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RIQ Editorial

Cloud brings sunny outlook for outsourcers

By Galiya Sayfutdinova
Editor, Russian IT Quarterly

The biggest event of the last quarter was the Gartner IT & Outsourcing Summit, where Reksoft represented the Russian software development industry alongside Russoft, the Russian software outsourcing providers association.

The international outsourcing community gathered to pick up the latest trends and to listen to the common buzz to divine the future of outsourcing.

The main themes of the event were cloud computing, the pros and cons of traditional and emerging offshore destinations, and the best ways to evaluate offshore providers.

According to the latest Gartner research, up to 10.2% of external IT spending is going towards cloud computing - and that's just the first step. The cloud computer market is evolving rapidly and Gartner expects SaaS in particular to be the main trend over the next 5 years. The most successful enterprises' IT departments will use cloud services to reduce the total cost of software ownership and avoid up-front investments, rather than own the assets and pay license fees.

How will this shift influence outsourcing services providers? Will it kill customised software development as enterprises enjoy easy-to-change working environments and applications available in the cloud for a small fee? Or will it cause a boost in outsourcing as most new products and services go online, skyrocketing the need for support and maintenance services?

SaaS will probably not diminish the volume of software consumption. First of all, not all enterprise needs might be satisfied with standard software and especially for those businesses that have high safety and risk requirements, such as transport and logistics, or specific business processes. And cloud software still has to be developed, with an attendant need for testing, support and maintenance of newly deployed software.

However, the working environment will certainly change for outsourcers. Some things will certainly become tougher. Information safety demands will increase and the ghost of Satyam will haunt outsourcing managers while choosing the right provider. The need to work with applications non-stop will create new and higher requirements for business consistency. But on the other hand, cloud computing will provide software development companies with more scalable development environment, diminishing project costs and increasing the flexibility in project launching. Taking all this into consideration, the software outsourcing industry's prospects look quite rosy.

This coincides with Gartner predictions that up to 30% of IT services will be industrialized by the end of 2015, and delivered through cloud. Software development services and outsourcing services will require more soft skills and a greater understanding of the client's business, with an attendant move away from time-and-material contracts to a focus on business KPIs, said Gartner analysts.

Summary

Vested Outsourcing: Game-changing Rules for Outsourcing

Successful outsourcing deals play by rules that are fundamentally different than conventional approaches for procurement [read more](#)

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04.10.2010

Gartner highlights outsourcing drive

More than half of European organisations plan to increase their use of outsourcing this year, according to Gartner, even though overall spending may not rise [read more](#)

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Nordic ITO buyers' satisfaction fuels market growth

Apart from Central/Eastern Europe which is one of the world's most tempting ITO spots, other European regions equally show positive tendencies and expand their ITO market. To get an insight into the current state of affairs of the Nordics outsourcing market let's turn to EquaTerra's recently released 2010 Nordics Service Provider Performance and Satisfaction study [read more](#)

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Europe Tops List of Safest Outsourcing Spots

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Vested Outsourcing: Game-changing Rules for Outsourcing

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Successful outsourcing deals play by rules that are fundamentally different than conventional approaches for procurement.

Peter Drucker challenged companies to "Do what you do best and outsource the rest!".

Unfortunately, too many companies jumped into outsourcing using the same approaches and methods that they used for procuring commodities and materials to run their operations. The result is that far too many outsourcing deals are less than optimal -- leaving most in search of a better way to outsource.

The University of Tennessee studied some of the world's most successful outsourcing deals as part of a research project funded by the U.S. Air Force. Our work has uncovered the fact that successful outsourcing deals had one thing in common; they played by an unwritten set of rules that is fundamentally different than conventional approaches for procurement.

We have distilled our research into an approach that we call Vested Outsourcing -- because it is typified by an outsourcing relationship where both parties have a stake in maintaining the arrangement and work together to create a performance partnership that takes both the company outsourcing and the service provider to levels of cost, service and profitability levels not realized previously.

These are the Five Rules of Vested Outsourcing.

