

Beyond Hourly Development Rates: **New business opportunities in application outsourcing**

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Executive Summary

The enterprise market for outsourcing application services is expected to grow almost 50 percent in the next five years. The mandate for the future seems clear: successful software service providers must deliver on the promise of helping customers achieve real business value. This paper explores recent industry trends to project how companies will outsource software services in the future. It suggests that shifts in the economy, in technology, and in the IT industry are going to significantly change how software is developed and software services are delivered, ultimately providing far greater value to businesses.

Introduction

In the past few years, the outsourcing of software services has moved into the mainstream, as evidenced by the many articles about the topic in the business press. Not surprisingly, this trend parallels a steep learning curve on the part of the organizations that are considering outsourcing their business application development.

Crossing the Chasm

Ten years ago, when the software service industry was relatively young, early adopters of outsourcing were willing to accept a relatively high degree of risk. Driven by necessity, they outsourced primarily maintenance, migration, and less critical development projects. Today, businesses from start-ups to Fortune 100 companies are much more educated about the benefits and risks of outsourcing. They know what they want to achieve and they expect the process to work. Increasingly, these clients are willing to outsource not only more complex but also more critical development projects.

In larger companies, outsourcing is increasingly becoming a strategic decision that is supported, and even driven, by senior management. Taking advantage of the growing number of outsourcing models, vendors, and locations, more and more of these companies choose to outsource even management roles and activities. By contrast, many small or mid-size firms do not have that choice. In these companies, senior management and IT executives juggle the tasks of defining business needs and managing ongoing work. Especially in the early stages of an outsourcing relationship, service providers spend a lot of time helping these clients work through their questions, in order to assess outsourcing options realistically and determine next steps.¹

“Hard” vs. “Soft” Outsourcing Criteria

Cost savings are still a driving factor in most decisions to outsource application services. However, companies that have gained experience in working with outsourcing service providers are beginning to look beyond the hourly development rate. Instead, they emphasize new criteria, such as industry experience, specific technology expertise, and flexibility in the development process. Believing that a partnership with their service provider generates long-term business value, these companies emphasize communication, project management, and organizational “chemistry,” while at the same time measuring those “soft” criteria in a quantitative way. The need for metrics was part of the reason the industry embraced the SEI Capability Maturity Model (CMM). CMM attempts to quantify “soft” factors and promotes ongoing process improvement that benefits both the provider and its client. While only one indicator of a service provider’s capabilities, CMM certification has gained importance in the minds of buyers partly because it provides a standard baseline in a confusing marketplace.

¹ For more information on outsourcing for small to mid-size companies, see K. Kumar, *Successful Offshore Outsourcing for Small to Mid-size Businesses* at www.trigent.com/news.

Looking Ahead

Recently, there has been a great deal of consolidation among IT service companies, a trend that will most likely continue over the short term. IT service companies in the U.S. have acquired offshore firms, and their counterparts abroad have acquired firms in the U.S. These companies have recognized that they need both offshore delivery capabilities to compete effectively on price, and proximity to their customers to attract and retain business in their local markets. In the future, “offshore capabilities” will be an integral part of a company’s business model. Where the work gets done will depend on the requirements of the project.

But there is another significant trend in outsourcing software applications. The value proposition of cost savings that has been driving growth in IT services in India will not be sustainable in the coming years. The industry will need to undergo fundamental changes in order to respond to customers demanding to go beyond cost savings to deliver real business value. In an effort to realize better business returns, organizations worldwide will build highly specialized, widely dispersed IT teams: a call center in Manila, a business analysis team in California, one application development team in Mumbai, and another in Beijing. The focus of those teams will be significantly different from the design and coding activities of the past, as increasing automation drives a decline in demand for “traditional” IT programming as well as back- and front-office business process outsourcing.

A New Source of Value

Historically, custom business applications have been costly to develop and maintain. Changing the application was often slow, painful and expensive. Tomorrow’s applications, on the other hand, will be much more agile. This is partly because the technologies underlying enterprise applications have evolved to better support incremental change and the exchange of information across platforms and systems. In addition, development automation technologies are emerging that will allow application code to be generated directly from requirement specifications.

Imagine a manufacturer who is replacing a parts management system that was created by a third-party and then customized. Application automation technology that generates code from the company’s business requirements would enable that manufacturer to conduct an in-depth requirements analysis at the beginning of the project to ensure that workflow processes are correctly defined, and identify possible integration issues with existing enterprise systems. Post-implementation, that same technology would support the rapid modification of the system over time, as business processes evolve. Analysts expect this type of technology to translate into potential savings of over 80 percent in ongoing maintenance costs. In essence, application automation will enable the creation of systems that are custom designed for a company’s unique business processes, while at the same time incorporating data structures that are more cost-efficient to implement and maintain than off-the-shelf products. As a result, companies will be able to focus their resources on their business, not their technology infrastructure.

