Realising the Real Benefits of Outsourcing
Seven steps to effective outsourcing measurement

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Executive Summary

These days firms are, more than ever, pressed to demonstrate returns on their investment in outsourcing. While the initial returns can always be associated with one-off cost cutting, outsourcing arrangements are complex, often involving inter-related high-value activities, which makes the realisation of long-term benefits from outsourcing ever more challenging. Executives in client firms are no longer satisfied with the same level of service delivery through the outsourcing lifecycle. They seek to achieve business transformation and innovation in their present and future services, beyond satisfying service level agreements (SLAs). Clearly the business world is facing a new challenge: an outsourcing delivery system of high-value activities that demonstrates value over time and across business functions. However, despite such expectations, many client firms are in the dark when trying to measure and quantify the return on outsourcing investments: results of this research show that less than half of all CIOs and CFOs (43%) have attempted to calculate the financial impact of outsourcing to their bottom line, indicating that the financial benefits are difficult to quantify (51%).

There is no doubt that client firms need to improve their ability to measure the benefits of outsourcing. These benefits go beyond the one-time cost saving. They strongly relate to the firm’s competitive advantage and therefore often represent the key success factors (KSFs) in a particular industry. We identify seven lessons that will guide executives to achieve better results from their outsourcing engagements. The starting point for any client firm is to understand the context of its outsourcing activities followed by the planning of its outsourcing strategy according to its resources and capabilities. Once an outsourcing strategy has been devised, a clear benchmark should be designed and clearly communicated to stakeholders involved. Setting up such a benchmark will allow the firm to then more carefully identify the service provisions expected from the vendor.

However, value is a dynamic concept that changes over time. Therefore, client firms should revisit the value generated from outsourcing relationships over time and as the rules of competition in their industry change. The last three lessons concern building outsourcing capabilities within the client firm. This will be achieved by making the CIO a strategist, shaping the retained organization according to present and future needs and by fostering outsourcing learning capabilities and close relationships with vendors.

As some vendors continue to specialise and to develop domain knowledge, we believe that client firms should adopt a learning approach in engagement with their suppliers. Put simply, if a client firm is to become a sophisticated outsourcing consumer, it has to learn how to closely work with its suppliers in order to avoid making mistakes as well as learn how to maximize the returns from its outsourcing arrangement.
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Current Trends in Outsourcing

The global IT outsourcing (ITO) market has increased each year since 1992. Back in 1989, global ITO was a $9 to $12 billion market. In 2008, the global ITO market was estimated to be worth between $220 to $250 billion. The business process outsourcing (BPO) market in 2008 was less than the ITO market, but grew at a faster rate. The estimate for the ITO market over the next five years, is that it will grow by 6-9% per annum while mainstream BPO expenditure is likely to grow worldwide by 10% to 15% a year, from $140 billion in 2005 to potentially $230 billion plus by 2013. BPO expenditure will be in areas such as the human resource function, procurement, back office administration, call centres, legal, finance and accounting, customer facing operations and asset management.

With the growing volume of ITO and BPO, there are some forces that shape the outsourcing landscape. Cost-cutting is still the dominant driver for outsourcing; however, other factors are becoming more prominent such as access to talent, achieving business transformation and innovation. Alongside this, clients are becoming more ‘outsourcing savvy’. Such clients expect to achieve real impact on their business through outsourcing. Long-term outsourcing contracts are becoming the norm with the expectation that large vendors will be able to provide end-to-end services across multiple business towers (e.g. HR, Finance, Procurement). Depending on their size and geographical spread, vendors become more specialised in certain areas of business processes with only a few large players that can offer end-to-end services. Knowledge process outsourcing is gaining momentum as Brazil, Russia, India and China (BRIC) and emerging countries move up the value chain. Captive centre activity has intensified, with some clients setting up captive centres in either near-shore or offshore locations, others looking to divest their captive centres and some terminating offshore operations. Lastly, both clients and vendors have been putting more efforts into socially responsible sourcing and green IT.