Rule #1: Focus on Outcomes, Not Transactions

Many conventional outsourcing arrangements are built around a transactional model. Most often this transaction-based model is coupled with a cost-plus or a competitively bid fixed-price-per-transaction pricing model to ensure the company buying the services is getting the lowest cost per transaction. The service provider is paid for every transaction -- whether it is needed or not. Thus, the more inefficient the entire process, the more money the service provider can make.

The company that has outsourced gets what it contracted, but perhaps not the best solution. Vested Outsourcing operates under a desired outcome-based model, with the emphasis on having the outsource provider align its interests to what the company really wants: an efficient and low-cost total support solution.

A Vested Outsourcing business model fundamentally shifts how a company buys services in a performance-based approach. Instead of paying an outsource provider for unit transactions for various service activities, the company and its service provider agree on desired outcomes. Desired outcomes are still quantifiable but take a different form: they can be set availability, reliability, cost, revenue generation, employee or customer satisfaction, or even asset investment targets. In essence, Vested Outsourcing buys desired outcomes, not individual transactions. The service provider is paid based on its ability to achieve the mutually agreed desired outcomes.

Rule #2: Focus on the WHAT, Not the HOW

Adopting a Vested Outsourcing business model does not change the nature of the work to be performed. At the operational level, there is still a need for parts to be

molded/fabricated, assemblies to be performed, items to be packed, orders to be fulfilled, spares and repairs to be managed, etc. What does change is the way that the outsourcing company purchases the services.

Using Vested Outsourcing, the company outsourcing specifies what it wants and moves the responsibility of determining how it gets delivered to the outsource provider. According to the outsourcing paradox, firms outsource to a supplier because they know the supplier can do a better job, yet write the contract as if they are the experts. Good companies outsource for a reason: in-house operations are either too expensive, ineffective, or both. Why dictate in an area where you have decided you are deficient? It is up to the service providers to understand how to put the supporting processes together to achieve the desired outcomes.

Rule #3: Agree on Clearly Defined and Measurable Outcomes

The third hallmark of a good Vested Outsourcing partnership is clearly defined and measurable desired outcomes. All parties must be explicit in defining the outcomes they want. These outcomes are expressed in terms of a limited set—ideally, no more than five—high-level metrics. Organizations should spend the time, collaboratively, during the outsourcing process, and especially during contract negotiations, to establish explicit definitions for how relationship success will be measured. Investing time up front is critical to ensure that none of the companies spends time or resources after implementation measuring the wrong things.

Once the desired outcomes are agreed on and explicitly defined, the service provider can propose a solution that will deliver the required level of performance at a predetermined price. This approach fundamentally shifts the business model, shifting risk from the company that is outsourcing to the service provider(s). Under the purest form of Vested Outsourcing, the company that is outsourcing pays only for results, not transactions; rather than being paid for the activity performed, service providers are paid for the value delivered by their overall solution.

Rule #4: Optimize Pricing Model Incentives for Cost/Service Trade-offs

The fourth hallmark of a Vested Outsourcing partnership is a properly structured pricing model that incorporates incentives for the best cost and service trade-off. The pricing model is based on the type of contract—fixed price or cost reimbursement—that will be used to reward the outsource provider.

When establishing the pricing model, businesses should apply two principles:

The pricing model must balance risk and reward for the organizations.

The agreement should specify that the service provider will deliver solutions, not just activities.

The essence of Vested Outsourcing is a strategic bet by the outsource provider that it will meet the service levels at the agreed price. If the service provider does a good job, it will reap the rewards of greater profitability. Vested Outsourcing does not guarantee higher profits for service providers, but it does provide them with the authority and autonomy to make strategic investments in their processes and product reliability that can generate a greater return on investment than a conventional cost-plus or fixed-price-per-transaction contract might yield.

Rule #5: Governance Structure Should Provide Insight, Not Merely Oversight

In the early days of outsourcing, many companies made the mistake of simply throwing the work over the fence to the outsource provider, with poorly defined requirements and often no performance metrics or service level agreements. The downside is that many have

gone to the other extreme. Today's outsource providers often have a small army of program managers who micromanage the outsource provider. An effective Vested Outsourcing partnership outsources to service providers that are real experts. Such partnerships should be managed to create a culture of insight, not oversight.

If a company has done a good job picking the proper outsource provider, a trusted expert in its field, why does it need a small army providing general supervision? A properly designed governance structure should establish good insight, not provide layers of supervisory oversight.

