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OUTSOURCERS FALL

Though outsourcing is booming, many users say they're less satisfied than they used to be

By Paul McDougall

TWO YEARS AGO, DYNEGY INC. APPEARED DESTINED TO follow its larger hometown rival Enron Corp. into scandal and bankruptcy. The Securities and Exchange Commission was suing the Houston energy company for questionable accounting methods, debt was mounting, and the entire energy industry faced punishing scrutiny in the wake of Enron's blowup. Dynegy, with 2003 revenue of \$5.8 billion, has since resolved most of its legal troubles, and it has cut debt by about two-thirds.

Dynegy's decision last year to outsource the bulk of its IT operations to Accenture is a big contributor to the turnaround, says Steve Moffitt, Dynegy's CIO and a senior VP. "We were stuck with a technology infrastructure built to support a \$40 billion company, and that's not where Dynegy was anymore," he says. Accenture has taken over systems management, help desk, application development, and most of Dynegy's other major IT operations. The result: The company has cut its IT costs by up to 30%. What's more, by outsourcing, Dynegy is better positioned to integrate operations from a recent \$1 billion acquisition of Exelon Corp.'s power-generation plants. "We're shifting to a global model, and Accenture has the means to support that," Moffitt says.

Dynegy's experience indicates why the outsourcing business continues to enjoy steady growth. Worldwide spending on IT services increased 6.4% in 2003 to \$570 billion, according to research firm Gartner. Despite that growth, IT executives aren't overly satisfied with their outsourcing partners. A recent InformationWeek Research survey of more than 300 business-technology professionals shows an average customer satisfaction rating of 6.4 on a scale of 1 to 10, where 1 is "not at all satisfied" and 10 is "extremely satis-

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fied." That's down from 7.1 in InformationWeek's last survey of outsourcing buyers two years ago. And nearly 30% say their outsourcer hasn't met their expectations. The survey also asked respondents what they seek in outsourcing providers, rating them in 10 categories, including reliability, reputation, cost/value, and vertical-industry knowledge.

No. 1 outsourcer Deloitte Consulting, which scored 7.4, was the only provider to score above 7 in the satisfaction ranking. Deloitte also ranked No. 1 in nine out of the 10 categories. That's partly because some of the expertise and best practices housed in the auditing side spills over to its outsourcing business, says IDC analyst Alexander Motsenigos. The firm insists it doesn't pursue outsourcing engagements with its audit clients. Still, Deloitte's connection to a big auditing firm is "a differentiator that others in the market don't have," Motsenigos says.

Deloitte also is the only outsourcer in the group that isn't publicly traded, and it attributes part of its success to the fact that it answers to customers, not Wall Street. "Outstanding," is how one customer describes Deloitte's reliability and responsiveness. The customer, an IT manager at a West Coast test-and-measurement equipment manufacturer, says Deloitte hit the mark with a recent Siebel Systems Inc. implementation.

Outsourcing pays off for Deloitte. Its revenue from systems integration, application outsourcing, and consulting

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increased 5% from 2002 to 2003 and now stands at \$5 billion a year, Motsenigos estimates.

Accenture and Capgemini tied for second in our ranking, with overall scores of 6.8. Accenture's flexibility is a strong trait, Dynegy's Moffitt says. Under the deal, the energy company owns its servers and software, and its employees have direct contact with Dynegy's internal IT staff when problems arise. "We wanted to maintain a lot of control internally, and they supported that," Moffitt says.

In last and next to last place, respectively, are two of the industry's most dominant players, IBM Global Services and EDS. Respondents gave IBM a mediocre 5.3 out of 10 for reliability, and IBM and EDS landed at the low mark of 5.4 for innovation.

IBM doesn't pay enough attention to its smaller contracts, says Brian Clement, delivery manager for human-resources and payroll-services firm Ceridian Canada. "They were being a bit lackadaisical and taking our business for granted," he adds. Ceridian has a multimillion-dollar contract with IBM to host its PowerPay payroll-management application from its data center in Toronto.

The mission-critical application crashed in June. "They made a mistake which actually brought the app down," Clement says. It was IBM's vaunted image as a blue-chip service provider that initially steered Ceridian toward the vendor. "We wanted to put that brand on it—outsourced by IBM," he says. Nevertheless, Ceridian Canada just renewed its contract with IBM; Clement wants to fix the relationship rather than ditch the vendor. Repairing the situation should be less of a hassle than engaging a new outsourcer, he says. IBM declined to comment.