There are also changes in the geographies of outsourcing. While India will continue to dominate the ITO and BPO scene, China will emerge as an alternative, though it will still struggle to achieve scale in Western European and North American markets. Near-shoring will emerge as a strong trend in which some countries will become preferred outsourcing destinations such as Central and Eastern Europe (CEE) servicing Western Europe, the Caribbean to the USA and Canada, and North Africa to France and Spain. Outsourcing successes and disappointments will continue as both clients and suppliers struggle to deal with a highly dynamic set of possibilities. The present downturn in the economy is certainly putting additional pressure on clients to realise cost savings from outsourcing as well as from vendors to demonstrate the value offered through an outsourcing proposition. Several reports from 2008 and 2009 have already indicated that the scope of outsourcing has increased since the start of the economic downturn. At the same time, several commentators have warned against short term expectations to see quick and significant return on outsourcing investment. Yet, the trend is clear: client organisations will seek a clear Return on Outsourcing Investment, which is timely, transparent and that is in line with the firm’s business objectives. It is the quest to develop a systematic approach to measure value from outsourcing arrangements that client organisations face. Below we look into these aspects in great detail.

About this Research

This research, conducted by Warwick Business School in collaboration with Cognizant, focuses on understanding the real benefits of outsourcing beyond a one-time cost saving alone. The study goes beyond this objective by trying to understand the underpinning factors behind client firms’ inability to systematically measure the benefits offered through outsourcing and by examining the strategic role that key players can play in achieving this goal.

The ideas presented in this paper are based on original research conducted at Warwick Business School (UK) and carried out by Dr. Ilan Oshri and Dr. Julia Kotlarsky. The researchers conducted semi-structured interviews and held discussions with experts in the field of outsourcing, including CIOs and CFOs from leading multinationals with headquarters based in Europe, such as ABN AMRO, Maersk, Shell and Phillips. These firms are considered to be some of the most sophisticated outsourcing clients and their practices have become a benchmark for many others. The ideas in this paper are also based on a quantitative survey, which was carried out in partnership with research organisation Vanson Bourne. The quantitative survey sampled 263 CIOs and CFOs across the UK (52%) and other European countries such as France, Germany, Denmark, Sweden, Switzerland and Benelux (Belgium, Netherlands and Luxembourg), comprising 48% CFOs and 52% CIOs at companies with revenues from $500m up to over $6bn (71% over $1bn) from financial services, manufacturing, logistics, retail, utilities, telecom and other sectors.
CIO and CFO Perspectives on Outsourcing

In this section we reflect on the insights gained from the survey and the numerous discussions we have had with experts in the field of outsourcing. In particular, we discuss:

- which functions are outsourced
- how critical these functions are to the business
- outsourcing models
- the drivers to outsource
- confidence in offshore providers
- the benefits expected from outsourcing
- the methods to quantify returns on outsourcing
- the role of the CIO
- outsourcing in difficult times
- future outsourcing trends.

Functions Outsourced

Clearly with ITO still growing fast, IT and IT-enabled business processes are still the most popular candidates for outsourcing. With the commoditisation of computer and data-transmission technologies over the last decade many firms are now relying on specialised third party vendors to carry out work on their behalf. Among the vast range of services outsourced, IT application maintenance is on the top of the list, being outsourced by 76% of companies surveyed, followed by IT development projects (outsourced by 53%) and IT and technology consultancy (50%). More specifically, among the various IT application maintenance activities, IT infrastructure support (e.g. network management, server and hardware maintenance) and data-centre management are the most commonly outsourced (by 54%).

Second most popular area to be outsourced is ERP maintenance, upgrades and implementations of applications such as Oracle, PeopleSoft or SAP (by 41%), as illustrated by Table 1.

Activities that involve sensitive or confidential information (e.g. Finance and Administration, HR, Payroll and CRM that uses clients’ and employees’ confidential data) or those that are related to core business and marketing activities (e.g. data warehousing and business intelligence systems) are less popular for outsourcing. While many of these processes are relatively easy to codify and transfer to a third party (Aron and Singh 2005), it is also a strategic decision by many companies to keep these processes in-house for security reasons or to move them offshore to captive facilities where a higher degree of control can be exercised at a lower cost.

Table 1: Areas of business being outsourced (CIO and CFO perspectives)

<table>
<thead>
<tr>
<th>Area</th>
<th>Outsourced Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>IT infrastructure and data management</td>
<td>61%</td>
</tr>
<tr>
<td>Software Testing or Software Quality Assurance</td>
<td>41%</td>
</tr>
<tr>
<td>BPO e.g. Finance &amp; Admin, HR, Payroll, Billing &amp; Invoicing, Internal/External Helpdesk, Call Centre</td>
<td>34%</td>
</tr>
<tr>
<td>Dataware housing and Business Intelligence Systems (business analytics)</td>
<td>33%</td>
</tr>
<tr>
<td>Other ITO e.g. provision of disaster recovery facilities, programming</td>
<td>22%</td>
</tr>
<tr>
<td>Other ITO e.g. provision of disaster recovery facilities, programming</td>
<td>18%</td>
</tr>
<tr>
<td>Other ITO e.g. provision of disaster recovery facilities, programming</td>
<td>1%</td>
</tr>
<tr>
<td>Other ITO e.g. provision of disaster recovery facilities, programming</td>
<td>0.4%</td>
</tr>
</tbody>
</table>

