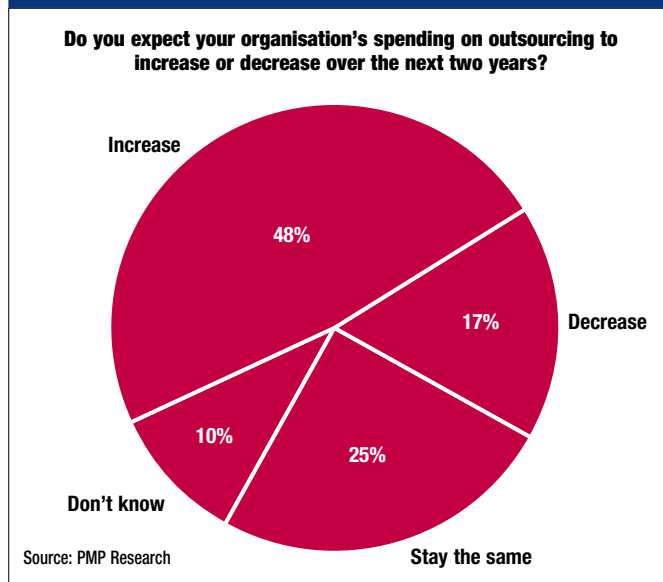


WISING UP

Shorter contracts, multiple suppliers and a trend to ‘insourcing’ – bringing outsourced services back inhouse – are all signs of a maturing market picked up by our latest research. Pat Sweet has the details.

FIGURE 1: Outsourcing investment trends



Once regarded as a step only for the brave, IT outsourcing is now seen as a key weapon in most companies' armoury. Organisations identify outsourcing as a way of winning the battle against rising IT costs, and early skirmishes with suppliers have been replaced by a more level playing field with advantages for both sides.

The first outsourcing initiatives tended to assume that the supplier knew best, with companies handing over responsibility for large chunks of their IT infrastructure to a third party for a period of anything up to 10 years.

Nowadays, many companies have considerable experience of outsourcing and so are better able to negotiate a deal which will deliver real value to their business. For their part, suppliers have shown themselves capable of developing more flexible and responsive solutions in what has become a much more competitive marketplace.

This year's survey, for instance, shows respondents adopting a whole range of outsourcing options, including managed services, ASP solutions, co-location, offshore outsourcing and business process outsourcing, as well as the traditional approach of having the outsourcer take over the existing IT department. Indeed, IT outsourcing in all its many guises is now so important that in the majority of companies (60%), decisions about whether or not to look for a third-party service are taken by the main board, along with the IT director in 55% of cases and sometimes the finance director (25%).

Evidently, outsourcing is a solution which works, since half (48%) of those polled state that their organisation's spending in this area is expected to increase over the next two years. A quarter (25%) anticipate that investment in outsourcing will remain the same, and only 17% feel it is likely to decrease (see Figure 1). Although organisations clearly plan to carry on investing in outsourcing, for most (58%) this will represent only a small element of their overall IT spend – less than 10%. But there are one or two companies for whom outsourcing is a way of life, since 10% put 50-75% of their IT budget towards this and 2% plough 75-100% of their total IT spend into outsourcing.

The typical value of an outsourcing contract varies widely. A quarter (24%) reckon to spend less than £50,000, and a similar proportion (26%) have contracts in the range of £50,000 to £500,000. But 16% put between £1 million and £3 million on the table, while 3% sign contracts for anything from £5 million to £10 million and 5% have contracts valued at more than £10 million.

SURVEY STATISTICS

We spoke to a broad cross-section of companies for this year's survey on outsourcing issues and trends. At one end of the scale, 7% have an annual turnover of between £1 billion and £5 billion while 15% top the £5 billion mark. We also sought the views of smaller organisations, with 10% reporting turnovers of between £5 million and £10 million and 18% falling into the £10 million to £50 million bracket. One in five (20%) have a turnover of £150 million to £1 billion.

Respondents come from an equally varied industry background, with a quarter (25%) drawn from the public sector which has seen some very significant outsourcing deals in recent years. Amongst commercial companies, manufacturing (17%), the financial sector (10%), telecoms (7%) and retail (5%) are well represented, along with companies involved in the chemical & pharmaceutical industries (5%), energy & utilities (2%), and transport (2%).

But while the contract figures may be larger than ever, the time horizon for outsourcing contracts is shrinking. Not a single company, for example, admits to signing a deal intended to last more than 10 years, although this was once fairly common practice. The majority now expect a contract to cover one to two years (39%) or two to five years (39%), with 3% looking for a deal lasting less than a year and 10% expecting the arrangement to survive between five and 10 years.