EDS's poor showing illustrates that the onetime powerhouse may have to work harder and faster at making

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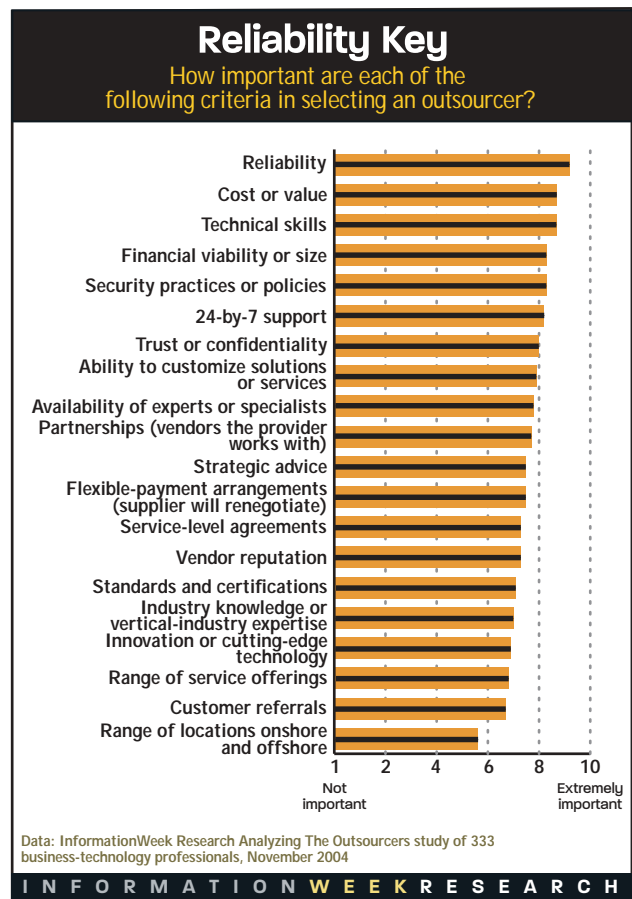
One-third of the IT pros we surveyed cite cost savings as main reason to outsource, down from two-thirds two years ago. To see how much companies spend on outsourcing, go to informationweek.com/1015/outlook.htm.

More than a quarter of respondents say they have outsourced at least one business process. Find out more at informationweek.com/1015/bpo.htm.

Find out how each of the 12 outsourcers fared at informationweek.com/1015/tool.htm.

For details on the survey methodology, go to informationweek.com/1015/methodology.htm.

For a copy of the InformationWeek Research Analyzing The Outsourcers report, go to informationweek.com/1015/report.htm.



the organizational and management changes demanded by CEO Michael Jordan, and delivering on its new IT road map to provide customers with a utility computing and mainframe migration strategy, even as it continues to try to solve some challenging financial issues. The company last week settled a dispute with outside auditors and reported a third-quarter loss of \$153 million from the write-down of assets related to a large contract to build a Navy intranet.

Some customers who say they're satisfied with EDS's service levels remain concerned about the continuing fiscal problems in Plano, Texas. "We're not immune to the allegations and issues they have to deal with," says Dick LeFave, CIO of Nextel Communications Inc. LeFave is committed to spending more than \$100 million with EDS over the next two years. He's not alone in wanting a partner that's on strong financial ground. Respondents to our survey assigned the financial viability of a vendor a score of 8.3 out of 10 in terms of importance in their selection process. However, LeFave sees improvements under Jordan. "They bring us a solid, reliable operating environment," he says.

Another prominent vendor, Hewlett-Packard, turned in a good performance, but its fifth-place tie with BearingPoint is a comedown from its first-place ranking two years ago. HP's professional-services revenue grew 13% year over year in the fourth quarter. The growth isn't coming at the expense of customer service, insists Joe Hogan, marketing VP for HP's outsourcing group. "You don't grow unless you have a high level of cus-

