

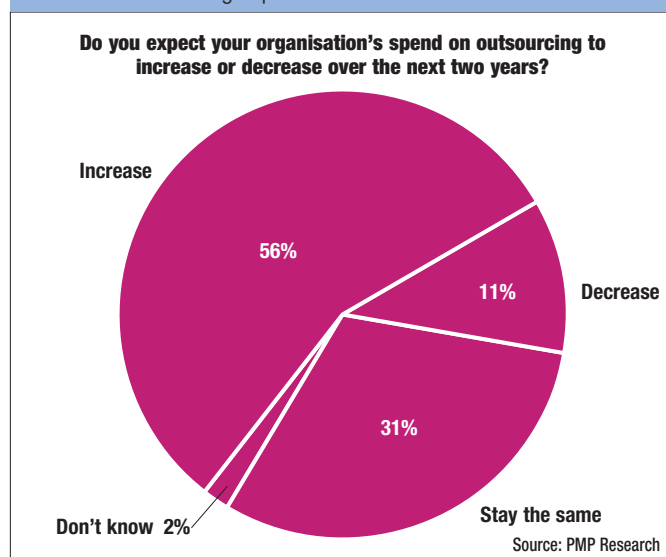
SURFING THE WAVE

The popularity of IT and business process outsourcing continues to spread, reports Pat Sweet.

Outsourcing is one of the few IT success stories of recent times. While sales of new applications hit the doldrums during the early 00s, outsourcing has been sailing full speed ahead. Its combination of advanced technology, lower costs and reduced risk has proved very appealing to companies grown jaded with trying to implement IT systems successfully themselves inhouse. This year's PMP Research survey confirms that many companies of all shapes and sizes are now choosing an option that was once the preserve of only the very largest organisations.

The research reveals that two-thirds of those polled (see Survey Statistics box, page 4) spend up to a quarter of their IT budget on outsourcing. While 38% devote less than 10% of their IT spend to outsourcing, a larger proportion (41%) reckon to spend between 10% and 50% this way, with 28% putting 10-25% of their budget into outsourcing and 13% pledging between 25% and 50%. Further up the scale, 8% put between half and three-quarters of their IT spend into outsourcing, with a further 8% committing anywhere from 75% to 100%.

FIGURE 1: Outsourcing expenditure



What is more, over half of the sample (56%) expect to increase their spend on outsourcing over the next two years, while nearly a third (31%) say their outsourcing investment will remain steady. Just 11% are predicting a cut in this area (see Figure 1).

In some cases, there are significant amounts of money going into outsource deals: 11% of the respondents reckon they usually plough more than £10 million into a typical outsourcing contract. On the whole, though, contracts tend to be more modest, with 19% estimating a typical contract at between £50,000 and £100,000, and 13% reckoning to invest less than £50,000. But while they are big spenders, companies do not hand over their money unconditionally.

It seems outsource purchasers like to keep the suppliers on their toes, since nearly half (45%) reckon a contract typically lasts for between two and five years, and a quarter (24%) put the typical timeframe at between one and two years (see Figure 2).

Few advocate an outsourcing contract of less than a year (6%) – and the sort of long-term arrangements common in the early days of outsourcing are now firmly out of favour. Only 6% say they sign contracts designed to last for seven to 10 years, and just 4% are prepared to look at a time horizon beyond 10 years.

When it comes to making the decision as to whether to outsource or not, the IT director remains in the driving seat in the majority (56%) of companies. But half (50%) report that the main board is involved in any decision, along with the finance director (36%). Interestingly, those closest to the action have less

