Backsourcing Pain

JPMorgan Chase's decision to first outsource IT and then bring it back in-house stands as a cautionary tale for any CIO considering an outsourcing megadeal.

BY STEPHANIE OVERBY
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When David Rosario got the official notice at the end of 2002 that his job would be outsourced to IBM, he was not surprised.

Rumors had been circulating for months at JPMorgan Chase, where he had worked as a network engineer since 2001, that the company would be signing away much of IT to an external services company.

The $5 billion IBM-JPMorgan contract was heralded at the time as the largest outsourcing deal on record, and it received a great deal of publicity in the mainstream and trade press as the wave of the future. JPMorgan itself had trumpeted the deal as a "groundbreaking" partnership that would cut costs, increase innovation and benefit its IT workers.

But Rosario and other employees soon discovered that they would have to re-interview at IBM for their positions. During that process, Rosario was told that his job at IBM would be secure for the foreseeable future. Others, however, were not so lucky. They were told by Big Blue that their jobs would likely be gone within a year or two. As a result, some left as soon as they could.

Rosario stayed.

But his sense of security didn't last. Rosario watched as IBM cut the pay of most of the consultants working for the bank and then eventually let many of them go. And with IBM's well-publicized penchant for sending work offshore, he wondered if—as a full-time employee—he would be next.

But before that could happen, on July 1, 2004, JPMorgan completed its merger with Chicago-based Bank One, which itself had canceled a well-publicized outsourcing deal with IBM and AT&T a few years earlier. Two and a half months later, the merged company announced that it would be ending its much-touted deal with IBM early and "backsourcing" its information technology, bringing it back in-house.

However, Rosario wasn't sure how long he could hold on to his regained position at JPMorgan. He knew that there were now Bank One employees doing the same work he was. And sure enough, not long after he began working for JPMorgan again, he found out
his job was on the list of 12 positions to be eliminated in his department. Lucky for Rosario, he had become skilled at reading the IT tea leaves, and had already secured a job for himself in another area of the company as an IT architect. But not before all the to-and-fro took its toll on him. "I lost my trust in management a long time ago," he says. "I don't believe anything they say or do. I know they'll put a spin on anything, as long as it allows them to keep retention up for just as long as they need to."

Rosario is just one of thousands of employees affected by JPMorgan's decision to outsource to IBM and its subsequent move to bring the work back in-house. And he is not the only one who suffered such whiplash. In interviews with a number of current and former employees, CIO repeatedly heard stories of diminished morale and decreased productivity over the past several years.

But the bank's decisions have had ramifications even bigger than poor morale or the loss of employee trust. JPMorgan's decision to bring IT back in-house—though applauded by most industry analysts, IT experts and even employees like Rosario as the right thing to do—has been a costly and difficult move, according to analysts and current and former employees. It has eaten up years of management time and attention as managers prepared the organization for the outsourcing and then reorganized again to bring the work back in-house. A number of IT projects were slowed down and some day-to-day tasks did not get done, causing a lot of pent-up demand for IT services, according to several employees. In sum, JPMorgan's experience stands as a cautionary tale for any CIO considering a multibillion-dollar outsourcing deal.

"Bringing outsourced work back in-house can cause such disruption to an organization that most people don't do it," says Ralph Schonenbach, CEO of the Trestle Group, an outsourcing consultancy based in Zurich, Switzerland. "It's a very difficult and painful change for an organization to go through."

For their part, JPMorgan officials deny any such struggle. "This has been a smooth transition because the same people—the IBM employees and contractors supporting the JPMorgan account—were transferred back to JPMorgan. They simply changed employers, not jobs," says JPMorgan spokesperson Charlotte Gilbert-Biro. "In addition, Bank One executives and managers are experienced at transitioning technologists back in-house."

**Employee Fatigue**

On Dec. 20, 2002, JPMorgan announced its seven-year outsourcing arrangement with IBM—including data centers, help desks, distributed computing, and data and voice networks—with great fanfare. "We view technology as a key competitive advantage," stated Thomas B. Ketchum, JPMorgan's vice chairman, in a company press release. "Our agreement with IBM will create capacity for efficient growth and accelerate our pace of
innovation while reducing costs, increasing quality and providing exciting career opportunities for our employees."

