

# Update

## Getting Smart Before You Start: Outsourcing Choices with Foresight

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Outsourcing receives a great amount of attention, spawned in part by the highly publicized announcements of organizations that decide to transfer substantial parts of their IT to external parties. Invariably, the deals are described as successes and the litany of advantages are espoused before the supplier even begins operationalizing the contract. However, as we all know, what is *expected* and what is *delivered* over a five- or 10-year contract can be two very different things.

Outsourcing was established as being highly imitative back in 1992 [5] — in effect, a “copycat” behavior. Because organizations attempt to duplicate the superficially observed success of others, there is a real need to discard myths or simplistic understandings. Accordingly, the first step in the Outsourcing Lifecycle [3] is the Investigate building block (see Figure 1). In this building block, the primary goal is to replace ideological concepts with realistic goals appropriate to the circumstances of your organization, its industry, and the markets in which you may procure services. It is about you becoming an informed outsourcing purchaser and manager — not with hindsight, as so many have done, but with foresight. But how does one become a smart buyer? This *Executive Update* helps answer that

question by outlining three vital steps before commencing outsourcing: (1) gather insight, (2) test expectations, and (3) collect market intelligence.

### GATHER INSIGHT

The first step in getting smart about outsourcing is to gather insight. The goal of this appraisal is to gather intelligence from those who have preceded your organization and to determine the potential implications for you. It is wise to cast your net wide across diverse sources when gathering knowledge. It is rare that any organization would conduct an outsourcing initiative in the same manner as it had previously, and the lessons learned are invaluable to others contemplating outsourcing. It is amazing to see some of the deals customers get themselves locked into unnecessarily when they decide to go cheap, quick, and with limited investigation.

A high-level industry review can often be conducted via publicly available information, but the particularly useful insight and learning is likely to be missing from such data. What is more valuable is harvesting the lessons your peers have learned from their earlier forays into outsourcing.

Many organizations have found it useful to examine their peers in

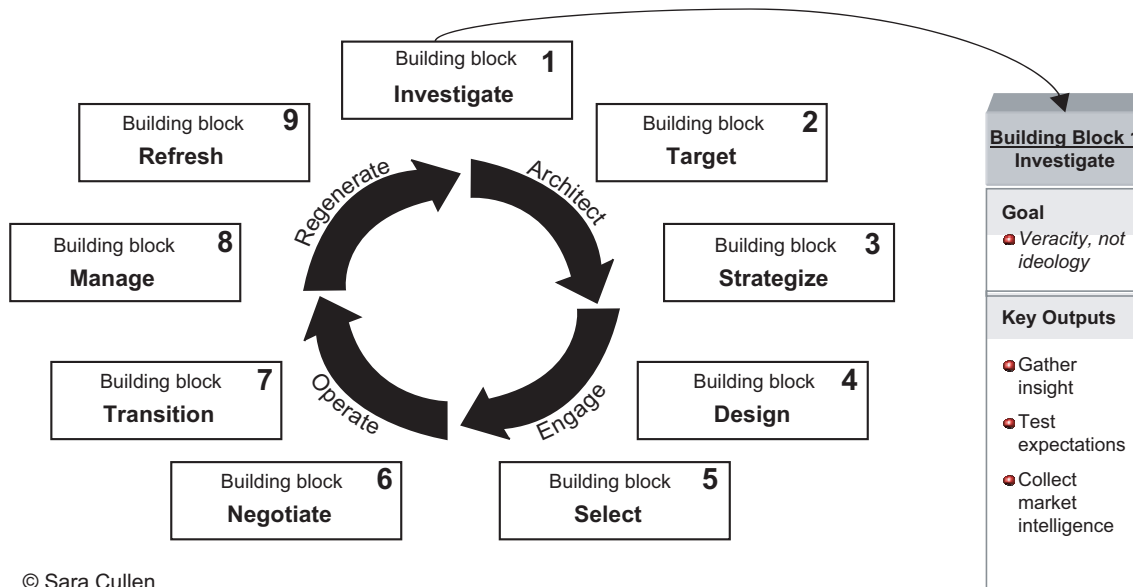


Figure 1 — The Outsourcing Lifecycle [3].

terms of the sourcing strategies they have evaluated and adopted — particularly if you are considering outsourcing on a scale or scope unfamiliar to your organization. Of course, in highly competitive industries such as banking or airlines, management may not feel free to discuss such strategies with competing entities, thus organizations with similar issues and nature of outsourcing under consideration must be sought instead.

As previously suggested, some of the information you would seek can be gained through published reports, guides, and other documents; however, a wide range of

sources will serve you better. Contact key personnel at client organizations, along with their outsourcing suppliers, to gather insights and opinions. Information from experts may also be able to be gained quickly from within the industry, ex-supplier staff, academics, and specialist consulting firms. If none of these channels are readily available to you, go to an outsourcing conference and establish contacts within the participant base. I have conducted many informal discussions with people all over the world in all these channels and rarely encountered anyone not willing to spend the time to share their experiences.

