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Outsourcing IT

Think of It as Another Utility Bill

By Curt A. Canfield
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In terms of business trends, most law firms lag corporate America by three to four years. And these are the law firm leaders. The reasons are straightforward. Corporate America funds itself for such efforts, which, because of their newness, are rather expensive and risky. Law firms join the bandwagon generally after the trends have become more mainstream in terms of acceptance, skills and price.

IT outsourcing has taken on a whole new wrinkle in the last two years, one which reflects the general evolution of technology itself. Like electricity production, which evolved from private power plants to general utilities, Corporate America has begun disabusing itself of the notion that "generic" IT systems and services are proprietary. They have begun to wise up to the economies and the service levels of treating some aspects of their IT as a utility -- "plug in" when you need the capacity and pay only for what you use.

Kodak had the first major IT outsourcing effort that was successfully contracted. Today, 12 years later, it is generally accepted that IT outsourcing can: (1) reduce costs through economies of scale and better management; (2) improve service levels; and (3) provide access to new and better technology.

Growth Curve

A recent survey of 150 U.S. and European companies that had outsourced some aspect of their IT found that 39 percent of the participants said cost cutting was the top benefit and 38 percent said that access to expert technology or to quick-start IT initiatives was another. Of course, all three of these benefits are dependent upon structuring the right kind of deal and then managing that deal through to a successful conclusion.

There is no doubt that IT outsourcing is growing in terms of volume and scope. A recent CFO magazine and AMR Research survey of 300 found that 64 percent of respondents were going to increase their level of IT outsourcing and 29 percent were retaining the current level. Merrill Lynch recently stated that companies spend about 5 percent of their IT budget on outsourcing; they expect this number to triple in the coming years.

Gartner Dataquest has stated that IT outsourcing will grow from its $138 billion level in 2000 to $249 billion in 2005. The significant components of this growth were:

H Hardware maintenance/service increasing from $18.5 billion in 200 to $27 billion n 2005;

H Software maintenance/service growing from $5 billion in 2000 t $10.3 billion in 2005;

H Operational services growing from $32.6 billion in 2000 to $52. billion in 2005; and

H HelpDesk spending growing from $4.9 billion to $5.0 billion (in a already mature market).

These first three projected rates of growth are driven by the IT as a utility concept (more on this later).

A second research group, IDC, has also said that IT outsourcing will rise significantly from $165 billion in 2001 to $245 billion in 2004.

The industry trend for IT has evolved from a "build" to "buy" mentality. The first systems were built on a proprietary hardware and software platform. They were all custom developed -- and expensive -- programs. Some readers may remember back to the days when the three main "islands of computing" were IBM, Digital Equipment Corp. and Wang.

The real revolution came with the PC canned third-party software and third-party hardware became available for the "masses" on the "open" DOS platform, then Windows and now Web-based systems. Microsoft effectively "outsourced" the development of its platform's application software to third parties. The success of "Wintel" over Apple was proof of this "unbundling" and advanced the adoption of IT by making it cheaper to buy applications than build them.

Critical Mass

IT services are now entering this phase of the market. They have reached critical mass, and third parties are now making it cheaper -- and more effective -- to buy these services rather than "build" your own -- with a twist: these services are being bundled with the systems themselves.

IT outsourcing is becoming a utility; a product where services have become bundled with systems, and both are available to their consumers on a "pay what you use" and on-demand basis. This is true of storage, servers and application software.

IBM, Compaq and others are, in fact, selling themselves as "utilities" in their marketing, citing that a pay-on-demand plan for equipment and staff is cheaper than buying your own. And it is working -- because this model allows a company to replace its fixed costs (in-house IT staff) with a variable cost.

Blue Cross/Blue Shield of Michigan is often cited as an example. It has outsourced its 10,000 PCs along with HelpDesk and on-site support. Although the PCs are leased; the monthly service piece of their bill is variable -- depending upon how much HelpDesk and on-site support is needed. Their IT director says that this variable cost replaces a traditional set of fixed costs, i.e. in-house IT staff. Those fixed costs may be as much as 38-40 percent of the IT budget.

It has been reported that IBM is now being deluged in Japan where the economy is down and hemorrhaging companies are shedding their IT functions. Japan Airlines recently signed up with IBM, completely outsourcing their IT function.

Technology itself facilitates the utility concept. Terraspring software is a new concept that is used by outsourcers in running their data centers. This software enables a "kilowatt" type of measurement for the use of IT, thereby providing a consistent means of charging per service unit.

What does this mean for law firms? Consider this.

Say 6 percent of a firm's revenue goes to IT expenses (excepting a major project). Seventy-two percent of the IT budget is a relatively fixed cost, breaking down into 34 percent for people (staff, temps, consultants) and 38 percent for operations (software, leases, etc). The remaining 28 percent goes into depreciation (capitalized goods).

As an example, a hypothetical 500-lawyer firm with $200 million in revenue would have an IT budget of $12 million. A 72 percent fixed cost of that IT budget translates into $8.6 million, of which $4.1 million is for IT staff and $4.6 million is for operations. Five years of these fixed costs (with no expansion) equals $43 million. How many CFOs and outsourcers would be interested in a piece of that?

Success Stories

Surprisingly, outsourcing has not really caught on with law firms.

There are some notable examples, however. Morgan Lewis & Bockius has outsourced its HelpDesk for several years. It has a 24 hours a day seven days a week on-site presence that is expandable for projects. Akin Gump has outsourced its HelpDesk as well, and is in the process of outsourcing its entire CMS/Open system and all finance & accounting functions (except billing) to Deloitte. One New York firm has outsourced its entire server complex to Aspire.net.

Before you consider outsourcing of any type, make it manageable -- and measurable -- by establishing a baseline with your users and setting up service level objectives. Do not plan to outsource a troubled IT operation with the hopes that the outsourcer will fix it. Fix it first -- get the baseline and then have the outsourcer maintain it or improve upon it. Remember, your ability to clearly define and measure service levels will help you manage the outsourcing arrangement.

Next, get expert help in structuring the deal. The best approach to selecting an outsourcer is to use an RFP in which you can clearly spell out what is being outsourced as well as what results are expected. Dun & Bradstreet noted that "25 percent of all outsourcing fails because the client doesn't communicate its needs."

Your contract should set key milestones for attaining service levels or bringing on new technologies -- with penalties for failure to perform. The vendor should think twice before it replaces the initial "A" team with the "B" team. One outsourcing deal specified that the vendor's failure to perform triggered payment of 20 percent of whatever remained on the contract to the company or to a replacement vendor.

In conclusion, outsourcing offers the opportunity to change fixed costs into variable costs. But, it should not be perceived as a panacea. Approach it carefully and methodically. First, understand your costs and services (be sure you can "fix" the scope of service and the service levels). Secondly, it requires knowledge to make the deal "work"; remember how to get into a good deal -- and how to get out -- since 25 percent of all deals fail because the client failed to communicate requirements. Lagging the market does have this virtue -- you get to learn from the pioneers.

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