

Market Intelligence



Does Application Outsourcing Bring Value?

Testing the Value of Application Outsourcing
Services through the Collective Wisdom
of 709 Clients

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Performance Monitor asked more than 700 clients
of Application Outsourcing service providers to
weigh in on the benefits of contracting this service.

Their input clears away the fog of rumor surround-
ing the value of this emerging service line.



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“Applications Are What We Do”

Across the business and IT services spectrum, providers both large and small agree that the application outsourcing market is going to be the next big thing.

The trouble is the market isn't entirely in agreement. Or is it?

While leading service providers such as Accenture, Hewlett Packard, IBM, Deloitte, EDS and others continue to see their application outsourcing revenues grow, this is a services area that inspires considerable debate as it represents what most clients view as a far bigger outsourcing step than others they have either contemplated or engaged.

Application Outsourcing (AO): in Application Outsourcing a service provider hosts and or operates existing enterprise applications for a client. This service generally includes all applications processing and support, data back-up and other risk management. Enterprise applications may be legacy or package software.

Five years ago, when speaking to ERP audiences about post-implementation strategies, I would ask for a hand-poll of those who would consider outsourcing their applications. Not only did I seldom get a hand raised, my question seemed to elicit bewilderment. The essence of crowd response was usually “Outsource my applications? I might outsource some infrastructure, or maybe some processes that aren't strategic. But applications? That's what we do.”

Since that time, application outsourcing has gradually been de-mystified and the value propositions that seemed so elusive in years past have begun to mature. The goals most frequently goals targeted by those outsourcing their applications are:

- ✦ Focus internal resources on core competencies
- ✦ Bridge a skills/expertise gap
- ✦ Drive increased profitability
- ✦ Drive new business/revenues
- ✦ Improved response to business needs
- ✦ Increased user productivity
- ✦ Reduce business costs
- ✦ Reduce IT costs
- ✦ Provide predictable costs

More Goals than a Soccer Match

If goals were achieved as rarely for application outsourcing clients as they are for a soccer team, there would be no market whatsoever. All the same, reading a variety of articles in our industry press, one could conclude that application outsourcing goals are rarely achieved and that the endeavor is not worth the risk.

At Performance Monitor, we are interested in anecdotes and elaborate stories from the field, but we do not find them particularly enlightening. Five, six, or eight cases, bound together, may perhaps, when properly woven, tell a story but businesses are not accurately guided by stories.

In September of 2006, Performance Monitor released the results of a major market study that measured the value clients are getting from outsourcing their applications. In total, 709 organizations participated in the research, and each study participant was active in their engagement. The research includes each client's assessment of their organization's overall goal attainment as well an assessment of nine individual goals. The scale used to evaluate goal attainment is provided below:

- ⊕ Falling Far Short of Expectations (1)
- ⊕ Falling Just Short of Expectations (2)
- ⊕ Meeting Expectations (3)
- ⊕ Slightly Exceeding Expectations (4)
- ⊕ Far Exceeding Expectations (5)

Every client has certain expectations when they make the decision to outsource their applications. While exceeding those expectations is nice, most clients are satisfied so long as their expectations are met. Using the scale above as a guide, a provider will have done their job if the client provides a rating of three or higher. When studying an index across this spectrum, we look for the degree of separation we get from a flat 3.00.

Much of the business and IT press has been skeptical of application outsourcing, so it may be a surprise to many to find that these seven hundred plus clients report that application outsourcing results in more than satisfactory goal attainment. The overall application outsourcing goal attainment index is:

3.26

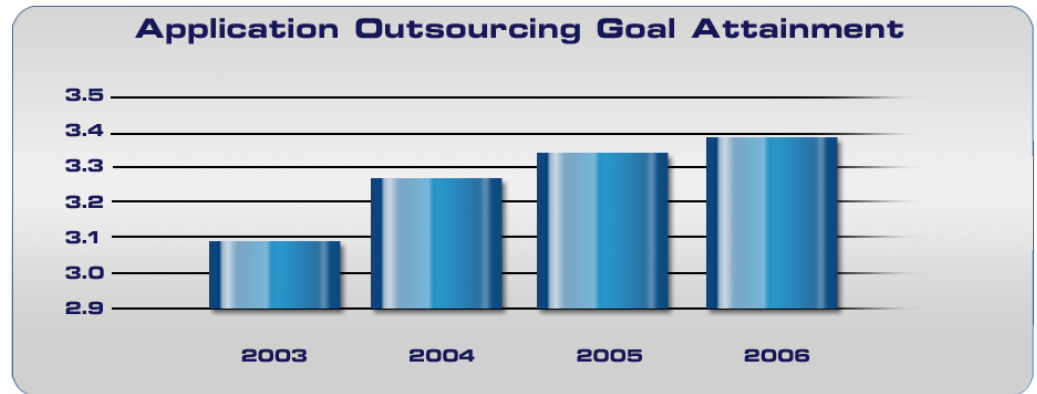
Such a result requires perspective, so consider that the market has long since accepted CRM services and application development services as viable. Both service lines have existed for quite some time and have continued to mature over a number of years. Therefore, let's compare their goal attainment indices to that of application outsourcing:

Goal Attainment Index			
Service Line	CRM	ADM	AO
Respondents	709	864	709
Index	3.15	3.41	3.26

Source: Performance Monitor

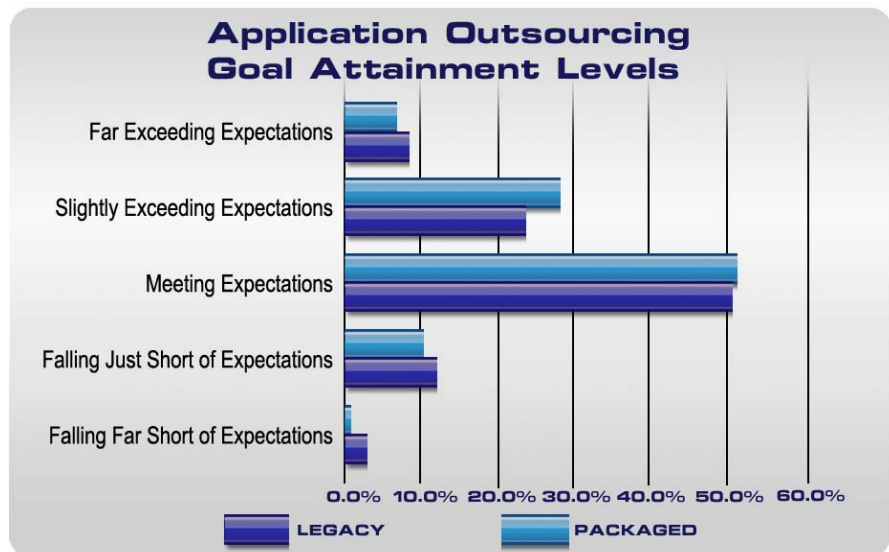
Of course, degree of difficulty may come into play but that is a variable too complex to add meaning to this comparison. Suffice to say, more than 700 clients of application outsourcing testify to a higher level of goal attainment than do more than 700 clients of CRM services.

More importantly, our research shows that goal attainment for application outsourcing clients is on the rise, which is a strong indicator of rising market maturity.



Source: Performance Monitor

This research includes application outsourcing clients for both legacy and packaged applications Here are the details for both:



Legacy applications = 281; Packaged applications = 358 (Total = 639 as not all respondents provided application type) Source: Performance Monitor

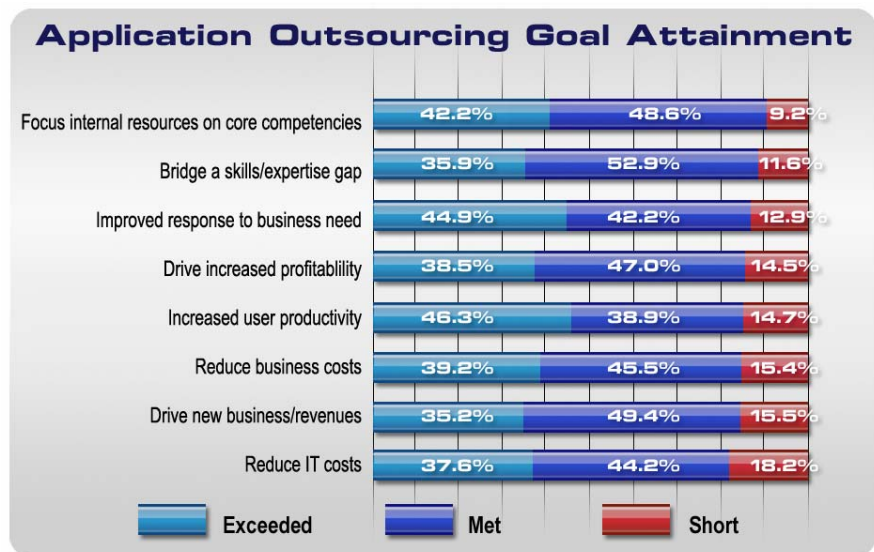
Altogether 86% of our respondents reported that their goals were met or exceeded, which strongly suggests that application outsourcing services are bringing value to their clientele. The total percentage of clients stating that their goals fell far short is 2% and the total percentage of clients stating that their goals fell just short of expectations is 12%.

