

UKSMA

Application Outsourcing: how do you know how much money you are losing/saving?

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VP Gartner Benchmarking Group
2009

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The current Applications Outsource market is showing significant focus on Cost and Price.

- Applications Development and Support Pricing has always seen to be somewhat of a mystery. What mechanisms exist to determine the price of an Application Development or Support Outsourcing deal? What works and what does not?
- Is size the only price driver? Is measuring the workload really the battleground we expect to see? Is offshore any different?
- Applications Development and Support (ADS) can account for more than 50% of an entire IT budget. Cost management is not possible without a clear understanding of what drives price in order to take effective actions to reduce costs.

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2009 CIO strategies reflect the need to reduce the cost of IT and raise IT performance

Ranking of strategies CIOs selected as one of their top 5 priorities

	2009	2008	2007	2006	2012
Linking business and IT strategies and plans	1	2	2	2	2
Reducing the cost of IT	2	10	12	*	6
Delivering projects that enable business growth	3	1	1	1	1
Improving IT governance	4	7	8	9	14
Implementing IT process improvements	5	6	12	*	13
Improving the quality of IS services	6	4	7	12	12
Improving the business and IT relationship	7	5	*	*	11
Attracting, developing and retaining IT personnel	8	3	4	5	5
Consolidating IT operations (e.g. shared services)	9	12	*	*	15
Use of information/intelligence	10	9	6	*	4
Developing or managing a flexible infrastructure	11	11	7	8	8
Building business skills in the IT organization	12	9	8	3	9
Leading enterprise change initiatives	13	13	10	*	3

* New question

Source: Gartner's CIO Agenda 2009

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3 Themes

1. The Applications outsource market
2. What types of model are required for benchmarking?
3. Practicalities and rules of engagement

■ ■ ■ ■ 1. The Applications outsource market

1. What's happening in the Apps Outsourced world? Still growing – but carefully

"The current economic environment has created two extremes of buyers:

- those financially distressed
 - and those exercising extreme caution
- but both are exhibiting extreme focus on cost reduction."

"Economic woes create extreme price pressure from clients and intensify competition. With nearly all organizations looking to reduce IT costs, ..."

Source: Gartner Research

"service providers face several challenges: ... extreme focus on cost

Clients are aggressively seeking ways to deliver immediate cost-benefits

Outsourcing levels are set to increase ... During the next two years, the number of organizations that evaluate their use of IT Outsourcing as high is set to grow

- from 30% to 41% in North America,
- from 25% to 34% in Western Europe,
- and from 31 to 51% in Asia/Pacific."

Source: Gartner Research

DataQuest Research has identified

- **51 new (large) Applications Outsourcing deals in 2008**
- **27 new (large) Applications Outsourcing deals in the first half of 2009**

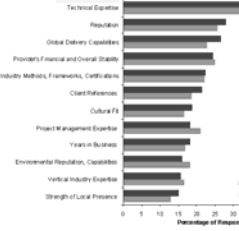
1. What's happening in the Apps Outsourced world? Focus is on Price and Cost Saving

Top Factors during Request For Proposal and in Final Selection

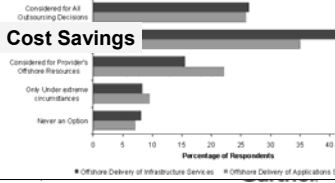


Gartner Research:
Economic Pressures Drive Cost-Oriented Outsourcing, Worldwide, 2008-2009

Price



Key Parts of Today's Outsourcing Strategy

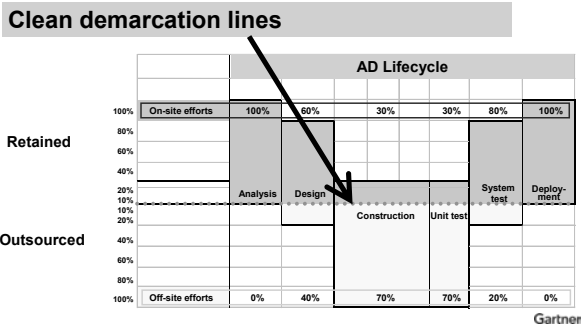


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1. The Applications Outsource Market What happens when Apps is outsourced?

