OVERVIEW

Strategic Out-Tasking
A New Model for Outsourcing

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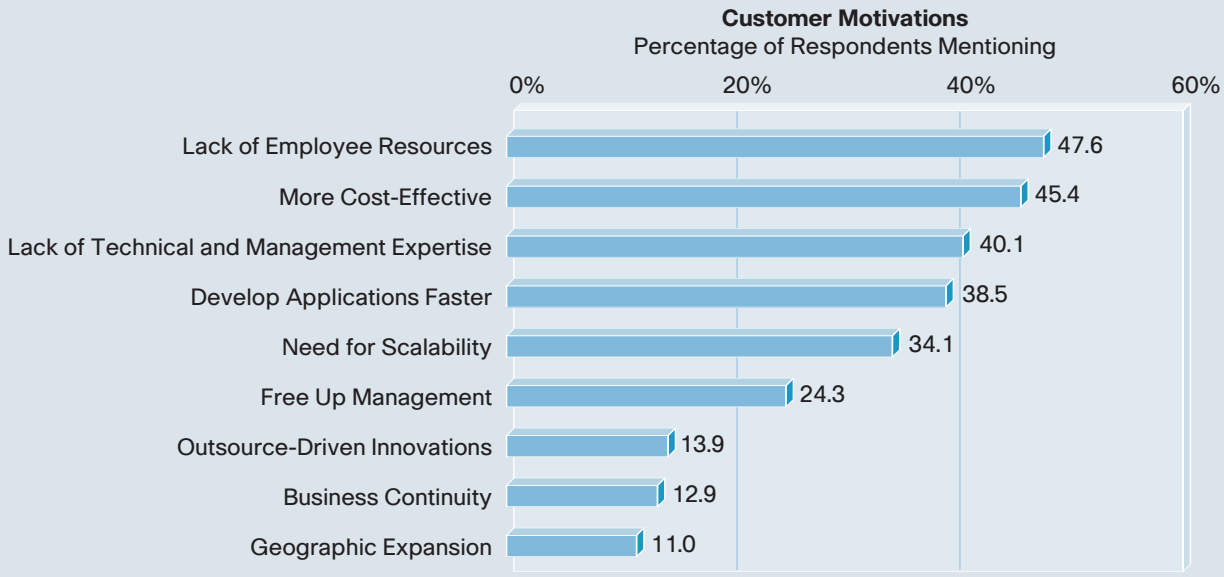
Section I: The Need for a New Outsourcing Model

IT outsourcing is a US$244 billion global industry with an impressive 7 percent annual growth rate.[1] The 2005 Cisco® Enterprise CIO Survey found that more than one-third of surveyed enterprises currently outsource at least 25 percent of their IT budget, and more than 60 percent of survey respondents expect a greater than 5 percent increase in their outsourcing over the next three to five years.[2]

The drivers for IT outsourcing are compelling (Figure 1). For example, often enterprises lack the in-house resources and expertise to keep pace with evolving customer demands. In addition, once freed from the distraction of managing large volumes of routine IT transactions, enterprises can focus their own resources on technological innovation to deliver better value to their customers.

FIGURE 1

Drivers for Outsourcing



Source: *CIO Insight* magazine, OUTSOURCING Survey, November 2003

[1]Gartner, Inc., 2005
[2]Source: Cisco Enterprise CIO Survey, 2005

Next to acquiring needed resources quickly, cost is the primary driver for outsourcing. Outsourcers spread the costs of infrastructure, technology, and personnel across many enterprises. Through such economies of scale and additional service efficiencies from the outsourcer's use of technology-enabled best practices, enterprises hope to cut costs by more than 15 percent[3]. Not surprisingly, then, IT outsourcing contracts are most often structured to achieve maximum cost reduction, and require outsourcers to stay focused on cost-cutting goals. Outsourcers may buy an enterprise's assets, transfer the enterprise's employees to their payroll, and agree to strict service-level agreements (SLAs) to establish performance levels.

Enterprises and outsourcers generally structure broad and long outsourcing contracts. Enterprises gain predictable pricing for IT services, while outsourcers gain more control over their operational risks. Two-thirds of outsourcing contracts are structured as five- to 10-year agreements, giving outsourcers the time they need to recover upfront investments in assets, people, and reorganization[4]. Longer-term contracts also secure cash flows and may "lock in" the customer for future contract renewals.

Today's Model Is Flawed

Despite cost-cutting successes, the current outsourcing model forces enterprises and outsourcers to accept a significant compromise. Contracts impose endless tradeoffs between enterprise desires for flexibility, innovation, and business-driven SLAs, and outsourcers' need to avoid cost overruns and SLA penalties. Neither party wins.

