

# Transformational IT Service Outsourcing

## Introduction

Increased demands on IT departments and overall network performance have stretched IT organizations to the limit, challenging expertise, budget assumptions, staffing levels, and business models. IT staff turnover rates, IT operational requirements, resolution times, and network instability have escalated, delaying adoption of new technologies and services. And at the same time, the importance of the IT function within the business hierarchy has increased both as a critical business enabler and as a member of the corporate strategic planning team.

In its ascent, IT continues to lag in acquiring many of the “business” skills and expertise to map projects, activities, and performance to business goals such as revenue growth and competitive differentiation. IT is thus vulnerable to challenges by executive management regarding staff levels, capital expenditures, and technology-adoption initiatives. The results have been elimination of or delays in IT resource investments and bringing new technologies on line to keep pace with business and market requirements. This is also one of the main drivers behind the emergence of the outsourcing industry. Highly aware of IT vulnerability to business case analysis the industry initially thrived on producing highly sophisticated sales presentations, Web seminars, and business case examples of transformational success. The outsourcing industry initially created a perception that it could provide everything that internal IT organizations could not—in addition to reducing overall operational costs. It eventually became apparent, however, that the wholesale outsourcing strategy that some companies pursued was neither economical nor effective.

As the outsourcing industry matured and organizations gained more confidence in and appreciation for the effect that IT and IP technologies had on their overall ability to conduct business and grow, they gained a new perspective on the transformational capabilities of these technologies. With this new perspective, companies have once again assumed full responsibility for their IT environments.

So how does corporate and IT management take advantage of this newfound outsourcing perspective to align with the company business strategy and models? Although there is a temptation to focus on short-term cost-reduction justification, organizations must balance this benefit against long-term strategic alignment and sustained governance requirements as well as many other factors that could diminish program success. This paper clarifies many critical concerns and highlights a decision framework that can guide IT managers and corporate executives alike through a decision process to deliver an optimized outsourcing strategy with its full transformational capacity.

## Defining the Road Ahead

Like technology, applications, architectures, and service demands, outsourcing has evolved tremendously over the past decade. With the rate of change and innovation required to keep up with best practices, align IT capabilities and performance with changing business strategies, control costs, and most importantly, improve customer satisfaction, outsourcing has become a primary consideration of corporate and IT organizations. But is outsourcing a solution for every company and every situation? Obviously the answer is no. IT outsourcing does not always save money—and it certainly is not always successful. In fact, the industry estimates that between 40 and 70 percent of outsourcing ventures fail to meet customer expectations. Evidence indicates that the outsourcing industry has some significant challenges ahead.

One of the problems involves different business motivations of providers and their customers. Outsource customers want to get maximum support for dollars invested, whereas providers want to increase profitability for each unit of support provided. In addition, some of the failures can be attributed to poor planning and lack of program governance by both providers and their customers. It is obvious that outsourcing requires careful planning, focus, and flawless execution to deliver on expectations.

To optimize the ability to sustain success over the life of a program, companies must understand both the dynamics of the outsourcing business and the alignment of IT with business objectives. A first step in developing a strategy is to clarify definitions and build a common understanding of what outsourcing involves, including ongoing influences that reshape how it is defined and sold in the industry. The definition of the term follows:

The purchase of any service or support function—both IT and non-IT functions—can be considered outsourcing. The concept now covers many niche categories of specific functions that address a broad spectrum of network as well as business requirements, from hiring a temporary network engineer to handle short-term projects (staff augmentation) to complex, multiyear outsourcing of all IT services and network support, with or without acquisition of human and network resources.

Outsourcing is also used to describe the practice of offshoring, but actually offshoring is a subset of outsourcing. This paper addresses IT or IT operations outsourcing only. Within this context, Table 1 outlines some primary classifications of outsourcing services.

**Table 1.** Elements of an Outsourcer's "Menu"

Process/Activity	Outsource Assignment
<b>Onsite maintenance</b>	Performs routine onsite like-for-like part replacement only (incident management); may be involved as onsite "hands, eyes, and ears" in complex troubleshooting as part of incident or problem management
<b>Installation</b>	Performs routine installations of configuration items (network elements) under control of customer change manager
<b>Project implementation</b>	Performs complex installation of new technology or service within the scope of a customer project
<b>Help desk</b>	Operates a call center to receive customer calls regarding IT problems; no troubleshooting supported; agent only creates incident report and forwards to IT service or support group
<b>Service desk</b>	Operates help desk function, but adds basic tier 1 assistance to callers according to a customer-designed script
<b>Network monitoring</b>	Monitors customer or vendor network-management systems for alerts and alarms; reacts according to agreed-upon processes
<b>Specific project execution</b>	Provides overall (prime) contract management for a specific project, including acquisition of equipment, integration of multivendor hardware and software into a customer-defined functional device, implementation, operational readiness, initial support (sometimes phasing to tier 2 support or no support as customer expertise matures)

<b>Specific subset of IT management</b>	Provides a range of management services for a specific subset of IT services; for example, security assessments, security services (virus protection, intrusion detection, intrusion prevention, etc.)
<b>Managed LAN interconnect</b>	Provides links (through either Internet or dedicated circuits), usually provisioning and link management—including managed incident response and capacity management of links to interconnect remote customer LANs
<b>Managed Services I</b>	Provides all incident management, change management, and potentially performance, capacity, problem, and service-level management for customer-owned IT resources
<b>Managed Services II</b>	Provides all incident management, change management, and potentially performance, capacity, problem, and service-level management, including acquisition and lease-back of IT resources
<b>Staff augmentation</b>	Provides expert manpower to perform (often on a temporary or project basis) some aspect of IT management—preparation (including training, process development, and other aspects of operational readiness), planning, design, implementation, operations, or optimization

Although the types of outsourcing continue to evolve with the complexity of the IT environment, the factors that accelerate the practice have not changed much over time. In other words, the perspectives regarding IT operations have not evolved at the same pace as new technologies and applications. IT generally continues to be considered an overhead cost item—facilities, finances, etc. However, recent emphasis on increased governance and business realities are beginning to alter that perception. The concept of IT as an enabler of business strategies is gaining acceptance. Four primary outsourcing trends are emerging:

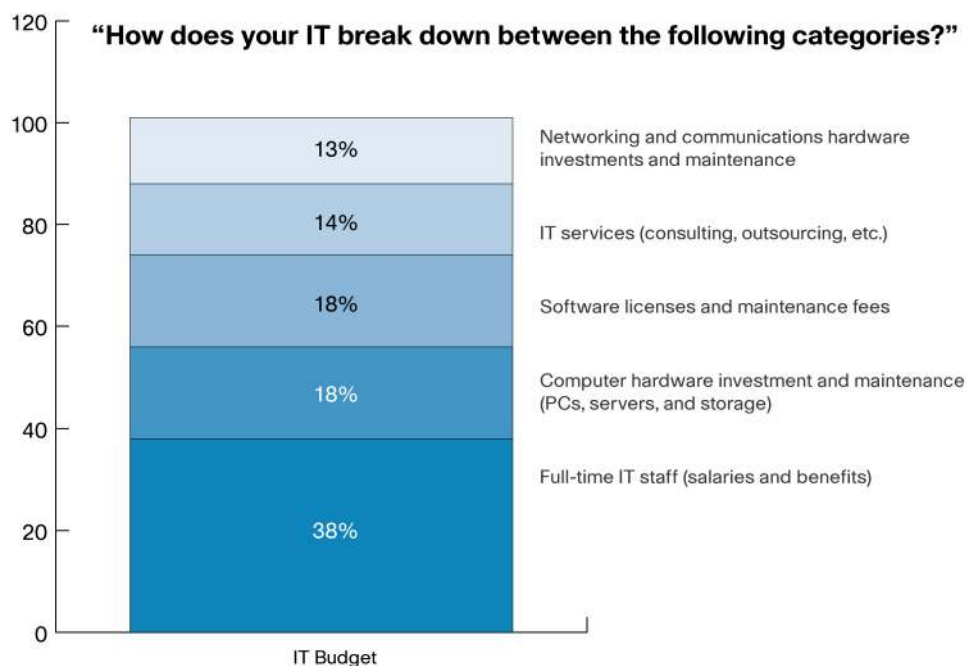
- Sustained momentum for outsourcing IT functions that are not critical to business success or for which the business does not have sufficient competency
- Increased due diligence by companies, resulting in slower IT outsourcing growth
- Lower cost of outsourcing contracts
- Industry consolidation and business-model transformation

These trends affect outsourcing decisions—the way IT operates, makes equipment decisions, and defines its long-term technology and support strategies. They also reflect the realities of any maturing market, so ongoing change will be the norm and continue to affect strategies both regionally and globally.

### Trend 1: Sustained Strong Motivation and Justification for IT Outsourcing

Internal labor costs dominate IT budgets. Forrester Research reports that full-time IT staff numbers vary from 38 percent (Figure 1) to 50 percent of total IT budgets.

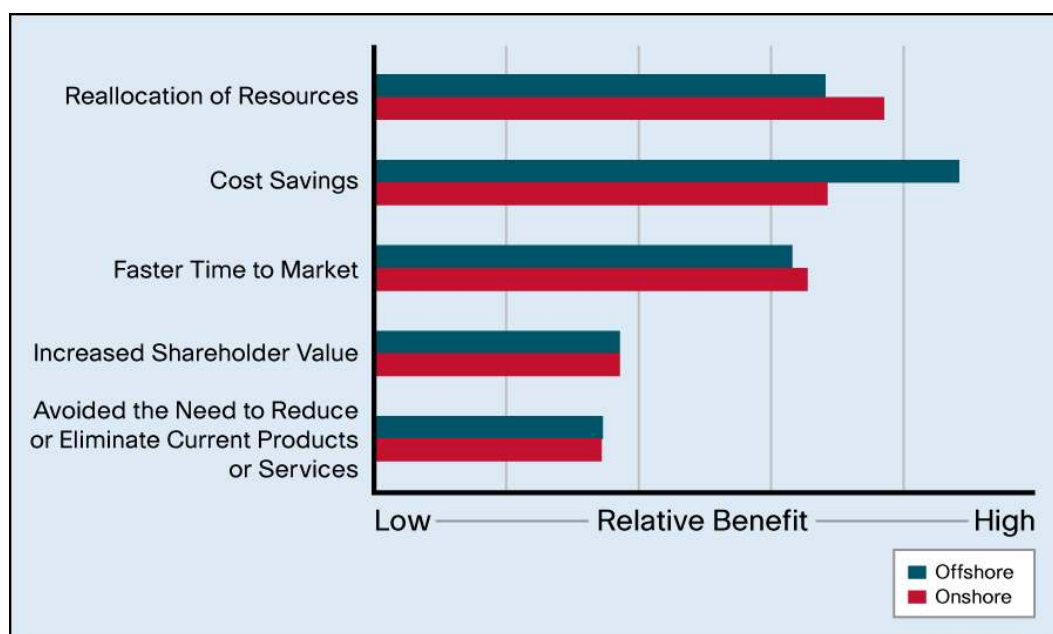
**Figure 1.** IT Budgets



Source: Forrester Research, May 2006

According to a survey conducted by Computer Economics Report in 2006, IT budgets were the highest percentage of the total corporate budgets since 1997 (2 percent). With this trend, the pressure by management to increase validation of IT contribution to overall business and revenue growth has increased, in addition to IT operations visibility and its effect on change business models, competitive differentiation, and profitability.

The primary motivation for outsourcing appears to be cost savings, which can lead to reallocating budgets to higher-priority transformational IT activities and projects. Figure 2 shows the metrics companies use to articulate the benefits of IT outsourcing and increase the perceived value of IT operations efforts and strategies.

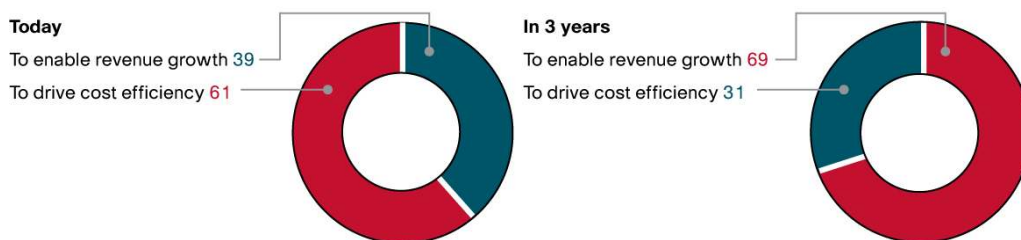
**Figure 2.** Outsourcing Benefits

Source: Diamond Management and Technology Consultants

However, although the primary focus on IT services is on cost savings and organizational efficiencies, evidence shows that this trend is changing. According to an Economist *[that's the magazine, right? If so, italicize here and on the source line in the figure; pls verify the name of the source]]* report sponsored by Cisco, the primary objective for IT is shifting from cost savings to revenue contribution—IT is moving from an infrastructure service center to a critical integrated element with strategic business value (Figure 3).

**Figure 3.** Economist Survey

In your view, what is IT's predominant role today in helping your company to achieve its' strategy goals, and what will it be in three years? (% respondents)



<sup>1</sup> The Economist Intelligence Unit's Business 2010 white paper, produced in 2005 (and sponsored by SAP), highlighted a similar finding. In a global survey of 4,018 executives conducted for the report 50% agreed that IT's primary role in five years's time will be to increase competitive advantage rather than drive cost efficiency. Executive confidence in this development has clearly grown since the Business 2010 study.

Source: Economist Intelligence Unit, Global Technology Forum survey, 2006

Gartner projects that nearly half of Fortune 1000 global enterprises will choose not to own their IT assets in the future, and instead will derive business benefits from shared IT infrastructure utilities owned and operated by service provider hybrids. How and when this will happen is yet to be determined, but until providers change models and perspectives, companies are taking a cautious approach to outsourcing. This approach is resulting in only modest growth, restructuring of contracts, and reassessment of IT service support strategies.