The deal would help JPMorgan create "significant value" for its clients, shareholders and employees, Ketchum promised. Less than a year into the relationship, then-CIO John Schmidlin said at a Gartner outsourcing summit that his only regret was that they hadn't signed the deal with IBM sooner.

Fast-forward to Sept. 15, 2004, when JPMorgan announced the premature end of the contract with IBM with equal flourish and similar promises. In another company press release, Austin Adams, the former CIO of Bank One who took over for Schmidlin as CIO for the $1.1 trillion merged bank, said, "We believe managing our own technology infrastructure is best for the long-term growth and success of our company, as well as our shareholders. Our new capabilities will give us competitive advantages, accelerate innovation, and enable us to become more streamlined and efficient." (Adams, who also presided over the backsourcing of Bank One's deal with IBM a few years earlier, declined to be interviewed for this story. Schmidlin could not be reached for comment.)

The fact that JPMorgan officials gave basically the same reasons for the retreat from the mega-outsourcing deal that they had proffered for inking the deal in the first place left some employees confused and resentful. "Morale was not high," says one former consultant who managed server support at JPMorgan and was let go. He asked not to be named.

Some workers had been hit by the outsourcing where it hurt even more—in their paychecks. Though many employees (such as Rosario) saw only the company name on their paychecks change, others (typically consultants) took significant pay cuts by moving to IBM. "The five people in my group [all consultants]—which included network, systems and database administrators—were all told that they had to reapply for their jobs," says Scott Kirwin, who worked as an independent consultant for JPMorgan in New York from July 2002 until April 2003. "A lot of them did, but they were hired at salaries that were 20 percent less."

JPMorgan declined to comment on any salary reductions or layoffs that may have occurred during the outsourcing and backsourcing. However, bank officials at the time said that approximately 4,000 people, including employees and contractors, were transferred to IBM during the initial phase of the outsourcing. According to the bank's 2003 annual report, 2,800 of these people were full-time employees. In a statement announcing it would bring IT back in-house, JPMorgan officials said that roughly 4,000 workers would return to the bank. According to the bank's 2004 annual report, 3,100 of those people were full-time employees and 800 were contractors. Some of the original contractors were either hired as employees by IBM at lower salaries or laid off, according to several current and former JPMorgan workers.
Meanwhile, productivity at JPMorgan took a hit, according to several former and current employees. "For more than a year, there were a lot of people not getting any work done. They didn't know where they were going to be, they didn't want to commit to projects, and they started slacking off," says a former consultant who used to manage server support for JPMorgan. (He has since gotten another full-time IT position at a major company.) Among the projects not getting done were server migrations, data center upgrades and network patches. "When people aren't productive, the company loses money," he says.

During the backsourcing, layoffs also occurred. Some were merger-related. (When Bank One made its own backsourcing move in 2002, the company chose not to invite back some of the employees it had transferred to IBM, taking the opportunity to "upgrade talent where appropriate," says JPMorgan spokeswoman Gilbert-Biro.) While JPMorgan says more than 97 percent of the employees and contractors accepted their offer to return to the bank when the backsourcing initially took place, Rosario says many people are worried they will no longer be needed because of the merger with Bank One. And some have already lost their jobs. "I've seen several project managers and IT middle managers let go," he says. "And I've seen some people who have the option leave before they got laid off. I had options here in the bank, and I exercised those."

Analysts confirm that there have been layoffs during the backsourcing. These firings "don't get much attention because they aren't nearly the size of the 4,000-person workforce involved in the megadeal at IBM, but layoffs have been occurring," says Susan Cournoyer, vice president of research with Gartner Research.

JPMorgan has announced that the merger will result in a total of 12,000 layoffs by 2007. The bank, however, insists that many of the merger-related job eliminations will not occur in IT. "The vast majority of job reductions are in call centers, operating centers and back-office support, and do not affect technology," says Gilbert-Biro.