FIGURE 2: Typical length of an outsourcing contract

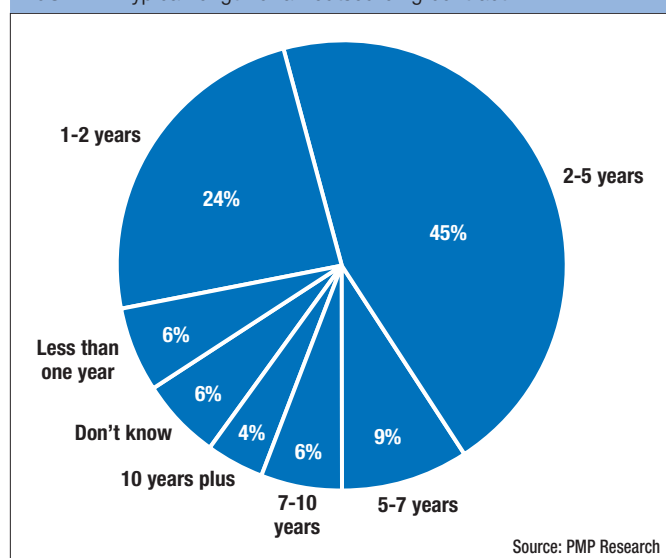
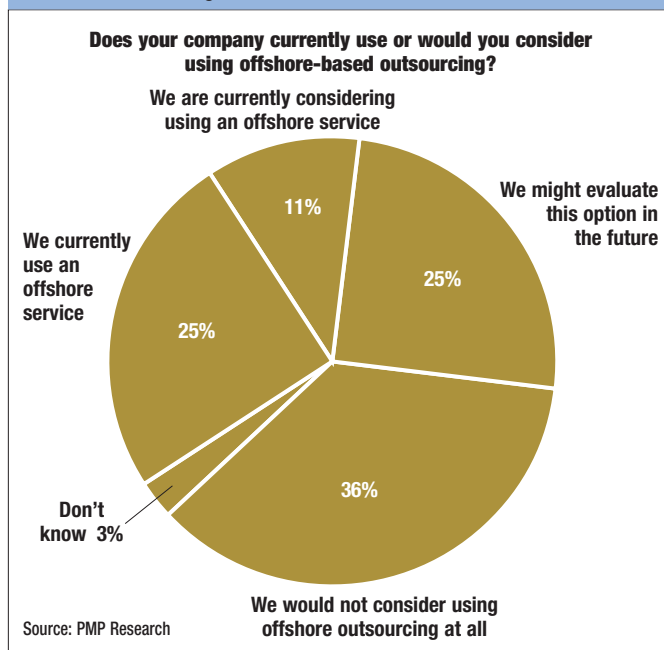


FIGURE 3: Offshoring



input, since only 22% of line-of-business directors get to make the decision about whether to outsource; and just 16% of companies consult representatives from the relevant business areas for their views.

As to what kind of decision is made, our survey suggests the majority still favour more established types of outsourcing. More than half (58%) are currently using 'traditional' outsourcing services, whereby a supplier's staff work in the client IT department, or client IT staff work at the outsourcer's site. Managed services, adopted by 54% currently, are also popular.

Application service provider (ASP) options have gained some fans, with 30% reporting they currently use this kind of service and a further 14% planning to follow this path in the future. A third of respondents (34%) have opted for business process outsourcing (BPO), whereby a specific function or departmental activity is provided by a third party. Another 20% say they intend to do so in future.

However, the respondent who describes BPO as "very difficult to get right and not affect service" is by no means a lone voice. The majority of respondents (60%) admit that problems in determining the boundaries of business processes remain a significant barrier to adopting this type of service. Half (50%) of the respondents concede that they have difficulty both in defining and measuring current business processes, which makes passing responsibility over to a third party a major challenge.

An even bigger proportion (62%) are wary of the amount of management time needed to define and oversee the processes involved in BPO – compared to just 30% who believe it would be hard to find a supplier with the right skills to run a BPO deal. Respondents are also lukewarm about offshore outsourcing, whereby services and facilities are located in a lower-cost economy, often in a different global region.

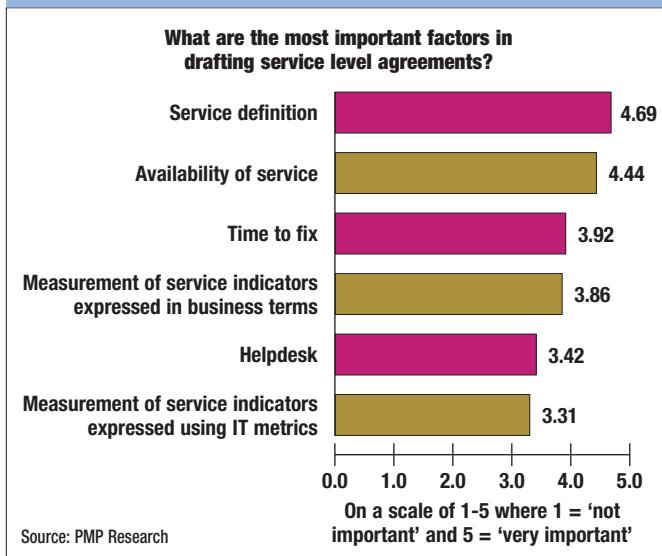
More than a third (36%) rule this option out completely, although 11% are currently contemplating such a move (see Figure 3). A quarter are already using offshore facilities, and a further 25% say they may evaluate this in the future, with the remaining 3% undecided. Whatever flavour of outsourcing provision they choose, most companies opt to involve a third party in their IT operations as a way of coping with the often essential but frequently distracting requirements of IT systems.