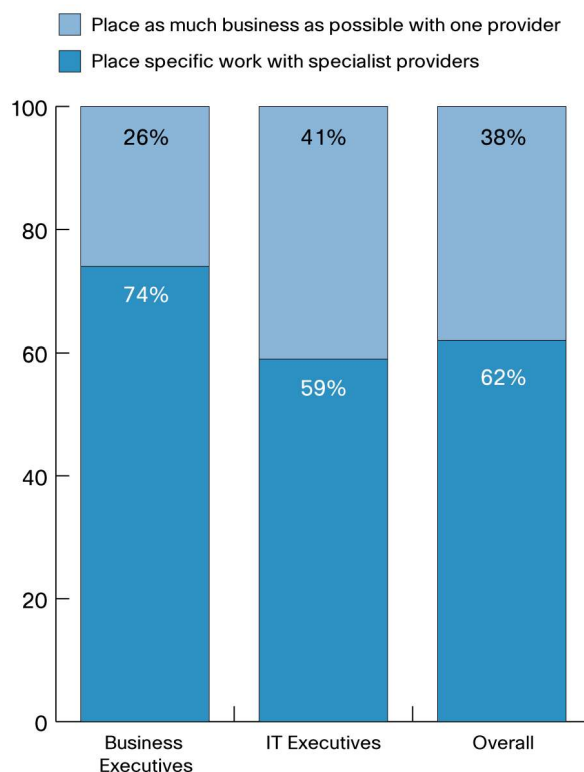
## Trend 2: Slower IT Outsourcing Growth and Smaller Contracts

Although companies appreciate the potential value that outsourcing can bring, they also realize that traditional outsourcing models did not and do not necessarily translate directly into lower costs and optimized profitability. According to Gartner Research year-end predictions for 2007 and beyond, “During the next four years, companies and organizations will flush \$100 billion down the toilet on networking technologies and services that are wrong for their businesses.” Recognizing this trend, companies have terminated or renegotiated many contracts prior to their expiration—clear indication that companies are getting savvier about their resources and outsourcing strategies and questioning many historic assumptions. More than 60 percent of outsourcing revenue in 2006 was directly associated with contract restructuring vs. new contracts. In addition, according to Forrester Research, more than \$100 billion worth of existing contracts is expiring by the end of 2008.

One of the traditional strategies that providers used that led to this situation was to create a rigid “take it or leave it” IT service offering. Although this model worked in an era of limited expertise and immature technology-adoption cycles, it is increasingly obvious that it was slanted in the provider’s favor. Today, however, many more companies are competing for business, company and enterprise expertise has increased, and adoption cycles of ever-increasing sophistication and demanding applications have dramatically accelerated. To address this need, customers are adopting best-of-class outsourcing strategies, resulting in contracts with multiple specialized providers rather than a single large generalist (Figure 4).

**Figure 4.** Approaches to Outsourcing

**“Which of the following most closely describes your firm’s preferred approach to outsourcing?”**



Source: Forrester Research, May 2006

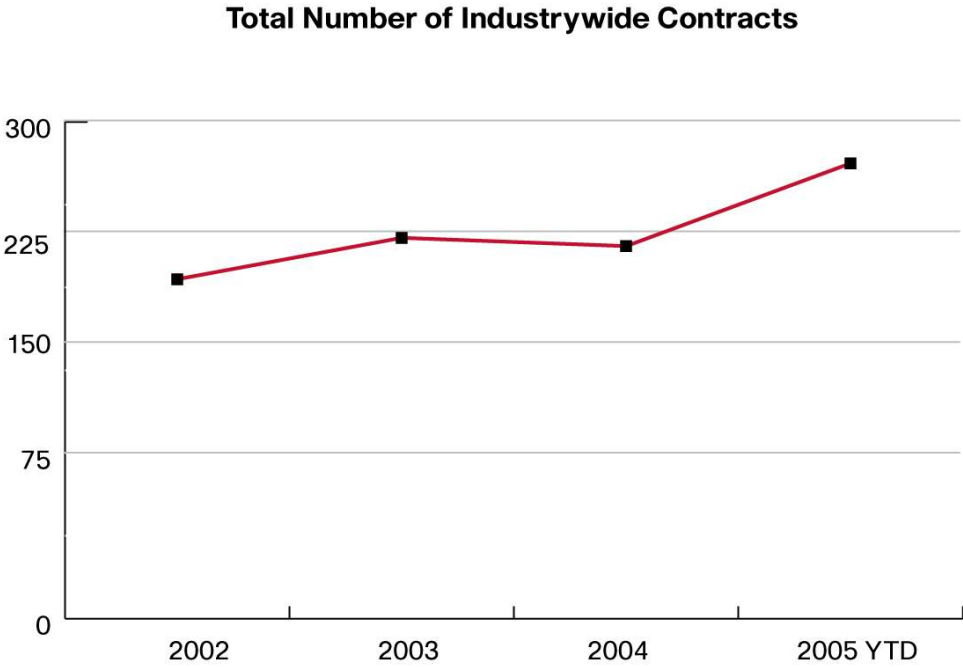
This trend has resulted in significant pressure to decrease contract size and complexity, while the number of contracts is increasing based on the leading practice and multivendor strategy (Figures 5 and 6).

**Figure 5.** Average Total Contract Value Relative to Cost [[ok?]]



Source: Technology Partners International

**Figure 6.** Number of Industry wide Contracts [[ok?]]



Base: Global industrywide outsourcing contracts with a total contract value greater than \$50 million

Source: Technology Partners International

### **Trend 3: Consolidation and Business-Model Transformation**

The trend for smaller, lower-priced service contracts is counter to the traditional provider model of large, vague contracts that minimized risk and maximized profits for providers. This situation in turn was counter to the customer goal of reducing risk and lowering overall IT program costs. Realizing that their future looks ever more challenging, providers have begun to find ways to gain specialized expertise as well as access to lower-cost labor sources. In addition, they have begun to expand their customer base beyond tier 1 customers to the small and medium-sized business (SMB) and emerging business markets. In a report published in April 2006, Forrester Research reported that over the previous 4 years, 11 of the top IT service providers had completed 72 acquisitions of infrastructure management providers, totaling more than \$17B. Clearly consolidation and retooling of business models is ongoing, but additional factors are imposing change on outsourcing and servicing providers.

Another trend disrupting outsource service provider models is the commoditization of domain-specific monitoring with embedded platform and system intelligence. Domain monitoring for availability and performance was once a prime profit center for the leading providers, but the maturing of embedded intelligence in IT platforms as well as the availability of open-source tools is beginning to threaten the proprietary territory these vendors once enjoyed. As this process continues, pure service vendors will need to shift their focus to the development of application and service software capabilities such as cost-effective Configuration Management Database (CMDB) solutions to address the Business System Management (BSM) area.

