

Analyzing Outsourcing Compared to Internal Costs

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Agenda

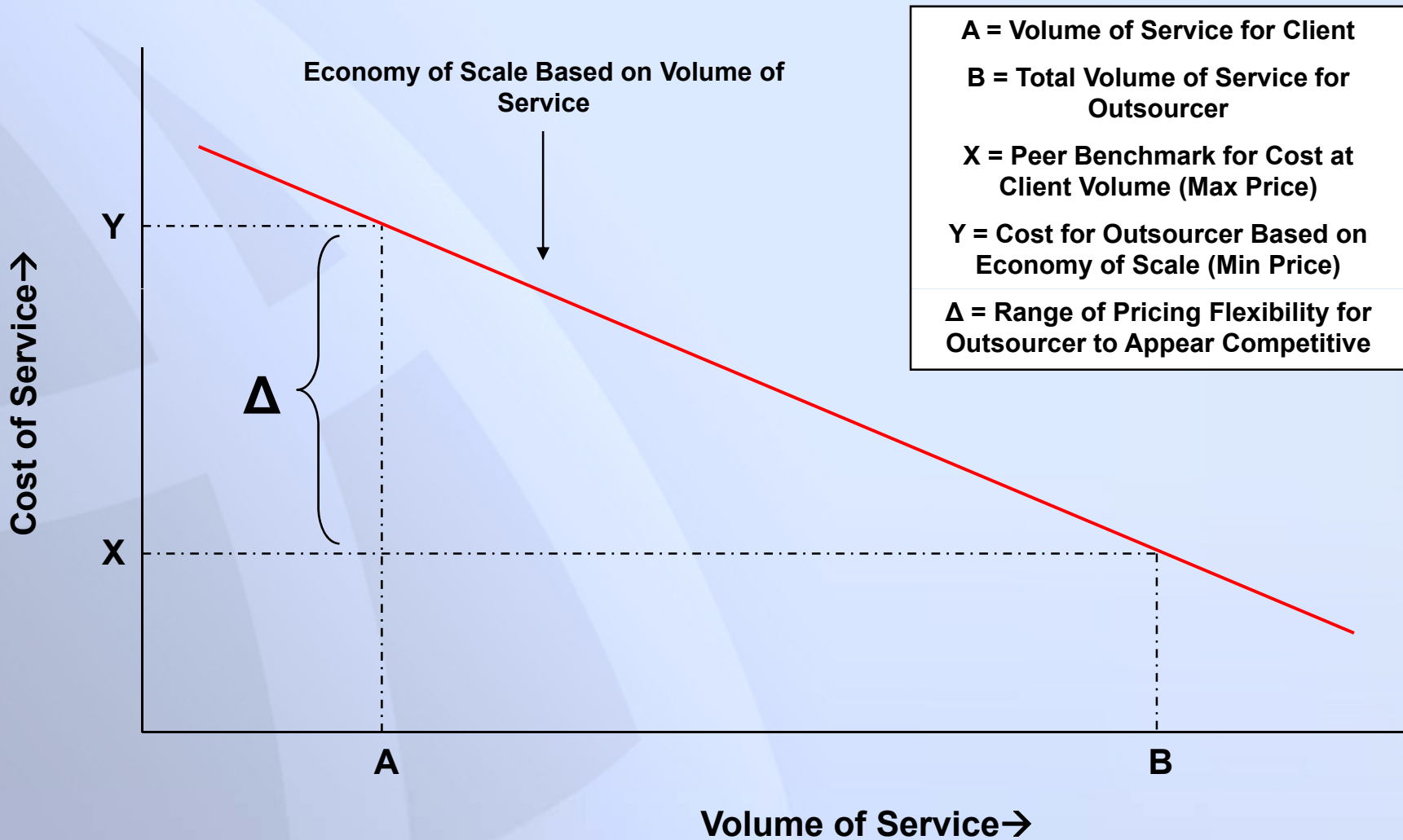
1. Background—Issues to Consider
2. Boiling Down Outsourcing to a Single Issue (for this discussion)
3. Considering the Economics at Play
4. First Appearances Can Be Deceiving
5. Real World Examples
6. Be Cautious of Quotes
7. Data Sources Available

- Outsourcing “chatter” and cost cutting (rightly or wrongly) go hand-in-hand
- Outsourcing companies are in the same recession as we are:
 - Reductions in overall economic activity should have downward pressure on demand for services and reductions in price
 - Outsourcing companies are striving to protect their revenue streams while reducing or flat lining their internal IT costs
 - A period of relative weakness of the U.S. dollar has led to an increase in domestic sourcing partnerships or pulling offshore jobs back to the U.S.
- A unique scenario *could* exist where:
 - Prices are low
 - Outsourcers are motivated sellers
 - IT organizations are looking to outsource
 - Bargains could be obtained

Boling Down Outsourcing to a Single Issue

- Outsourcing decisions should NOT be made purely for financial reasons—this is one of several factors:
 - Organizational/cultural effects (both positive and negative)
 - Capability improvement opportunities
 - Delivery strategy changes
 - Etc.
- While these other factors can be critical, cost is a major consideration, and often the deciding factor
- We'll be isolating and analyzing cost for the purposes of this presentation

