

IT OUTSOURCING MARKET: STRONG, GROWING...AND WITH HIGH CUSTOMER EXPECTATIONS

Executive Summary

Recent global market research conducted by Knowledge Systems and Research, Inc. makes it clear that the IT outsourcing market is thriving amidst a state of customer satisfaction. There is high penetration for outsourcing one to two IT functions (data center, applications, desktops, networks); in large companies on a global basis and in the United States-based Fortune 500[®]. However, half of the market is outsourcing only one IT function or not outsourcing, which bodes well for future growth. Although the expectations for outsourcing are very high, they are met for the majority of customers that have outsourced. High on the list of customer expectations are: cost reduction, improved operational efficiencies, and improved stability/effectiveness of IT. High levels of satisfaction with current outsourcing projects has led most companies to plan on outsourcing additional IT functions. Increased outsourcing by current customers will fuel IT Outsourcing market growth.

Accompanying the strength of IT outsourcing is growing executive involvement in purchase decisions. CIOs are the most frequently involved, in both the instigator and primary decision maker roles. CFOs and CEOs follow. (Third parties are much less involved in these roles.) Several criteria are being applied to the purchase decision, led by best-in-class IT expertise, price competitiveness, and customer/industry knowledge. Of note, fewer than ten percent cite price competitiveness alone as the key decision factor.

IBM emerges as the leading provider of IT outsourcing, both at present and with respect to future customer intentions. It is also strongest in customer loyalty, with over 90 percent of the Fortune 500[®] likely to consider IBM again for outsourcing.

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About This Paper

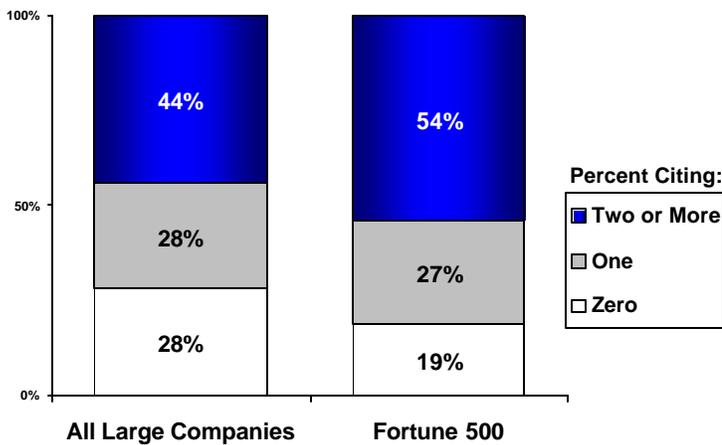
This paper includes findings from 575 senior executive interviews conducted in March and April 2004 by Knowledge Systems and Research, Inc. (KS&R). The objectives were to determine executive attitude, purchase intent, and buying behavior for IT outsourcing. Interviews took place with both IT and business executives, principally at the C-level. Large companies (with greater than US\$500 million annual revenue) and a separate breakout of findings specific to Fortune 500[®] companies are the focus of this paper. This research spanned six countries (across North America, Europe, and the Asia-Pacific region).

IT Outsourcing at Present

The IT outsourcing market continues to be strong, with 72 percent of large companies currently outsourcing at least one function (see chart 1). In fact, over 40 percent of large companies outsource two or more functions. The chart reveals that penetration is even greater if we focus only on the Fortune 500®. Approximately one-quarter of large companies interviewed outsource only one IT function, while another one-quarter do not currently outsource, leaving room for growth in outsourcing going forward.

Chart 1:

Number of IT Functions Currently Outsourced



There is also sizable penetration of outsourcing within the major IT functions, though room for continued growth remains. Application outsourcing leads at 45 percent among large companies, with each of the following at nearly one-third penetration: data center, data network, desktop, and "other IT" (e.g., help desk, client/server management).

"There is also sizable penetration of outsourcing within the major IT functions."

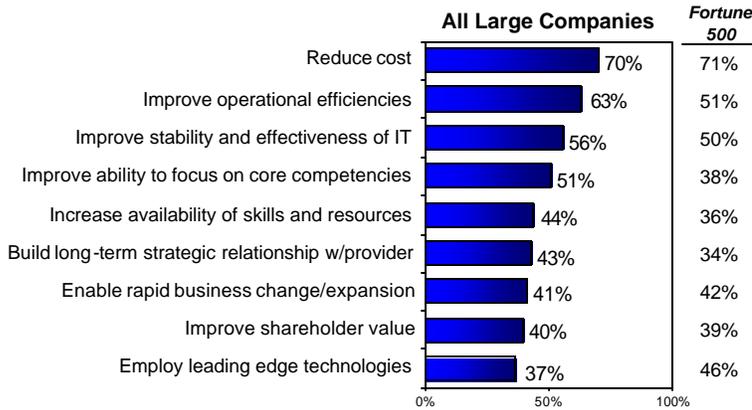
Customers' High Expectations for IT Outsourcing Met

The expected benefits for IT outsourcing contracts are “very high” across a wide range of areas (see Chart 2). Expected benefits include: reduce costs, improve operational efficiencies, and improve stability and effectiveness of IT. After these, large companies are most likely to cite “improve ability to focus on core competencies,” and the Fortune 500® companies cite “employ leading edge technologies.” Impressively, most companies state that their high expectations have been met (and occasionally exceeded) for each expected benefit area.

