European IT Outsourcing Intelligence Report 2010.

Part 2: trends and challenges among the Danish outsourcing and non-outsourcing companies (Reduced Version)

IT Sourcing Europe Ltd

Nearshore IT Outsourcing Market Research & Consultancy

Coventry, West Midlands
The United Kingdom

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Table of Contents

I. Executive Summary

The recent economic crisis has proven to be the major force driving Western European and Nordic countries to look for 'survival strategies'. Since in-house software/web development, deployment and maintenance involve tremendous costs, more European companies have turned to IT Outsourcing (ITO) as a way to reduce operating costs. While being considered as the strategy most frequently adopted by large companies in the pre-crisis times, today's ITO practices find more and more supporters among the mid-sized and small companies, for whom cost efficiency is as important as an opportunity to have access to skills and services that can generally improve their online presence and business performance.

However, engagement in ITO relationships has proven to be the most impactful and culture-changing experience that does not always result in success. For some companies the outsourced software development can be a ruining rather than an improving practice. It mainly happens because companies begin to adopt ITO as a reaction to short-term economic pressures and are not focused on the benefits they may gain in a longer-term perspective. Other reasons of the failure of the ITO relationships include, but are not limited to the wrong choice of an Outsourcing destination, partnering with a wrong ITO services supplier, underestimation of the outsourced project scope etc.

However, as the global economies slowly stabilize, more European companies begin to realize the true value they can gain from the right ITO engagement and start transforming their business plans to source new avenues for generating revenue, and increase productivity and effectiveness of their Outsourcing endeavors. This is how the Western European and global ITO landscapes look like today.

In the beginning of 2010 IT Sourcing Europe initiated the Danish IT Sourcing Survey 2010 as part of its ongoing All-European ITO Research. We reached our vast network of Danish business contacts and invited corporate IT decision makers to complete our online Survey and share their ITO experience with a broader business community both within and outside of Denmark. As a result, 331 companies kindly responded to our invitation and filled out the online questionnaire.

Further on, in order to compare and contrast the outsourced software/web development with the best practices of the in-house development and understand why some Danish companies refuse to outsource their IT function to a 3d party, we have conducted another Survey of Danish non-outsourcing companies. As a result, 225 companies with no ITO experience completed the Survey and allowed us to assess the key factors keeping Denmark's businesses away from the outsourced development.

II. Danish IT Sourcing Survey 2010

Of the 331 Danish companies who kindly agreed to complete our online questionnaire, 50% are small (less than 50 employees) and 50% are mid-sized to large (50 to 500+ employees). In 2010 38% of the surveyed companies expect to gain EUR 1M to 49M annual revenue and 37% expect to have revenue less than EUR 1M. Only 9% of companies report anticipating EUR 100M – 499M annual revenue. Regarding the revenue growth, 39% of companies expect 1% - 9% growth and 33% - 10%-19% growth in 2010. Only 9% of Danish companies report expecting 50%+ revenue growth.

Fifty-five percent of the surveyed companies have more than 3 years of general software development Outsourcing experience, 33% have 1 to 3 years experience and 12% first outsourced their software/web development only less than 12 months ago.

Thirty-four percent of the participating companies currently outsource their software development nearshore (maximum 2 time zones away from home country), 19% outsource offshore (at least 3 time zones away from home country), 18% outsource within own country, 11% outsource both nearshore and offshore, 10% outsource offshore and within Denmark and 8% outsource nearshore and within Denmark.

Fifty-two percent of the surveyed Danish companies outsource their software/web development to a single IT services provider, while 48% distribute their development among 2 and more providers. Fifty-five percent of respondents partner with small ITO providers (less than 50 in headcount), 28% partner with mid-sized (50 to 499 in headcount) and only 17% partner with large providers (500+ in headcount).

The following percentage of Danish companies that do staff augmentation (i.e. the process of hiring a dedicated team of additional staff to bring better efficiency in the work process) have the following number of team members on the outsourced software/web development teams: 23% - 1-3; 33% - 4-8; 12% - 9-10; 15% - 11-20; 4% - 21-30 and 13% - more than 30 team members.

