OUTSOURCING'S TRUE VALUE STILL GOES LARGELY UNTAPPED

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Companies that outsource IT functions save between 12% and 17% of the cost of doing the work in-house, a new report from Forrester Research Inc. finds.

The savings take into account the expense of moving the work to an outside provider, advisor and legal fees, severance for any employees let go, taxes and ongoing management of the deal. Moreover, the discount is conservative, said Forrester analyst Paul Roehrig, because it does not factor in harder-to-quantify benefits that can be accrued in a good outsourcing deal.

"There's additional skills that you would get, technology expertise, predictable delivery costs, none of which is included in these savings figures," said Roehrig, who covers sourcing and vendor management at the Cambridge, Mass.-based firm.

The Forrester study was done in conjunction with TPI, a global advisory firm in The Woodlands, Texas, that specializes in structuring large outsourcing deals. The firm publishes the TPI Index, a quarterly report on outsourcing trends based on data from its clients, primarily global 1,000 corporations. TPI reported that in 2006 it handled outsourcing contracts worth $21 billion.

The Forrester report analyzed data from 53 separate outsourcing transactions handled by TPI from 2003 to 2006. All of the deals include infrastructure management services; 22 also included application services. The savings rate was calculated by comparing the projected internal costs without outsourcing with the total planned cost with outsourcing. The average savings across all deals was about 15%, or about $3.3 billion in total commercial value.

Why does it matter? Well, saving money on IT matters. Seventy percent of IT decision makers tell Forrester they remain focused on finding ways to "curtail IT services spending" in 2007, Roehrig said. And, contrary to popular belief, IT outsourcing is not widespread among U.S. companies. The global outsourcing market is estimated at $77 billion per year, with U.S. companies accounting for about $44 billion. According to Forrester, only about 30% of U.S. businesses outsource IT infrastructure, putting the potential U.S. outsourcing market at $110 billion. Applying the 15% average discount realized by TPI clients, the untapped $66 billion market is sitting on a potential savings of $9.9 billion per year.

"That's a big number. Even if you're 10% or 15% off, it's still a big number of commercial value that is locked up," Roehrig said. "The other side of the coin is that these outsourcing plays, at this level, shouldn't just be about savings. There are other benefits of outsourcing that have a multiplier effect on the dollars saved. Such as flexibility, such as a market presence in another part of the world, additional skills, technology expertise, all of which is not even included in these technology savings."

Roehrig said he expects much of the market potential will go to the established multinational players, particularly business from state and federal governments. But India-based service providers will continue to capture market share from the traditional players, he said.

Ayan Mukerji, senior vice president, product engineering solutions at Bangalore, India-based Wipro Technologies, has worked in IT services and focuses now on Wipro's $1 billion research and development services, which represent about 33% of the company's business. "Typically we are seeing savings of between 15% and as high as 30% on IT and product engineering products both," he said. But increasingly clients make the decision to use Wipro for revenue generation rather than absolute savings, such as access to global markets, new ways of doing business and time to market.

"They don't have the bandwidth, they don't have the skills, and many times they are saying, 'Hey can you help us get this product to market for this Christmas,'" Mukerji said. "An extra quarter of sales ends up being of more value than a cost reduction."

Sweet spots

The TPI data pointed to a "sweet spot" for savings. The greatest savings tended to come from deals with a total contract value of between $200 million and $1 billion, an annual spend of between $50 million and $120 million and a duration of seven years. These clients can expect to see savings of about 17%, Roehrig found.

"The smaller deals, you tend not to be able to get the aggregate savings. The larger deals have a higher level of complexity, so you don't accrue the same kind of value," he said. The caveat on all the findings, Roehrig said, is that the TPI clients represent a subset of all commercial activity. They are big deals that a TPI-type firm is asked to handle. They usually involve multiple services and span geographies.

Asked if he had qualms about using data from a firm with a vested interest in showing that outsourcing saves money, Roehrig pointed to the longevity of TPI, which has been in business since 1989, its sizeable market share and deal transparency. The customer data TPI used to determine the savings is based on the contractually committed financials of the deals they have.

"This is stuff written down somewhere on a spreadsheet. It's not thumb in the air," Roehrig said. Much of the data has been made public through the TPI Index, the firm's quarterly reports on market trends, giving clients ample opportunity to dispute claims, he said. "TPI has been open with its data, which is smart, and interested in participating in the research. I often wonder why some of these other firms are not as transparent."