The commoditization of management tools and processes is also reflected in the rise of industry operational best practices evidenced by recent traction of programs such as the IT Infrastructure Library (ITIL). Increased adoption of the ITIL by corporations and certified IT professionals is equalizing the business domain with a common database of processes, frameworks, and procedures that help standardize IT knowledge and improve IT operational excellence.

Gartner Dataquest summarizes this trend: “Even mission-critical services have become commodities, and customization is giving way to an ‘80 percent is good enough’ standard for service offerings designed for the shared environment.”

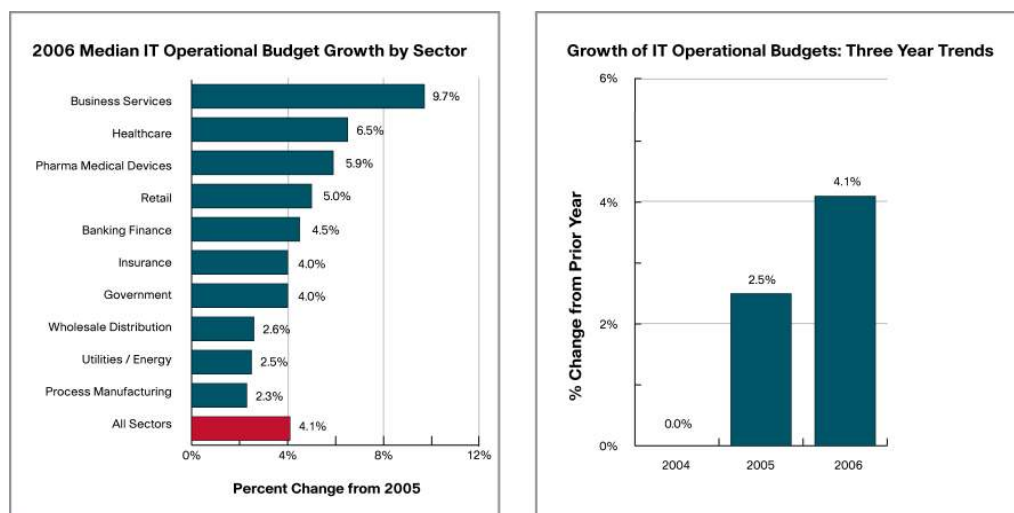


## Industry Effect and Reference Points

### IT Budgets

According to Computer Economics Report, research indicates that budgets are growing, but only slightly. The journal further clarifies that growth of IT operational budgets varies from market to market (Figure 7).

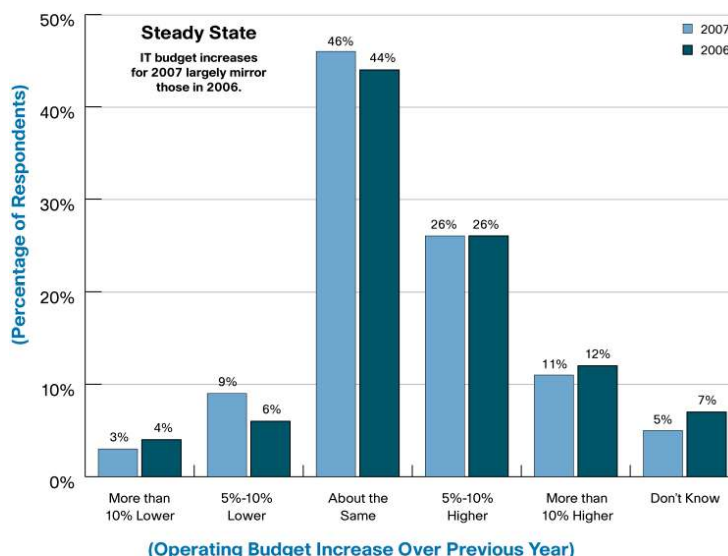
**Figure 7.** Projected Outsourcing Growth by Sector and Year



Source: *Computer Economics*, 2006

Based on a study, CIO Decisions magazine summarized the IT operational budget forecast as follows: “Meanwhile, nearly half of survey respondents say their operational and capital budgets will hardly budge in 2007—the same percentage citing no IT budget growth in 2006. But there is good news as well: A nearly equal number of respondents say these budgets were going to grow by more than 5%” (Figure 8).

**Figure 8.** IT Budget Forecast by CIO Decisions Magazine

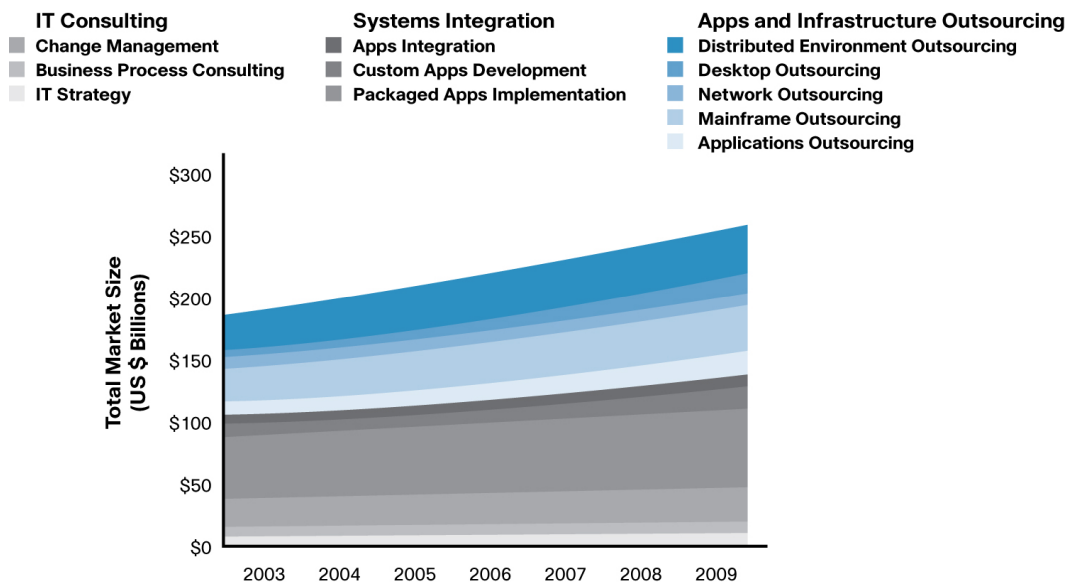


Source: CIO Decisions magazine, Sept. 2006

### IT Service Outsourcing Budgets

Gartner Group estimates that the value of IT outsourcing is on an upward trend, from \$145.7B in 2004 to \$250B in 2009 being estimated for the United States alone. Gartner goes on to emphasize that double-digit growth rates of the 1990's for IT management outsourcing has stabilized at about 6.6 percent (Figure 9).