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The Criticality of Outsourcing to the Business

While 33% of all respondents view outsourced business arrangements as critical or very critical to their business, there are different perceptions among the CIOs and CFOs surveyed in this study. 39% of CIOs believe that outsourcing is critical to their business while only 27% of CFOs thought so (see Table 2). The explanation for these differences is simple. CIOs, who typically act as the initiators and sponsors of an outsourcing arrangement, see the immediate impact on the organisation, in particular when the organisation is changing its strategic approach towards the IT function to focus on building the retained organisation, which are the roles and the people filling these roles in the client organisation who will remain onboard to make sure the deal is successful. Under such circumstances, the criticality of the outsourcing activity to the business is high as most firms find themselves having a growing dependency on their outsourcing partners. CFOs tend to look at outsourcing through a cost-saving lens, which does not always materialise in the short term, and in some cases would never do. One CIO commented on the CFO’s view of outsourcing:

CFOs always expect short term cost savings. They are looking at the short term. If you outsource this year then the CFO will ask you: ‘What were the cost savings this year, bottom line?’

Clearly, such differences in perceptions raise the question: what is the role of the CIO in conveying a clearer message to the executive board about the real value in outsourcing? We discuss this aspect in great detail in the section ‘The Role of the CIO’.

Outsourcing Models

Many clients who have had experience with outsourcing for several years have by now learned that working with multiple suppliers often helps to keep them on their toes with regard to their cost, quality, and business transformation offerings. At the same time, managing multiple suppliers requires advanced sourcing management capabilities and in-house learning capabilities that not all firms can afford to build and maintain. Those clients, therefore, often choose a selective sourcing approach. Some outsource some business functions to two to three ‘best of breed’ suppliers (based on domain or geography). Others might choose a ‘supplier panel’ approach that involves a panel of ‘preferred suppliers’ that constantly compete for contracts throughout the outsourcing arrangement. More sophisticated clients will outsource end-to-end services across multiple business towers to a single vendor, in what is now known as a ‘bundled services’ outsourcing arrangement. Each outsourcing model has its advantages and challenges. And there is a development path in which clients move along the outsourcing learning curve and gradually become outsourcing savvy. In this journey, clients first develop their sourcing management capabilities and their learning abilities to adapt and change according to market conditions and their internal needs. Some believe the selective-sourcing model will become one of the dominating models in the near future. Within this outsourcing model, the most popular services to be outsourced to more than one vendor are IT infrastructure and maintenance (by 25% of respondents) and IT and technology consultancy (17%).

Key Drivers of Outsourcing

While the common belief is that cost-cutting is the key strategic driver for outsourcing, the results of this research show that access to skills not available internally is perceived by CIOs and CFOs to be more important in 2009 (61%). The second driver is cost reduction (41%) and access to innovative processes and practices (also 41%) (See Table 2). Clearly, there is a shift in the way client organisations see the strategic drivers behind outsourcing. CIOs and CFOs are now focusing on the need to access talent and innovative ideas as a source of competitive advantage. In this regard, vendors with extensive domain knowledge developed through work with multiple clients are perceived as knowledge-bases of ideas and innovations. Cost advantage is achieved by such vendors through the location of some of their delivery centres in either near-shore or offshore locations. These results also show that the benefits expected to be delivered from outsourcing are not the one-off type. Seeking innovation and accessing talent imply that client organisations perceive their vendors as partners to the long-term development
of business strategy through the support and improvement of services and products. In this scenario the vendor becomes a true partner in improving the client’s competitive advantage through cutting edge ideas and costs cutting. Another key strategic driver that came out from the interviews is flexibility. CIOs argued that outsourcing has allowed them to quickly scale up or down operations in response to market demand without having to bear the costs involved. This key driver has become critical during the present downturn as firms need to respond quickly to changes in markets. One CIO stated:

*Our vendor is much more able to scale up staff than we do. I would need to think twice before hiring staff. But I can ask my vendor: “Can you scale up the number staff working for us in the next couple of weeks to 200 because we have a new project?” That’s agility!*