We asked our sample to identify the key reasons their company uses outsourcing, using a scale of 1 to 5 where 1 represents 'not important' and 5 stands for 'very important'. The aggregated scores show that two major factors drive companies to consider outsourcing, namely the need to gain access to specialist IT skills (4.10) and the desire to be free to focus on the core business (4.01). Reducing operational costs is also high on the list (3.92).

In contrast, companies demonstrate much less interest in improving visibility of costs through outsourcing (3.37) or in reducing capital costs (3.30). Nor are they particularly concerned about gaining access to advanced technology (3.21). What they do expect outsourcing suppliers to deliver is improved service levels (3.86) and reduced risk (3.54), plus the ability to respond more quickly and flexibly to any changes in the business (3.51).

In order to check whether they are getting what they pay for, the majority of companies (80%) plump for service level agreements (SLAs) as their main method of monitoring the performance of an outsourcing contract. Regular reviews with the service supplier are another prerequisite, mentioned by 72%.

FIGURE 4: Service level agreements



Significantly, over a third (38%) of organisations have set up an internal department specifically charged with monitoring the performance of any outsourcing deal. However, only one in five (20%) say they have a board-level director involved in this process.

With SLAs so central to the way companies manage outsourcing suppliers, it is clearly vital for them to get the details right. We asked our respondents to assess the most important factors in drafting SLAs, again using a scale of 1 to 5. The aggregated scores show that the most critical consideration is service definition (4.69) followed by availability of service (4.44), as shown in Figure 4. In other words, companies need to lay out what they expect the supplier to deliver in clear terms.

Interestingly, companies appear to put much more emphasis on getting the service right first off, than on establishing arrangements to fix any problems should something go wrong – with issues such as the supplier’s time to fix difficulties (3.92) and helpdesk quality (3.42) rated lower in comparison. It is also more important that the performance of any outsourced service is measured using an indicator which gauges the impact in business terms (3.86), rather than by using IT metrics (3.31).

So an SLA is more likely to dictate, for example, that the end-of-week reports must be available by a specified time, rather than simply demanding 99.9% availability. The key question, of course, is how successful or otherwise suppliers are at meeting SLAs. Our study shows that, on the whole, outsourcing vendors are doing well in this respect. Indeed, 17% of our sample maintain that their SLAs are actually being exceeded, while the majority (36%) report that SLAs are being met as anticipated. Whilst it is true that a quarter (24%) of our sample are disappointed – feeling that their supplier does not succeed in meeting their SLA expectations – in only 6% of cases does there seem to be a serious breach. The remaining 17% either cannot assess SLA performance or have had mixed experiences.

Indeed, the complexity of managing SLAs is not generally viewed as a major barrier to successful outsourcing, according to 42%. Instead, the major concern for many organisations when using or considering outsourcing is the loss of specialist IT knowledge internally, which is cited by 62%. This may seem odd given that organisations have earlier indicated that access to specialist IT skills is one of their key reasons for choosing to outsource in the first place. However, it may well be that companies continue to feel some vulnerability about putting their IT systems into the hands of someone else.

Next on the list of potential problems in outsourcing are worries about changes in personnel at the outsourcing supplier (58%), difficulties in managing the relationship with the supplier (48%) and lack of contract flexibility (44%). On this last point, organisations may have cause to be worried. We asked our sample how easy it has been for them to change requirements once an outsourcing contract is underway. The majority (43%) report that this has been either ‘very hard and expensive’ (26%) or ‘very hard’ (17%).

However, a third (32%) say that making changes has not proved to be a problem, since their contract includes a facility to do this, while 6% have not needed to make any alterations. Added to this, on some occasions, suppliers clearly promise rather more than they can deliver. For 19% of our sample this has happened ‘frequently’, although the majority (38%) say that while suppliers sometimes fail to provide a service as specified, it has been possible to deal with this.