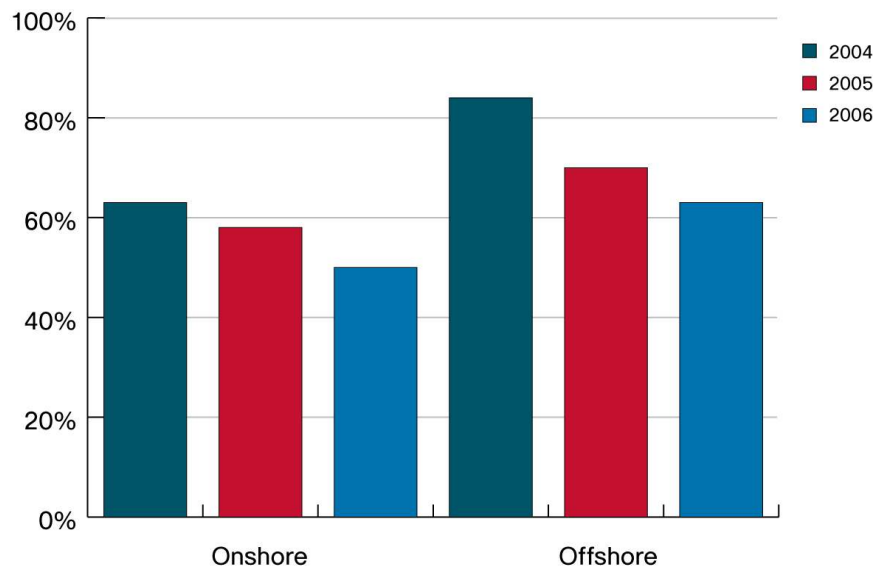
**Figure 9.** Growth Rates of Outsourcing



Source: Gartner Group

But while total budget and IT outsourcing markets are growing, the amounts individual companies are investing in outsourcing is declining—further evidence that contracts are being scrutinized and reduced in size, scope, or cost-per-managed unit (or all). Figure 10 highlights this trend; it summarizes part of a study done by Diamond Management & Technology Consultants, Inc.

**Figure 10.** Buyer Plans to Increase Outsourcing Investment



Source: Diamond Management and Technology Consultants

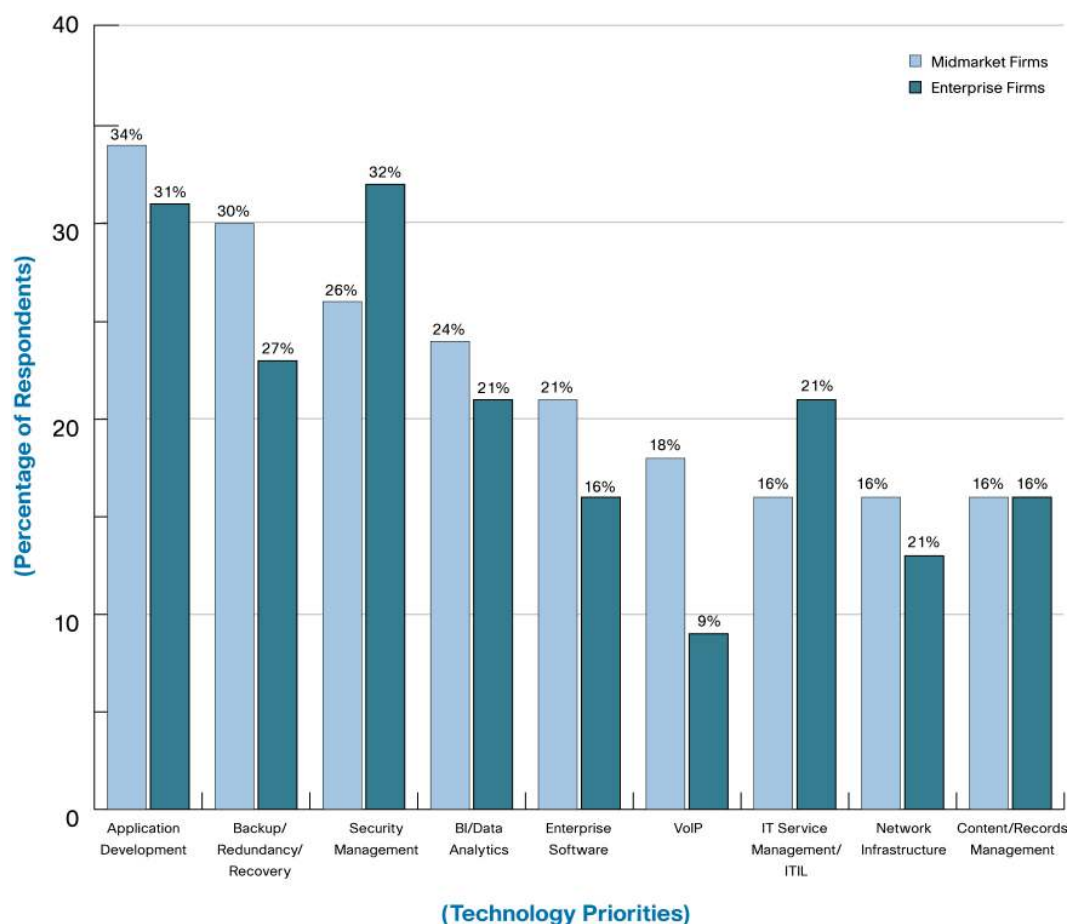
### IT Service Vendors

Although a multitude of service vendors are in the market, BMC, HP, CA, EDS, and IBM are considered the true global leaders, with portfolios to address technical and business-management requirements. Another group of vendors, including Capgemini, Infosys, etc., are strong contenders with robust portfolios, but they present a more regional or technology-specific focus. Still others have even more granular focus on specific technologies, functions, services, or regions.

### Corporate Technical Priorities

According to CIO Decision magazine as part of a yearly report conducted in September 2006, the picture for 2007 technical priorities is similar to that of 2006. It is interesting to note that backup, redundancy, and recovery are second only to application development, with security management in third (Figure 11).

**Figure 11.** Parallel Tech Priorities: Large and Midsize Companies Have Similar Technology Priorities for 2007, with Voice over Internet Protocol a Notable Exception



N = 318; \*Respondents chose top three priorities from a list of 21 possible responses. CIO Decision magazine, Sept. 2006

## Where Do We Go from Here?

This data indicates that the decision to outsource is complex and requires a substantial amount of planning and research to ensure a successful outcome. In addition, with the increased reliance on IT as a strategic business tool, IT outsourcing decisions will certainly affect not only cost savings but also the ability to run a business and sustain a positive public image. As part of this process, companies need to understand the facets of an outsourcing decision to properly align it with their business and IT operational strategies. They need to establish a decision framework that they can apply to IT outsourcing and build a solution roadmap based on business and financial requirements. To define and implement a successful outsourcing program, companies should address five primary elements:

- Vendor-selection criteria: Which vendor has the best solution for specific business requirements?
- Business strategies: Where and how is IT a critical component of the business, and which vendor best fits that model?
- Current network and operations analysis and benchmarking: Where are we, where do we want to go, and how do we get there?
- Return on investment (ROI) and operating expenses (OpEx): What are the true costs of running the network and delivering services, and how do they translate into profitability and revenue growth?
- Outsourcing management oversight: What are the appropriate monitoring and governance strategies needed for optimized impact

### Vendor-Selection Criteria

Like technologies, IT outsourcing vendors have evolved with market needs and requirements. Vendors have realized that companies are no longer looking for a single vendor to do everything but are instead looking for best-of-class capability to address specific projects, programs, or services. As a result, the ongoing trend is toward consolidation of outsourcing vendors as they acquire specialist companies to create portfolios of services. But in spite of this consolidation, the number of vendors has increased dramatically, reflecting the increased demand for specialization and diversification. As a result, it is more challenging than ever to identify the right vendor for the job, and it is more important than ever for IT organizations to clearly understand their current requirements and capabilities to be able to identify the suppliers that best align with their needs. It is also critical that companies clearly identify areas they believe are core to their business. They must evaluate outsourcing strategies when company core intellectual capital and expertise are involved to ensure long-term company viability is not sacrificed for short-term expediency.

