



According to Gartner, over 50%
of outsourcing efforts fail!

How Fixed Priced Projects can actually increase your risk

by Jack Bicer

Many companies like to outsource fixed priced software development projects in an attempt to control or minimally to limit risk. In reality, this may actually increase the project risk and may even put your project delivery in jeopardy.

The main issue in fixed price projects is cost risk management. To manage risk, we buy insurance. We usually pay a premium over the expected cost to pass the risk to our vendors.

Professional software development companies are not in the business of losing money, so when they take on the fixed-price risk, they believe the premium they receive will be more than enough to cover the risk(s) they are taking on.

The questions are then (1) when is it in your best interest to pay a premium and attempt to transfer the risk to your vendor and (2) when is it in your best interest to keep the premium and take on the risk?

If you know exactly what you want done, with a good technical specifications, then fixed priced projects are a good way to go. Maintenance work, infrastructure support, rewrites of old software, moving to another technology platform, small additional features to existing software may all fall in this category. When the potential surprises from unknowns are usually small, you can pass the risk to your vendor and expect to get a good service.

If the specifications are not well defined, or you are developing a new product or a major new enhancement, there will always be some unexpected surprises. This will result in a higher number of changes. Therefore the premium you would need to pay for the higher risk would be relatively high as well: high enough so that vendors can believe that they will still make money after coming to terms with Murphy's Law.

Change management, the process of managing changes from the original requirements, also puts you and your vendor at odds. You want to have the right software built. But your vendor, who has not signed up for implementing your newly discovered needs, wants to be paid for the extra effort. For most budget conscious companies, this creates a tug of war, usually resulting in reduced customer satisfaction and less trustworthy vendors. A lose-lose proposition for both sides.

Let's assume for a moment that you take on this higher risk by entering a straight Time & Materials contract, and keep the additional premium. You can put more thought into your change requests, resulting in fewer changes. You can also allow better access to your experts, explore fewer options, communicate more thoroughly, which will all reduce the project risks and lower your cost of development. This will put you in the driver seat to manage the risks and control your costs.

So the rule of thumb is that if the work is well defined and specified, you can expect to reduce your risk by using a fixed price contract at a reasonable premium. If not, a time and materials contract is likely to serve you better.

Let me also share a dirty little secret of the outsourcing and offshoring industry. You may find vendors who will take on loosely defined projects at fixed price model and at a low cost. It'll be inexpensive and the vendor takes on the risk. You may even think have found the right people who understand your need to stretch your budget. Great! Or is it?

Vendors may give you a low bid to get the project, knowing full well that there will be a fair number of changes. Changes result in change orders, which result in additional costs. Half way into the project, when you are fully committed to your new vendor, the change orders start getting more and more expensive, providing a way for the vendor to make up for the initial lower fixed price. At this point, as long as you wish to complete the project, you, as the client, are not in control of the costs. If you cut down on the changes, you will get an inferior product. If you don't, the project will cost more. A classic catch-22. The cost benefits of the fixed price development model will disappear with the escalating costs, which can get up to three or four times the original bid.

Your best defense: Use reputable vendors that you can trust, who are interested in a long term relationship with you. Be knowledgeable about the process, as well as the risks. Find a way to manage the risks intelligently and fairly, respecting that the relationship needs to work for both sides to be successful.

About the author:



Jack Bicer is the CEO & CTO of Septium Corp., a *hybrid* offshore custom web software development company, combining offshore cost savings with US management expertise. Prior to Septium, Jack held several CTO roles in Internet companies since the early days of the Internet and as a turnaround CTO, enjoyed the sale of 1GlobalPlace to VeriSign. A 28 year software industry veteran, Jack is an industry expert in SaaS/web software, new product development, off-shoring, technology strategy and management. Known as the "*Father of Uninstall*", he invented the uninstall concept and wrote the first uninstaller. He is also credited with inventing the "Automated Software Updates". In 2003, Jack founded TechBiz Connection, one of the largest non-profit technology management associations in Southern California, and currently serves as its Chairman and President. Jack can be reached at jbicer@septium.com.