For a quarter of respondents this has not been an issue, since 17% report that only ‘very rarely’ has an outsourcing supplier failed to provide a service once a contract has started and in 9% of cases this has never happened (see

FIGURE 5: Service reliability

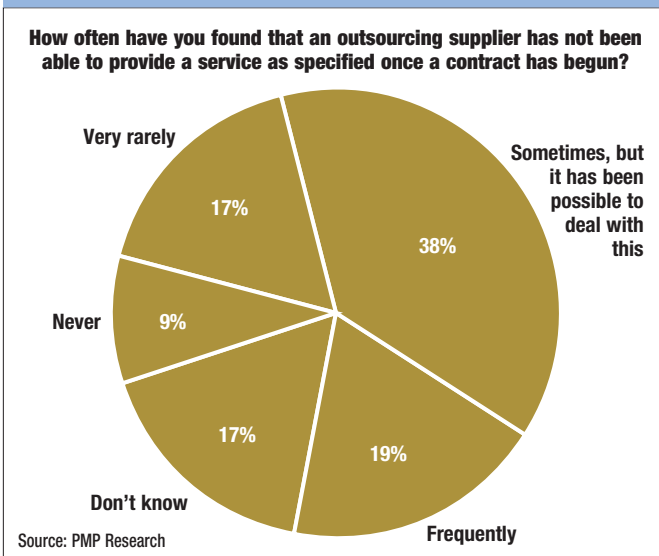


Figure 5). Respondents are evenly split between those who have and haven't tried to transfer work from one outsourcing supplier to another, or to take facilities back inhouse.

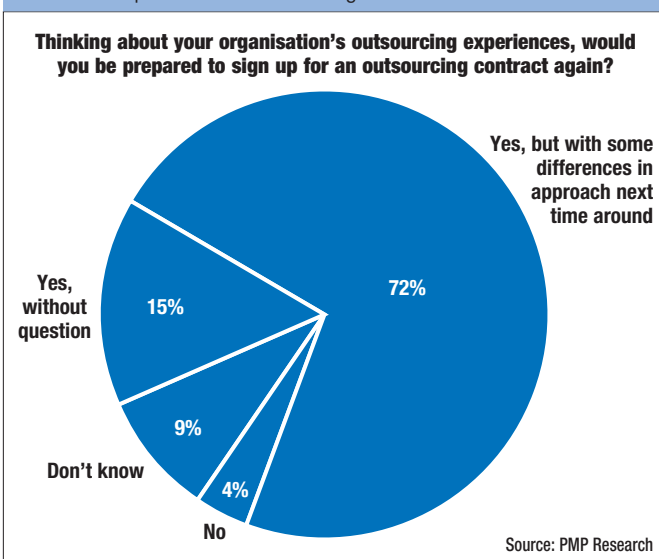
For those who have, half (52%) describe the process as 'difficult' and 10% label it 'very difficult'. But while none feel this has been 'very easy', for a third (33%) it has proved 'relatively easy'. One sign of the growing maturity of the outsourcing market is that 81% of companies re-evaluate the roles and responsibilities of inhouse IT personnel once applications or functions are outsourced, in recognition of their new circumstances.

But the most important question of all is whether or not outsourcing delivers true benefits. For a third (34%) it is either 'very easy' (8%) or 'easy' (26%) for them to calculate the ROI involved. For 30% this is 'hard', while 11% find it 'very hard' and 8% say it is not possible to do so.

Of the remaining 17%, many would probably agree with the respondent who feels that the "benefit is difficult to measure when the business environment is frequently changing". But overall, the acid test is whether the respondents would be prepared to sign up for an outsourcing contract again, given their experiences so far. As Figure 6 shows, 87% give the concept strong support, and just 4% rule it out entirely. Outsourcing has most definitely found a berth in the modern organisation.

● *Pat Sweet is the research analyst. If you are interested in this study, please contact Steve Markwell at PMP Research. Email: stevem@pmpresearch.co.uk.*

FIGURE 6: Experience of outsourcing



SURVEY STATISTICS

We spoke to a broad cross-section of companies for this year's survey on outsourcing issues and trends. Around a third (32%) are those very large organisations who have traditionally been the pioneers in this area – 13% report a turnover of between £1 billion and £5 billion, and 19% top the £5 billion mark. A further third (34%) come from companies with turnover ranging from £100 million to £500 million, while 11% are in the £500 million to £1 billion bracket.

But the views of smaller organisations are also included, with 8% having a turnover of between £50 million and £100 million and another 8% in the £10 million to £50 million range. At the lower end of the spectrum, 5% of our sample have a turnover of between £1 million and £10 million. Respondents are drawn from an equally varied range of sectors, including the public sector (21% of the sample) which has seen a number of major outsourcing initiatives in recent years. Amongst commercial companies, telecoms (10%) and financial services companies (8%) are well represented, along with companies involved in retail (8%), chemical & pharmaceutical (4%), construction (4%) and education (4%).