Because companies are increasingly dependent on their IT infrastructure, they must ensure that the vendors of choice have the right mix of knowledge, skills, technology, and best-practice processes and that these capabilities are complementary to internal strengths. Time spent in training vendors, defining and negotiating service-level agreements (SLAs), building appropriate governance capability, and selection and implementation of tools is a significant overhead investment that needs to be clarified and agreed to by both parties. Carefully defined vendor criteria and selection process could save hundreds of thousands of dollars or more over the life of the contract. As a result, a baselining of targeted vendor qualifications is critical to quickly eliminate any undesirable candidates and determine the best-in-class capabilities that align with current and long-term company requirements. Selection criteria for each company will be different,

so it is necessary to establish a decision framework around a company's unique business goals, existing organizational maturity, best-practice alignment, and culture.

For some companies the goal may be to simplify increasingly complex operational management. In those cases a single multiservice vendor may be the optimal solution. In other cases, a vendor specializing in voice over IP (VoIP), video, or unified communications may provide the best solution, especially if an organization recognizes a deficit in internal skill or knowledge. However, in either case the value and performance vision needs to be clearly defined and communicated to the internal IT organization, vendor management, and outsourcing vendor. All stakeholders should clearly understand the decision context and the way in which long-term success will be defined and assessed.

Considerations for vendor selection include:

- Specific market, application, or technology experience
- Staff size and skill levels
- Customer references
- Aligned network architecture or management structure
- Compatible or aligned monitoring and reporting tools
- Accessibility to IT management data
- Documented policies, processes, procedures, work instructions, and templates
- Alignment with industry best practices and standards; for example, ITIL, ISO2000, eTOM, etc.
- Sophistication of internal outsourcing governance infrastructure

### **Business Strategy and Vision**

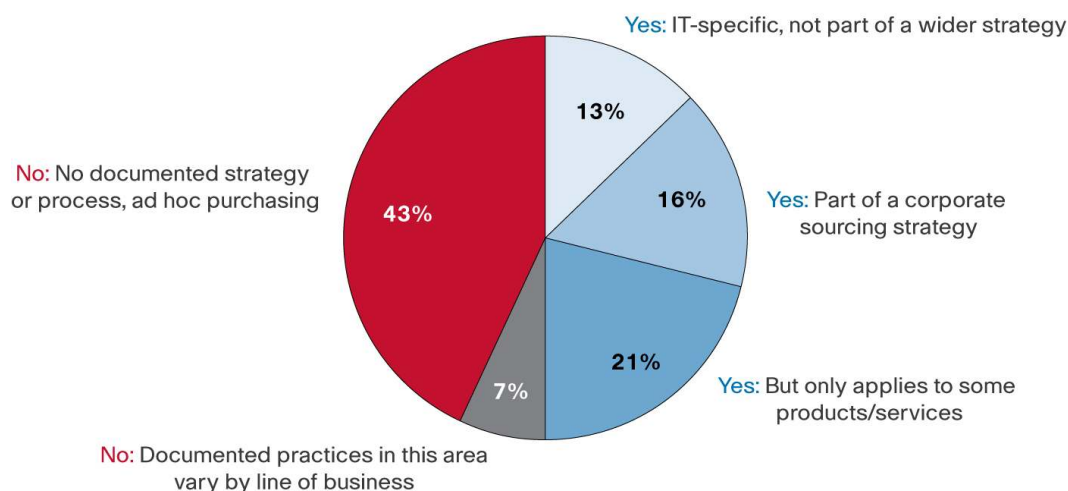
The Lewis Carroll quote, "If you don't know where your going, any road will get you there", is applicable in many situations in pointing out the value of planning and clarifying goals and objectives. As a foundational step in building the right mix of internal and external support infrastructure, it is critical to align IT operational processes and systems with business goals and objectives. Only then can appropriate performance metrics be established that will provide guidance in determining the best IT support strategy and measurement of value—likewise with IT outsourcing strategy. Clarity of objectives and goals is critical to determine the best vendor as well as measure performance over time with respect to specific performance metrics. For many organizations, the alignment of IT with business strategies is neither fully understood nor implemented, creating a gap between IT strategies and performance and the awareness of how it is transforming business and influencing innovation.

Although clearly defined strategy and vision have always been a critical success factor for corporations, the need to translate those factors into meaningful IT terms has not. Early IT infrastructure generally was all about speeds, feeds, and connectivity, with little thought of the effect of IT on profitability and revenue growth. This situation tended to translate into fairly flat IT organizations with rigid roles and responsibilities, fragmented (versus integrated) functions, and limited performance criteria. Today, however, with the increased dependence on IT for the enablement of most if not all business functions, the picture is different. Business and IT strategies in this environment must be completely aligned and fine-tuned to accommodate the increased contribution and value of IT to overall company success.

IT outsourcing, like all other corporate activities, must be able to validate its value and performance through tracking and measurement programs. But the ability to develop an IT outsourcing strategy—let alone a metrics program—that is aligned with overall company objectives seems to be elusive at best. The results of a study done by Giga Information systems are illuminating (Figure 12).

**Figure 12.** Giga Sourcing Strategy Survey

### Do you have a corporate sourcing strategy that governs purchase of IT goods and services?



Source: Giga Information Group

According to this study, 43 percent of companies have no documented strategy for outsource purchasing, and no one has a fully functional outsourcing strategy. This general lack of focus on this subject highlights the need to increase efforts if outsourcing costs are to be minimized and value optimized.

Another critical area of outsourcing strategy is flexibility. Most outsourcing contracts are static by design. Specific services are contracted with a specific timeframe defined. It is critical that contracts are flexible enough to allow adjustments based on dynamic real-world business, network, and organizational environments.

#### Best-Practice Usage and Benchmarking

Outsourcing priorities are impossible to establish without first prioritizing outsourcing alternatives, and outsourcing alternatives cannot be defined without objective assessment of internal capabilities, requirements, performance, and gaps in the context of business strategies and objectives. These principles are foundational to developing a program that is manageable and measurable against defined metrics and expectations. To build a set of metrics that can be used in this process, it is critical to establish a thorough understanding of existing operational capability against industry best practices. When these metrics are set and a history of performance has been documented, gaps will begin to appear that provide guidance in defining what elements could benefit from outsourcing as well as what areas must be improved and invested in to build internal capability. It is also important to understand that the same principles that govern an internal IT operational program also apply to the vendor, so companies should not be shy in asking—and in

fact should expect—that outsourcing vendors verify their performance against these same industry best practices and performance. But even here the concerns are not always clear and vendors are not necessarily forthcoming in their commitment to performance monitoring.