“A majority of companies are very satisfied with the technical expertise/skills of the provider”

Chart 2:

Areas Where Expected Benefits for “Largest IT Outsourcing Contract” Were Very High*



*Percent citing this area from among those with a current IT Outsourcing Contract

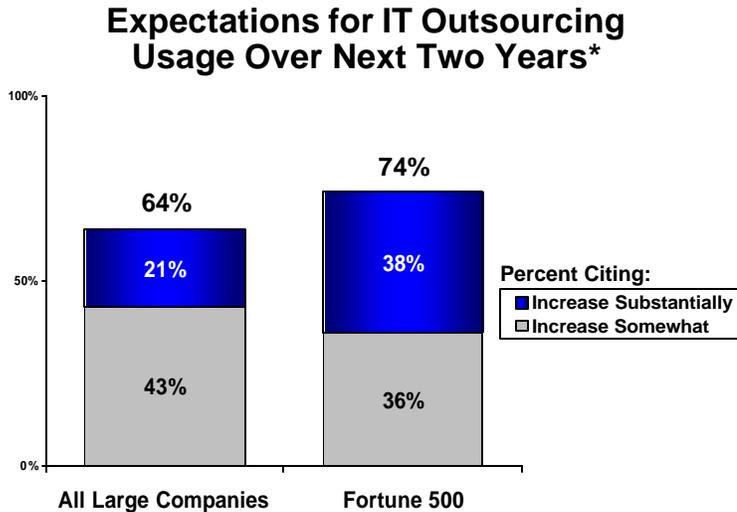
A majority of large companies also state that they are very satisfied with the technical expertise/skills of the provider of their outsourcing contract. Additionally, at least 40 percent are very satisfied with these other attributes of their provider:

- The quality of their service and delivery (e.g., degree to which contractual terms and conditions are met)
- The provider’s understanding of the customer’s business and industry
- The support they provide (e.g., in assuming responsibility, taking the initiative, and in being flexible).

Continued Growth Anticipated in IT Outsourcing

In part due to their very positive outsourcing experiences, most companies are expecting to increase their IT outsourcing usage in the next two years (see chart 3). Among large companies, nearly two-thirds project an increase. This is even higher for the Fortune 500® (three-quarters anticipate an increase and over half of those expect a “substantial increase”).

Chart 3:



*Among those currently outsourcing some aspect of IT or that might consider outsourcing IT in the future

Top drivers for planned increases in existing IT outsourcing contracts over the next twelve months are:

- A strong working relationship between the customer and the provider
- The meeting/exceeding of customer cost and delivery expectations
- Provider flexibility toward price and contract terms
- Proactive suggestions from the provider to better manage operations
- Provider thought leadership and innovation

Given the substantial current penetration of IT outsourcing noted earlier, most of the growth will come from increased activity among existing practitioners (e.g., purchasing a new contract, increasing current contract scope). However, nearly one-quarter of the large companies indicating a likelihood to outsource will actually be new IT outsourcing customers.

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Multiple Criteria Guiding Purchase Decisions

Another reflection of the increasing reach and importance of outsourcing within the large-company market is the extensive set of purchase criteria being applied to evaluate the provider and its associated approach (see Chart 4). The criteria rated as most important are: best-in-class IT expertise, price competitiveness, and customer/industry knowledge. These are followed by other attributes of the provider (stability, business/IT thought leadership), or characteristics of its outsourcing approach (tight SLAs, strong fit with customer).

Chart 4:

Multiple Purchase Criteria Importance*

<u>Relative Importance</u>		All Large Companies
First Tier	}	Best-in-Class IT Expertise
		Price Competitiveness
		Company/Industry Knowledge
Second Tier	}	Stability
		Tight SLAs
		Strong People/Cultural Fit w/ Company
		Provides Business and IT Thought Leadership
Third Tier	}	Flexibility to Renegotiate
		Regarded as Outsourcing Market Leader
		Global Presence/ Capabilities

*Among those currently outsourcing some aspect of IT or that might consider outsourcing IT in the future

Several additional factors, while of lesser importance, are still repeatedly cited. And multiple factors are generally in play in outsourcing purchase decisions. In particular, only eight percent of large companies indicate that price competitiveness alone is the key factor that distinguishes one provider from another (and this drops to one percent among the Fortune 500® segment).

