

Measuring Return on Outsourcing

Executive Summary

To help clients contend with ongoing economic uncertainty and boost returns from their IT investments, Cognizant has created a methodology to accurately capture and assess the long-term business value of outsourcing applications development and maintenance.

This white paper lays out the rationale for measuring the cost advantages and business benefits of outsourcing. It also reveals how Cognizant's recently updated Return on Outsourcing (ROO) Calculator enables clients to benchmark their financial and operational performance vis-à-vis the competition, gain insight into best practices and fine-tune their strategies to improve business outcomes.

Introduction

Companies across industry and throughout the globe have outsourced elements of their IT operations for nearly two decades. They've done so, throughout economic growth and retrenchment cycles, for one compelling reason: to reduce operational costs. In fact, outsourcing applications development and maintenance has in some cases saved organizations up to 40% annually.

But after achieving initial cost savings goals, companies industry-wide begin to wonder what's next. They ask, "Are we doing enough to optimize existing IT infrastructure?" "Are we

wringing costs from the right activities?" "How do our outsourcing outcomes stack up against others in the marketplace?" "Are we putting in place an IT foundation to meet business mandates from the C-suite?" "Are we able to quantify the business value derived from outsourcing initiatives?"

Many CIOs can't answer these questions -- unless they can measure what matters. The reason: Their companies not only have a hard time calculating the expense side of the IT equation, but they also find it challenging to factor in the role IT plays in generating business value. Very often, a third party -- removed from the politics of IT management and line-of-business pressures -- can more objectively and effectively calculate not only the returns on IT investment but also the soft and hard contributions that IT makes to business outcomes.

Think, Calculate ROO

Working with Forrester Consulting, Inc., an independent technology and market research company located in Cambridge, MA, Cognizant developed a tool to calculate existing and projected returns on investment achieved by outsourcing application development and maintenance.

Called the Return on Outsourcing (ROO) Calculator, the tool enables clients to:

- See the business value and cost advantages that can be achieved by partnering with a mature global services partner like Cognizant.
- Understand the operational conditions and best practices that lead to long-term success.
- Compare projected financial returns with those of other companies within their industry peer group -- and beyond.

Via a series of interviews with C-level and line-of business managers, Cognizant team members create a baseline assessment of IT spend, examining the company's alignment of IT strategy with business objectives -- while factoring in risk -- to calculate realistic potential returns from outsourcing applications development and/or maintenance services to a global IT services provider such as Cognizant (see methodology, page 6). The calculator can also be used to justify third-party delivery of both new and adjacent application value management services.

Importantly, the tool presents two different but compelling views:

- Through one view, clients can see their initial cost savings and the projected impact that outsourcing could have on their financial performance and underlying business processes. This data can be viewed with or without mitigating risk factors.
- The second view enables clients to compare their current and projected performance against industry peers inside and outside their particular vertical markets.

The calculator is based on Forrester Consulting's concept of Total Economic Impact™ (TEI™), a proprietary methodology used by the firm to advise clients on technology decision making. Forrester Consulting tailored TEI for use with Cognizant's ROO Calculator. (See footnote on TEI, page 6.)

The ROO Calculator was initially built on Microsoft Corp's Excel. Cognizant recently made major usability improvements to the tool by moving it to a Web-based environment that preserves all of its computational power and comparative features.

The new version enables:

- **Accelerated data collection.** The Web-based version obviates the need to maintain multiple versions of the Excel workbook by delivering a single view of the data and computation results to multiple authorized users within an account.
- **A bird's eye view of multiple vendor engagements.** The tool allows authorized users to easily assess vendor performance by enabling an objective comparison of provider scorecards stored in the tool. Program managers can then make informed decisions on rationalizing their provider portfolios.
- **A repository of past measurements to track progress over time.** This allows stakeholders to monitor progressive value delivered by the provider, track the effectiveness of vendor management programs, and recalibrate objectives as necessary.

Cognizant's ROO Calculator is a key component of our overarching methodology designed to help clients shift their thinking toward overall business value and away from more narrowly defined cost-savings issues. For instance, beyond detailing (in aggregate) already achieved and potential cost savings, the tool allows users to measure operational flexibility and business value obtained from an outsourcing relationship.