InVesting in Vested Outsourcing

For many, Vested Outsourcing will seem like heresy to tried and true outsourcing methods. For others, it will seem like a fresh approach to help companies achieve better success with outsourcing. Thought leaders from Microsoft, Intel and UPS are early advocates for the process. In fact, Microsoft has had such good success that they won the Shared Services Outsource Network "Best Mature Outsource Service Delivery" of the year award in April 2010. And leading practitioners like Brad Mitchell, President of Distribution and Logistics for UPS has proclaimed that "Companies will take a vested interest in Vested Outsourcing," projecting it will be one of the top 5 trends in Supply Chain..

Gartner highlights outsourcing drive

ComputerWorldUK
07.09.2010

More than half of European organisations plan to increase their use of outsourcing this year, according to Gartner, even though overall spending may not rise.

The analyst group found 53 percent of organisations said they would outsource more in 2010, with 40 percent of organisations planning to boost spending on external IT services.

There is a growing trend for some organisations to outsource the majority of their IT, a Gartner survey revealed.

The percentage of organisations spending 50 percent to more than 75 percent of their IT spending on external service providers is on the rise, the analyst house noted.

"However, the results also showed that the pressure on capital and IT operating expenditure is still strong, and European organisations expect providers to deliver further cost reductions," said Claudio Da Rold, vice president and analyst at Gartner.

"Although 40 percent of respondents said that they will increase the external share of their budget, only 24 percent said that they will increase the budget for providers, and almost a quarter of organisations still expect that their IT services budget will continue to decrease in 2010."

Gartner has found evidence that outsourcing is increasingly attractive to smaller organisations. It found that almost 15 percent of organisations with IT budgets of less than £1 million (£830,000) expressed interest in outsourcing, up from barely six percent in 2009.

"Organisations can see that managed services and cloud computing financial models allow them to achieve their goals whilst reducing capital expenditure, said Nathan Marke, CTO of IT services company 2e2.

He highlighted the way infrastructure as a service and platform as a service offerings could allow organisations to re-platform legacy applications and sweat their assets for longer.

However, Gartner suggested that after several years of rapidly increasing interest in software as a service (SaaS), cloud computing and infrastructure utility (IU) delivery models, demand for these "industrialised services" delivery models may have peaked.

Gartner found cost control is the major consideration in outsourcing decisions but end users also increasingly require access to resources and capabilities, flexibility and scalability. "This more complex set of business requirements is not easy to address," said Da Rold.

An online survey was conducted among 206 organisations in Europe during in the first quarter of 2010. The survey was directed at individuals who were involved in decision making on outsourcing and IT services in 2010.

Nordic ITO buyers' satisfaction fuels market growth

ITOnews
13.08.2010

Apart from Central/Eastern Europe which is one of the world's most tempting ITO spots, other European regions equally show positive tendencies and expand their ITO market. To get an insight into the current state of affairs of the Nordics outsourcing market let's turn to EquaTerra's recently released 2010 Nordics Service Provider Performance and Satisfaction study that covers the Information Technology Outsourcing (ITO) and BPO markets, usage and service provider performance.

The sweep of the survey is impressive: the 2010 Nordic study investigated over 440 outsourcing contracts held by over 220 of the top IT spending organizations in the Nordic region. The total annual value of the contracts included in this study is over €3 billion, accounting for around two-thirds of the total Nordic outsourcing market in terms of annual contract value. All commercial sectors are represented in the study.

The 2010 results reflect positive tendencies: the ITO market is growing and the buyers are considerably satisfied with the delivered services. In more detail, you can see the exact percentage ratios summarized below:

- 84% of all Nordic ITO buyers polled indicated they will continue to outsource at the same or higher levels going forward.
- 72% of Nordic ITO buyers, up 8% compared to last year, indicated that outsourcing contributes significantly or moderately positively to meeting the primary drivers and benefits sought from their efforts.
- 55% of respondents are very satisfied or satisfied with their ITO efforts, and 29 % are somewhat satisfied. Only 6% are very or somewhat dissatisfied.
- 84% of all Nordic ITO buyers are satisfied with their outsourcing service providers in terms of general satisfaction, and 91 % of buyers would recommend their service provider(s) to another outsourcing buyer organization.