One of the reasons companies are reluctant to sign up for more than five years is that they know their business is likely to change radically within that timeframe, along with their requirements, and they fear being locked into a contract which no longer suits their needs. In fact, though, this is probably less of a concern than some may think. We asked our sample to judge how easy it has been to change their requirements once an outsourcing contract has started. Half (48%) report that this has not been a problem, as their contract has specifically included the facility to make changes (see Figure 2).

A quarter (26%) have found it more difficult to do this, and also very expensive, while 11% admit this has been a very hard goal to achieve. Significantly, only 10% of the sample claim to have never needed to make alterations in this way.

Given these findings, it may well be that companies prefer shorter contracts because they represent a way to keep the outsourcing suppliers on their toes, as re-negotiation of the deal is never far away. Similarly, the survey underlines the trend for companies to avoid putting all their eggs in one basket. At the moment, two-thirds (68%) prefer selecting multiple suppliers rather than opting for a single outsourcer (19%). Looking to the future, three-quarters (77%) indicate they will be going down the multi-sourcing route, compared to the 16% who want to stick with one supplier.

Certainly, most companies do not want the outsourcing provider to regard their contract as a job for life. When it comes to initiating a new outsourcing deal, just 5% say they simply discuss their options with the incumbent supplier.

Double that proportion (11%) start searching for a new vendor, perhaps because of unhappy experiences with the previous one. But the majority (74%) say they talk to both their existing supplier and anyone else in the marketplace they feel could do the job. This suggests customers have become more sophisticated in their approach, and see mixing and matching suppliers as a way of keeping standards high.

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Companies use a variety of measures to assess how well an outsourcing contract is performing. Most are not prepared to rely on service reports alone, since holding regular reviews with the supplier is the most popular way of judging performance (72%), along with implementing service level agreements (SLAs) and establishing an internal department charged with monitoring contract performance (27%). Despite the impact that outsourcing can have on business performance, only 15% give a board-level director responsibility for checking on progress.

We asked our respondents to identify the most important factors in drafting SLAs, using a scale of 1 to 5 where 1 stands for 'not important' and 5 is 'very important'. The aggregated results shown in Figure 3 put service definition top of the list (4.63), along with availability of service (4.39) and time to fix (4.07). Clearly, the most important element of any

