A Publication from INPUT's Federal Information Technology Market Program

Outsourcing and The Federal Market

General Outsourcing Discussion

To gain some perspective on outsourcing in the federal marketplace, it helps to briefly look at the ongoing commercial outsourcing explosion. Though some of INPUT's competitors claim even higher rates of growth in the market, INPUT's own estimate is healthy enough—18% compounded over the next five years.

The reasons for this strong growth are summarized in Exhibit 1. The primary reasons are:

- The continued slump in the economy makes the immediate cost reductions offered by outsourcing attractive to more companies.

- The relative success of IBM's ISSC and EDS in smoothly transitioning major outsourcing clients is stimulating increased acceptance of the concept.

- The outsourcing arrangement itself is beginning to include much more than just processing operations or software maintenance. It now includes software development, network management, desktop services and even education and training components.

Exhibit 1

Growth Factors for Commercial Outsourcing

- Continuing economic slump

- Success of major vendors

- Outsourcing more comprehensive

Source: INPUT

There are also some examples of entire business operations being turned over to outsourcing vendors. This trend is expected to accelerate as the decade progresses and clients become more comfortable with the outsourcing partnership that is evolving.

Federal Outsourcing Activity

Does this same level of activity pervade the federal market? INPUT projects the growth at a disappointing 9% for the same five-year period from 1991 to 1996. That still represents a $1.7 billion business, growing to $2.6 billion by 1996. The federal market is now the second largest outsourcing market and will still be in 1996, though by a smaller margin (see Exhibit 2).
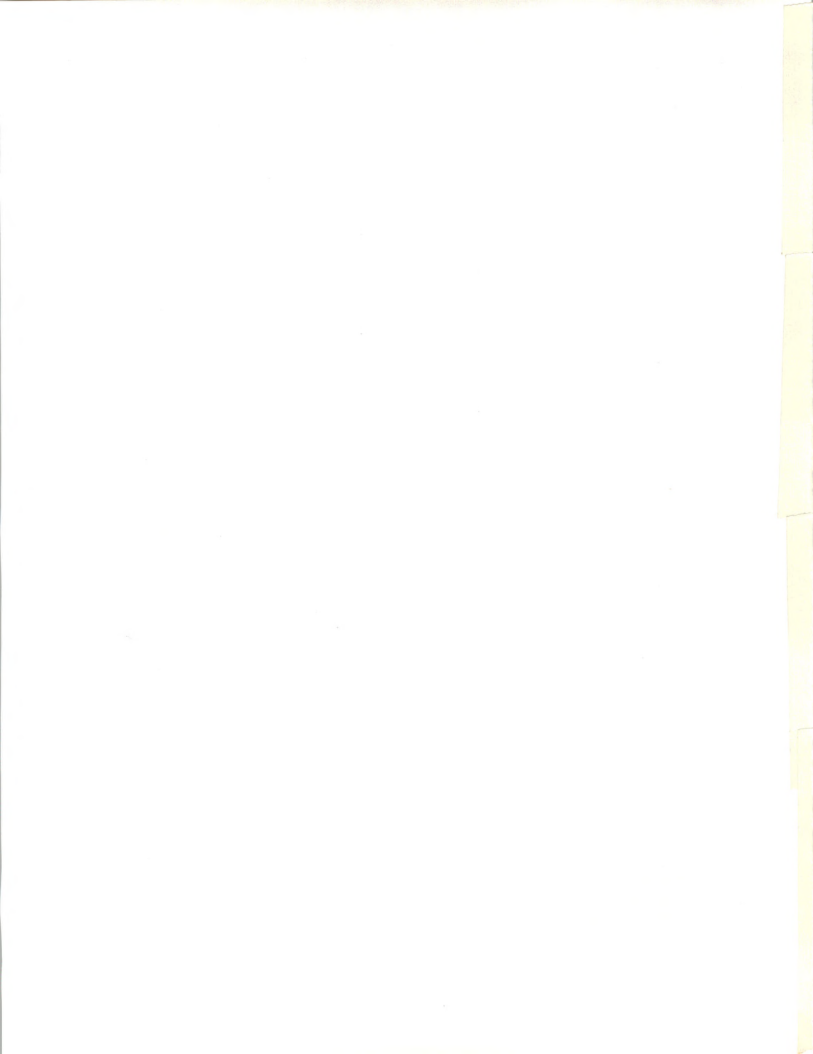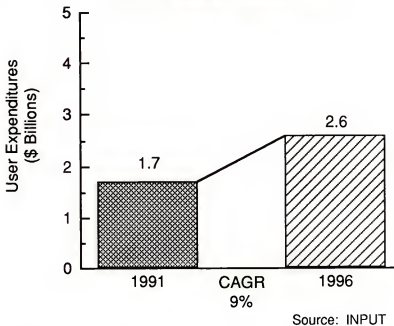
Exhibit 2