For one thing, traditional, long-term contracts can reduce an enterprise's flexibility. A seven-year contract initiated in 1995, for example, is unlikely to have taken Internet solutions and associated productivity improvements into account. Enterprises must continually adapt and evolve to keep pace with market shifts and changing business and customer needs. However, long-term contracts can risk an enterprise's competitive edge, and perhaps its very survival.

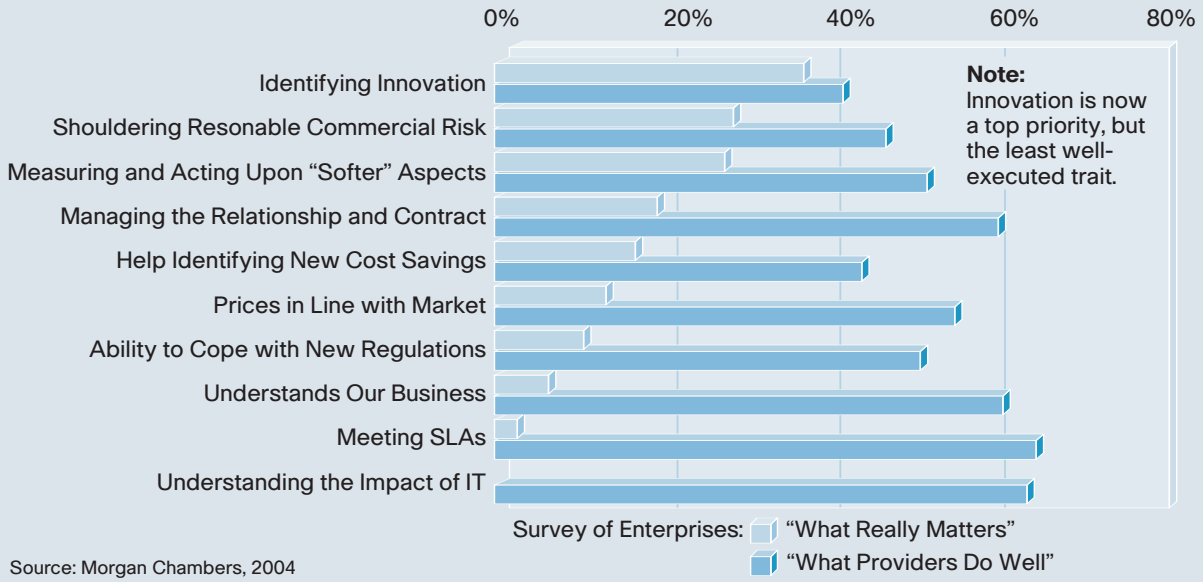
Innovation also suffers under the current model. Forty percent of respondents to the 2005 Cisco Enterprise CIO Survey said they felt that innovation had either stayed the same or had declined since they began to outsource. Similarly, Morgan Chambers, a leading European outsourcing advisor, found that while innovation ranks first in importance to enterprises, it ranks last in what providers do well (Figure 2).

The importance enterprises assign to innovation today stands in marked contrast to its minor ranking as an outsourcing driver by *CIO Insight* magazine's 2003 OUTSOURCING Survey, shown in Figure 1. The reason is thus: while enterprises fall into the trap of buying based on cost, several years into the contract they realize that they "got what they paid for"—an outsourcer focused on cutting costs rather than innovation. Enterprises must actually accelerate their innovation rate to succeed in today's global business environment, but traditional outsourcing contracts specify precise service parameters and penalize enterprises for major changes with high-cost change orders or contract renegotiation.

[3]Gartner, Inc., 2003
[4]IDC, 2004

FIGURE 2

Growing Innovation Gap in Outsourcing



Source: Morgan Chambers, 2004

For instance, traditional desktop outsourcing contracts often need significant restructuring to support new mobile devices such as PDAs and mobile PCs, often restraining their rollout and adoption. This can be especially frustrating in environments such as hospitals and logistics centers, where LAN-based wireless solutions offer greater flexibility to their mobile workforce than traditional desktop solutions, but with comparable (or even superior) price-performance. And innovations, especially those that result in technological shifts, tend to be disruptive in nature. Thus, for example, when one of Cisco's high-tech manufacturing customers wanted to migrate to a next-generation converged IP telephony infrastructure, it faced a significant migration premium. To keep costs low, the customer's outsourcer had previously negotiated a slower upgrade schedule into the contract.

The demand for innovation is building steadily as enterprises gain experience and "hard knocks" on their first forays into major IT outsourcing.

For their part, outsourcers suffer their own troubles even when they do exactly what is asked of them: they often end up managing an enterprise's "IT mess for less." Deals priced to win, low margins, and aggressive cost curves have placed outsourcers on a performance treadmill. The market remains fragmented, yet competition is only increasing. With contracts of $1 billion or more at stake, enterprises have tremendous negotiating power: to win business, outsourcers are forced to commit to aggressive cost reduction. SLA penalties due to the enterprise's own broken service delivery processes only add to cost concerns. And because outsourcers must tailor services to each enterprise's, and even department's, unique needs and conditions, they find it difficult to realize the economies of scale and reduced management expenses that they counted on when pricing the contract.