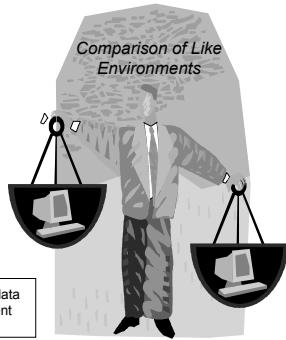
- **Application Development** is split between the Service Recipient and the Service Provider and the lifecycle responsibilities are initially defined but soon fall apart
- **Applications Support** scope expands considerably to incorporate e.g.:
 - Help Desk, operations management, and configuration management,
- On-shore/off-shore mix is initially planned as part of the outsourcing business case – but the profiles change under geographically driven price differentials.
- Additional responsibilities are added to fill the gaps in the Service Recipient's previous organisation,
 - Lead Systems Integrator role
 - Risk management

1. The Applications Outsource Market The contracted AD Effort and Phase Allocation



2. Benchmark Models: What is a Benchmark?

- A benchmark is a metric comparison of a defined environment to a peer* group with similar environments.
- Analysis can measure cost, price, efficiency, effectiveness and deviation from peer group norms.



*Peer — An Organization whose benchmarking data points match the characteristics of the environment being benchmarked.

2. Benchmark Models: What types are required for benchmarking?

Staff augmentation

- The model used must be linked to the type of deal:

Project-based

- Staff Augmentation – Day Rates
- Project – Price and Productivity for Project

Full Application outsourcing

- Full Outsourcing – Price for Service

2. Benchmark Models: Staff Augmentation

Staff augmentation

Rate Card Assessments.

- Uses a combination of Skill Level models and detailed Job Description information.
- Requires details from SR (and SP) of:
 - Contract terms,
 - Roles and Responsibilities of resources
 - On-shore / off-shore profiles

Gartner		Agreed Success															
Job Characteristics		Role 1 - Ops Engineer															
• Job Name	Ops Engineer																
• Responsibility Cluster	This role is used primarily for Desktop Engineers here of the Center Cluster as a good match for it. It is not targeted for Cluster A as the best option to work with. Cluster to advise whether they have comparable responsibility cluster. Programmatic responsibility cluster. Technical support discipline. Applied subject matter knowledge to resolve general support issues. Act as a team member, providing information and support to team leads.																
• Skills Cluster	This role is used primarily for Desktop Engineers here of the Center Cluster as a good match for it. It is not targeted for Cluster A as the best option to work with. Cluster to advise whether they have comparable skills clusters.																
Education Required		None for Center education level															
<table border="1"> <thead> <tr> <th>Title</th> <th>Responsibilities</th> <th>Skills</th> </tr> </thead> <tbody> <tr> <td>System Integrator</td> <td>Install, configure, and maintain hardware and software systems.</td> <td>Hardware and software installation, configuration, and maintenance.</td> </tr> <tr> <td>System Administrator</td> <td>Manage and maintain the organization's IT infrastructure.</td> <td>Network management, system administration, and troubleshooting.</td> </tr> <tr> <td>Help Desk Support</td> <td>Provide technical support to users and resolve issues.</td> <td>Customer service, problem-solving, and technical knowledge.</td> </tr> <tr> <td>IT Support Specialist</td> <td>Assist with various IT tasks and provide user support.</td> <td>General IT knowledge and user support skills.</td> </tr> </tbody> </table>			Title	Responsibilities	Skills	System Integrator	Install, configure, and maintain hardware and software systems.	Hardware and software installation, configuration, and maintenance.	System Administrator	Manage and maintain the organization's IT infrastructure.	Network management, system administration, and troubleshooting.	Help Desk Support	Provide technical support to users and resolve issues.	Customer service, problem-solving, and technical knowledge.	IT Support Specialist	Assist with various IT tasks and provide user support.	General IT knowledge and user support skills.
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Approved by: _____ Date: _____ Approved by: _____ Date: _____																	

2. Benchmark Models: Project Based

Project-based

Combination of Productivity calculation and Rate Card approaches used to benchmark Price of a Project.