The Danish companies that do software/web development project Outsourcing have the following values of their projects: 27% - EUR 0-49K; 37% - EUR 50-199K; 15% - EUR 200-499K and 20% - EUR 500K and more.

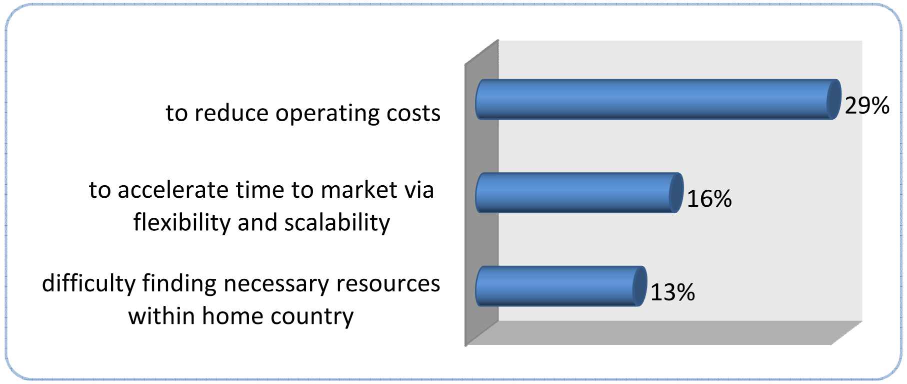
II.I. Key Survey Findings

- In Denmark, companies that outsource their software/web development **nearshore** outnumber those that transfer their software development function offshore by almost twice.
- The **Top Three reasons** why Danish companies choose to outsource their software/web development are: **to reduce operating costs; to accelerate time to market via flexibility and scalability** and **difficulty finding necessary resources within home country**.
- **Web 2.0** and **Enterprise 2.0 solutions** remain the most outsourced ones among the Danish companies.
- Most Danish outsourcing companies partner with only one IT services provider.
- **Low costs** and **vendor's reputation** remain the key factors impacting the Danish companies' choice of the Outsourcing destination and vendor.
- **Delays in delivery schedules** is the most frequently cited **challenge** facing the Danish outsourcers, followed by **poor communication** with / **poor quality** of the vendor's project management.
- The majority of the surveyed companies report **40%-59% actual savings** from the outsourced development.
- The majority of the surveyed Danish companies believe that **outsourcing** their software/web development has been **the right decision**.
- Most of the Danish outsourcing companies **do not know** the exact salaries of each of their team members on the outsourced development team, meaning that their current ITO engagement does not allow them to **have 100% managerial control** of project teams and costs associated with Outsourcing.

II.II. Trends Analysis

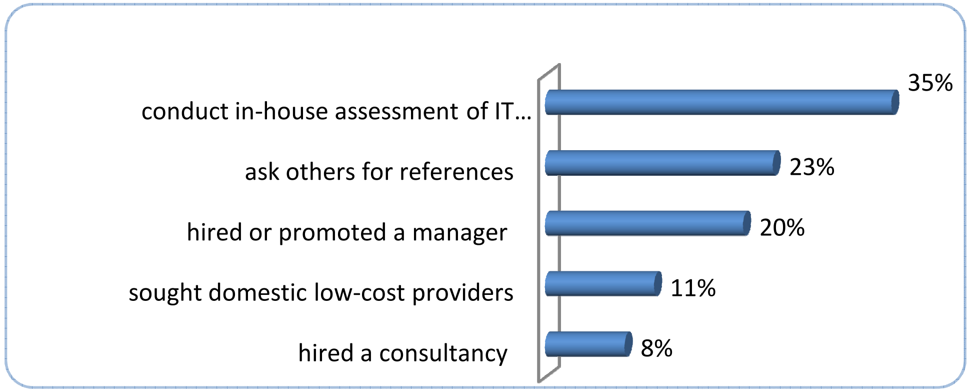
Cost Reduction Remains the Major Driver of the Decision to Outsource!