**Table 2: Key drivers of outsourcing**

<table>
<thead>
<tr>
<th>CIO and CFO perspectives</th>
<th>0%</th>
<th>10%</th>
<th>20%</th>
<th>30%</th>
<th>40%</th>
<th>50%</th>
<th>60%</th>
<th>70%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Access to skills-set not available internally</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>41%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cost reduction</td>
<td></td>
<td>64%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Access to innovative processes and practices</td>
<td>41%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Frees up internal resources for other purposes</td>
<td>41%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>40%</td>
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</table>

**Confidence in an Offshore Provider**

Firms that are contemplating outsourcing high-value knowledge-intensive work to offshore providers should consider numerous risks. For this reason some firms mitigate such risks by setting up their own captive centres in offshore locations. The drive behind such a move is to maintain control over critical activities while reducing costs. However, as many firms realise, the concept of the captive centre - a subsidiary of the parent firm that provides services from offshore location - still requires massive investment and management attention to make it successful, simply because the concept of the captive centre is changing. For example, some firms (successfully) divested their offshore investment (e.g. British Airways) while others had to close down their service centres (e.g. Dell). The risk associated with offshoring work to a third party provider also depends on the nature of the task. Repetitive tasks that can be easily codified are promising candidates for offshoring through a third party provider. Tasks that include components of tacit knowledge with high degree of dependency on other services are less favourable for offshoring. Yet in recent years we have witnessed the emergence of Knowledge Process Outsourcing (KPO) in which high value work that requires significant domain expertise is increasingly outsourced to offshore vendors. The central theme of KPO is to create value for the client by providing business expertise rather than process expertise from offshore locations. The results of the survey show that CIOs and CFOs have a high level of confidence in offshoring work to a third party provider in particular in the area of IT development (63%), and to a lesser extent in the areas of IT maintenance (47%) and BPO (44%). These results demonstrate the level of maturity that the surveyed firms have developed in preparing their repetitive (IT maintenance) and knowledge processes (IT development and some BPO) to outsourcing. One of the most straight-forward practices in this regard was expressed by one CIO:

*We don’t believe in “ship it and then fix it”. We believe in “fix it first and then ship it”. So we fix our processes first and then we ship then to our vendors.*
Return on Outsourcing Investments

With large scale, lengthy outsourcing contracts becoming the norm, there is a question regarding the expected time clients should achieve an impact on their business through outsourcing. C-level executives we have interviewed claimed that the real impact can be achieved only after two years. The reason being is that it usually takes about six months to set up the outsourcing relationship (e.g. client to vendor transition), after which the vendor becomes more involved in the client’s line of business to improve current services, offer innovations and demonstrate a return on the investment in outsourcing.

The results of the survey show that both CIOs and CFOs prefer to demonstrate a return on outsourcing investment within up to one year (51%). Interestingly, 60% of the CIOs would like to see such ROI within one year or less versus only 42% of CFOs. The majority of CFOs (33%) expect to see ROI within 18 months. Clearly, pressed by the economic downturn, CIOs and CFOs are seeking to utilise outsourcing as a means through which returns can be demonstrated quickly. One CIO warned against this approach saying:

[...] you will see CIOs now desperate as they are looking for a quick outsourcing deal to get their cost down, which is wrong. It is absolutely wrong because if you just do it for lower cost, then I would say to you: ‘don’t go into outsourcing because you will be disappointed because the costs will go up.’

Table 3: Time to achieve ROI

However, with outsourcing contracts becoming more complex, often involving multiple suppliers and several areas of the business, ROI can be a tricky concept to analyse and properly calculate. Clearly, when clients expect vendors to join them in their journey to achieve competitive advantage, there will always be a challenge to realise the ROI at any given time. The results of the survey support this observation with only 39% of the CIOs and CFOs believing that the financial contribution of their outsourcing activities can be assessed. Furthermore, as more and more outsourcing contracts are about high-value activities which often involve intense and ongoing collaboration in the form of a joint venture between the client and the vendor, translating benefits from outsourcing activities into financial terms is becoming ever more challenging to achieve. Only 28% of the CIOs and CFOs surveyed believed that their organisations can assess the business value beyond the one-time cost savings of the project (see Table 4).
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Table 4: Response to the following question: Do you think the business value of your organisation’s outsourcing arrangements can be assessed beyond the one-time cost savings for each project?