The use of offshore outsourcing in the Nordics has significantly increased over the past year. 52 percent of Nordic ITO buyers are currently making use of offshore outsourcing, up 11 percent compared to last year. This complies with the global tendencies of greater use of nearshore resources with similar language skills, cultural proximity, and closer time zones.

Europe Tops List of Safest Outsourcing Spots

ITOnews
06.08.2010

In the context of global sourcing and new emerging locations, security and safety concerns are becoming the top issue for companies considering outsourcing their IT projects to cost efficient locations offshore. In this respect, the annual research conducted by the Black Book of Outsourcing with the rankings of the most dangerous / safest outsourcing spots around the globe attracts great attention among companies as a reference point for long-term business strategies.

The latest research for 2010 interviewed 3,100 corporate development leaders, including more than 400 outsourcing customers, to indicate their company's inclination to consider specific offshore locations for outsourcing (including IT outsourcing and BPO). The survey asked respondents to rank those cities on various perceived threats and weaknesses, including geopolitical risk, terrorist threats, climate concerns, legal maturity, environmental waste and pollution, IT and telecom infrastructure security, and crime rates.

According to the 2010 results, Central/Eastern Europe (CEE) tops the list of the safest offshore locations, while Pakistan, Colombia, and Mexico top The Black Book of Outsourcing's 2010 list of the most dangerous places for offshoring.

The results are particularly important for companies engaged in high-risk business, like finance, where security, stability, IP and data protection come first and often outweigh cost factors. According to the published survey results, CEE proves an ideal secure and cost-efficient spot for outsourcing IT projects.

"Even the perception of risk factors such as high crime, corruption or terrorist threat can paralyze a region's offshore business momentum," says Douglas Brown, Research Director of Datamonitor's Black Book. "That required sense of security can be destroyed, even in the most vibrant and progressive of communities, entirely on what is perceived by the corporate decision maker."

Crucial Moments in Outsourcing Relations

Outsourcing Center by Kathleen Goolsby
01.08.2010

Outsourcing relationships are often like a marriage where the people realize after they get together that there are aspects about each other and the relationship they hadn't anticipated and planned for or issues about which they had mistaken assumptions. Those moments when the buyer becomes aware of such circumstances are what I call "aha" moments. The buyer's thought process is: "Aha; I now realize we need to change the way we are operating together."

Those are crucial moments.

If the parties don't manage to satisfactorily address such issues by changing the way they work together, they will end up going their separate ways.

Outsourcing Center's 2010 Outsourcing Excellence Awards program surveyed buyer participants about the timing of their aha moments, the root causes, and outcomes from addressing the issues uncovered in their aha moments.

Of the 64 buyers surveyed (whose outsourcing relationships had been in existence for longer than one year and had moved beyond the transition phase), one reported a significant aha moment 10 years after signing the contract. Two buyers said their moment occurred two years after contract signing, and one was four years into the relationship. They are unusual cases. The remaining 60 buyers reported their aha moments occurred during the transition phase.

In fact, the study revealed that nearly all of the aha moments occurred in the early weeks or months of an outsourcing relationship – when it's crucial to achieve some "wins," crucial to develop mutual trust.

Root causes of aha moments

It's important to note that all of the relationships studied had aha moments, regardless of the buyers' prior experience in managing outsourcing relationships. The root causes of most of their aha moments lie primarily in incorrect planning and expectations up front.

Among the causes of aha moments that led to a change in the way the parties worked together, the most frequently cited cause was that the buyer's business (or its IT system) was so complex that it required more communication and collaboration than originally anticipated. Seventeen percent of the surveyed buyers encountered this situation.

Ranking as the second most frequently cited root cause (six percent) is the fact that the parties began their relationship without financial incentives to motivate the service provider to achieve continuous improvement.

At five percent, the third most frequently cited source for an aha moment was that the buyer failed to realize at the outset that the service provider could do more work and at a higher level than had been contracted.