U.S. Federal Government

Chart showing User Expenditures ($ Billions) on the Y-axis (0 to 5) for years 1991 and 1996.

- 1991: 1.7
- 1996: 2.6
- CAGR 9%

Source: INPUT

Why is there such a difference in growth? After all, systems outsourcing was an early phenomenon in the federal marketplace. GOCO (government-owned, contractor-operated) and COCO (contractor-owned, contractor-operated) facilities management contracts have existed for years.

In fact, the distinction of who owns the facility has become insignificant. The term *mission contracting* has evolved to describe the outsourcing arrangement. It really means the same thing—namely, that a vendor assumes total responsibility for an agency's data processing requirements.

There is still a shortage of sufficient technical skills in the government to operate and manage computer centers and implement new technologies. There still is a strong mandate for agencies to provide services to the public that serve the public welfare and the security needs of the citizens. The A-76 initiative is still in place, encouraging the use of private contractors. These factors, summarized in

Exhibit 3, favor the growth of outsourcing.

But there are negative factors at play also. Budget restrictions continue to plague the procurement plans of agencies and to delay, if not derail, many needed IS upgrades and expansions. DoD in particular is saddled with this problem. Vendor protests are also delaying the procurement process. Since most of the outsourcing procurements are major awards, these are particularly affected by protest action and congressional scrutiny. The CORN outsourcing contract recently awarded to EDS is a classic example of one that had to be passed through the procurement process twice before it was finally awarded. The recent anti-grand-design study by AMS for GAO is also tempering plans for new large procurements and is causing some of the procurement efforts to be segmented.

Exhibit 3

Federal Outsourcing Growth Factors

- Lack of technical skills persists
- Mandated services required
- A-76 initiative still in place

Source: INPUT

Outsourcing Components in the Federal Market

Now that we know the driving forces and inhibitors for the federal market, are there other differences? The one glaring difference, in INPUT's opinion, is that the expansion of outsourcing to include other services such as desktop services and business operations will not happen as rapidly, if at all, in the federal market.

There are two reasons for this, illustrated in Exhibit 4. First, many agencies are already acquiring the services needed through a series of procurements. Many agencies, for example, do not need a network management component in their outsourcing contract because they are required to use FTS 2000. Others have already established PC/workstation procurement/ management contracts such as EDS's SMC (the Army's Small Multiuser Contract) and so they do not need desktop services in their outsourcing agreements. Still others are accustomed to using SETA agreements for their software development and cannot or will not change these relationships.

Exhibit 4

Differences in Federal Outsourcing Market

- Service acquisition split up

- Reluctance to turn functions to private sector

Source: INPUT

Second, many federal agencies—DoD agencies in particular—are reluctant to turn over complete responsibility for functional operations to commercial vendors.

- DoD cannot accept civilian contractor personnel in IS functions. Many of these functions would become mission critical or even high risk in times of emergency.

- The IRS will not turn over certain functions of tax return processing completely to a commercial vendor, though vendors will be used extensively to help IRS improve its systems capability.