**The Cost of Reorganization—Times Two**

There was a price to pay at JPMorgan—not only in low morale and employee turnover during the back-and-forth of sourcing, but also in the reduced well-being of the IT organization and corporation as a whole. That price included the time and expense it took to first reorganize the company to support an outsourcing arrangement and then to reverse those changes to prepare for a backsourced environment. Kirwin saw the distraction it caused at JPMorgan, as managers and staff had to work on things such as documenting and presenting information required for the outsourcing—describing staffing levels, current skills, budgets and work assignments, and quantifying what their teams did on a day-to-day basis—all in addition to their normal duties. This kind of additional work lasted from the time when the initial plans for outsourcing were being discussed all the way through the period after the outsourcer was chosen, and continued through the outsourcing deal's duration.
"The minute you start talking about outsourcing, you lose productivity, not just among us employees but managers and directors who have to set aside what they're hired to do to talk about this significant business change," says Kirwin. "And there's never a dollar figure attached to that." If there were, "they might not sign these deals in the first place," he adds.

Specifically, you have to bring in a consultancy to help you figure out your outsourcing strategy and how to reengineer your processes for outsourcing. And then, you have to make lots of investments in HR to counsel employees, the Trestle Group's Schonenbach says. You also have to spend money on retention bonuses to keep key employees around during the transition.

Then, "if you decide to insource, you have to do that all over again in reverse, and it costs you twice as much," he adds. "These deals take a long time to pay off for both the customer and the outsourcer. So when you end it early, you're losing a lot of money."

JPMorgan won't say how much the divorce cost them, and IBM isn't talking either. But a number of analysts say that because the bank ended the contract prematurely—just 21 months into its seven-year contract—it paid a substantial price.

To terminate a contract of that size that early into the deal, JPMorgan likely had to pay IBM millions of dollars, says Christopher Ford, a partner at the law firm Alston & Bird in Washington, D.C., who recently led a team of lawyers on ING Insurance Americas' $600 million IBM outsourcing deal. Cournoyer agrees that a "low-end estimate" for the final penalty would be in the multimillions of dollars.

When companies bring IT back in-house, it routinely costs them more—in the short term at least—to run their own data centers, help desks, distributed computing, and data and voice networks than it does to continue outsourcing them, according to Jeff Kaplan, senior consultant with the Cutter Consortium's Sourcing and Vendor Relationships Advisory Service and the managing director of ThinkStrategies. Clearly, JPMorgan will be taking advantage of the $1 billion that Bank One invested in its own data centers and IT infrastructure over the past few years. But it must now reestablish all of its own systems, staffs and operating procedures, and "realign them with the business so that they fit with the corporate structure and strategies," Kaplan says.

Employees confirm there is a big readjustment going on inside the bank. "In some cases, responsibilities are getting greatly redefined, sometimes completely reversing the way things had been done," Rosario says.

That's why, even though the majority of outsourcing deals are less than satisfactory, most companies try to work things out with their service providers rather than backsourcing. According to a recent study by Deloitte Consulting, 70 percent of senior executives reported significant negative experiences with outsourcing projects, but only 25 percent of respondents brought the work back in-house. "That organizational disruption is what's kept companies from backing out of outsourcing relationships," Ford says.
JPMorgan officials, however, say the disruption was minimal. "We were only 21 months into the contract with IBM, and JPMorgan hadn't yet moved the bulk of the work to IBM's data centers," says Gilbert-Biro.

The Price of Stagnation

In recent years, IBM has made a successful push toward signing more mega-outsourcing deals. For the past three years, in fact, its IT services business has accounted for nearly half the company's total revenue, growing from $36.3 billion in 2002 to $46.2 billion in 2004. In its 2004 annual report, IBM noted that its IBM Global Services unit earns more than twice the annual revenue of its closest rival. In fact, around the same time that JPMorgan signed its deal with IBM, IBM also signed several multibillion-dollar contracts (five worth over $1 billion in 2002 and seven in 2003) with major companies—including American Express ($4 billion in 2002), Deutsche Bank ($2.5 billion in 2002) and Michelin ($1.21 billion in 2003)—that have not been canceled.