Exposing Hidden Value

The ROO Calculator helps CIOs to expose the strategic business value, risk reduction and economic impact of outsourcing applications development and maintenance. On either a project or program basis, the tool can help:

- Reveal the factors that lead to long-term success of strategic outsourcing.
- Set initial ROO expectations (cost savings, plus long-term business value) that can be generated through an outsourcing engagement.
- Provide a roadmap that details ways in which a company can generate enduring business value by leveraging a third-party partner's strengths and competencies in application value management.

Initially, the ROO Calculator reveals the potential short-term savings derived from labor arbitrage. It then helps the CIO assess the long-

term value derived inside and outside the IT organization by outsourcing applications development and maintenance. The calculator

Following extensive pilots with key clients, the ROO Calculator is now available in a Web version.

illustrates how clients can reduce IT costs and achieve greater operational flexibility over time. From there, Cognizant uses an extensive ROO methodology -- comprised of additional diagnostic tools and workshops (see Appendix, page 7) -- to show clients how they can apply freed up resources to bolster core competencies that generate additional business value.

Cognizant's ROO Calculator details business value generation from the following perspectives:

- IT Governance and Control
- Process Knowledge and Expertise
- Project Management/Project Delivery Skills
- Technology Expertise

Enduring business value can be viewed in three ways:

- **Inside-Out Improvements.** By partnering with a mature partner like Cognizant, clients can take advantage of extensive project management and process delivery capabilities and can reduce risk and improve outcomes. By improving delivery, clients add business value that can be measured in terms of reduced operational costs and increased revenues, which together have tangible impact on the bottom line.
- **Outside-In Improvements.** By using data aggregated from Cognizant clients and prospects, IT organizations can compare their existing and

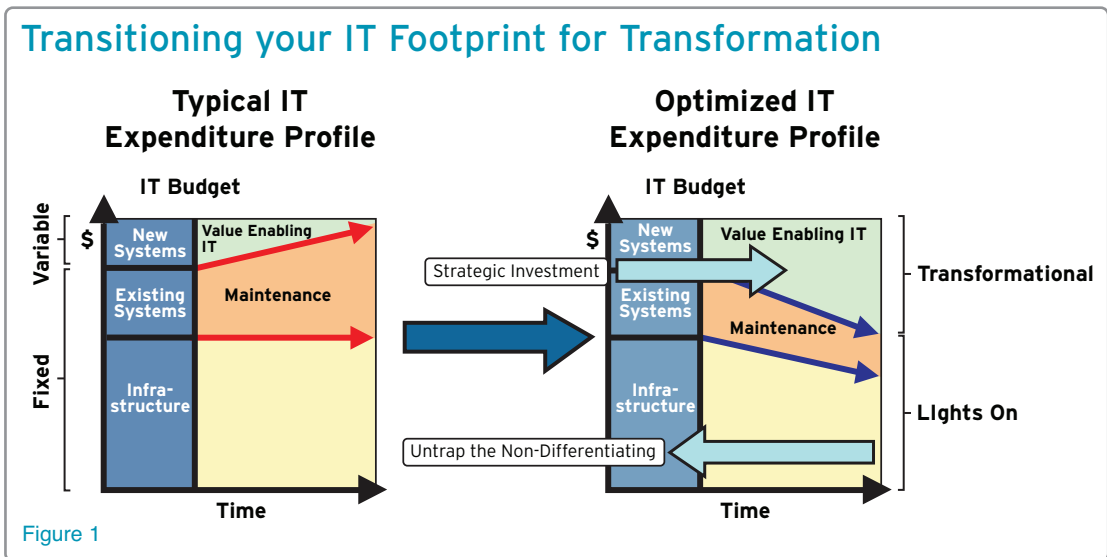
projected performance with a cross-section of companies. This comparative data, focused on project management and governance, can graphically detail how the company stacks up to the immediate competition and, more importantly, how far it needs to go to be successful.

- **Actionable Recommendations.** ROO metrics reveal gaps that need to be addressed for the client to achieve the full benefit of outsourcing to a mature partner.

Seeing the Strategic Benefits of Outsourcing

The ROO Calculator can also help clients better understand and detail the returns they receive from Cognizant's "Transform while Perform™" (TwP) methodology (see Figure 1). TwP helps clients reduce IT expenditures and then apply cost savings to initiatives that drive business innovation. IT departments typically spend upwards of 80% of their annual budgets on maintenance and infrastructure, which leaves precious few dollars to build new applications that generate incremental revenue or enable new operating efficiencies.