- Projects are sized,
- Productivity drivers are documented,
- Project performance is modelled from database productivities,
- Additional factors are used to address:
 - Testing demands to meet required Service Levels,
 - time compression to achieve deadlines,
 - Additional Service Provider management

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2. Benchmark Models: Full Outsource

Full Application outsourcing

Full Applications Price Benchmark

- Based on combination of Productivity calculation and Rate Card approaches used to benchmark Development and Support.
- Using models to support shared/split responsibilities through the development lifecycle.

Challenges:

- "Agile" methods will undermine the current ability to allocate performance responsibility between SP and SR
- Sizing of Development outcomes – Function Points is still the best approach but there are pockets of significant resistance
- Moves to "Business Value" outcomes will require rethink on measures of productivity

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2. Benchmark Models: Typical results and uses

Benchmarking ...

- ... provides a measure for continuous improvement
- ... tests the validity of fees for certain services
- ... evaluates relative performance within a peer group
- ... creates leverage for price adjustments
- ... quantifies the appropriate price/service delivery balance

Benchmarking basics:

Coverage areas	When?	How often?	Comparison metrics	Methodology
Peer group selection	Provider selection	Realistic definitions	Benchmark management	How to use results

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2. Benchmark Models: Peers & Normalisations – extract - data template

Contract: Price Benchmarking Applications Maintenance: Peer Contracts						
		Peer Contract 1	Peer Contract 2	Peer Contract 3	Peer Contract 4	Peer Contract 5
Scope of Offering						
Applications Support	100%	100%	100%	100%	100%	100%
Consulting and Emergency Maintenance	100%	100%	100%	100%	100%	100%
Proactive Maintenance	100%	100%	100%	100%	100%	100%
Release Packaging	100%	No	5%	100%	100%	100%
Technical and End User Support	100%	No	4%	100%	100%	100%
Minor Enhancements	100%	100%	100%	100%	100%	100%
Business and Operations Support	No	No	No	No	No	100%
Technical Upgrades	No	No	10%	100%	No	100%
Scale						
Size of Applications Portfolio (Function Points)	204,075	244,201	3,61%	256,231	4,69%	256,466
Weighted app years	5.1	5.9	4.03%	11.8	4.91%	17.7
Geography						
Required to engage on non-base sites with End Users?	No	No	No	No	No	No
#100 - How many sites?						
Supported Environment						
Development Methodology	No	No	No	No	No	No
#100 - what is the method?						
Business Criticality of Maintained Applications	Highly profile					
Change Management Strategy						
As above	No	10%	-0.05%	20%	-0.10%	7%
Via release	Quarterly	80%	41%	97%	92%	80%
Process Maturity Rating	-1	1		1	1	1
#100 - what is the rating?						
Maintained Technologies						
Language Profile	8%	44.8%	10.5%	1.0%	14.4%	43.9%
JAVA			4.0%	0.3%		
COBOL			9.9%	0.7%	81.7%	
#100 - what is the profile?						

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2. Benchmark Models: Peers & Normalisations - normalisation factors

Contract: Price Benchmarking Applications Maintenance: Peer Contracts						
	Peer Contract 1	Peer Contract 2	Peer Contract 3	Peer Contract 4	Peer Contract 5	Peer Contract 6
Scope of Offering						
Applications Support	100%	100%	100%	100%	100%	100%
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COBOL			9.9%	0.7%	81.7%	
#100 - what is the profile?						

Normalisation factors are applied to adjust for differences between the peer's characteristics and those of "this deal"

	The deal	The peer	Factor
FP Size	204,075	244,201	3.61%
Apps Age	3.1	5.9	4.03%

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2. Benchmark Models: Summary Normalisations & Price Comparison

XYZ Application Support Calculated price per year											
Contract	Unadjusted Price	Net Adjustment	Adjusted Price	Scope of Offering Impact	Scale Impact	Geography Impact	Supported Environment Impact	Maintained Technologies Impact	Service Levels Impact	Terms and Conditions Impact	Market Factors Impact
BP1	£ 565,936	8.2%	£ 489,947	-0.6%	-0.6%	1.7%	2.0%	3.6%	6.0%		
BP2	£ 649,593	4.1%	£ 548,947	-2.7%	-0.6%	3.5%	1.3%	2.7%	3.6%		
BP3	£ 662,308	-2.6%	£ 643,947	-1.6%	1.1%	0.0%	3.1%	0.8%	2.7%	-2.5%	
BP4	£ 790,543	19.8%	£ 643,947	2.9%	0.0%	-1.2%	2.7%	0.0%	7.9%	3.6%	
BP5	£ 650,910	0.8%	£ 643,947	-5.7%	3.6%	2.7%	-0.6%	-2.7%	-1.4%	1.3%	3.6%
Average		4.3%	£ 643,947	4.5%	1.8%	1.3%	0.6%	1.7%	8.5%	3.6%	2.9%