However, in the past year, the outsourcing contracts IBM has signed have been smaller and shorter in duration. Experts such as Schonenbach and Dane Anderson, research director at Gartner, say this is largely because megadeals are not that profitable for the vendor, particularly in the short term. As a result, some outsourcers try to make money by charging customers for services they consider outside the contract, experts say. And if the customer resists paying for these extra but often necessary improvements, it can have a deleterious impact on IT. And indeed, a number of employees who worked on both the Bank One and JPMorgan outsourcing deals say they were bad for the banks in terms of IT innovation and efficiency.

In the Bank One deal, "outsourcing the entire IT staff stagnated us, from a technology viewpoint," says the JPMorgan systems engineer who survived the outsourcing—and then backsourcing—at Bank One. "Once they signed the contract, we didn't move at all beyond that date as far as picking up new technologies that would give us a competitive advantage. Technology was not refreshed, and new projects were not rolled out."

The problem was with the way things did—or, more accurately, didn't—get done. "The contract between Bank One and IBM had enough vagueness within it that IBM could charge for anything that wasn't already being done within the bank before the deal began," he says. "Our IBM managers said if something wasn't stated specifically in the contract—a particular task or a type of support—they wouldn't have us do it unless the bank paid them more. So a lot of things didn't get done."

For example, every time Bank One needed him to add or remove a user because of a new hire or fire, he and his team of 50 had to go onto all 1,500 servers to add or remove that person. There was a Tivoli module that could have been added to help manage user accounts more efficiently, and he notified his IBM manager. "If you can find a way to make the bank pay for it, then we'll do it," he was told. The module was never added. Another Bank One systems administrator who was hired on by IBM says he also saw
several examples in which IBM declined to implement additional improvements because Bank One would not pay for them.

The same thing happened with JPMorgan during its time with IBM, say several employees involved in that outsourcing deal. According to the former consultant who worked for the bank in New York before and after the outsourcing relationship, "IBM caused tremendous headaches for JPMorgan and the company's infrastructure, nickel-and-diming to control their own costs."

Others saw the same things at other IT locations. During the 21 months when IBM was in charge, "Things that used to get done no longer got done," says a database administrator who was hired by IBM from JPMorgan in Columbus, Ohio.

In fact, it seemed that even ordinary office products were hard to procure in a timely manner. "Even office supplies had to be approved two levels above my boss," Rosario says. "[IBM] even delayed getting batteries for our pagers, and some project managers had to go and buy their own reams of paper at Staples." Rosario adds that during the last six months of the JPMorgan outsourcing deal, IBM halted all projects. An IBM spokesman declined to comment, citing contractual obligations.

Once the work was backsourced, even the JPMorgan systems engineer—who knew what to expect, having gone through the same thing at Bank One—was amazed by the projects that had sat idle during the outsourcing. "What I'm seeing now is a whole lot of pent-up project demand," he says. "Now that it's all insourced, we're pushing straight ahead, and it's really keeping us busy."

However, the procedures put in place to deal with an outsourced environment continue to slow work down, according to two JPMorgan employees. During the outsourcing, all connectivity and possible combinations of hardware and software were tested in a lab environment before JPMorgan told IBM what it could install and how to do it. "They wanted to make sure the vendor would put things in the right way and always use best practices," says the systems engineer. "They have certification labs to test things to the nth degree, which on the surface sounds good. But [because of the testing backlog], they’ve got equipment out there that's six or seven years old and hasn't been upgraded. It's really slowing us down." JPMorgan confirmed that it continues to rely on the certification processes.

More Outsourcing Ahead?

Despite JPMorgan's insistence on the value of backsourcing, some analysts speculate that the bank plans to do more offshore outsourcing in the future. The bank already has a captive offshore center in Mumbai, India, that performs business process functions, such as accounting and call center work. It will have 3,000 employees by the end of 2005, according to CIO Adams. And JPMorgan has already done some IT work with Cognizant, Infosys, mPhasis and Wipro—though over the past several years, both the bank and its offshore partners have been mum on their current and future projects.
However, Gartner's Cournoyer predicts there will be more going offshore. "They seem to be replacing one big megadeal with a more diverse multisourcing strategy that includes offshore," says Cournoyer.

Even so, experts don't expect that JPMorgan will announce a big offshore outsourcing deal with the fanfare that accompanied its IBM arrangement. "No big financial services company is going to say, We just ended our $5 billion deal with IBM, and we're sending most of the work in piece parts to India," Cournoyer says.