Figure 1. ***Top Three Pressures that drive corporate decisions to outsource software/web development.***



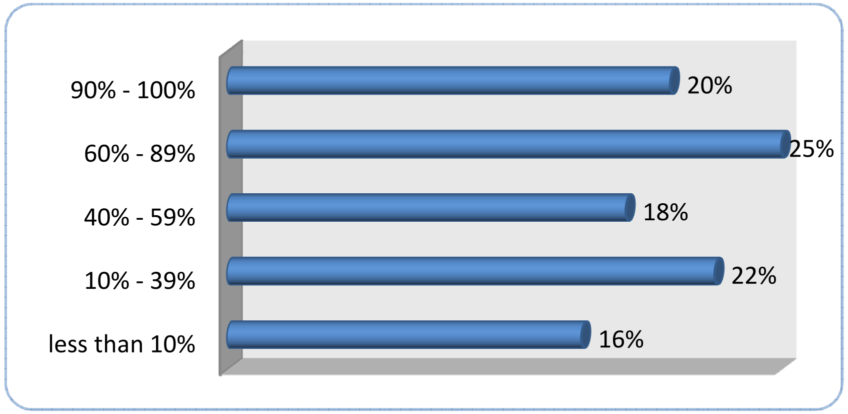
In-House Assessment Comes First, Consultants - Last!

Figure 2. ***Actions companies take prior to signing an Outsourcing contract.***



Up to 90% of Corporate Software Development Goes to ITO Suppliers!

Figure 3. ***Volume of the outsourced software development.***



An extended Trends Analysis is available in a full version of the Report.

II.III. Findings Discussion

The Danish IT Sourcing Survey 2010 allows us to observe certain trends among the companies that outsource their software/web development function to a 3d party either offshore or nearshore. Thus, cost reduction remains the key factor driving most Danish companies to adopt the outsourced development. Other most cited factors include: acceleration of time to market, difficulty finding necessary resources within Denmark, freeing in-house resources for other business purposes, business development strategy improvement and pressure from investors / executive management to cut operating costs.

Prior to looking for the ITO partnerships, most of Danish companies do in-house assessment of the IT areas to be outsourced and ask others for references. Another big fraction of the sample reported hiring and/or promoting a manager to lead the Outsourcing process rather than hiring a consultancy. A smaller fraction reported seeking domestic low-cost IT services providers to offload their software/web development function to. Only 8% of respondents admitted entrusting their Outsourcing decisions to a consultancy. This finding explains well a rather high rate of the failed Outsourcing contracts – refusing to rely on true technology professionals and bring in any outside assistance, many Danish companies overestimate their factual capability to do the proper assessment of the areas to be outsourced and, as a result, make the wrong choice of the ITO destination and supplier. This eventually results in poor savings from the outsourced relationship, paying overheads and inability to manage the outsourced project.

Most Denmark's companies outsource their software/web development to a single ITO supplier of 1 to 200 or 500+ employees in size. Analysis of the survey responses suggests that the greater the company, the bigger supplier it tends to partner with.

The research presents the following findings with regards to the Outsourcing destination and vendor selection criteria among the Danish companies:

1) To select an Outsourcing destination, companies pay attention to low costs of doing business, available IT talent pool, positive references and geographical and cultural proximity. Factors such as political and economic stability, maturity of legal system and Intellectual Property (IP) security and strong R&D base are considered to be less important by most of the Danish companies in their choice of the Outsourcing destination.

2) To select the right ITO supplier, the Danish companies consider low service fees, references and supplier's reputation, specific skills (most of which are hard to find within own country), experience in similar projects and successful pilot project completion. More companies begin to consider innovative and flexible business models that help differentiate suppliers from their competitors. Such criteria as available level of quality certification (ISO, CMMI etc) and supplier presence in home country are less important for the Danish companies' choice of the Outsourcing partner.

Overall, the Danish clients challenge their Outsourcing partners to be able to provide transparent cost structures as well as a combination of speed, cost management and growth supported by business agility and unprecedented technological innovation.