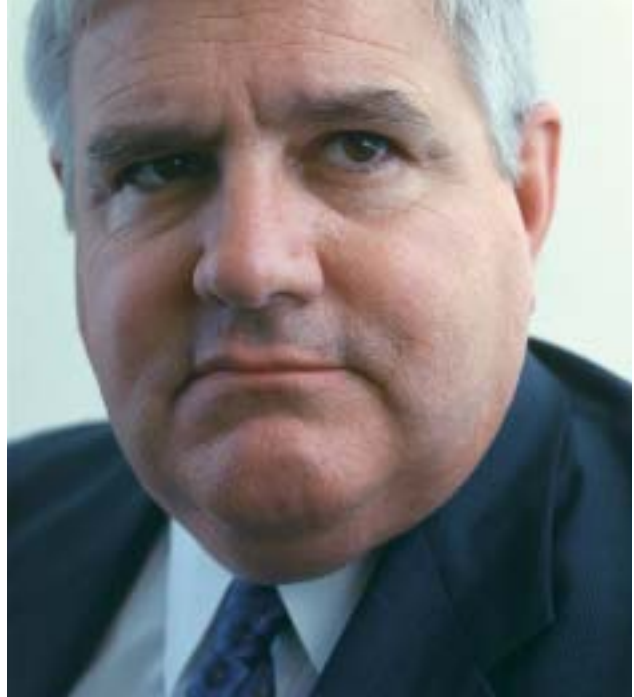
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tomers satisfaction,” he says.

Some technology chiefs, however, seem antsy with their outsourcing partners. Larry Bonfante, CIO at the U.S. Tennis Association, has his ax out. In 2002, the group outsourced most of its IT work to Affiliated Computer Services Inc. (Affiliated didn’t garner the 25 user responses required to qualify for a place in our survey.) The national governing body for tennis had hoped to access more efficient, capable IT workers through its application and infrastructure outsourcing deal with ACS. It didn’t. Bonfante found ACS’s process controls wanting and complains that the staffers assigned to his account lacked flexibility. That’s a big problem for the association, which has an internal IT staff of eight, but its 675,000 members depend on its Web-based TennisLink application for everything from scheduling tournaments to managing league play.

Next year, Bonfante will split his IT outsourcing purchase into two contracts: one for application outsourcing and one for infrastructure management. “The different providers have strengths and weaknesses; asking one to do it all may be a bit too much,” he says. ACS may get a sniff only at the application contract, an area where Bonfante says the company “did a credible job.”

It may be no coincidence that there’s something of an inverse relationship between a service provider’s market share and customer satisfaction. ACS is the fifth-largest U.S. outsourcer by revenue; IBM and EDS rank first and second. They simply may be getting too big. “Meeting service levels becomes a challenge as you get bigger,” says Atul Vashistha, CEO of outsourcing advisory firm neoIT. Part of the problem for the big vendors is finding enough qualified staffers to meet service obligations, Vashistha says.



While Nextel has been satisfied with EDS’s service levels, there are concerns about its fiscal problems, CIO LeFave says.

That has some buyers looking at smaller, more specialized vendors. To develop apps, Bonfante says the tennis association may turn to Keane Inc., a service provider with about a third the revenue of EDS, which focuses on application development and management.

A number of CIOs have begun to look for help outside the country. About a quarter of IT services spending among survey respondents went offshore to low-cost locations such as India, or near shore to Canada and Mexico. Some outsourcing business went to far-flung operations of U.S. companies. Accenture, for instance, provides Dynegy with application-development services in India. Moffitt likes the cost savings, but he concedes that the time and cultural differences present management challenges. “It does increase complexity,” he says.

Offshore providers hardly represent a panacea. The three Indian companies in our survey—Infosys Technologies, Tata Consultancy Services, and Wipro Technologies—all ranked in the lower half of the results. Offshore service providers are generally perceived as offering the best price because they can draw upon an inexpensive labor pool, but only Tata received a notably high score (7.0) for value.

Our survey addresses one piece of conventional wisdom that’s commonly misperceived: Outsourcing isn’t always done at the expense of IT jobs. Nearly a third of the organizations surveyed increased IT jobs in the past year, even though they outsourced some work. Many businesses farm

