



## **Large-Scale Outsourcing Saves Nearly Half the IT Budget**

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*Lance Travis*

**The Issue: Large-scale outsourcing can help IT departments cut their budgets by more than 40%, but IT departments must pursue a range of options**

Currently, about 20% of IT organizations outsource anything, and we expect this number to increase to 50% the next three years. The reason for the dramatic growth is quite simple: cost savings from outsourcing are too compelling to ignore. The more aggressive a company's outsourcing strategy, the more money it can save. Unfortunately, risk increases along with savings.

### **Keep the strategically important processes and outsource the rest**

In order to outsource more aggressively, companies must rethink their entire outsourcing strategy. One consistent benefit is the ability to focus on core or strategic initiatives. Companies must maximize this benefit by moving as many nonstrategic tasks to an outsourcing partner as possible.

Just because tasks are compulsory or necessary for survival, it doesn't mean that they offer competitive advantage. For example, companies must comply with safety, health, and environmental regulations to avoid penalties, lawsuits, and negative publicity. However, compliance does nothing to add revenue or increase customer loyalty. Rather than devoting management attention to compliance at the expense of strategic initiatives, most companies would do far better to outsource compliance to experts that guarantee their services.

### **Mature service delivery and technology make now the time to increase outsourcing**

Service delivery models have matured for the better. Companies can now take advantage of outsourcing services provided on-site, in regional delivery centers, and in lower cost countries geographically close (near-shore) and geographically far (offshore). Companies whose first offshore outsourcing attempts failed two or three years ago are now finding success because of more mature global delivery processes. Matching the delivery model to the task being outsourced is a critical skill for companies pursuing an aggressive outsourcing strategy.

Maturing global communications and technology infrastructures now allow outsourcing to become location independent. Virtual Private Network (VPN) technology allows workers in any geography to access and support systems. Advances in provisioning, systems, networks, and storage make shared infrastructures less risky and greatly reduce the need for dedicated company-specific data centers.

Companies starting complex outsourcing arrangements can devote more than a year to select a service provider and negotiate a contract. The transition to the service provider can take another six months to a year, delaying outsourcing benefits by up to two years. Since most companies moving to offshore services start with a small pilot project and gradually outsource more, four to five years may elapse before significant benefits begin. Meanwhile, companies already in the pilot phase or moving to more full-scale outsourcing will be able to reinvest savings in product innovations and company expansion.

### **Outsourcing cost savings comes in many ways**

An aggressive outsourcing strategy can lead to IT savings in three areas:

- **Head Count**--Represents 19% of the total IT budget. When outsourcing IT services, companies need to retain people with project management, architecture, and strategy experience and business process expertise. However, the remaining 85% of IT head count can be effectively outsourced. By using offshore resources that cost approximately 40% of in-house resources, companies can slash their IT budget by 10%.
- **External Services**--Represent 10% of IT budgets. The bulk of services are provided by local domestic providers. By moving more of their existing service contracts to offshore firms, companies can cut existing IT

service spending in half and lower their total IT budget by 5%.

- **Application Software**--Represents 13% of the total IT budget, and enterprise business software (ERP, SCP, CRM, procurement/sourcing) represents 67% of the total software spend. By outsourcing to Business Process Outsourcing (BPO) services the support for the two-thirds of enterprise software that provides no strategic advantage, companies can lower their IT budget by 6%.
- **Software Infrastructure and Hardware**--Represents 36% of the total IT budget. Enterprise software represents 67% of the application budget, and a corresponding 67% of the software infrastructure and hardware budget is needed to support the enterprise software. As such, BPO that eliminates 66% of the software can also eliminate 66% of the infrastructure used to support the software. Additionally, companies overprovision by as much as 70%, and on demand variable deployments can reduce the remaining infrastructure by as much as 80%. The total infrastructure reduction can lower the IT budget by 22%.

To reap the full benefit of outsourcing, companies must outsource aggressively. While using 15 offshore resources to augment a development staff will bring a few benefits, pursuing a three-pronged approach of large-scale global services, BPO, and on-demand strategies will garner huge rewards.

### **Companies that minimize outsourcing risk will reap rewards**

Outsourcing increases risk for a company most often in the following areas:

- Loss of control and visibility
- Lack of flexibility and adaptability
- Cost overruns

To overcome the risk, follow these guidelines:

- Build service levels around continuous improvement and desired business outcome. Do not be satisfied with a one-time process improvement from outsourcing. Exploit the skills and experience of the outsourcing provider for continuous process improvement.
- Invest in project management, relationship management, and program management skills training. Management jobs change in a highly outsourced environment, and companies adopting an aggressive outsourcing strategy must retrain people with the appropriate skills. Control returns with effective relationship and program management.
- Continually benchmark service levels, and use the benchmarking data to push process improvements through your outsourcing partners. Knowing your costs prior to outsourcing and using benchmarking data to understand outsourced costs are essential for effective cost management.
- Match the skills and geographic location of your outsourcing partner with the tasks being outsourced. Not all outsourcing partners are adept at every task. Different tasks are better suited for on-site, regional, near-shore, and offshore outsourcing relationships. Unlike the problems of integration created by a best-of-breed software strategy, a best-of-breed service strategy does not increase management overhead exponentially.

### **Recommendations**

Companies that can tackle outsourcing successfully will free 40% of their IT budgets to invest in innovation. But to get there, they will have to aggressively outsource large chunks of their operations.

Winners will heed the following advice:

- **Starting with the executive committee, formalize your outsourcing strategy.** Develop the management processes to segment processes effectively into those that provide competitive advantage and those that don't. Management must be able to honestly appraise its own organizations for strategic importance.
- **Don't expect protectionist legislation to prevent competitors from aggressively outsourcing offshore.** Labor arbitrage is only one component of the savings from outsourcing. Bigger savings are possible by using process transformation and on demand to eliminate waste rather than just outsourcing it to cheaper labor markets.

- **Baseline existing processes and capabilities.** Negotiating complex outsourcing deals easily can take 12 months. Be ready for the negotiations by understanding your costs and processes for providing services today. Speed up negotiations by defining clear business outcomes for your outsourcing partnerships.

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