The Imperative for Change Is Growing

Although enterprises and outsourcers are not happy with their current arrangements, outsourcing is likely to accelerate in the coming years. Enterprises will continue to find the value propositions of guaranteed cost reduction and access to skills and capital very compelling. By transitioning current fixed costs into variable expenses, enterprises could more easily "dial up" or "dial down" their third-party services, greatly increasing their ability to respond to changing customer and industry conditions. And, for their part, outsourcers will continue to be lured by "locked-in" five- to seven-year revenue streams. Outsourcers are now expanding the breadth of their offerings: they are moving beyond traditional IT functions into business processes such as HR, finance, and customer care. In fact, business process outsourcing is the fastest-growing services segment. By 2008, it is projected to be a $131 billion industry.[5]

Even as their commitment to outsourcing increases, enterprises and outsourcers remain concerned that today's arrangements will become untenable in the future and, worse, may even unravel—not unlike some of the well-publicized contractual fallouts. Innovation and flexibility in core business processes are critical for any successful business, and the limits of the current outsourcing model will only grow more apparent. A new model—one that promises a more mutually profitable and lasting partnership—must now replace the old.

Mutual Investment Is the Key

We believe that enterprises and outsourcers must change the way they outsource. Under the current model, enterprises will not achieve cost savings and innovation, nor will outsourcers secure new contracts and higher margins. This compromise can be broken, but both parties must invest in a superior outsourcing foundation before entering into an outsourcing contract. By mutually investing in people, IT strategy and architecture, and infrastructure that is shared across multiple customers, enterprises and outsourcers can create dynamic IT services that adapt to changing enterprise demand and are profitably and predictably delivered. The next section details this mutual investment.

Section II: A New Model

"Outsourcing," in this paper, refers to the current outsourcing model where an outsourcer takes on responsibility for entire functions of an enterprise's business. As discussed in Section I, this model promises significant benefits, but also exposes enterprises and outsourcers to business risks such as slower innovation rates, reduced flexibility, and cost concerns. We propose a new outsourcing model—"Strategic Out-Tasking" (also referred to simply as "out-tasking")—to minimize these risks and enable the promising win-win.

At its heart, Strategic Out-Tasking empowers enterprises to retain final ownership and accountability for business outcomes, even when they partner on specific operations. Enterprises redefine their IT capabilities as discrete but interoperable IT services. Working within this modular services

[5]Gartner, Inc., 2005

model, they can outsource at a more granular level of business processes. They can retain real-time visibility and influence over out-tasked processes and, therefore, gain an increased ability to influence or directly impact remedial or even proactive changes. Enterprises can also outsource specific services strategically to achieve long-term competitive advantage, rather than outsourcing entire IT functions simply to cut costs.

On their end, outsourcers build virtualized services, not the dedicated applications for individual business functions or departments that they market under the current model. Virtualized services enable enterprises to share services such as storage and computing power across departments—and to scale these services to meet new and changing business and innovation needs. Services can be standalone or bundled, and are standardized to integrate seamlessly with internal operations as well as other discrete IT services that the same (or a different) outsourcer provides. No longer must services be tailored to meet the needs and conditions of a specific enterprise or department. The enterprise IT function, outsourcers, or a third-party systems integrator may provide the integration among the varied IT services and related business processes.

Clearly, for the Strategic Out-Tasking model to succeed, mutual investment is a must. The model calls for both parties to invest not only in discrete managed services, but in the following as well:

- **The partnership**—Both parties invest the time and money to align outsourcers with the enterprise's strategic direction. Enterprises, for example, should do more than penalize outsourcers if SLAs are not met: they should better orchestrate partnerships to ensure coordinated delivery and seamless integration. They can invest in enhancing current employee skills and hiring new talent to ensure there is a team in place that can manage the partnership effectively. For their part, outsourcers can invest in breakthrough solutions while offering industry expertise and best practices to guide enterprises toward competitive advantage.
- **Innovation**—By outsourcing many operational transactions, the enterprise can channel its own resources into accelerating innovations. But enterprises will continue to rely on outsourcers to introduce them to new technologies and, more important, to scale and integrate more promising innovations into existing operations. If partner selection and remuneration are tied to the enterprise's innovation goals, outsourcers, too, will be both willing and much more able to align with specific project milestones or long-term agendas.