HOW THEY RANK

	OVERALL	RELIABILITY	SERVICE-LEVEL AGREEMENTS	AVAILABILITY OF EXPERTS	INDUSTRY KNOWLEDGE	REPUTATION	COST/VALUE	RANGE OF OFFERINGS	STRATEGIC ADVICE	TRAINING/ EXPERIENCE	INNOVATION
Deloitte	1	1	1	1	1	1	2	1	1	1	1
Accenture	2	2	6	2	2	3	7	1	1	10	3
Capgemini	2	3	3	6	2	2	7	3	3	1	5
Unisys	4	4	2	6	5	4	4	10	5	3	3
BearingPoint	5	5	8	8	2	4	9	4	5	3	6
Hewlett-Packard	5	8	7	4	6	6	3	7	4	5	2
CSC	7	6	4	4	6	6	9	5	7	8	7
Infosys	8	7	5	3	10	8	5	5	9	6	8
Wipro	9	11	12	10	8	8	5	7	8	6	10
Tata	10	8	9	8	10	10	2	9	10	8	8
EDS	11	10	10	11	9	11	11	11	12	11	11
IBM	12	12	11	12	12	12	12	12	11	12	11

Data: InformationWeek Research Analyzing The Outsourcers study of 333 business-technology professionals, November 2004

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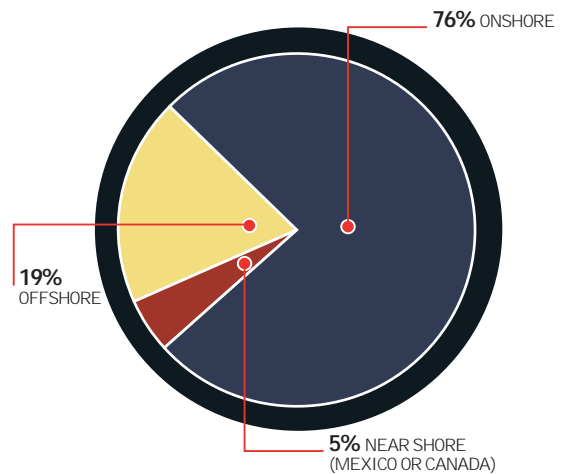
out technology work because their own staffs are working at full capacity. Ceridian Canada hasn't reduced its IT head count since striking its deal with IBM. Rather, the company turned to the service provider as a means to launch quickly a new project with skills it lacked in-house. "We wanted to get to market quickly because we knew a competitor was coming out with something similar," Clement says.

By far the largest number of survey respondents, 47%, pointed to operational expertise as one of the most important reasons to partner with an outsourcer. More people cited expertise over cost savings (35%), which could reflect a general upswing in the economy. In 2002, cost savings was the reason respondents most frequently cited for outsourcing. The shift means businesses may be thinking more strategically about IT. The main reason health insurer Blue Cross Blue Shield of Massachusetts signed on for a multiyear, \$320 million extension to its contract with EDS was "to help move our business forward," CIO Carl Ascenzo says. To be sure, Ascenzo wants EDS to help him keep his IT costs in check, but he wants access to applications such as EDS's MetaVance, which lets Blue Cross Blue Shield members tailor their own interactions with the insurer.

That a good outsourcing partner can deliver revenue-generating business enhancements, and not just cost

Location Of Services

How does the total amount of money your company spends on third-party service providers divide up?



Note: Percentages represent average breakdown of money spent.

Data: InformationWeek Research Analyzing The Outsourcers study of 333 business-technology professionals, November 2004

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savings, may partly explain why outsourcing spending is rising. In 2002, 51% of businesses *InformationWeek* surveyed spent \$1 million or more on outsourcing, and only 20% allotted more than \$10 million. Now, nearly 60% earmark \$1 million or more, and 25% spend more than \$10 million.

OFFSHORE CONNECTION: Location is a small issue

For the first time, offshore providers garnered enough responses to be included in *InformationWeek* Research's Analyzing The Outsourcers study. While the companies—Infosys Technologies, Tata Consultancy Services, and Wipro Technologies—didn't score particularly high in the overall rankings, their very appearance shows the shifting landscape of the IT-services market.

Most of the Indian firms have been providing a range of offshore services for years. However, they've shown stunning growth in recent quarters. Infosys, Tata, and Wipro are expected to, on average, see revenue growth of 36% this year, according to company projections, while expansion in the IT-outsourcing market as a whole is expected to be in the single digits. And overall, worldwide spending on offshore IT services will grow to \$17 billion in 2008 from \$7 bil-

lion in 2003, a compound annual growth rate of almost 20%, according to IDC.

So what drives buyers of IT services to employ Indian labor? It's more than price. All three offshore firms scored well in terms of domain expertise and range of offerings, an indication that Indian service providers are outgrowing their reputation as body shops that specialize in commodity work. A number of offshore players are winning more infrastructure-management contracts.