Quantifying the Returns on Outsourcing Investments

Some sophisticated vendors have perfected their performance management systems by developing metrics that capture and quantify any activity carried out by their staff. In this way, these vendors secure their margins and avoid the ‘winner’s curse’ syndrome (Kern et al. 2002). On the other hand, most clients tend to mainly rely on Service Level Agreement (SLAs) as a mean to assess their satisfaction from outsourcing arrangements. One CIO described their approach to assess satisfaction from outsourcing arrangements:

We try to simplify it. It’s too much over the top. We have everything we outsourced on service level agreements and we have a pretty good matching system.

Quantifying the indications provided by SLAs seems to be a challenge. 37% of the CIOs and CFOs in our survey never tried to quantify the financial benefits from their outsourcing arrangements. Additionally, 20% of the CIOs and CFOs in the survey did not know whether such an attempt was carried out in their organisation. Of those CIOs and CFOs who quantified the financial benefits from outsourcing arrangements (113 respondents), 43% of them were not confident in the way they have measured such returns (see Table 5). One of the respondents commented on this question saying:

That is the problem. You know what it costs but you don’t really know what the value is.

Not surprisingly, according to the survey, CFOs are more confident in the way they quantify such returns than CIOs.

Table 5: Response to the following question: How confident are you in this quantification?
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When asked: Why have you not tried to quantify the financial contribution of your outsourcing arrangements? 51% of the CIOs and CFOs in our survey said that such financial benefits are difficult to quantify, and 41% of the CIOs and CFOs thought that such benefits were assumed to be positive (see Table 6).

Table 6: Response to the question: Why have you not tried to quantify the financial contribution of your outsourcing arrangements?

<table>
<thead>
<tr>
<th></th>
<th>CIO perspective</th>
<th>CFO perspective</th>
</tr>
</thead>
<tbody>
<tr>
<td>Difficult to quantify</td>
<td>53%</td>
<td>49%</td>
</tr>
<tr>
<td>Benefits assumed to be positive</td>
<td>21%</td>
<td>19%</td>
</tr>
<tr>
<td>Metrics not available</td>
<td>34%</td>
<td>48%</td>
</tr>
<tr>
<td>It is a relatively low priority</td>
<td>32%</td>
<td>6%</td>
</tr>
<tr>
<td>Other</td>
<td>15%</td>
<td></td>
</tr>
</tbody>
</table>

The Role of the CIO

Outsourcing arrangements of IT development and business processes are critical for the competitiveness of most firms. The CIO and the retained organisation are expected to act as the connecting link between the business strategy and markets through the smooth execution of the sourcing strategy. For this reason, it is imperative that the CIO will be able to bring the business case to the executive board and act as a change agent within the firm to achieve business transformation and innovations through outsourcing partnerships. However, according to our survey, 64% of the CFOs do not think that CIOs succeed in communicating the financial benefits from outsourcing arrangements. This raises a question regarding the maturity and sophistication of the retained organisation in some firms, where the CIO is incapable of communicating the business case of outsourcing to the executive board and demonstrate the financial benefits to be gained. One CIO reflected on these results by giving an example:

[…] in my network when I discuss with other CIOs and I ask them, “How are you doing on your business case?” They said, “What do you mean business case?” I then say: “You need something to describe against a report. If you don’t start with a business case, if you don’t start with clear objectives, how are you going to report it”?

The results also show that some of the critical strategic benefits from outsourcing are perceived by CFOs to be poorly communicated to the executive board by CIOs, such as business transformation and impact on competitive advantage. The fact that many of the CIOs are not members of the executive board magnifies this problem: is the message the CIO is sending to the boardroom through the CTO or another board member getting ‘lost in translation’?
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Outsourcing in Difficult Times

With the global economy still shaky, CIOs and CFOs are taking some actions to shelter their firms from the storm. CFOs are looking for cost reduction across the board. Also, there are indications that firms are hesitant regarding new outsourcing projects, delaying their decisions to better times, while some CIOs attempt to re-negotiate the terms of some of their large scale on-going outsourcing projects. One CIO commented in the survey:

We would want to increase and improve the delivery of services from outsourcing, but will “hold-off” in the short-term.

About 40% of our respondents indicated that they pulled work back from outsourcing providers or slowed the growth of outsourcing initiatives. Among those who have pulled work back from outsourcing providers or slowed the growth of outsourcing initiatives (105 respondents), the main reasons for doing so were unclear value for money (78%), high vendor management costs (46%) and lack of governance (38%), as shown in Table 6. Poor quality (17%) was not considered a key factor in bringing back work or slowing the growth of outsourcing initiatives. Clearly, client firms perceive value creation as a critical element in developing long-term relationships with outsourcing partners. To develop such partnerships between vendors and clients, the benefits of outsourcing should be transparent, timely, easy to communicate and in line with the key success criteria of the business.