One area of possible confusion involves the subject of what parameters are critical to measure and benchmark to build a cohesive three-dimensional view of a company's IT operational maturity. In the past views have varied on the subject, but increasingly experts agree that the ITIL provides the best enterprise framework for this activity. One advantage of the ITIL framework is that it is the standard to which most organizations align their IT activities, so ample data is available for comparisons. In addition, the ITIL framework is flexible enough to adapt to specific markets, regions, or industries and facilitates construction of a program aligned with a company's unique needs. And finally, the ITIL provides a list of key performance indicators (KPIs) associated with each process that can be used as a guideline in understanding existing maturity levels. KPIs and the trends they reveal can be used for fine-tuning programs and to ensure compliance with basic principles and performance criteria. The major elements of ITIL include: service desk, incident management, problem management, release management, change management, configuration management, continuity management, availability management, security management, financial management, capacity management, and service management. Although these processes form the foundation for an ITIL-based IT operations function, they represent a framework rather than a definitive set of processes, so each company must decide which ones will most significantly affect performance and how each should be designed and implemented.

### **Return on Investment versus Operational Expense**

Obviously most companies know how much they have budgeted for their IT program based on line-item amounts, but these expenditures may not be tied to or easily associated with contribution to business objectives or prioritized based on value. The challenge comes in attempting to map these expenditures to actual value in contribution to achieving company revenue and performance targets. By basing plans on a strategic perspective versus tactical elements and line-item expenditures, companies will be able to establish programs that reflect true lifecycle costs and value against overall company performance. IT cost and influencing elements should include:

- Network outages
- Limited application availability
- Delay in introduction of new services due to aging infrastructure
- Failures of service or implementations due to lack of IT operational discipline
- Lack of automation
- Lack of operation and organizational alignment
- Costs associated with measuring and monitoring

All of these factors represent risk to a company's ability to manage and control costs and should be analyzed and benchmarked against industry best practices to reveal weaknesses and strengths. Based on this analysis, outsourcing strategies can be established that provide the value where and when a company needs it, along with appropriate cost and value targets as a foundational step in the outsourcing process. Likewise, an evaluation of internal capabilities to perform IT functions that are critical to business success is necessary in developing required expertise in functions and technologies that will be supported internally and not outsourced.



Although cost savings is a primary goal of outsourcing, realizing those savings is not easy. In a study done by KPMG in 2007, 79 percent of the more than 650 organizations surveyed did not know the cost of the vendor-selection process, let alone the cost of managing ongoing outsourcing programs. With 80 percent of companies taking at least 9 months to make these decisions, costs could be substantial—especially in light of the fact that a large portion of the resulting relationships will be unsuccessful. As referenced earlier, corporations will lose more than \$100B in outsourcing between 2006 and 2010. The context of this projection is that outsourcing alone is never a panacea for cost savings. Outsourcing contracts must be accompanied by appropriate levels of expertise, negotiating skills, dedicated resources, analysis of internal maturity levels, and tightly managed SLA programs with clearly defined roles and responsibilities. Too many times outsourcing results in simply transferring budget money from one department to another with no actual savings—and many times increased expenses. To properly execute outsourcing programs and optimize the financial rewards of those programs, foundational elements need to be in place from day one. As a requirement for building an outsourcing program that optimizes real cost savings with reciprocal alignment with business objectives and productivity, companies must:

- Conduct careful analysis of existing infrastructure, operations, and staffing levels against associated business goals and value
- Align outsource strategy with validated provider operational expertise and capability
- Ensure appropriate staffing to provide vendor selection, oversight, and management
- Negotiate a contract with flexibility but clearly defined SLAs and responsibilities

### **Outsourcing Management Oversight: IT Metrics Framework**

Not every organization has the skills, commitment, or organizational structure to properly manage or achieve optimum results in an outsourcing program. A CIO Insight survey published in March 2007 entitled “I.T. Outsourcing: Expect the Unexpected” points out that, “The inability to effectively supervise vendors is the single biggest reason outsourcing fails.” As mentioned previously, early outsourcing programs were characterized by large, unwieldy arrangements that companies were largely unprepared to manage or properly monitor. This situation occurred because companies assumed that the IT function was not necessarily critical to the company strategy or profitability. Companies considered IT an overhead expense that was better left to outside experts who understood the technology and could reduce costs. Outsourcing was used as a relief valve that could be used when frustration levels grew too great, network outages became too frequent, or costs appeared to be out of control. Although the dynamics of IT management were not very well-understood, this lack of understanding was only surpassed by an industrywide lack of ability to properly qualify and manage outsourcing vendors. This early period was characterized by large, multiyear contracts with vendors in control and taking advantage of the lack of customer oversight. Results included increased dependence, loss of core competencies, and failure to meet overall business goals. A dramatic turn resulted when companies realized that their business and strategies were increasingly reliant on IT technology, their outsourcing vendors, and the lack of performance. With this revelation, many companies have begun to take back control of many critical technologies or services and regain their ability to properly manage IT programs, but this time with a renewed sense of purpose, focus, and direction. For outsourcing vendors this situation translates into smaller, narrower-focused contracts combined with best-of-class vendor-selection criteria. But even with skills and expertise back in house, the unique skills and knowledge required to manage vendors and large projects continues to be a serious challenge for companies.