From all these sources, you can obtain an indication of:

- The drivers for the sourcing decisions made, as well as the results and the gained hindsight of the approaches taken
- The nature of services under consideration for further outsourcing or back-sourcing
- The structure of the deals and what worked well and what did not work as planned
- The necessary contract management to be put in place
- Where there are competitive markets and the quality of the suppliers in those markets

**A HELP DESK ASSUMES OUTCOMES JUST HAPPEN**

One of the key reasons a help desk was outsourced was to demonstrate, through the example exhibited by the supplier’s staff located onsite, a new mentality toward work. The organization specified the type of individuals it wanted the supplier to staff for the help desk. These specifications included education, dress, attitude, and dedication to the job. Management believed that if staff witnessed “professional behavior,” they would adopt it as a matter of course. No culture-change program was designed to go along with the desired new behaviors — the existence of the supplier’s staff alone was to provide the impetus to change. However, what actually occurred entrenched the existing culture further, as staff quickly asserted an “us vs. them” mentality and, in fact, ignored the supplier’s staff altogether.

**TEST EXPECTATIONS**

Next, it is important to establish real expectations about what is possible from outsourcing. Outsourcing is often oversimplified and emotive, based on the strength of individual beliefs in its benefits or drawbacks. The most controversial aspect of outsourcing is the degree to which the espoused benefits and disadvantages are real.

Organizations that have outsourced IT have reported substantial benefits in a number of areas. Figure 2 shows the results of studies showing where substantial benefits have been achieved over three survey periods since 1994 [1, 2, 4]. Of particular note has been the subdued record on cost savings so often peddled as a reason to outsource. This is a cautionary note to those using outsourcing as a cost reduction strategy.

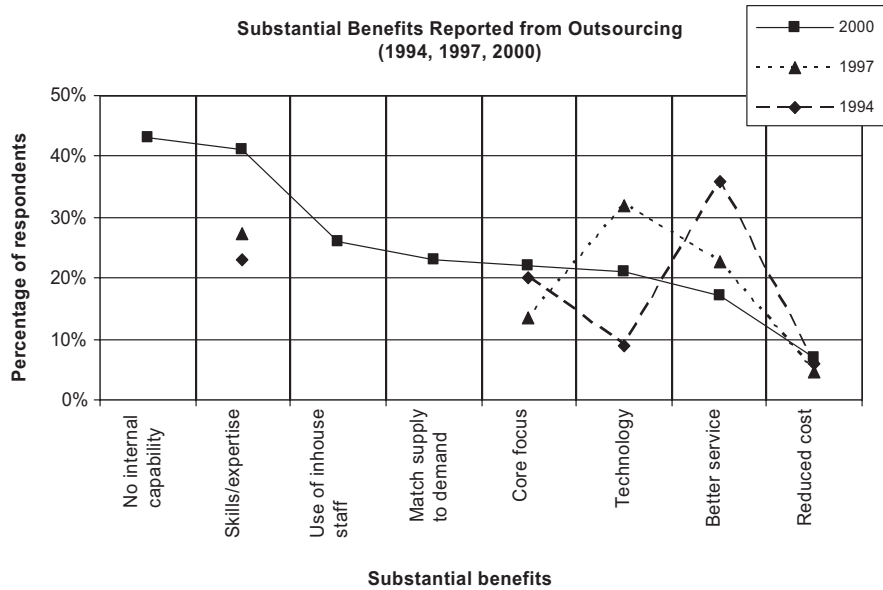
Most organizations believe that ultimate success has largely been moderate; likewise, the degree of failure has been moderate as well (see Figure 3). Outsourcing is rarely seen as a total success or total failure. However, there is a noticeable gap between anticipated and actual benefits.

In most cases, organizations were getting benefits but invariably less than they had expected. The key lesson that organizations consistently relearn on their outsourcing journey is that benefits are not inherent with the act of outsourcing alone — the goals need to be articulated and the means by which they will be achieved worked through. Otherwise, there may well be hidden costs and unanticipated consequences, as the sidebar “A Help Desk Assumes Outcomes Just Happen” illustrates.