FIGURE 2: Contract flexibility

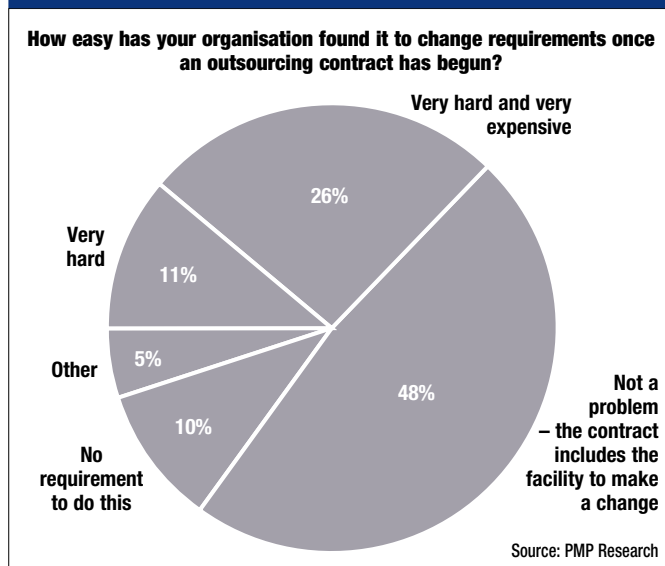


FIGURE 3: Key service criteria

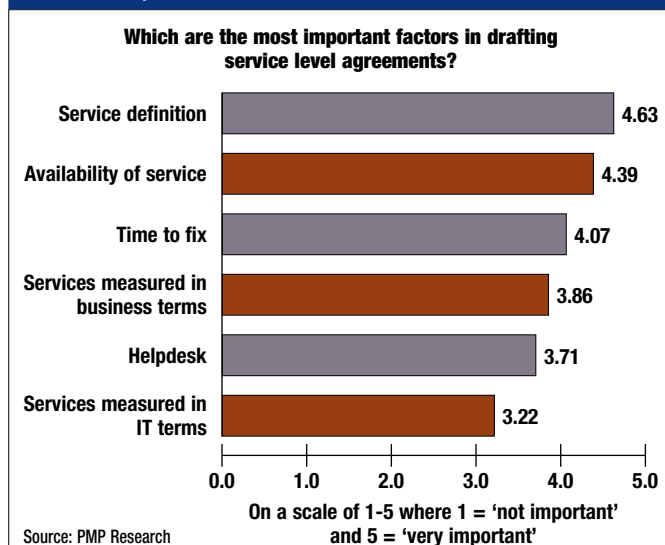
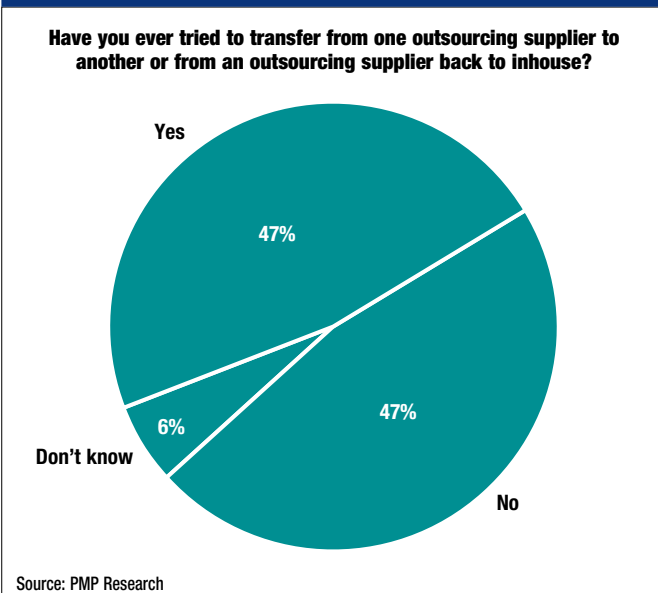


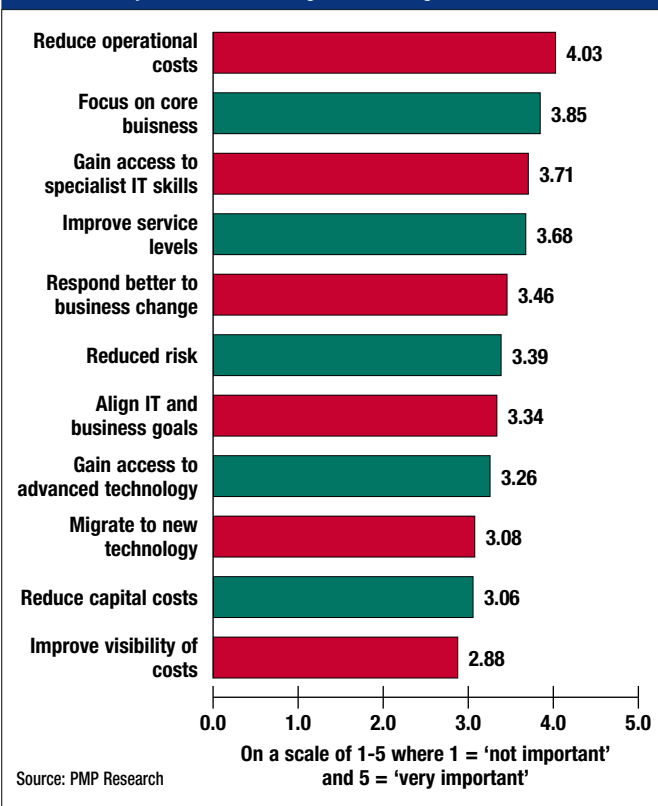
FIGURE 4: Requirement to terminate contracts



SLA is knowing exactly what service or facility it is designed to measure. Helpdesk performance was rated rather lower down the scale (3.71), suggesting most companies want their outsourcing supplier to focus on keeping services running, rather than on putting things right once they have gone wrong.

On the whole, suppliers are doing a good job of providing what is required. Half of our sample reckon their current SLAs are either met exactly as anticipated (26%) or even exceeded (36%). In around a quarter of cases (23%), companies feel the outsourcer's performance has not met SLA expectations, but only 3% say supplier performance has fallen well below agreed standards. Moreover, 10% of the sample report that there has never been an instance where an outsourcing supplier has been unable to provide a service as specified once a contract had begun. A third (33%) say such a problem is very rare and 38% maintain that while this has happened occasionally, it has been possible to find a solution fairly easily. Only a minority (13%) label this as a frequent event.