example

XYZ Application Support Calculated price per year			
	Support Price	ABC price is % of	Range vs. min.
Minimum	£ 489,947	132%	100%
Average	£ 555,700	116%	113%
Maximum	£ 790,513	91%	145%
Client XYZ	£ 645,923		

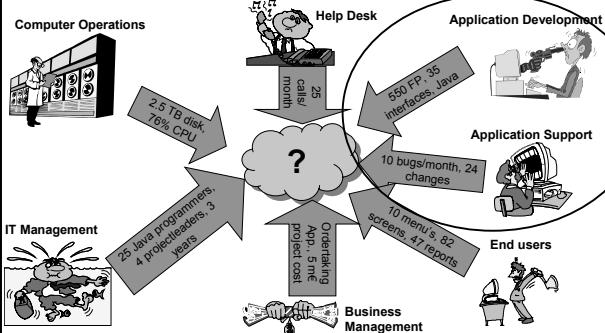
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3. Practicalities:

3. Practicalities and rules of engagement

- Everyone's favourite subject
- Sizing

3. Practicalities What's the size of an Application? Who is looking?



3. Practicalities different sizing approaches for different deals

<ul style="list-style-type: none"> • Counted Function Points – Formal FPA <ul style="list-style-type: none"> - e.g. with the International Function Point User Group (IFPUG) or NESMA methods • Fast Function Points <ul style="list-style-type: none"> - e.g. Gartner Fast Function Point Analysis (FFPA) 		} OK for Drill down Benchmark
<ul style="list-style-type: none"> • Express Size <ul style="list-style-type: none"> - Number of objects x factor : only for portfolio • Counted Lines of Source Code → “Backfired FP” <ul style="list-style-type: none"> - Part or whole portfolio (i.e. not for individual apps.) 		
<ul style="list-style-type: none"> • Estimated Lines of Code • Comparative Functionality 		} Option for High level Benchmark

Source: Gartner best practices
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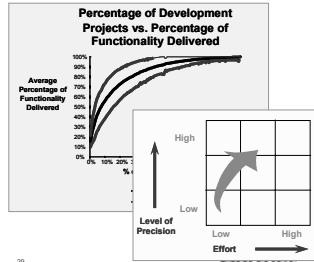


3. Practicalities Is sampling OK?

- Sampling is acceptable

? How much data is needed?

- Enough to be representative
- As agreed between Service Recipient and Service Provider



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3. Practicalities Good Measurement Practices

- Size is a major price driver for outsourcing contracts in Application Development and Support, but not the only one. Others are: complexity, quality, technology, volatility (for Apps Support)
- Each of these needs to be measured.
- Use Function Point Analysis to determine the size of an Application in Support or to be developed. Lines of Code can be an alternative,
- Have the functional design counted TWICE: once by the SR, once by the SP. In case of conflict, seek arbitrage via a 3rd party.
- Agree on the size (and other price drivers) before negotiating on price
- Base contracts for AD and AS on a productivity figure (hours/FP), or on a price (£/FP)
- Create metrics to stimulate the ESP to meet requirements of the deal which could be increase productivity, reduce defects, or reduce costs.

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■ ■ ■ ■ In closing

Measuring Success
What Works and What Doesn't ... Lessons Learned

- **Adopt a benchmark process based on a proven methodology, a robust database and market trend understanding.**
- **Be prepared to be pragmatic in measuring functional size. Select the right technique for the needs of the benchmark**
- **ESP and SR should be equally involved during the benchmark process.**
- **Don't focus on data exclusively from industry peers — you may find the best practices elsewhere.**
- **Normalisation is normal!**
- **Benchmark the contract and remember the constraints under which the SP has to operate.**

■ ■ ■ ■ Q & A