Table 7: Causes of cutback or slowdown of outsourcing

Economic Downturn and the Impact on the Labour Force

Firms seeking to improve their financial position during an economic downturn often consider outsourcing as one possible route. While some firms would have indeed preferred outsourcing as a means to improve their financial position, these firms could be forced to hold on to their staff and refrain from contracting work out to a low-cost highly skilled work force. One CFO summarised this aspect well, arguing that:

Outsourcing has worked very well for us, but maintaining jobs is the priority.

There are several aspects in the European context that provide an explanation for this approach. These vary from protective labour law to public resentment towards sending jobs overseas. In some countries, for example France, the labour law is protective, therefore making redundancies or outsourcing very difficult. One French CFO commented in the survey:

The French want to preserve their jobs, so outsourcing is likely to suffer.

A similar approach is pursued in Germany. A German CFO commented in the survey:

In Germany, companies are having to keep staff in jobs so outsourcing is not currently popular.
The survey provided support to this approach. CIOs and CFOs indicated that they will be inclined to freeze salary rises first (74%), then reduce person-hour (37%) and only then reduce headcount (32%), as shown in Table 8.

Table 8: response to the following question: In the current economic environment which of the following moves are you contemplating for your business?

![CFOs perspective chart]

### The Future of Outsourcing

Is outsourcing a trend or the onset of fundamental transformation of crucial business arrangements? Many believe that we are on the verge of a major transformation in which sourcing will play a significant role. In this regard, the ability to work with a network of suppliers will become part of the firm’s core competencies and will therefore redefine what is core and what is non-core for the firm. Sixty per cent of CIOs and CFOs believe that their firms will increase or maintain the same level of outsourcing activities as before. This clearly shows that firms believe in the value that outsourcing can deliver and in the impact that outsourcing can have on the firm’s competitive advantage.

There are several particular areas where firms anticipate to continue outsourcing in the future - most notably in IT infrastructure and data management (41%), IT and technology consultancy (38%) and ERP support and implementation (25%) (See Table 9).

Table 9: Functions to be outsourced in the future

![Table 9 chart]

With new advances in Information and Communication Technologies (ICTs), mobile and nano-technologies and the recent improvement of IT infrastructure in India, China, and most CEE countries, we have witnessed the emergence of new sourcing models that rely on remote service provisions and remote access to computing resources. In particular, we are seeing more services offered in a Software-as-a-Service (SaaS) fashion. SaaS is a business model of software deployment where an application is hosted as a service and provided to customers across the Internet (i.e. Web-based application). Forty three per cent of the CIOs indicated that they are likely to explore this service in the next three years (see Table 10). Thirty nine per cent of the CIOs will very likely explore Remote Management Services (e.g. infrastructure and network management). Other emerging sourcing models, such as business process utility, information utility and cloud computing are also of interest but at much lesser extent.
Table 10: CIOs perspective on which services firms will be using in the future

- Software-as-a-service (Application Service Provision): 43%
- Remote Management Services: 39%
- Business Process Utility: 22%
- Information Utility: 22%
- Cloud Computing: 15%
- None: 36%
The Road to Realising Real Benefits from Outsourcing: Seven Steps

Any firm would like to clearly present the benefits from its outsourcing arrangements. However, many firms will eventually realise that they don’t know what exactly they have gained and at what price. The simple reason for that is: the journey to realising your benefits from outsourcing arrangements cannot allow any shortcuts. Being in a position to realise the real benefits from outsourcing requires a step by step approach. First, the context of the outsourcing activity should be understood and analysed. Part of that is realising the drivers, internal resources and expectations. Based on the context of the outsourcing activity, the firm should now make decisions on how and where to outsource (e.g. nearshore or offshore). This will be the firm’s outsourcing strategy. Once the drivers and strategy have been figured out, it will now be imperative to understand the benchmark that would best suit the firm’s outsourcing arrangement. Figuring out the benchmark to use in the outsourcing arrangement would not mean that the firm has realised the value gained from its outsourcing arrangement. Value can and will change over time and as the outsourcing arrangement matures and evolves. For this reason, value should be reassessed throughout the outsourcing arrangement to allow adjustments in value creation between the parties involved. At the same time, the firm will need to ensure the development of three critical organisational resources. These are the retained organisation; the firm’s learning capabilities; and the role the CIO is playing. We now describe each lesson in detail.