Regarding current challenges facing the Danish outsourcers, the most frequently cited ones are: delays in project delivery schedules, poor communication with the vendor's project management/development teams, cultural difference and unexpected overheads. These findings suggest that in 2010 the Danish businesses continue to face the same challenges as they had before the recession and the major challenge related to ITO is the lack of proper communication between the client and vendor. Most companies pointing to the above mentioned challenges are offshore outsourcers, which generally proves the thesis that it is harder to organize, maintain and improve client-vendor communication, if your back office is located at least 3 time zones away from the home country. On the other hand, companies that outsource their software development nearshore or both nearshore and offshore claim to be more satisfied with their ITO supplier(s) than typical offshore outsourcers. This finding suggests that the quality of Central and Eastern European suppliers is much higher than that of the leading Asian Outsourcing hubs. It eventually allows nearshore outsourcers to save significantly more from their outsourced development in a longer-term perspective, even though the CEE suppliers' service fees are a way higher than those of the Asian ones.

More thought-provoking findings are discussed in a full version of the Report

III. Danish Software Development Best Practices Survey 2010

Of the 225 Danish companies who completed our Software Development Best Practices Survey of non-outsourcing companies, 55% are small (less than 50 employees), 33% are mid-sized (50 to 499 employees) and 12% are large (500+ employees). Fifty-eight percent of companies expect EUR 1M-49M and 22% expect less than EUR 1M annual revenue in 2010. Thirty-eight percent of companies anticipate 10%-19%, 32% of companies - 1%-9% and 14% of companies – 20%-49% revenue growth for 2010.

Sixty-six percent of Danish non-outsourcing companies develop, manage and maintain their software through internal IT departments, 14% - through local IT partners, 13% - through freelance software/web developers and 8% purchase pre-built customizable applications instead of developing their own ones.

Thirty-six percent of non-outsourcing companies have 1 to 3 IT specialists on their internal IT teams, 18% - 4 to 8 team members, 15% - 11-20 team members and 12% have more than 60 staff members in their IT departments.

We asked our survey participants whether they believe their software is being currently developed at the highest possible quality level or not. As a result, 32% believe so versus 61% of those who think their software leaves much to be desired.

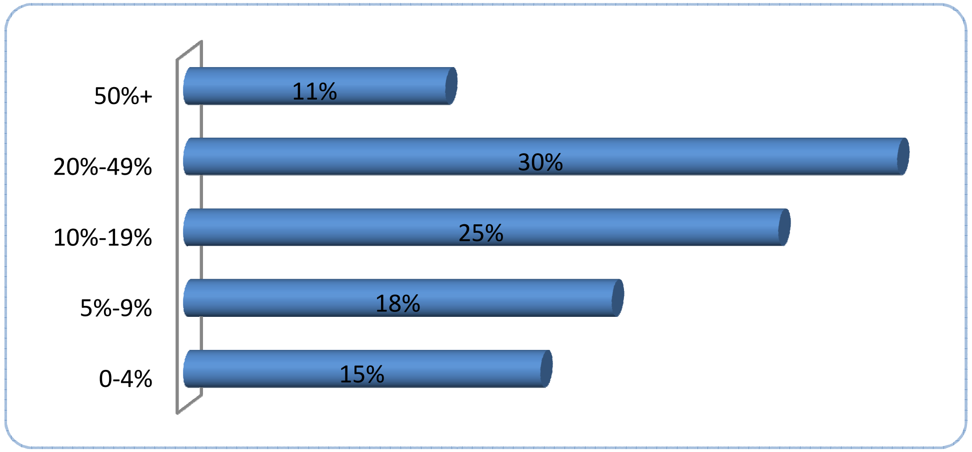
III.I. Key Survey Findings

- The majority of the surveyed Danish non-outsourcing companies do not think their software/web is being developed at the **highest possible quality level**.
- **Time** it takes to complete a software development project, **high cost** of development and implementation and software bugs / errors fixing are the **three key obstacles** to successful in-house development in Denmark.
- Most of the Danish companies **do not** outsource, because they **want to have 100% managerial control** of their software development project and team members and because they think that **Outsourcing** and **vendor management** will eventually **cost** them **more money**, **efforts** and other “**headaches**”.
- Most surveyed Danish companies will **start considering outsourcing** their software/web development, if they need **faster time to market**.