That's leading a number of Indian service providers to increase their presence in the United States. Wipro has more than 3,000 employees in the United States and Canada and maintains offices in almost every large North American city. Other major Indian firms are following suit.

A Wipro survey this year of 145 technology executives worldwide showed that 30% planned to offshore their com-

panies' IT infrastructure over the next year. Our survey shows that location was the least important factor driving the selection of a service provider—technology executives are more concerned with a vendor's reliability, value proposition, and technical skills.

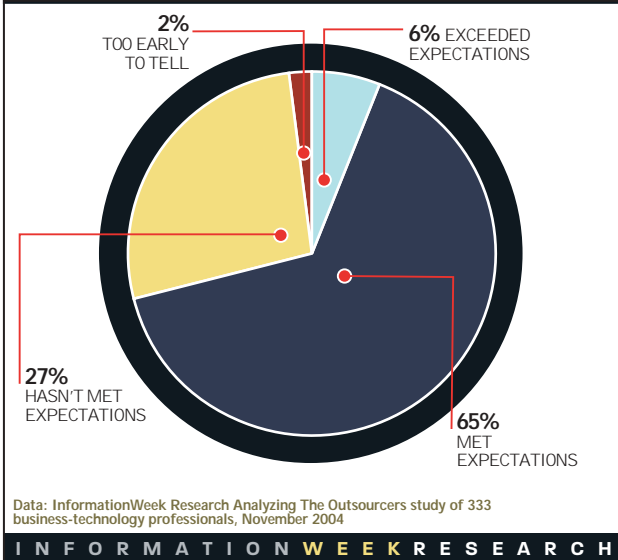
Next year, a new market entrant could pull even more business offshore. General Electric Capital International Services, based in India, is being spun off from parent company GE and plans to compete aggressively for IT and business-process-outsourcing contracts outside of GE. With more than 12,000 employees and plans to expand into South America and Eastern Europe, expect the GE spin-off to show up on future reports. Says Stan Lepeak, outsourcing analyst at Meta Group: "They will be a significant player in the market." —PAUL MCDUGALL

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Outsourcers Meeting Expectations

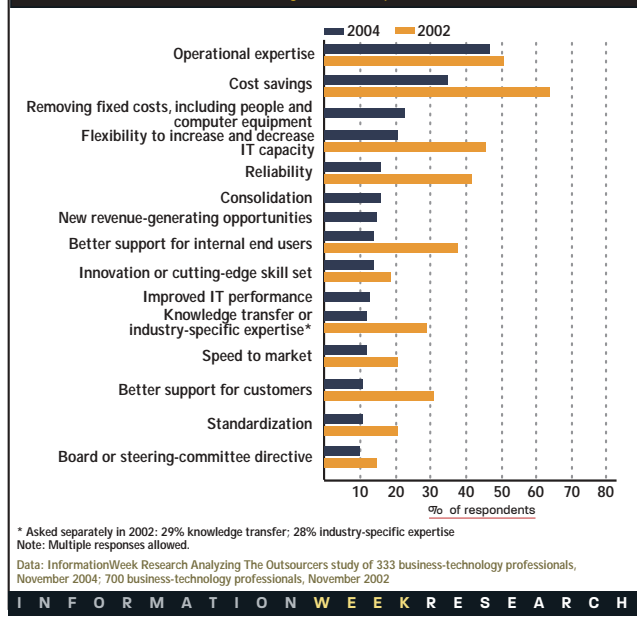
Overall, would you say your company's outsourcing experience has met expectations?



Increased spending on outsourcing means an increased focus on the minutia of the deal. Nearly half of our respondents get outside help when constructing outsourcing deals. Such deals are more complex as businesses turn over a greater portion of their operations to third parties. "The issues can range from whether there is a legal transfer of intellectual property to who is responsible for the pensions of employees that get moved to the outsourcer," says lawyer

Changing Outsourcing Drivers

What are the most important factors driving your company's decision to enter into a continuing relationship with an outsourcer?



William Bierce of law firm Bierce & Kenerson. At Ceridian Canada, in-house counsel helps to construct tighter contracts with IBM to avoid future problems. "We are moving from service-level objectives to service-level agreements," Clement says.

Outsourcers face tough challenges to satisfy their clients as companies rely more on their services. And, as our survey suggests, there's plenty of room for improvement.

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