Change is Good

There are a variety of emerging standards and technologies that are contributing to this automation, including the Semantic Web, Natural Language Processing, rules-based systems, semantic capture and translation tools, and application code generators. Their impact on the software development lifecycle, and the roles within it, will be substantial.

Figure 1 indicates that we will initially see the greatest impact from automation technology in the design and coding phases of the development lifecycle, which will eventually be compressed to a small fraction of current costs and timelines. Ultimately, the capture of business requirements and the creation of specifications will undergo similar automation. Over time, new technologies will enable not merely the automation of the daily tasks that a software engineer performs, but also a significant change in what she does on a day-to-day basis. Some kinds of activities (and jobs) will disappear, and new ones will be created.

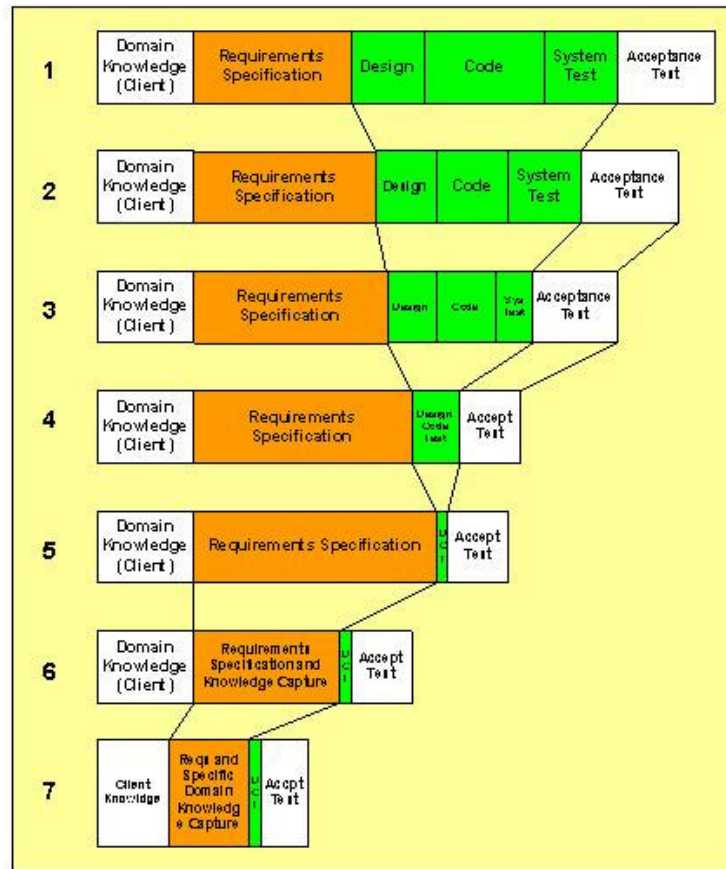


Figure 1: Compressing the Software Development Lifecycle.

The transition to a new business paradigm also promises more opportunities at smaller companies. As the industry transitions to a new value proposition, smaller businesses will be well-positioned to compete because they have little invested in maintaining the status quo. In the future, headcount may become a less meaningful indicator of a company's viability than average earnings per employee, as companies compete to deliver productivity gains to their clients.

Summary

While we can expect technology evolution to bring significant change to the industry, it will also provide great opportunities to software and IT service companies that can leverage it and to their clients who will reap the business benefits.

About the Authors

Bharat Khatau, *Chairman and CEO, Trigent Software*

Bharat Khatau is a pioneer in offshore software development. Prior to founding Trigent Software in 1995, he headed Technology Resources International, a software services firm specializing in offshore development services for U.S. clients. Mr. Khatau has held previous positions as co-founder and CEO of Better Software Technology (BST), a consulting and software development company serving the high-volume PC software market, and as head of his own consulting company that focused on enterprise resource planning. Previously, he led lab and process automation work in the telecommunications industry and in hardware and software system design for analog computers and processors. A graduate of the Indian Institute of Technology (IIT), he holds a Master's Degree in Electrical Engineering from Cornell University.

Chuck Rehberg, *Chief Technology Officer, Trigent Software*

As Chief Technology Officer, Chuck Rehberg sets the direction for Trigent's technology initiatives. Under his leadership, Trigent developed patent-pending information harvesting and rules engine technologies that facilitate highly effective business solutions. Mr. Rehberg has more than twenty years experience in the hi-tech industry, developing leading-edge IT solutions. His work in the area of Artificial Intelligence (AI) was instrumental in the development of AI-based configuration software for manufacturers at Digital Equipment Corporation. He has held senior positions in software development at Ardent Software, Dovetail Software, Cayenne Software, R&O Holdings, and Informix Software. Mr. Rehberg holds a Master's Degree in Computer Science and is co-inventor of a patented process for transforming and storing information for enterprise computing systems.

About Trigent

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