III.II. Trends Analysis

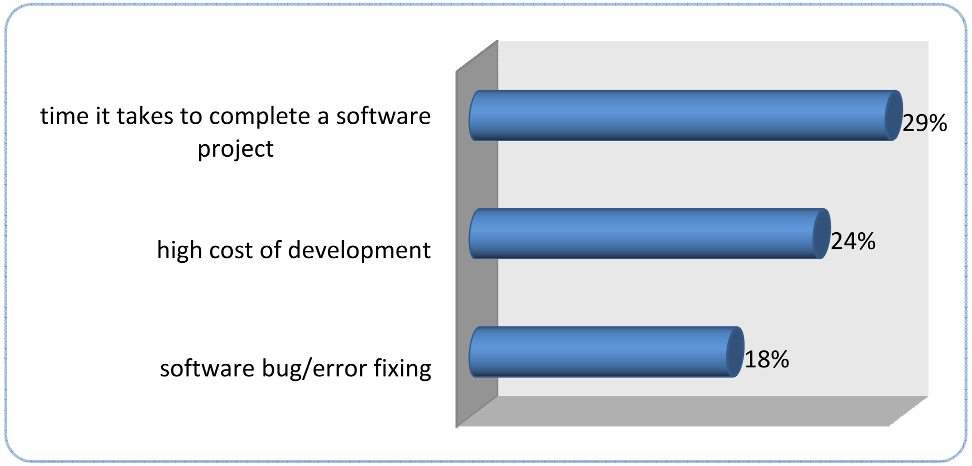
20%-49% of Danish Corporate Budgets Go To Software Development!

***Figure 15.* Portions of corporate IT budgets that go to software development.**



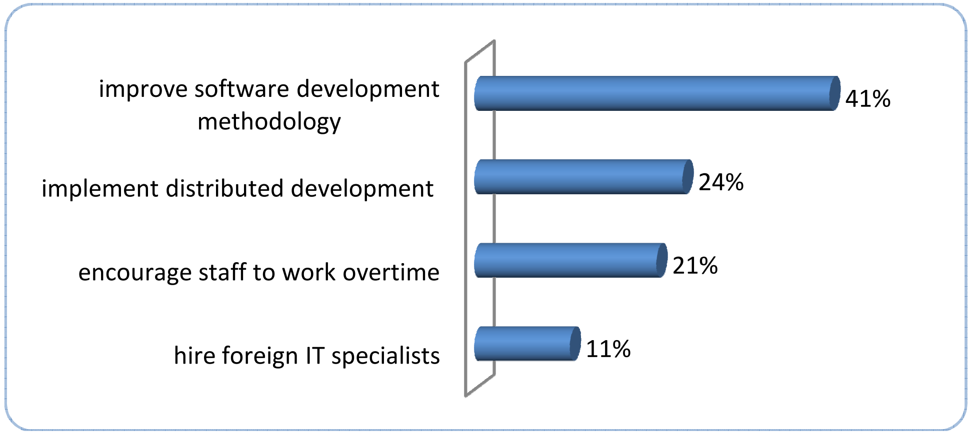
Slow Time To Market and High Costs Are the Hugest Barriers To Successful In-House Software Development!