“Only 8% of large companies indicate that price competitiveness alone is the key factor that distinguishes one provider from another”

C-Level Executives Drive Major Purchase Decisions

A variety of executives are playing roles as decision makers for the major IT outsourcing purchases in large companies (see Chart 5). CIOs are by far the most frequently cited primary decision makers (by 67 percent). CFOs are the next most commonly cited (by nearly half), followed closely by CEOs. Slightly over one-quarter note business unit heads as decision makers. For the instigator role, CIOs again dominate (at 71 percent), with four other executive types being cited in about one-quarter to one-third of large companies.

“CIOs are by far the most frequently cited primary decision makers and instigators.”

Chart 5:

Involvement in Major IT Outsourcing Decisions*

		All Large Companies	
		As Instigator	As Decision Maker
Most Often Cited	}	CIO	CIO
		CFO Other IT Executive BU Head CEO	CFO CEO
Secondary Mention	}		
Third Tier	}		BU Head

*Among those currently outsourcing some aspect of IT or that might consider outsourcing IT in the future

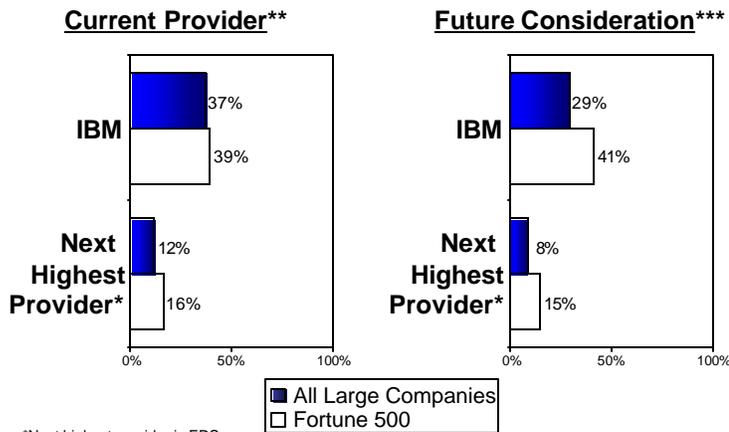
Some of these roles have been changing. For instance, CIOs and other IT executives are now playing the role of instigator more than they have in the past—in part reflecting their increasing involvement/insight into business planning across the company. Conversely, as these executive roles are being enhanced, third party advisors are not frequently used as instigators (by eight percent) or key decision makers (by three percent) for major purchases.

IBM is the Leader in Penetration and Loyalty

IBM holds the leading share position as current provider of IT outsourcing for both the large company and Fortune 500® segments—and has a wide advantage in this regard over other providers (see Chart 6). IBM also holds the lead position among companies being considered as future providers of IT outsourcing.

Chart 6:

IT Outsourcing Provider...



*Next highest provider is EDS

**Among those with a current IT Outsourcing Contract

***Among those currently outsourcing some aspect of IT or that might consider outsourcing IT in the future

An indication of company loyalty is that a majority of Fortune 500® customers of the leading IT outsourcing providers state that they would consider their current provider for future work. This is supported by the statistic previously stated, that most companies' current outsourcing expectations have been met by that provider. IBM has the highest such loyalty rating: 92 percent of its outsourcing customers among the Fortune 500® indicate they would consider IBM again in the future. Only 56% of Fortune 500® outsourcing customers of the next highest provider indicated that they would consider them again in the future.

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Final Observations

While there is much in the current press about businesses reconsidering their outsourcing positions or pursuing outsourcing solely from a cost reduction perspective, this research tells a much different story. It reveals that companies have widely embraced outsourcing, but that they have maintained very high expectations for it and are using a wide variety of criteria to evaluate both their purchases and their satisfaction with IT outsourcing. Also, the increasing involvement of their executives in the instigation/purchase decision processes demonstrates the criticality of outsourcing—and their reasoned approach to it.

In fact, the majority of large and Fortune 500[®] companies interviewed expect to increase their use of IT outsourcing, often substantially. And while many providers are addressing this growing market, IBM stood out in the research, as the vendor of choice currently and for future purchases, and with the highest degree of loyalty among its customers.

About Knowledge Systems and Research, Inc. (KS&R)

Many companies focus only on market research or management consulting. Since 1983, KS&R has provided the synergy of both disciplines, yielding strategic support grounded in accurate market knowledge.

We offer our customers numerous assets: exceptional people, accurate and timely data collection, thorough and strategic analysis, a proactive support style, and commitment to exceed expectations. KS&R's process ensures that our clients are fully supported from project inception to completion. The success of our clients measures how well we do our job.

Our conclusions have guided high-level decision makers worldwide. Our industry expertise includes technology, communications, health care, media, financial services, and consumer products. We understand the issues confronting individual industries, and we have the capacity to address them effectively.

For more information, please visit us on the Web at www.ksrinc.com or call us at (315) 470-1350.

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