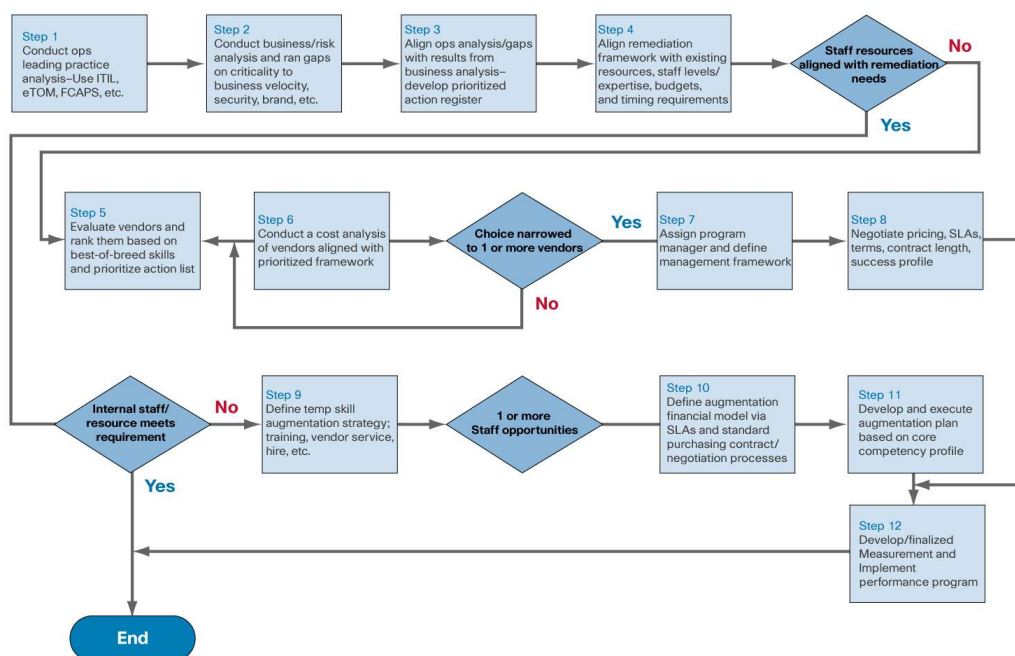


The projection that \$100B will be wasted over the next few years attributes that waste to a failure to have the appropriate IT management skills, lack of definitive metric and measurement programs, and organization structures that are detrimental to outsourcing success. Many companies assume that existing IT personnel can handle the outsourcing function because the vendor will address many of the tasks that they were doing. Another common approach is to have the purchasing department provide oversight because it probably negotiated the contract. Both of these approaches are suboptimal because vendor management requires both negotiating and project-management skills as well as the technical skills and insights of the network engineering teams. What is needed is a unique combination of technical and program-management proficiency, IT operational expertise, and business acumen that allows the IT strategy and outsourcing capability to be molded into a powerful transformational tool. Certification of internal vendor management teams in ITIL, PMP, ISO20000, or programs such as PRINCE2 along with a high degree of technical knowledge are critical to giving companies the ability to build, manage, and monitor outsourcing programs with optimal results.

## Conclusion

An overall, comprehensive plan is the only sure way to minimize the risk presented by the many outsourcing pitfalls. Figure 13 summarizes the approach proposed in this paper.

**Figure 13.** High-Level Outsourcing Decision Flow



Outsourcing companies and their vendors face a growing number of challenges. Vendors increasingly need to rapidly adapt business models to changing technologies, services, and customer sophistication. Customers, on the other hand, must increase technical knowledge, IT operational expertise, and program-management capability. Vendors have begun to focus on smaller, shorter-term projects, and major vendors have launched acquisition strategies to acquire unique capabilities for specific services, technologies, or regional markets. ITIL certifications have dramatically increased over the last few years, and ITILv3 has just been introduced. ITILv2 focused on vocabulary alignment and process definition, whereas v3 focuses on alignment of

these processes with business strategies and corporate objectives. Companies are also continuing to converge their various network needs and service requirements into uniform, homogeneous structures that are integrated with business requirements instead of an afterthought. Initiatives such as the Cisco® Service-Oriented Network Architecture (SONA) for the enterprise market and next-generation networks (NGNs) for service providers are targeted at reconciling technology and business strategies and transforming markets, industries, and customer experiences with personalized, highly reliable, and flexible information and communication structures. But whatever the IT architecture, program, or standard, the evolution of outsourcing will continue to change. The success of companies and vendors is linked, so they must continue to work together to find mutually beneficial policies and service portfolios that together deliver the network performance and reliability that assure users access to any service, anytime, any place, to any device.

Critical for companies planning to outsource is establishing a complete understanding of their existing IT capabilities, resources, performance, and business priorities. They can then align this knowledge with outsourcing vendor portfolios and abilities to create a decision framework focused on transforming IT technology into what Forrester Research calls “Business Technology”. As part of this process, companies must increase their understanding of the outsourcing industry, vendors, and program alternatives in order to establish a best-of-class approach focused on delivering optimal value. In addition, they must abandon perspectives, attitudes, and policies developed in the mainframe era. Key to this process is understanding the company’s limitations, strengths, and gaps and embracing the transformational power of business-based IT methodologies. Also, as a fundamental part of an outsourcing strategy, enterprises must realize that an outsourcing program will be only as successful as the enterprise’s commitment to properly manage and monitor the program. A failure to take this lifecycle approach to planning, designing, and implementing an outsourcing program will seriously jeopardize program success. By establishing a program based on these comprehensive policies and principals, companies will be able to take full advantage of outsourcing to enhance their ability to adopt new technologies, increase customer satisfaction, and transform business models to achieve new levels of profitability and competitive differentiation.

**Sources:**

- Aberdeen Group: Outsourcing IT Infrastructure: The Productivity Payoff, March 2007
- Gartner: Gartner’s Top Predictions for Industry Leaders, 2007 and Beyond, December 2006
- Diamond Management and Technology Consultants, Inc.: 2006 Global IT Outsourcing Study, Tom Weakland and Brian Tumposky
- Economist Intelligence Unit: Global Technology Forum Survey, 2006
- KPMG: Strategic evolution—A global survey on sourcing today, April 2007
- IT Sourcing Process, Mike Dodd and William Martorelli, January 2003
- CIO Insight—I.T. Outsourcing: Expect the Unexpected, by Allan E. Alter, March 7, 2007



**Americas Headquarters**  
Cisco Systems, Inc.  
San Jose, CA

**Asia Pacific Headquarters**  
Cisco Systems (USA) Pte. Ltd.  
Singapore

**Europe Headquarters**  
Cisco Systems International BV  
Amsterdam, The Netherlands

Cisco has more than 200 offices worldwide. Addresses, phone numbers, and fax numbers are listed on the Cisco Website at [www.cisco.com/go/offices](http://www.cisco.com/go/offices).

CCDE, CCENT, Cisco Eos, Cisco Lumin, Cisco Nexus, Cisco StadiumVision, the Cisco logo, DCE, and Welcome to the Human Network are trademarks.; Changing the Way We Work, Live, Play, and Learn is a service mark; and Access Registrar, Aironet, AsyncOS, Bringing the Meeting To You, Catalyst, CCDA, CCDP, CCIE, CCIP, CCNA, CCNP, CCSP, CCVP, Cisco, the Cisco Certified Internetwork Expert logo, Cisco IOS, Cisco Press, Cisco Systems, Cisco Systems Capital, the Cisco Systems logo, Cisco Unity, Collaboration Without Limitation, EtherFast, EtherSwitch, Event Center, Fast Step, Follow Me Browsing, FormShare, GigaDrive, HomeLink, Internet Quotient, IOS, iPhone, iQ Expertise, the iQ logo, iQ Net Readiness Scorecard, iQuick Study, IronPort, the IronPort logo, LightStream, Linksys, MediaTone, MeetingPlace, MGX, Networkers, Networking Academy, Network Registrar, PCNow, PIX, PowerPanels, ProConnect, ScriptShare, SenderBase, SMARTnet, Spectrum Expert, StackWise, The Fastest Way to Increase Your Internet Quotient, TransPath, WebEx, and the WebEx logo are registered trademarks of Cisco Systems, Inc. and/or its affiliates in the United States and certain other countries.

All other trademarks mentioned in this document or Website are the property of their respective owners. The use of the word partner does not imply a partnership relationship between Cisco and any other company. (0805R)