It should be noted that results for clients with legacy applications are roughly equal to results for clients with packaged applications.

By the Numbers: Application Outsourcing Goal Attainment

According to these 709 clients, those seeking to shed themselves of the day-to-day burden of non-strategic activities and/or fill gaps in expertise are being well served. Less than one in ten clients seeking to focus internal resources on core competencies claims to have fallen short of expectations. Slightly more than one in ten clients seeking to bridge a skills or expertise gap claims that they fell short.

Thus, while applications may still be “what you do”, you may be able to focus your personnel on more strategic projects and create a more predictable cost structure without the day-to-day burden of managing your applications yourselves.



Source: Performance Monitor

According to our seven hundred plus respondents, clients seeking cost reductions through application outsourcing will find those goals more challenging than others but still well within the realm of probability. Application outsourcing costs, especially in the first few years, are heavily driven by two activities:

- ✦ Transition of activities from the client to the vendor
- ✦ Ongoing vendor governance.

If transition is not orderly or cost-effective, savings will be directly eroded due to higher internal and external costs. If insufficient resources, processes, or tools are assigned for vendor governance, application outsourcing performance may suffer and thus drive up the costs.

Attaining any of these benefits requires more than simply throwing your applications over the wall and paying a monthly bill. Among the best practices to be applied are:

Determine the level to which application outsourcing should be contracted. Various models include:

Application Maintenance: basic applications hosting/operations, break/fix, debug, backup, etc.

Application Management: maintenance functions (above) plus a level of application improvement, upgrade, and/or business process transformation.

Many clients take the “little steps for little feet” approach and seek successful application maintenance before taking further steps up the chain.

There are three levels of application management:

- Functional application enhancement as needed to assure *basic continuity*
- Frequent application enhancements to provide some *optimization*
- Defined levels/stages of business process *transformation*.

For example, clients with packaged applications find that the “bridge” between application maintenance and application management is turning over the majority of software configuration tasks to the service provider.

Complete an enlightened outsourcing provider selection process, including shortlisting, request for proposal, review of service provider responses, and final negotiation and due diligence with a chosen provider. Anything less than a formal selection process is inadvisable.

Form a new vendor governance unit to assure quality and cost-effective service delivery.

Diligently plan and execute transition to the new service; such transition should place a high priority on mutual knowledge transfer.

Application Outsourcing Market Maturity

The market maturity of any business or IT service line is measured across an X-axis of service capability and a Y-axis of client acceptance. We believe these results place application outsourcing higher up on that X-axis than might be expected by most clients.

In order to get the most out of application outsourcing, clients have to scale a steep learning curve and we trust that the results included in this research will accelerate that learning curve since the first step forward cannot be taken unless you believe that application outsourcing can bring value.

The next time I do a hand-poll of a large audience in regard to who is considering outsourcing their applications, I will be sure to have these results at hand as they clearly demonstrate that, even when applications are “what you do”, application outsourcing services can provide a rich harvest of benefits.

Michael Doane is Chief Intelligence Officer of Performance Monitor LLC, the leading provider of fact-based research and advisory focused on monitoring the field performance of professional services firms.

About This Research:

In order to gain deep insight into the field realities of application outsourcing, Performance Monitor gathered input from more than 700 clients of leading AO service providers, including performance scoring, problem management, goal attainment, and more. For more information, visit www.performancemonitor.net

Research Demographics

Medium (\$1B- <\$5B)		
Small (<\$1B)	Medium (\$1B- <\$5B)	Large (\$5B+)
36.0%	25.0%	38.9%

Respondent Role			
Leadership	Organization	Delivery	Stakeholder
18.2%	9.6%	43.0%	29.2%

Respondent Level		
C-Level	Management	Staff
10.7%	59.4%	29.9%

Application Outsourcing	
Application Maintenance	Application Management
36.1%	63.9%

for Application Management clients Application Management Levels		
Continuity	Optimization	Transformation
29.5%	48.4%	22.0%

Legacy Applications	Packaged Applications
44.1%	55.9%