**COLLECT MARKET INTELLIGENCE**

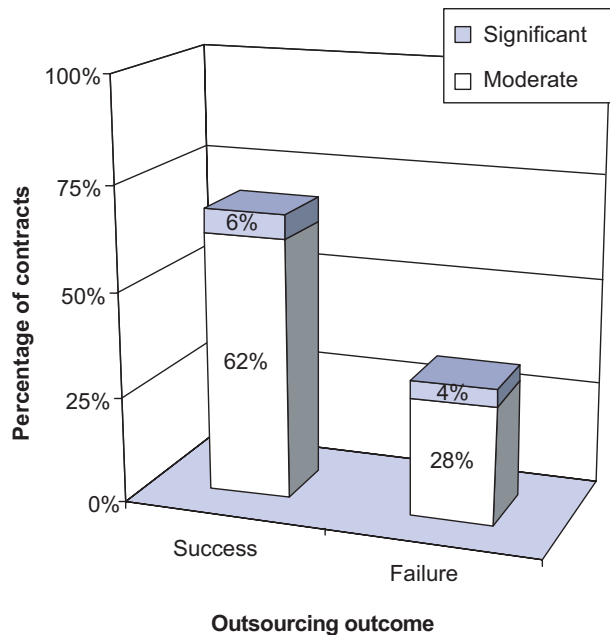
The next vital step is to collect market intelligence. This becomes more imperative when you do not have intimate knowledge of the industry as well as experience with the type of suppliers that may be potential providers.

It can be as simple as gathering basic information about potential suppliers, such as major industries, customers, and services. Even in mature IT supplier markets, most suppliers are constantly undertaking new initiatives, targeting new markets, and developing new



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Figure 2 — Substantial benefits achieved through outsourcing (227-233 respondents per activity).



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Figure 3 — Outsourcing success vs. failure (75 responses).

products and services. Their strategies and capabilities need constant monitoring. Consider the case study in the sidebar “A Technology Manufacturer Nearly Missed the Market.”

Early investigation into potential suppliers is often overlooked, particularly if you view all suppliers as equal and envision that a potential deal will be done foremost on price. Although suppliers share

### A TECHNOLOGY MANUFACTURER NEARLY MISSED THE MARKET

After failing to attract any outside customers to its commercialized IT services division, an international manufacturer of technology components decided to outsource its operations and concentrate on the core business. It was not going to be a major outsourcing deal but would still be worth millions per year to a supplier. Because of the moderate size, the organization had originally intended to invite only the second-tier suppliers, ignoring the major international companies. It was management's understanding that a contract would need to be worth hundreds of millions of dollars to gain the attention and focus that the organization wanted of its supplier. However, the forthcoming opportunity hit the industry grapevine, and the majors were able to convince management that this belief was unfounded. After a competitive process, one of the majors won the deal and the relationship has been deemed quite successful, even years after the honeymoon.

similar characteristics, predominately centered on the profit motive, they rarely have the same approach to their customers, contracts, and relationships. Even though outsourcing contracts tend to be shorter (three years or less), they often have renewal terms that make the relationship much longer, and the potential nature of a relationship is worth investigating at an early stage. Furthermore, discussions with suppliers can generate strategic sourcing concepts not previously considered, introduce new ideas for pricing and gain sharing, and start to form opinions on the nature of the suppliers' culture and strategies.

For any organization looking at outsourcing across countries, it is critical to know that supplier capabilities tend to vary geographically. The structure, culture, and services of a supplier in the US can be very different from the same supplier in Europe, and it is worth investigating how these geographic variances may affect preliminary sourcing concepts. Global organizations that allow their various geographies to select their own providers often choose different ones due to the local capabilities and prices of the suppliers.

The type of general information of most use at this formative stage is often as follows:

- **Market share in industry segments and service segments.** Is there local competence in your organization's industry and architecture?
- **Number of customers and percent of revenue that major customers represent.** Is there an overreliance on a single customer in a particular geography?
- **Financial viability.** Are the suppliers' local businesses established and sustainable?
- **Data centers, solution centers, centers of excellence, etc.** Is there appropriate infrastructure in the locations that may service your geographies?
- **Use of subcontractor entities.** How do the suppliers use other providers to fill capability shortfalls?
- **Composition of suppliers' top management.** Who are they, and what are their backgrounds?
- **Suppliers' strategies.** Where is their short-term and long-term focus, and what are their target customers, industry, and services?
- **Timing.** Are there other organizations seeking a competitive (or noncompetitive) process during the time in which you are considering going to market?

Might there be major changes to the supplier in the near future? What impact may this have?

- **Winner's curse.** If the suppliers have made low-price bids in the past, find out in detail how they can do so and still make a respectable profit.

This type of information can be collected informally via discussions or more formally via a request for information (RFI) process, whereby suppliers are invited to supply the required information in a formal response. Also, never underestimate the usefulness of harnessing the market intelligence of the organization's own staff!

### CONCLUSION

Given the habitual hurry to outsource once a decision has been made, any organization would benefit by harvesting the hindsight of those that have been there. People are not making new mistakes with outsourcing, only repeating very old lessons time after time. In this manner, other's hindsight can be turned into your foresight.

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