenters

Every workshop is led by one of Cutter Consortium's expert Senior Consultants — experienced IT professionals who have honed their skills and developed their methodologies over years in the field at companies like yours.

Verna Allee
Scott Ambler
Robert Austin
James Bach
Kent Beck
E.M. Bennatan
Doug DeCarlo
Tom DeMarco
Jonathan G. Geiger
Michael Guttman
Tushar Hazra
Peter Herzum
Jim Highsmith
Claudia Imhoff
Wendell Jones
Joshua Kerievsky
Tim Lister
Lisa Loftis
David Loshin
Michael Mah
Larissa Moss
Joyce Norris-Montanari
Ken Orr
Ray Pettit
Carl Pritchard
Helen Pukszta
Thomas Redman
Suzanne Robertson
Johanna Rothman
Lou Russell
Michael Schmitz
Ken Schwaber
Rob Thomsett
William Ulrich
Karl Wiig
Ed Yourdon

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

Tel: +1 781 648 8700
Fax: +1 781 648 1950
Web: www.cutter.com
E-mail: sales@cutter.com