

CEDARCRESTONE'S OUTSOURCING White Paper Series

PART FOUR – ECONOMIC JUSTIFICATIONS FOR HOSTING

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Introduction

While not all motivations for outsourcing are simply cost-based decisions, an analysis must still show that there is good economic justification for pursuing an outsourced solution. We often find, however, that the typical attempt at a Return-on-Investment (ROI) analysis will be problematic, perhaps even misleading.

Traditional ROI analyses are attempts at measuring the impact an investment will have on cash flow, and typically will use either Net Present Value (NPV), or Internal-Rate-of-Return (IRR) calculations. These methods attempt to place a value on the cash flows that will be generated in the future, with investments that are made today.

One of the problems with this approach is that it requires correlating technology investments to the business's bottom line. This is extraordinarily difficult for basic infrastructure components that serve to enable many—sometimes all—processes, procedures and tasks that span the enterprise. Consider technology staples such as the PBX telephone system, or the local area network, or printers and fax machines—these are investments that support numerous underlying and multi-threaded business processes. A similar argument can be made for CRM, ERP and other back office systems.

And there are other problems with technology-based ROI's, such as predicting useful life, and accurately estimating support and maintenance costs. Thus, while the cost reduction impacts are fairly easy to isolate and quantify, the direct correlation between the increased opportunity and the bottom-line cash and revenue impacts often remain fuzzy.

Justification Factors

We understand the difficulty that IT organizations face in documenting an economic justification for any initiative. The contribution of IT assets and services to the business bottom line is simply not clear-cut. However, we find that analyzing outsourcing arrangements—such as PeopleSoft hosting—can be easier to address when the following four categories of savings and benefits are specifically quantified:

- Cost Reduction
- Cost Avoidance
- Opportunity Creation
- Other Benefits and Intangibles

Cost Reduction

Cost reductions can come from eliminating or reducing internal resource expenditures as a result of such an outsourcing arrangement wherein the outsourcer pays these as a part of your monthly hosting fees. These can include such cost line items as:

- RDBMS licensing or maintenance fees
- Hardware (server) maintenance fees
- System software maintenance fees (e.g., OS, compilers, etc.)
- Other third party software maintenance fees (e.g., report writers)
- Training and conference fees
- Reductions in support staff headcount (e.g., DBA, Unix/NT admin, PeopleSoft level 2/3 technical support, security admin, etc.)

Cost Avoidance

Cost avoidance can come from obviating the need for future resource expenditures that would otherwise be required if you were to continue “internal self hosting” of the PeopleSoft applications. These can include such cost line items as:

- Upgrades to existing server platforms (Web, Application and DB servers) to accommodate the increased capacity demands of the Release 8 architecture, including:
 - Additional CPU
 - Additional memory (RAM)
 - Additional disk storage
- Upgrades to workstations for core support personnel
- Updates to the security architecture (firewalls, proxies, Web/DMZ)
- Installation services for PeopleSoft databases and components
- Technology spending to implement failover and/or disaster recovery capabilities
- Additions to IT staff to handle increased workloads that result from new initiatives and projects

Opportunity Creation

Opportunity Creation comes from the fact that resources currently assigned to the maintenance and support of the PeopleSoft applications and infrastructure can now be redirected towards more value-added initiatives and activities. Of course the economics of this particular factor can vary greatly among organizations, and must take into account the projected value of such new efforts:

- Value derived from staffing the new business initiatives
- Sale of capital assets no longer required under an outsourcing arrangement

Other Benefits and Intangibles

Other less tangible benefits often result from an outsourcing arrangement simply because existing service levels will be increased without having to add additional resource expenditures. Such items can include:

- Higher availability and reliability due to system redundancies and failover
- Increased functionality due to faster application of upgrades and patches
- Tighter security controls that reduce exposure and risks
- Implementation of a disaster recovery solution that further reduces risks
- More predictability in year-to-year support budgets
- Immediate availability of world-class PeopleSoft expertise

While the required “payback” metrics can vary greatly among organizations, we recommend that justification calculations be addressed for the term length of the initial outsourcing contract (typically three years.)

As an example: Assume that a client’s PeopleSoft hosting profile calls for an initial setup fee of \$20,000, and an annual hosting fee of \$256,800, which over a three year contract represents a total investment of \$790,400. Over that three-year period, the client would need to identify...

- Cost reductions
- Cost avoidance
- Opportunity creation
- Other benefits and intangibles

...totaling \$790,400 to achieve a “break even” economic justification, or totaling \$908,960 to achieve a 15% return on the outsourcing arrangement.

An Economic Justification Calculator

Businesses need a tool to enable them to perform their **own** economic analyses on outsourcing options.

We’ve developed such a tool—a simple and relatively straightforward Excel spreadsheet. All of the factors described above are itemized and totaled, and then compared to the hosting costs, all over a three-year contract period. An “equivalent ROI” is automatically calculated to allow a quick determination if the Hosting arrangement is economically justified based on the conditions unique to that business profile.

This Excel spreadsheet—the “[Hosting Justification Worksheet](#)”—is freely available to anyone. Likewise, our management consultants are also available at any time (and at no cost) to assist in the usage and application of this tool.

To arrange immediate access or assistance, simply call your CedarCrestone Account Manager, or contact our Managed Services Center through:

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ABOUT CEDARCRESTONE

CedarCrestone delivers real client success by developing enterprise solutions that strategically incorporate consulting, hosting, and managed services for the deployment, management, and optimization of Oracle Fusion Middleware technology, Oracle's E-Business Suite and PeopleSoft Enterprise applications.

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