Information & Management 46 (2009) 42–51

Contents lists available at ScienceDirect

Information & Management

journal homepage: www.elsevier.com/locate/im

Strategic Out-Tasking: Creating "win–win" outsourcing partnerships

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ARTICLE INFO

Article history:
Received 16 March 2008
Received in revised form 14 May 2008
Accepted 20 November 2008
Available online 23 January 2009

Keywords:
Outsourcing
Out-Tasking
IT
Outsourcers
Partnerships
Contracts
Services
Strategic

ABSTRACT

IT outsourcing is one of the most prevalent trends in business today. Yet traditional outsourcing models force tradeoffs by both the enterprise and its outsourcer. The former often compromise operational flexibility and innovation while the latter price deals to win, resulting in razor-thin margins and aggressive cost reduction. Strategic Out-Tasking can be seen as a "win–win" model that breaks the traditional, vicious cycle of negative compromise. Many visionary enterprises and leading outsourcers are embracing the guiding principles of a Strategic Out-Tasking model. From an operational perspective, this helps drive greater innovation within enterprises, yields higher outsourcer margins, and, more importantly, reduces partnership risk. We believe that Strategic Out-Tasking can, over the next few years, deliver $16 to $23 billion in industry bottom-line savings that enterprises and outsourcers can share.

1. Introduction

IT outsourcing is estimated as a $233 billion global industry with an impressive 8% annual growth rate [13]. In a recent Gartner survey of financial services companies, roughly 60% of respondents reported high or moderate levels of IT outsourcing [14]. According to this survey, the next 2 years will see these IT outsourcing levels increase to nearly 80%.

1.1. Compelling motivations to outsource

Enterprises have several strong business drivers for outsourcing IT. Nearly 75% of respondents to a recent survey of IT executives (from companies with annual revenues greater than $1 billion) identified cost reduction as their primary reason [8]. As shown in Fig. 1, the Gartner survey also confirmed cost takeout as the top driver for outsourcing. Through economies of scale and incremental efficiencies in services delivery, outsourcers can gain cost reductions of 15% or more [23]. Not surprisingly, average contract terms have increased to nearly 6 years in duration, allowing outsourcers sufficient time to recover up-front personnel and system investments needed to realize promised cost reductions [15].

1.2. The current model has flaws

With the current outsourcing model, enterprises are forced to compromise operational flexibility and innovation. In today's marketplace, enterprises continually need to adapt to shifts in customer preference and market realities. Yet the common trap is for them to award outsourcing contracts primarily on cost. Later, a few years into their outsourcing relationship, the enterprise realizes that the singular focus on cost savings often penalizes innovation and business flexibility. Fig. 2 shows the results of a Morgan Chambers survey that found that, while innovation ranked first in enterprise needs, it ranked last in what outsourcers delivered [12]. This loss of innovation can significantly compromise the ability of an enterprise to respond rapidly to changing business conditions.

To illustrate the problem, let us imagine an enterprise that, in the late nineties, was locked into a long-term IT outsourcing contract. Such a traditional, long-term contract would probably have restricted the deployment of emerging, Web-based technologies for operational transformation. Delays in adopting such a disruptive innovation would clearly result in a severe competitive disadvantage and perhaps even risk the survival of the firm.

Yet even today we see examples of restrictive contracts. A Forrester Research survey confirmed that nearly 70% of enterprise

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0378-7206/$ – see front matter
doi:10.1016/j.im.2008.11.004

Fig. 1. Foremost drivers for outsourcing or considering outsourcing IT services.

respondents claimed IT outsourcers often failed to meet expectations on innovation (see Fig. 3) [17]. One of Cisco's leading manufacturing customers, for example, faced a significant price premium when it wished to migrate to a next-generation converged IP telephony infrastructure. The expensive change request forced lengthy contract renegotiations, delaying the much needed technology deployment.

Traditional outsourcing models also negatively impacted outsourcers, who become unable to realize sustainable high-margin returns. Their deals are often priced to win. A number of sizable contracts are at stake: Gartner estimated that there were more than 10 outsourcing deals in 2007 with greater than $1 billion in total contract value. In order to win these mega-deals, outsourcers often were forced to commit to aggressive cost reductions with significant penalties if the committed returns were not realized. The economies of scale and process efficiencies initially envisioned and priced into the contract sometimes were difficult to realize. Enterprises have unique needs that may require customized solutions. Outsourcers often have to fix broken or erroneous enterprise processes, some of which were not previously identified during the initial due diligence stage. Such operational risks can adversely impact the outsourcer's already thin operating margins.

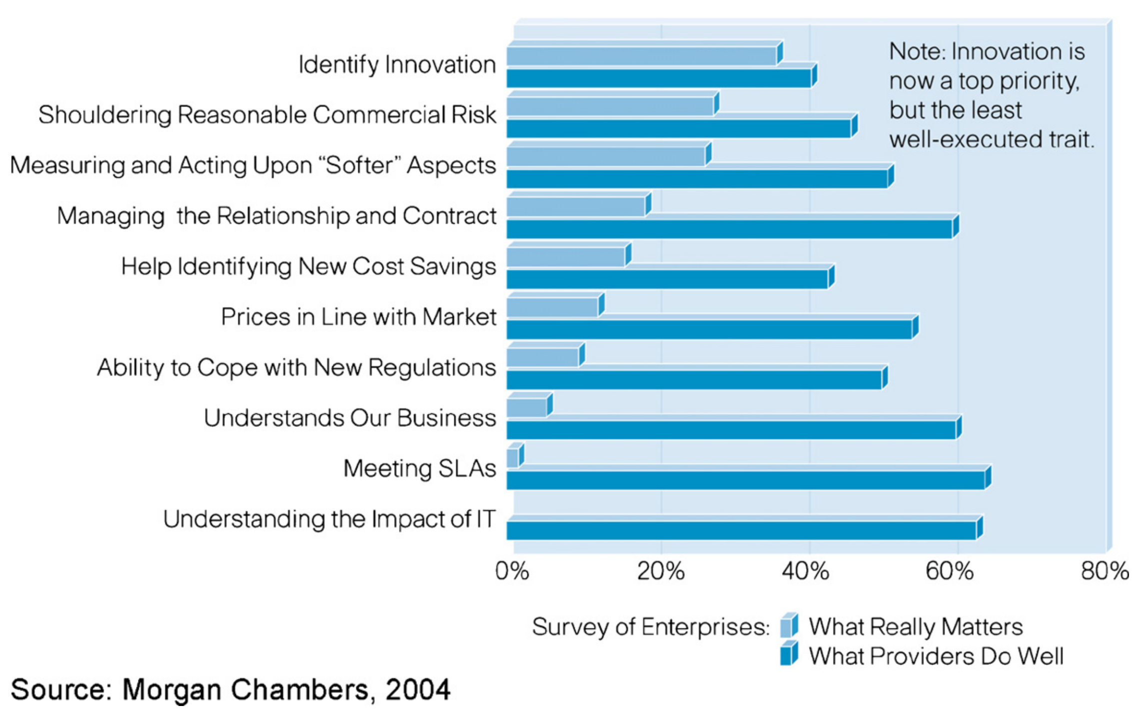

Fig. 2. Growing innovation gap in outsourcing.