With IT budgets flat -- or trending downward relative to previous years -- many companies need help optimizing their IT expenditures. Companies that partner with Cognizant traditionally begin with infrastructure management and application testing and maintenance projects aimed purely at cutting operational costs through labor arbitrage. Over time, they gain operational flexibility, adding and subtracting third-party resources as needed, which delivers additional cost savings.



As clients improve their financial performance, they can then invest cost savings in initiatives that drive revenue growth and operational effectiveness.

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additional business value across the organization.

Once demonstrated on a project basis, clients begin to see the virtue of working with a mature services provider on engagements that drive value across the organization.

ROO Metrics

By using the ROO Calculator, clients can better understand the cost advantages and business value delivered by outsourcing applications development and maintenance. The tool enables this through two different dashboard views that reveal, across multiple dimensions, the financial impact and improved performance that results from a mature outsourcing partnership on applications development and maintenance activities.

Dashboard Views

Financial Dashboard

The Financial Dashboard enables clients to drill down into costs and cost savings for individual projects within an engagement.

The net impact on overall cash flow can also be assessed. The key questions addressed include:

- What are the detailed three- and five-year cash flows from an investment?
- What are the quantified costs, benefits, flexibility and risk of such an investment?

A Financial View, which includes the Financial Summary Report (see Figure 2), details costs savings and the business impact of outsourcing that can be realized through labor arbitrage and improved agility (along with net ROO) over a period of time.

The findings are presented in both risk-adjusted and non-adjusted views. Through a cash flow analysis table, the Financial Summary Report

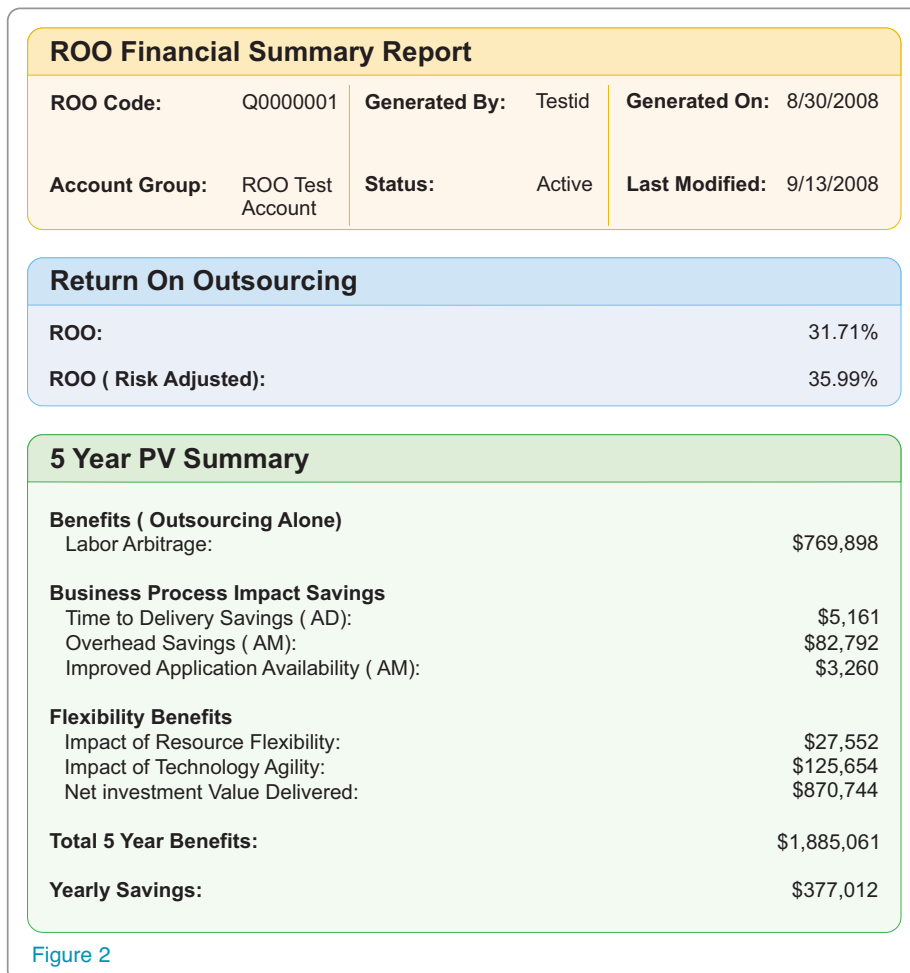


Figure 2

highlights the financial impact of outsourcing from the following perspectives:

- **Operational Flexibility (business options and efficiencies) to enable:**
 - More reliable and enhanced internal processes
 - Improved adaptability to future requirements
- **Business Value (top- and bottom-line benefits) to enable:**
 - Initial cost savings
 - Continuous cost efficiency
 - Improved innovation and quality
 - Time to revenue/value
- **Total Cost of Ownership includes expenses related to:**
 - Cognizant services
 - Internal labor
 - Additional capital expenditures
- **Risk and Uncertainty:**
 - Risk and risk mitigation of IT services is detailed (including a confidence range) in terms of current delivery strategy and alternatives.

The Financial Dashboard also includes a financial summary graph (see Figure 3) that shows how the value pie is distributed between labor arbitrage, business impact and flexibility savings. Distribution will vary depending on billing rate variances, offshore ratios, and level of maturity of the client and the outsourcing partner.

Performance Dashboard

The Performance Dashboard view (see Figure 4) offers:

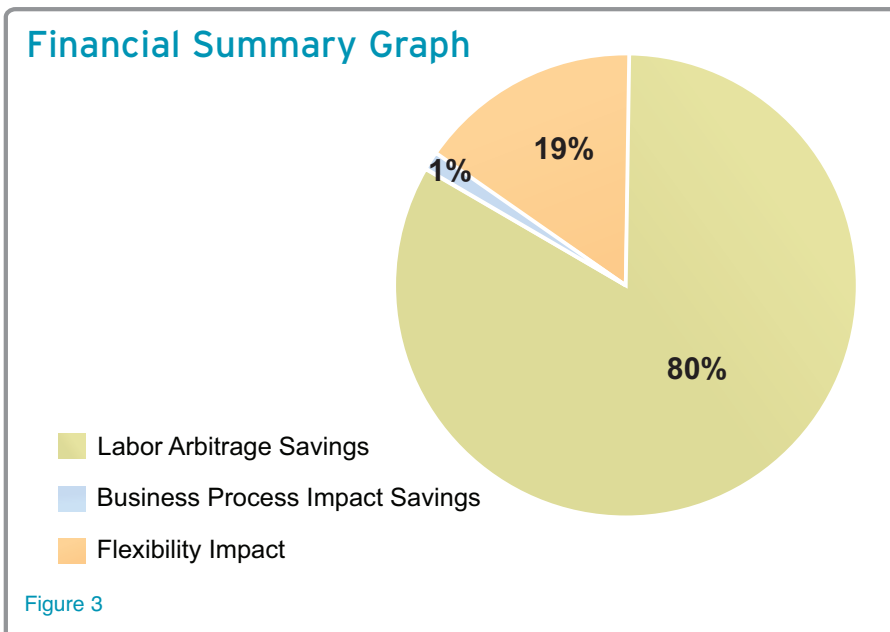
- **Comparative Benchmarks** that assess the client's performance against best-of-breed companies outside of its vertical industry.
- **Best Practice Comparative Estimates**, from which recommendations can be made for improving performance.
- **The Benchmark** also enables users to compare providers with industry best practice estimates.

The key questions that are addressed include:

- What are some of the key performance metrics to compare my company with others that have adopted strategic sourcing?
- What metrics should my organization use to measure the short- and long-term impact of strategic outsourcing?

This view also details comparative best practices and addresses the following key questions:

- How does our organization compare with our peers in terms of best practices around strategic sourcing?
- What are the key best practices for driving the most desired outcomes?