Lesson 1: Figure Out the Context of the Outsourcing Activity

A good starting point is to understand why the firm would like to outsource a service and what resources are available to successfully carry out an outsourcing project. We observed a couple of common mistakes in this regard: a bandwagon effect in which firms outsource because the competition does so (also known as ‘me too’ strategy) or firms outsource ‘a problem’. These are the wrong reasons to outsource a service. The consequences of such an approach can be dire, with a combination of potentially major difficulties to understand and benefits to realise from this outsourcing arrangement.

Instead, firms should follow a systematic approach to analysing the context of the outsourcing activity. There are several criteria that a firm should examine. Some are about the service and some are about the firm’s resources and capabilities. Simply ask yourself the following questions:

- What is the firm trying to achieve by outsourcing?
- How critical is the service to my competitive advantage?
- How dependent is the service on information or other inputs from the firm?
- How difficult is it to codify and monitor work considered for outsourcing?
- How precise are the metrics?
- How mature is the firm in managing outsourcing arrangements?

Answering these questions should give you a clear understanding of the drivers to outsource, your internal resources and your expectations. A service that is a source of competitive advantage should be
kept in-house. Realising the benefits of an embedded service that is difficult to codify be challenging as it increases operational risks. Likewise, outsourcing processes that are difficult to monitor (e.g. R&D, supply chain coordination); in particular when the firm does not have precise metrics to evaluate quality is not recommended. In these cases, the firm should examine its maturity level in outsourcing. A high degree of outsourcing maturity and sophistication will allow the firm to devise methods that overcome some challenges and help to mitigate some operational and structural risks.

This is only the first step but lays the foundations for moving on to the next step: your outsourcing strategy!

**Lesson 2: Figure Out the Outsourcing Strategy**

The outsourcing strategy will dictate the complexity of the outsourcing arrangement and therefore the ability to realise its benefits. Our advice to firms is simple: choose an outsourcing strategy that the firm’s resources and capabilities can cope with. By doing so, you will be able to assess and realise the benefits gained from your outsourcing arrangements.

Surprisingly, many firms experiment with sourcing models that are beyond their organisational capabilities. For example, in recent years many firms experimented with multi-vendor sourcing arrangements. We noticed that few firms can actually realise the benefits offered by the multi-vendor outsourcing model. It takes advanced sourcing capabilities to effectively and efficiently manage a single vendor in a particular business function, let alone multiple vendors that coordinate several transformation programs across several business functions. To be successful in this model, a firm needs highly developed outsourcing management and learning capabilities to realise the benefits delivered by each vendor as well as achieve value from having multiple sources of skills involved. Another example is the outsourcing of a range of services within a particular business function (e.g. HR) to a single vendor. While the client might perceive this as a straightforward outsourcing arrangement in which the benefits should be easily realised as there is only one vendor involved, the client will in fact need to develop sophisticated outsourcing capabilities that will allow realising the benefits from synergies between outsourced services. We have learned that most clients have failed to realise this promise.

**Lesson 3: Figure Out the Benchmark**

Many firms rely on Service Level Agreements (SLAs) as the main mean through which value from an outsourcing arrangement can be realised. SLAs are critical in any outsourcing arrangement; however, they don’t give the entire picture and in some case SLAs can be misleading. Firms that rely on SLAs to realise the benefits from outsourcing arrangements are basically monitoring service performance, which can be meeting the service provisions; however, offer little transformation. Therefore, the challenge for firms is to realise the impact of outsourcing on the business and not on the service performance. For this reason, firms must figure out the benchmark to use when measuring real benefits. The benchmark is usually a key success factor (KSF) in that industry. In one industry it could be the time to market of a new product while in another industry it will be quality. Once a benchmark has been identified, SLAs can be drafted to correspond with the provisions that generate a competitive edge. This will promise that the key effort of the client and the vendor is to improve the firm’s competitive advantage through business transformation that is monitored through a set of SLAs.

**Lesson 4: Realise What is Value Over Time**

Value is a dynamic concept. The desired value to be delivered from an outsourcing arrangement set by the client and vendor in the beginning of the project is destined to change over time. Few firms are aware of this and even fewer take steps to mitigate this risk. Clearly, by not sensing the changes in value over the outsourcing project life, tensions and disagreement are likely to emerge between the parties, which will eventually erode the benefits from the outsourcing arrangement. At the same time, the dynamic nature of value does not mean that clients are entitled to redefine their expectations every week. There should be a joint approach to address this challenge.