Figure 16. ***The top three challenges of the in-house software development.***



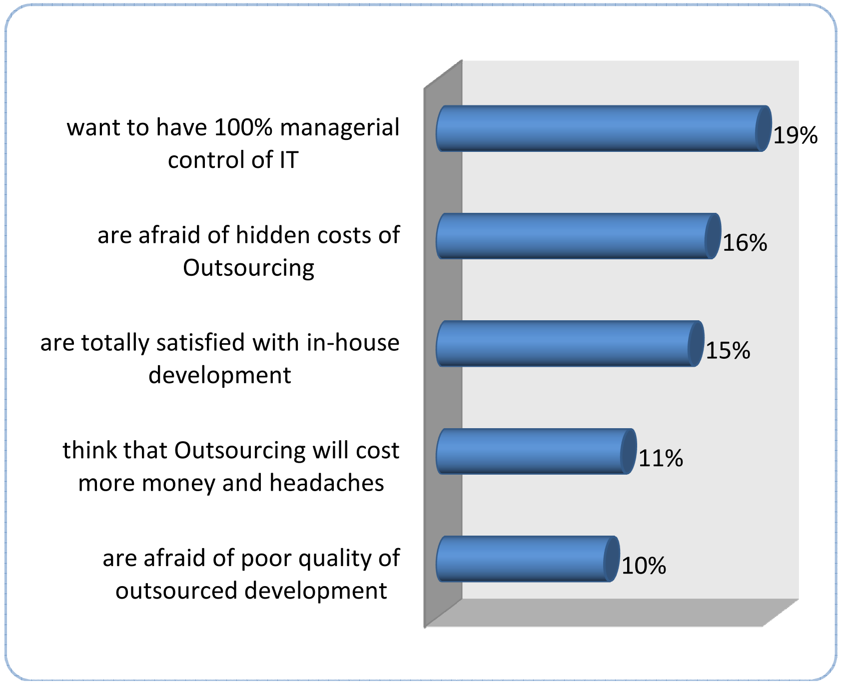
Methodology Improvement Is The Solution!

Figure 17. ***Top 4 strategies that Danish companies use to respond to challenges.***



Danish Companies Do Not Outsource, Because They Want To Have 100% Managerial Control of Their IT!

Figure 18. ***Key reasons why Danish companies refuse to outsource their software development.***



An extended Trends Analysis is available in a full version of the Report.

III.III. Findings Discussion

The Danish Software / Web Development Survey 2010 allows us to observe certain trends among the Danish companies that develop their software solutions internally and stay away from Outsourcing.

Unlike their outsourcing counterparts, the Danish non-outsourcers do not view reduction of operating costs as the major driver of their future outsourcing decisions. Most companies have admitted the likelihood to outsource software/web development, if they need faster time to market via flexibility and scalability. Another most frequently cited reason to start considering outsourcing in the future is if there are no necessary IT resources left in Denmark for successful software development.

Again, unlike the Danish outsourcers, the non-outsourcers express willingness and readiness to outsource nearshore and/or within own country rather than offshore. Although low costs are still cited among the major drivers of the choice of the outsourcing destination, such factors as available IT talent pool, legal system maturity and geographical and cultural proximity are considered to be very important for the future sourcing decisions of today’s Danish non-outsourcers.

Regarding the future choice of ITO suppliers, current non-outsourcers name references and reputation, specific skills, sound experience in the similar projects, innovative business models and low prices among the most impactful selection criteria.

More findings are discussed in a full version of the Report

IV. Conclusions and Recommendations

The Danish IT Sourcing Research 2010 arrives at some important conclusions which help better understand current trends, challenges and problem solving techniques related to the outsourced software/web development. The key findings are that in 2010 more small to mid-sized Danish companies start outsourcing their software development function to a 3d party either within own country, or nearshore, or offshore. Small companies prefer partnering with small ITO suppliers, while large companies partner with one or several large ITO suppliers. Cost reduction remains the major force driving the Danish companies to outsource their software development. Besides, the Danish clients are looking for innovation, faster time to market and flexibility in their outsourcing deals.

Currently, Danish companies outsource mostly nearshore and within own country, and the number of companies that place their software/web development offshore is significantly shrinking in 2010, compared to the past years.

In Denmark, the major ITO demand relates to the Web and Enterprise development, while mobile, embedded development and cloud computing Outsourcing remains less demanded.

More conclusions and recommendations are available in a full version of the Report

About IT Sourcing Europe

IT Sourcing Europe Ltd is a UK-based research and consultancy company specializing in nearshore IT/software development Outsourcing. Our services include:

- Independent IT Outsourcing market research and analysis
- Independent surveys of Western European outsourcers and their ITO demand
- Independent surveys of Central and Eastern Europe's ITO services providers and their factual capability to deliver top quality products and services on time and on budget
- Consultancy and recommendations to companies planning to change their current outsourcing strategies
- Consultancy and recommendations to companies planning to outsource their IT function nearshore
- Custom market and competition research and surveys

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