Comparative Benchmarks - Technology Expertise / Skills

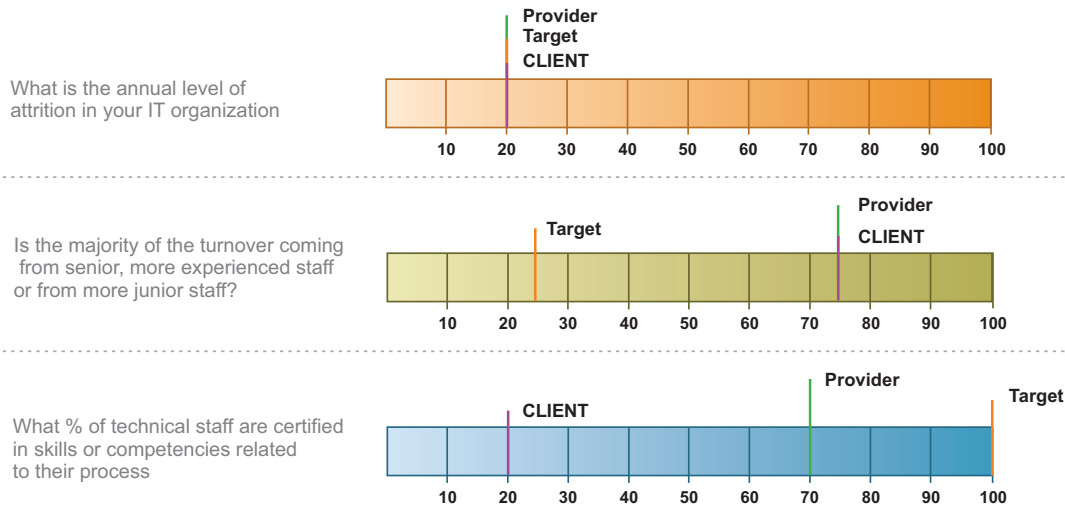


Figure 4

Real-World Results

The industry average for return on outsourcing is ball parked at about 35%. Clients with whom we have conducted ROO assessments show returns of between 35% to 47%. These better-than-average returns are indicative of superior program governance, process/project management expertise and technical competence, our deep-dive analysis reveals.

Examining the ROO pie (which consists of labor arbitrage, business impact and flexibility benefits), most clients with whom we have conducted ROO assessments, initially show a higher percentage of savings from labor arbitrage (around 80%), which is not too surprising since most companies' initial goals are focused on pure cost containment. But as the outsourcing relationship matures, the labor arbitrage pie tends to decrease and other benefits such as direct business impact and higher orders of operational flexibility (i.e., the ability to ramp up or down resources and apply greater organizational agility) become more pronounced.

In several of our assessments, we have uncovered gaps in the client's vendor management organization that need to be addressed to help realize the full value of outsourcing. Through a collaborative process Cognizant can help clients continuously fine-tune their outsourcing strategies to ensure outcomes that meet business objectives.

Methodology

The ROO Calculator is a Web-based questionnaire-driven tool populated by inputs from C-level and line-of-business managers. Client-supplied data is used to generate baseline IT spend calculations and business alignment assessments. Data can be collected by client personnel, or with the help of Cognizant team members, and be simultaneously entered into the tool.

The process is divided into the following phases:

Step 1: Basic Organizational Information

- Identifies high-level corporate information.

Step 2: Initial Operational Savings

- Calculates initial cost differences between an organization's application cost structure before and after an outsourcing engagement.

Step 3: Sustained Business Improvement

- Examines how improving quality delivery and risk reduction can drive value across the organization.

- Focus is on the relationship between application delivery and its impact on the business process supported by the application.

Step 4: Enabling Business Agility

- Examines the transformational benefits provided by the service provider through resource flexibility and enhanced technological capability.

To gain access to the ROO Calculator, clients must register and provide basic information such as name, organization and email address. Subject to approval, clients can access the tool with the support of Cognizant consulting personnel. (The ROO Calculator resides at <https://roo.cognizant.com>.)

The ROO Calculator is a questionnaire-driven tool populated by inputs from “C” level and line of business managers.

The ROO Calculator allows multiple users registered within a client organization/account to fill in the required data. Once the relevant data has been captured and submitted, the tool

calculates an absolute ROO figure that can be viewed in the Financial Dashboard.

A follow-up workshop can then be conducted to interpret the results and chart a path for realizing superior outsourcing returns. A spreadsheet version of the tool is also available, which can be customized to the client’s business requirements.

Footnote

¹ Forrester Consulting's Total Economic Impact (TEI) provides the methodology, training, tools, techniques, and technology expertise needed to implement enhanced technology decision-making processes. In use for over a decade, TEI enables organizations to better understand and demonstrate the worth of a technology, align its implementation with business strategy and improve partnerships with other key business stakeholders. While Forrester Consulting owns the intellectual property that comprises TEI, Cognizant owns all ROO data collected from engagements with our clients.