Some of the other triggers for aha moments the surveyed buyers mentioned include:

- Ineffective contractual process change control (in some cases, it was not rigorous enough; in others, it was too restrictive)
- Wrong baseline data at the outset (which then impacted the provider's operations)
- Faster-than-anticipated growth of the buyer's business
- Overly aggressive expectations of each other at the outset before facing the realities of working together
- Inflexibility in the pricing model
- Inefficient allocation of responsibilities and accountabilities between buyer and provider in cases where the buyer retained some functions of the outsourced process
- Provider's lack of expertise in a process that the buyer added to the scope early in the relationship but after contract signing
- Ineffective SLAs not driving the right behavior
- Provider's lack of insight into some critical aspects of the buyer's industry
- Negotiated rate was not high enough to ensure the provider would hire people with the necessary level of skills to manage some complexities of the buyer's business

All of these factors, if left unresolved, would lead to one or more of the following outcomes:

- Increased costs for the buyer
- Increased costs or lower profit for the provider
- Missed opportunity for creating greater value through outsourcing
- Dissatisfaction among end users
- A growing number of relationship challenges and issue escalations

Addressing the issues

When and how the parties addressed the issues depended on (a) whether the issue was a critical matter they needed to resolve in a short time frame, and (b) how much informality existed in the relationship's communication patterns.

The study found that 50 percent of the buyers raised the issue during a regularly scheduled daily or weekly operational meeting or in daily conversations at the work level. This discussion around observations of an issue led to fact-finding, which then led to escalating the issue to executives in a formal governance meeting or a project management meeting to resolve the issue.

Twenty-nine percent first brought up the issue in a regularly scheduled monthly or quarterly formal governance meeting and then assigned a task force or scheduled additional sessions to resolve the issue.

Twenty-one percent handled the issue entirely in informal conversations between the relationship managers and did not escalate it to a governance meeting.

Outcomes of aha moments

Bringing the issue to light and discussing how to resolve it, whether in an informal conversation or a formal meeting, achieved more than resolving the actual issue. It also resulted in the parties turning a corner and going in a different direction together.

For example, some of the buyers studied in the Outsourcing Excellence Awards program stated their aha moment resolution discussions had the following outcomes:

- Defined how the parties will interact when push comes to shove on difficult topics. (Example: "It became apparent that we had to get everything on the table before we could have an honest dialogue.")
- Resulted in an agreement that one party doesn't have to pay all the costs of resolving an issue
- Led to a commitment to cooperate, not just compromise
- Developed a methodology for determining what the real problem is
- Led to an understanding that the parties lacked the right level of executive focus on the relationship
- Learned to listen and understand the other party's feelings. (Example: "It doesn't feel right to me, even though the contract is structured that way.")
- Created visibility into whether one party is hiding behind an issue and really does not want to resolve it for mutual success
- Led to more openness in discussions, which helps build trust (Example: "We didn't initially pave the way for openness when things get complicated.")
- Led to renegotiating the contract to be more mutually fair
- Resolved to fix issues by looking at not just the facts but also seeking mutually beneficial opportunities

- Caused a commitment to ensure that addressing issues takes an approach of helping each other be a success

All 64 study participants reported that their aha moments became a major positive factor in the way their relationships developed thereafter.

When it comes to facilitating success in outsourcing, those are crucial moments, indeed.

Lessons from the Outsourcing Center:

- After signing the outsourcing contract and starting to work together, many companies find there are aspects about each other and the relationship they hadn't anticipated and planned for or issues about which they had mistaken assumptions. If they fail to satisfactorily address such issues by changing the way they work together, they will end up going their separate ways.
- Most incidents that cause buyers to recognize a need to change the way the parties work together occur in the early weeks or months of an outsourcing relationship – when it's crucial to achieve some "wins," crucial to develop mutual trust.
- A top cause of such incidents is that the buyer's business (or its IT system) is so complex that it requires more communication and collaboration than originally anticipated.
- Another frequently cited root cause of such incidents is the fact that the parties begin their relationship without financial incentives to motivate the service provider regarding continuous improvement.
- Many buyers make a mistake at the beginning of the relationship in failing to realize at the outset that the service provider can do more work and at a higher level than may have been contracted.
- A proven way of operating for mutual success in outsourcing is for the parties to resolve issues by not just looking at the facts but also seeking mutual beneficial opportunities and taking an approach of helping each other be successful.