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**Readers Viewpoint**

**Deja Vue**

Posted: SEP 26, 2005 06:54:20 PM

This was one painful article to read, for anyone who has been victim of outsourcing. Just about every bad thing that happened with this deal, happens with just about every outsourcing deal. Too bad there aren’t good statistics about the percentage of these deals that go bad, but there does seem to be a five year life cycle from initial transition to bringing IT back in house. The sad fact is that except for a very short period of time, outsourcing ends up costing far more than it saves, key projects don’t get done, employee morale suffers, and the aggravation level amongst the outsourcer and the client organization goes up exponentially. I think what keeps many of these issues from surfacing more often is the CEO dis-inclination to admit to his/her board that a major mistake was made. Thanks for publishing such an honest article albeit a painful one.

Robert Zimmerman
IT Project Manager
City of Antioch

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**Interesting article**

Posted: SEP 26, 2005 04:15:01 PM

I would tend to agree with the comment made by Pradeep in that it a well researched article. "However, while the article raises a lot of questions, it is silent on the diagnosis of the problem and possible solutions."

It is easy to say that outsourcing is wrought with issues, challenges and risks; and also a fact that mitigating such risks is a challenge in itself. However, where does it leave the reader?

- Mohan,

(Author: "Offshoring IT Services"; Publisher:McGrawHill)

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**Outsourcing: Backsourcing Pain**  
Posted: SEP 24, 2005 10:26:05 AM  
It is a well researched article. However, while the article raises a lot of questions, it is silent on the diagnosis of the problem and possible solutions.

In my view, most outsourcing deals of this nature suffer from management myopia. A long term strategic plan is not created before embarking on such initiatives. I am not sure if JP Morgan management had thought through the impact on the outsourcing initiative, in the event of a) offshoring to India in near future and b) possible mergers and acquisition. This requires visionary leadership in sourcing group to model alternate scenarios and provide for risk mitigation steps.

Secondly, most outsourcing deals fail due to lack of transition planning. This was evident from the statement that between 2002 to the time the backsourcing decision was taken, very few IT activities had really been transitioned to IBM.

Lack of proper governance after contracting, is one of the other reason for most failed outsourcing deals.

It would be nice to know how much attention JP Morgan leadership had given to the above three factors, while implementing the initiative.
Pradeep Mukherji  
Managing Director  
neoIT

**Excellent Article**  
Posted: SEP 15, 2005 01:40:21 PM  
Very well written article, Stephanie. Extremely well researched and documented. Completely in-depth and covering all the angles. Keep up the great, intelligent and thoughtful work.

**Outsourcing**  
Posted: SEP 14, 2005 11:01:00 AM  
Outsourcing: Lessons Un-learned

One of most important items in any implementation methodology is that at the end of the project, the project team makes an evaluation of what went right and what went wrong during the implementation itself. Hopefully, it is expected that most of the tasks and activities during such implementation have gone right, requirements and product quality have been met; otherwise, the project will be in for along overhaul. This is what is called the “lessons learned”.

It seems that CXO’s never learn the painful lessons of outsourcing, the story and the results repeat themselves over and over again. Case and point: JPMorgan and IBM, EDS and GM and many other largely publicized outsourcing deals gone south. From my
professional and personal point of view, and from the analysis of those deals, it is obvious that outsourcing is upper management’s tool to make financial gains in the short term; therefore, making personal gains in terms of bonuses for meeting short term goals. However, in the long term financial operational gains are disastrous, employee morale is destroyed, trust in management is lost and an entire gamma of negative issues that result as a product of the outsourcing deal.

Outsourcing has never been a panacea for mismanagement of the IT function, and the examples of such deals are plenty around us. Instead of outsourcing companies need to evaluate what has worked within their IT organizations and apply the same principles in those areas where they are lacking resources, experience or knowledge. Implement an ever going program for process improvement and constantly evaluate the outcomes of strategic and corporate decisions.

There is an old saying that goes like this "the wish bone will never replace the backbone". That seems to be true with outsourcing, many people at corporate management wishes that outsourcing will replace a well structured and strategic management plan. That will never happen.

Daniel Jaramillo
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