Appendix

Additional Tools & Workshops

While our ROO Calculator is a powerful tool that can help you assess the returns from your outsourcing program, it is among one of many tools that can be used to enable better outcomes and obtain greater returns on your investment. Cognizant has designed a program with various tools that can help you:

- Review ongoing outsourcing initiatives
- Identify gaps, and
- Recommend action

The following are among the frameworks we offer:

Sourcing Benchmarking Assessment

Outsourcing is a collaborative exercise where service provider and client share responsibility for the outcome. Outsourcing programs often fall short of envisioned or agreed to returns because of poor sourcing decisions and governance. Cognizant’s sourcing benchmarking assessment is a Microsoft Excel-based, questionnaire-driven tool that enables clients to assess the maturity of

their sourcing organization vis-a-vis other Cognizant clients/industries. A client’s sourcing capability is measured in terms of its maturity in sourcing strategy and execution and is displayed on a benchmarking dashboard (*see Figure A*). Maturity of the sourcing strategy is measured along a variety of attributes including existence of a formal sourcing function, the level of prominence of the sourcing function within the organization, and its effectiveness in establishing and adopting best practices. Execution metrics evaluate specific processes in vendor selection, governance, relationship management and value creation. From our preliminary sample, nearly 30% of clients studied have a nascent sourcing organization as evinced by their low scores on strategy and execution, while 40% do not have a clear sourcing strategy, as characterized by below average scores on sourcing strategy. Using this self-assessment tool, clients can measure their strengths and weaknesses and close gaps in their sourcing practices.

Joint Discovery Workshop

One of the reasons outsourcing deals hit roadblocks is the lack of definition and synchronicity between near- and long-term IT priorities. This becomes a huge challenge in the case of clients

who are keen to establish a partnership with their preferred vendor to take the outsourcing relationship to the next level of value creation. Cognizant, in partnership with the ITSMA (Information Technology Services Marketing Association), has designed a mind-mapping workshop aimed at joint-planning between companies and IT service providers. Facilitated by ITSMA, the workshop helps companies to commit to IT priorities and helps services providers make suitable investments to better define and improve outcomes. Through this joint-planning exercise, our clients have been able to lay the foundation for a stronger and mutually rewarding relationship with their preferred providers.

Core vs. Context Workshop

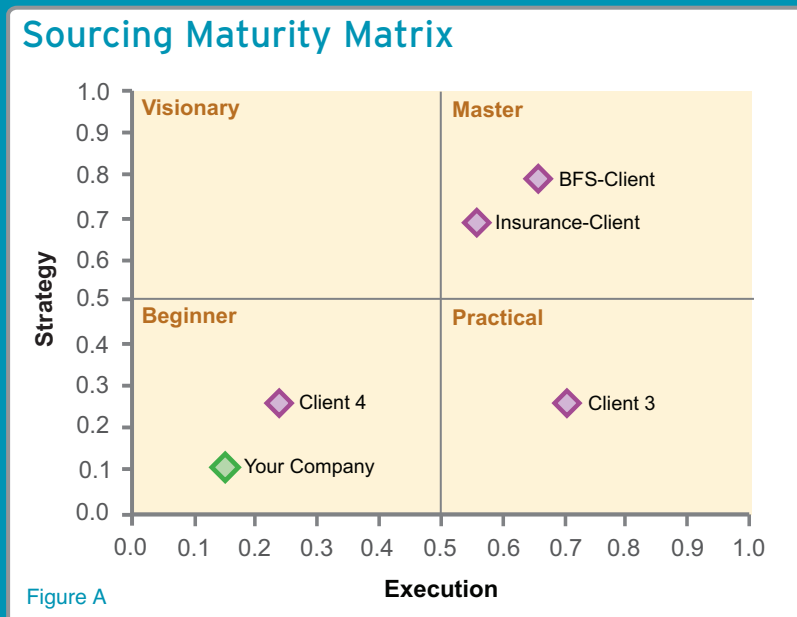
Companies continually strive to attain competitive advantage by investing in their core capabilities. The same is true for IT, especially given the growing role IT can play in enabling competitive advantage. This workshop, facilitated by IT industry guru Geoffrey Moore, helps clients to separate business-critical IT capabilities from lower priorities, and shift investment from contextual to core processes that drive business advantage. Clients from the technology, manufacturing, pharma and insurance industries have used this workshop to develop plans that are helping them free-up resources to invest in core activities.