The first step is therefore to develop sensing mechanisms for changes in value. Sensing mechanisms are best supported through shared learning between the client and the vendor. The more shared
learning opportunities are created between the client and vendor teams, the more likely that value as a dynamic concept will be monitored. Our research found that value is best sensed when the outsourcing arrangement is based on relational value. Under such circumstances, efforts are put into the development of the supply network relationships by responding to the changing nature of value.

Lesson 5: Make your CIO a Strategist

Many CIOs, as we have learned in our research, do not ‘speak’ the ‘business language’. Most of them are not executive board members. Many of them have emerged from the IT/IS ranks and often had little exposure to and involvement in shaping the firm’s business strategy. In recent years some argued that in fact the role of the CIO is now less strategic, mainly because IT cannot anymore be considered as a source of competitive advantage. However, in the last fifteen years, the CIO has led outsourcing projects and transformed the way services are designed and delivered. The boundaries of the firms have been redefined and sources of innovations have been reconsidered. Clearly, nowadays the CIO is, if anything, more strategist than ever and its role within the firm is destined to grow. However, to cope with such changes the CIO needs to learn. They need to learn the ‘business language’ spoken at the executive board. They need to learn to design and argue a strong business case of an outsourcing arrangement at the strategic, operational and financial level. They need to learn to focus on business improvement processes rather than service improvement processes and on business transformation rather than IT improvements. Their role within the organisation should be more central, with a direct influence on decisions made at the board level. A CIO then should become a central figure and a driving force in implementing Lessons 1-4, 6 and 7, as depicted in Figure 1 above.

Lesson 6: Build the Retained Organisation

The CIO alone will not be able to transform the firm and deliver value from outsourcing arrangements; however, the CIO can and should build the retained organisation to act as a change agent that examines and monitors value delivery. Most firms consider the retained organisation as the minimum resource needed to support IT function continuity. The mistake in this approach is the focus on IT function continuity. Instead, the retained organisation should be perceived as the resource that drives firm’s transformation and innovation. For example, in many outsourcing arrangements the client transfers staff to the vendor. A common mistake by CIOs is that they tend to keep the bright and talented across the various areas of skills. Instead, a CIO should transfer bright and talented staff to the vendor in those areas of skills that the vendor is expected to take leadership, for example application development. At the same time, the CIO should build new expertise within the IT function to ensure that the focus of the IT function is on continuity, transformation and innovation. But the retained organisation includes other capabilities, such as relationship building, which concerns the wider communication between business and IT communities. It involves helping users understand the potential of IT for the creation of value, helping users and IT experts collaborate, and ensuring users’ ownership and satisfaction. For most firms this is a major challenge simply because the tremendous difference in culture between “techies” and “users”. Role holders with this capability have to facilitate a shared purpose and constructive communication among people engaged in the business and the IT function. Without this capability, the retained organisation will enable IT function continuity, but will fail to demonstrate the benefits of business transformation.

Lesson 7: Invest in Outsourcing Learning Capabilities

One of the most critical capabilities that outsourcing clients need to develop is learning. And still, clients tend to take a narrow approach to learning by focusing on learnt lessons from a single outsourcing arrangement and often paying little attention to building a learning capability across multiple outsourcing arrangements. Furthermore, clients often apply all their resources to ensure that vendors meet the service provisions while ignoring opportunities to learn from their vendors. Just consider the vast experience acquired by a vendor over time in a particular industry. Also consider the

7 Willcocks and Craig (2008) op.cit.
growing specialisation of vendors in a particular industry or technology mainly achieved through the knowledge acquired by centres of excellence (CoEs). Experts from these CoEs have dealt with multiple outsourcing arrangements, reviewed numerous contracts, negotiated benchmark and SLAs metrics and work together with various clients to make these arrangements a success. Furthermore, some leading vendors have perfected their knowledge management systems to ensure that their learning capability supports multiple engagements in an efficient manner (e.g. reuse of concepts). And yet, clients, as we learned, refrain from consulting with these experts. It is still the notion of ‘us’ and ‘them’ that inhibits learning between clients and vendors.

Removing these learning barriers requires vision and courage. If a firm is to become a sophisticated outsourcing player, it has to learn how to learn from its vendor firstly to avoid mistakes we have seen make again and again by inexperienced clients and, secondly, to improve the benefits that can be gained from an outsourcing arrangement.

\[9\] Oshri et al (2007) op.cit.
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