The outsourcing components that are most likely to be included in federal procurements are therefore:

- Processing operations, particularly at laboratories, logistics and engineering facilities

- Software maintenance

- Applications software (primarily of non-mission-critical applications such as financial management software)

The following components will probably continue to be separate contracts or retained internally:

- Network management (voice, data and image/video)

- Software development

- PC/workstation support (including LAN administration)

- Education and training

Conclusions

The reduced set of requirements for federal outsourcing contracts still gives vendors an opportunity to operate in this market with a leaner, more efficient support group in the operational phase. This doesn't apply to the marketing phase of federal outsourcing activities, since the rigors of the procurement process are already well known and require
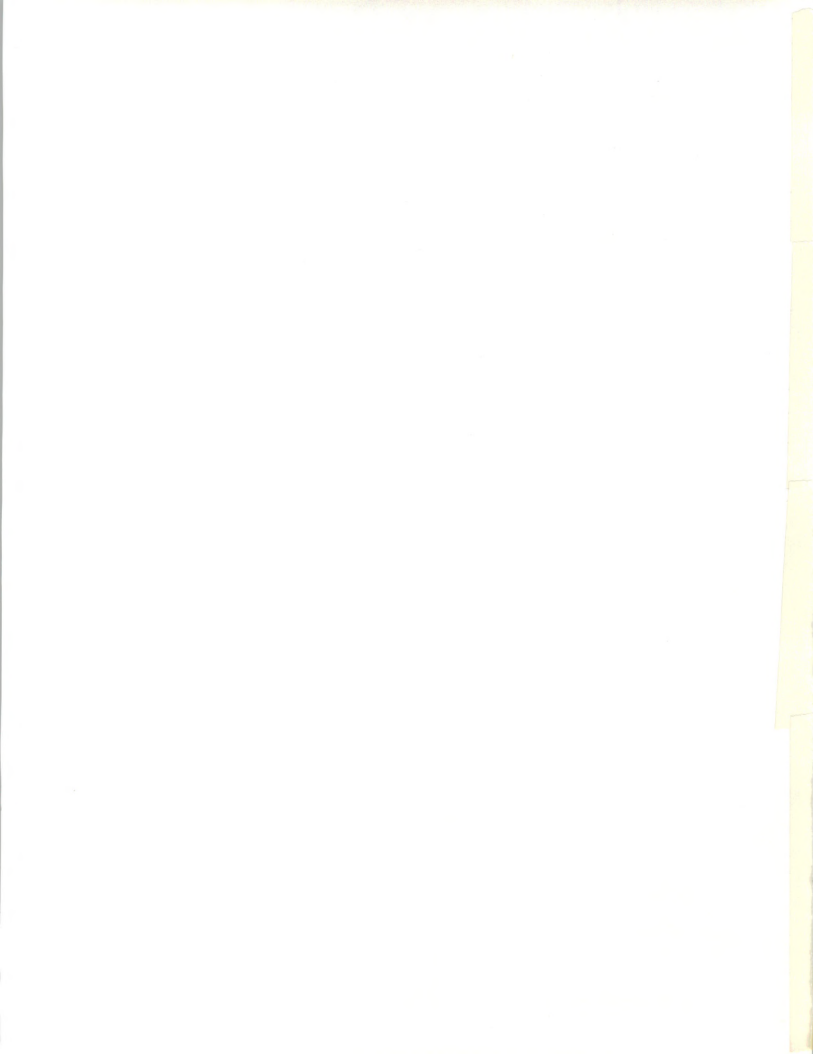
much more marketing support than most commercial opportunities.

There is a substantial market for outsourcing services in the federal market that will continue to grow, but at a slower pace than the commercial market. The demand for services will include only a subset of the services required in the commercial arena. Certain well-entrenched vendors such as IBM, EDS, Martin Marietta, Boeing Computer Services and CSC have experienced teams that know how to operate very cost effectively in the structured federal contracts environment.

More to Come

INPUT has scheduled a closer look at the federal outsourcing market in the fourth quarter of 1992. At that time, the size of the market will be analyzed in detail and parallels will be drawn between the commercial and the federal sector that will be valuable to vendors trying to move from one market to the other.