Portfolio Analysis/Rationalization Framework

A thorough analysis and rationalization of a company's applications portfolio can help CIOs

reduce operating costs; eliminate functional overlaps or redundancies; enforce standards conformance/compliance; decrease "niche" skills requirements; optimize the technology footprint; increase software maintainability; and improve infrastructure usage/capacity utilization. Cognizant Business Consulting (CBC) can perform this assessment on a wide variety of portfolios consisting of heterogeneous applications running on diverse operating platforms (mainframe, Unix, Windows, etc.), built with multiple programming languages (C#, Java, Visual Basic, COBOL, etc.), leveraging disparate databases (DB2, Oracle, VSAM, etc.), and spanning numerous technology towers (Enterprise Application Integration and Data Warehousing software, etc.). CBC's nine- to twelve-week engagement begins with a collaborative data collection workshop focused on client business, technology and process/resource capabilities, as well as cost constraints.

CBC consultants then assess the entire portfolio and underlying infrastructure for fit with the client's overall business model. Our consultants then delve into individual apps to see how they mesh with business goals, among other things. Recommendations are then made on which applications should be retired / decommissioned; reengineered / re-architected; consolidated; or rationalized. CBC then creates an implementation plan to translate recommendations into action. Cognizant's Portfolio Analysis/Rationalization Framework offers clients a comprehensive and time-boxed methodology to help clients reap greater value from their investment in application software.



Vendor Portfolio Mapping

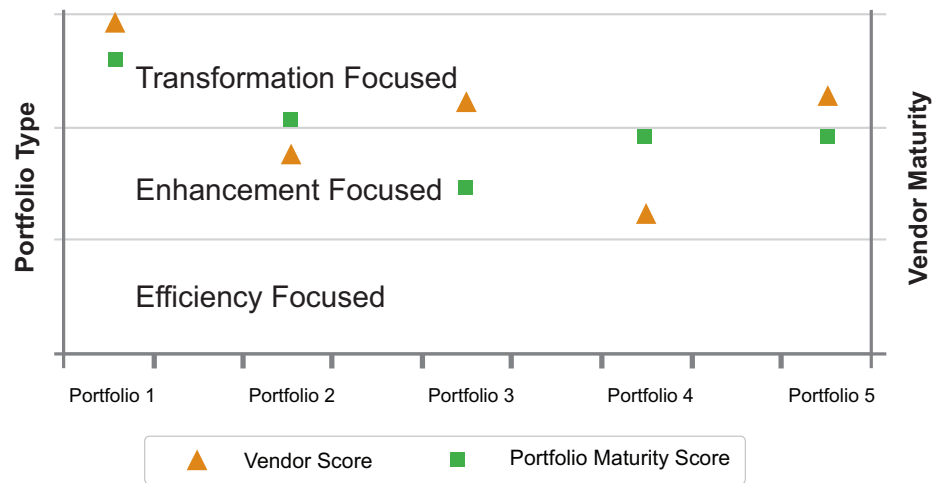


Figure B

Vendor Portfolio Analysis

More often service partner selection decisions are made on an adhoc basis. This is especially true in cases where the client, with hopes of capturing additional operational synergies, extends an outsourcing relationship to an incumbent vendor without due consideration of the provider's suitability to the new portfolio. Vendor Portfolio Analysis is an objective assessment of various portfolios and the provider landscape to identify and remove misalignments. In collaboration with the client, Cognizant populates requisite data into an Excel-based tool which maps vendor capability with portfolio type (see Figure B). The portfolios can be efficiency driven (i.e., projects aimed at operational cost reduction), enhancement driven (i.e., projects that help improve customer experience), or transformation driven (i.e., projects that are expected to provide long-term competitive advantage). The end result is a blueprint for reallocating portfolios with the appropriate providers to achieve desired outcomes.

About Cognizant

Cognizant (NASDAQ: CTSH) is a leading provider of information technology, consulting and business process outsourcing services. Cognizant's single-minded passion is to dedicate our global technology and innovation know-how, our industry expertise and worldwide resources to working together with clients to make their businesses stronger. With more than 40 global delivery centers and approximately 59,500 employees as of September 30, 2008, we combine a unique onsite/offshore delivery model infused by a distinct culture of customer satisfaction. A member of the NASDAQ-100 Index and S&P 500 Index, Cognizant is a Forbes Global 2000 company and a member of the Fortune 1000 and is ranked among the top information technology companies in BusinessWeek's Hot Growth and Top 50 Performers listings.

Start Today

For more information on how to drive your business results with Cognizant, contact us at roo@cognizant.com or visit our website at www.cognizant.com/go/roo.



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