FIGURE 5: Key reasons for using outsourcing



Since satisfaction levels are evidently high, it may seem surprising that half the sample (47%) report trying to transfer from one outsourcing supplier to another at some point, or even taking their facilities back inhouse (see Figure 4). The fact that half also describe this process as either 'difficult' (53%) or 'very difficult' (5%) is surely indicative of some serious problems. But 'insourcing' is actually a sign of growing maturity within the outsourcing market. Along with the trend to appoint multiple suppliers and opt for shorter contracts, it is part of a strategy that allows companies to pick and choose how they use outsourcing, rather than leaving themselves at the mercy of the supplier.

Another sign that attitudes to outsourcing are maturing is that most organisations (84%) re-evaluate the roles and responsibilities of their inhouse IT staff once the outsourcing deal has been arranged. Three-quarters also change the skillsets of their employees as a result of signing the contract.

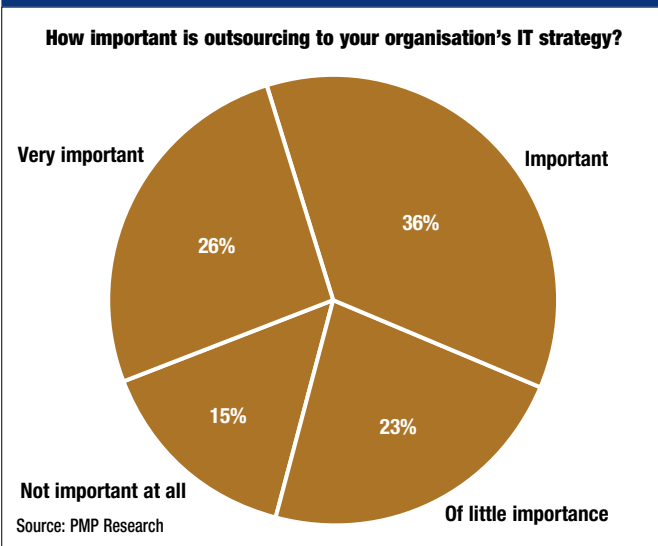
New organisation

Companies now recognise they need to develop a different kind of retained organisation when IT applications and services are being handled by a third party – with the emphasis on close monitoring of contract performance and a

clear means to assess what value the organisation is getting from outsourcing.

This approach is very different to what went before, when many organisations were only too happy to turn their systems over to a supplier and see what happened next. But there has been little change in the fundamental reasons why outsourcing appeals to a whole range of companies. We asked our sample to rate their reasons for using outsourcing on a scale of 1 to 5, where 1 is 'not important' and 5 stands for 'very important'. The aggregated results (Figure 5) indicate there are two key

FIGURE 6: Strategic importance of outsourcing



factors in any company's thinking: the need to reduce operational costs (4.03) and the desire to focus on core business activities (3.85).

These business drivers score more highly than IT-related benefits, such as gaining access to advanced technology (3.26) or the ability to migrate to new technologies (3.08) – although companies are also keen to get hold of scarce specialist IT skills (3.71) and to improve service levels (3.68). Companies are less concerned about using outsourcing as a way of reducing risk (3.39). Nor are they looking to improve their visibility of costs (2.88) – evidently they know what their IT systems cost them and are seeking a way of squeezing those costs as hard as possible.

We asked our respondents to identify the critical requirements in their ideal outsourcing supplier, using the same 1 to 5 scale. Top of the list is that the vendor is willing to work in partnership

(4.34) and is financially stable (3.98). Being prepared to share risk (3.94) and having a good cultural fit with the client (3.87) are also important, but a commitment to innovation (3.42) and a global capability (2.31) are viewed as much less significant.

Shared vision

In essence, companies are seeking an outsourcer who shares their vision of how their business and IT systems should be working and developing, and who talks the same language as they do. And the signs are that more and more companies are able to find such a match.

We asked our sample whether or not they would be prepared to sign up for an outsourcing contract again, based on their previous experiences. A third (35%) would do so without question, while 60% say they would, but with some differences in approach next time around. None have ruled out outsourcing altogether and just 5% are unsure.

This endorsement of outsourcing is underlined by the finding that almost two-thirds of the sample feel outsourcing is either 'important' (36%) or 'very important' (26%) to their organisation's IT strategy (see Figure 6). However, before outsourcing suppliers become too complacent, it is worth noting that three-quarters find it either 'fairly hard' (54%) or 'very hard' (23%) to calculate the return on investment from outsourcing. Measuring value and assessing benefits is the next major challenge in this field.

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

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