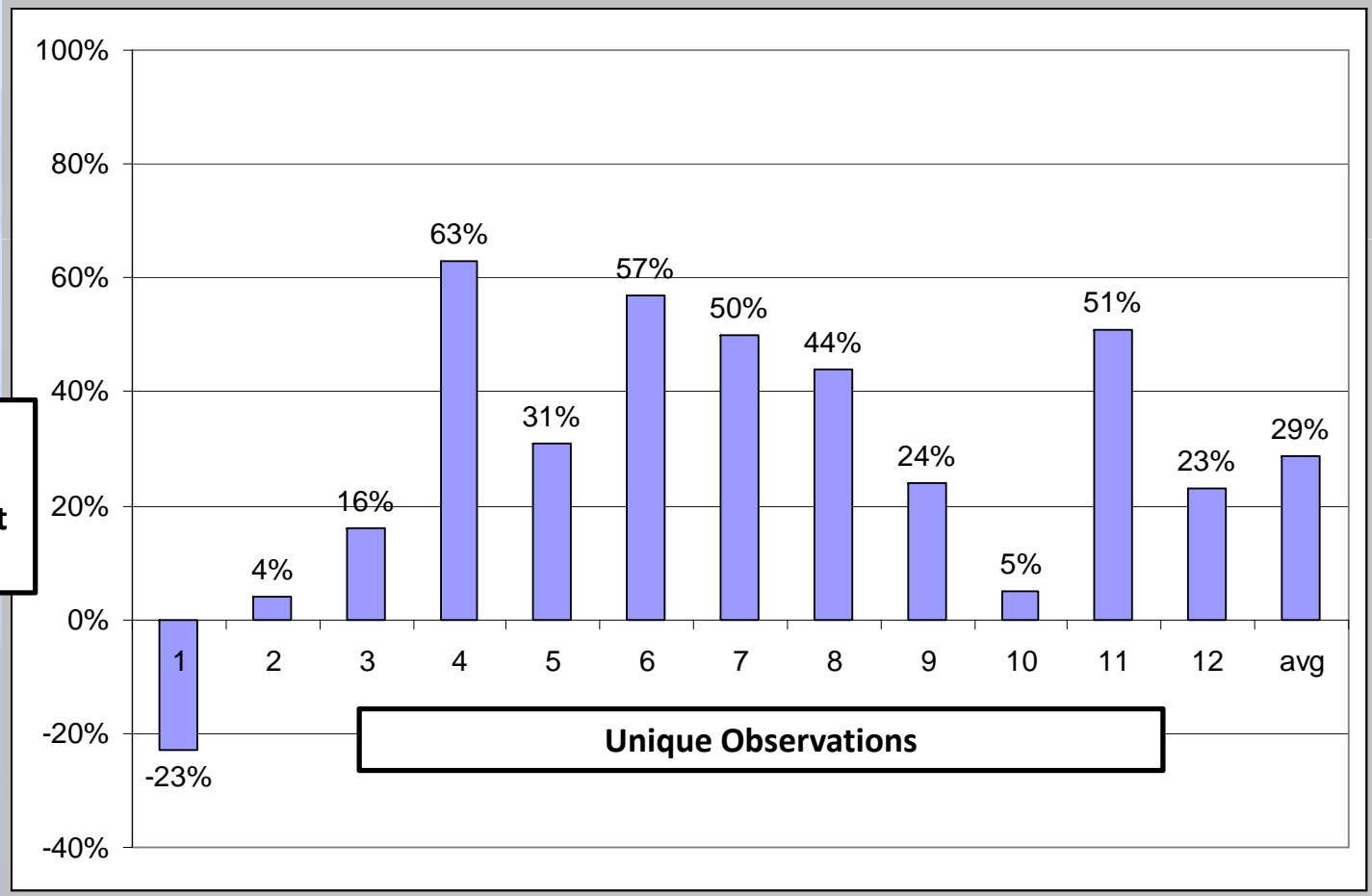
Considering the Economics at Play



First Appearances Can Be Deceiving

This chart compares the cost of outsourced services (in year 3 of a 5-year outsourcing contract) to a peer benchmark of insourced services

Variance from peer benchmark baseline (0% = competitive cost for internal delivery)



- IMF worked with a company in an unfavorable outsourced situation:
 - Service prices had been steadily increasing for years
 - Service quality was causing issues with their end users and potential problems with clients
 - The working relationship had deteriorated, causing stress on both sides
 - The outsourcer was making every attempt to block constructive conversations about improving services while maintaining fair costs
- A peer benchmark provided the leverage needed to bring the outsourcer to the table—the benchmark illustrated the variance between the competitive costs and the actual price charged
- The company also requested “like-for-like” quotes from other providers for additional negotiation points and for potential changes in course

Be Cautious of Quotes

- The initial like-for-like quotes for this company had very large variances (greater than 100% differences in some cases):
 - The company needed a better understanding of communicating requirements to potential vendors
 - The company pushed a vague RFI/RFP document to vendors as they were motivated to stay ahead of their current vendor
 - Seeing an opportunity, each vendor pitched the services and pricing structures they wanted to provide
 - The company was, for a time, more confused and felt unable to improve their situation
- When a detailed review of the current contract and a clear RFP were both completed, the company received significantly better price quotes and was able to change course (with a combination of new vendors and some service brought in-house).

- Outsourcing market data is a good start, but doesn't tell the whole story
 - Remember the huge variance observed in the case study
 - There is a lot “behind the curtain” on the deals in the comparative database
 - Contracts often contain unique considerations
 - Part B
 - Price schemes e.g. 2 year zero cost
 - Not available, or no right to use data (vendor confidentiality)
- Internal benchmarks with outsourcing modeling scenarios help complete the story
 - Price data for peers to the outsourcer are not easily obtainable whereas cost data for peers to the client are
 - Customers should negotiate based on the cost that a reasonably performing client would incur if they were to perform this work in-house