We understand that adopting this new model is no easy or inexpensive task. But the returns are worth it. Cisco has benefited significantly from deploying these strategies in-house, and leading global outsourcers and over 50 leading enterprises from different geographies and vertical sectors have validated our vision and recommendations. The outsourcers—whether in networking (British Telecom and SBC, for example), data centers, or business process outsourcing (ADP and Paychex)—are achieving margin improvements from below 10 percent under the outsourcing model to an average of 14 to 20 percent under Strategic Out-Tasking. These cost savings translate into benefits that enterprises share. For enterprises and outsourcers, we estimate that successful out-tasking strategies can yield $10 billion to $14 billion in bottom-line impacts.

The rest of this section briefly addresses how the Strategic Out-Tasking model can best be implemented.

1. How Do You Invest in Discrete Managed Services?

Instead of viewing information and communication technology (ICT) as an internal operating function or even as a cost center, enterprises should begin to see it as a set of discrete services that collectively optimize overall business operations. The IT management focus should shift as well, from operational resources to the processes needed to create and deliver the discrete services. Enterprises must look to external providers to deliver some of these services and associated processes, using the scale and expertise that only these specialists can offer. And, importantly, enterprises may be able to reduce or perhaps eliminate significant upfront investments when deploying new solutions.

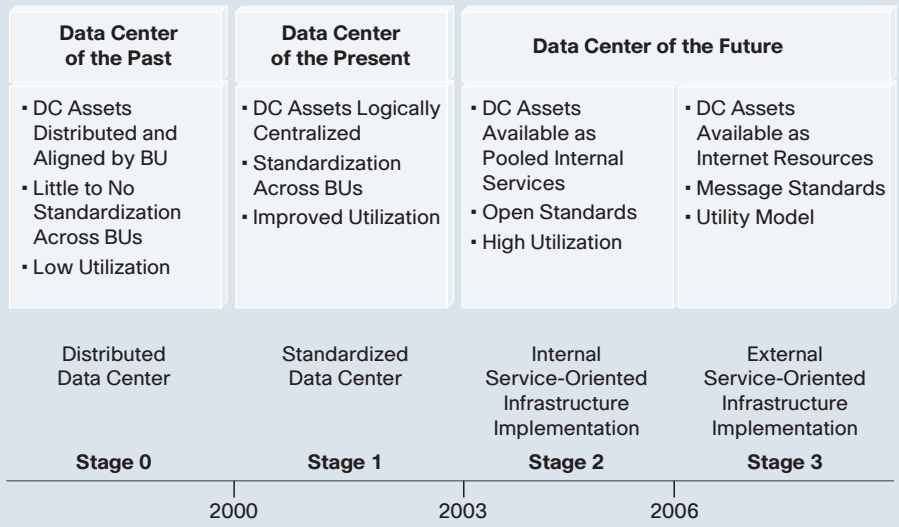
At the same time, the new model forces enterprises to choose carefully the supporting service creation and delivery processes they retain. Outsourcing entire business functions, including an enterprise's broken processes and operational control—a common practice under the traditional model—is not the means to a win-win partnership. The sheer scope of such contracts makes it difficult, if not impossible, for outsourcers to fix or streamline suboptimal processes to control costs. As costs escalate, innovation is abandoned. Thus, enterprises, too, end up on the losing end, and the partnership is jeopardized.

Enterprises can improve outsourcing outcomes by out-tasking mature and standalone services that would benefit from an outsourcer's scale and expertise. In addition, to realize desired business outcomes, they should retain the processes in-house that help them maintain operational control and accountability.

But it is not just enterprises that must adapt and evolve. By moving from cost takeout to adding business value, and from outsourcing complete business functions to a more discriminating service delivery process, enterprises will change both what outsourcers deliver and how they deliver it. The next-generation data center is an excellent example of the new discrete managed services focus. Historically, data center applications have been siloed functions that use their own servers and storage. Low utilization rates and inflexibility are often the result. Leading outsourcers, however, now offer data center assets as interoperable, shared services (Figure 3). Utilization is high because services are allocated from a shared pool and scaled dynamically according to demand. In addition, standardization eliminates the costly integration issues often encountered during service deployments. The focus on standards-based services delivery does not, however, preclude the customization that will always be needed. If, for example, 80 percent of an outsourcer's services are modularized, standardized, and virtualized, enterprises can easily scale these services and integrate new and innovative ones to meet changing market demands.

FIGURE 3

Data Center Roadmap



Source: Cisco IBSG, 2005

Clearly, when evolving to the new model, outsourcers will have to make choices: they must select the services in which they will be best of breed and the partners with whom they will go to market. It is unlikely that any one outsourcer will be world class in all services or have the scale to provide globally consistent coverage. Yet, as enterprises learn to outsource services selectively, they will be empowered to select best-of-breed providers for each IT service. Some enterprises will play the orchestration role while others will select a prime outsourcer, but enterprises will always utilize their standard service definitions to demand a higher level of integration from their providers.

Security is another essential area of integration. With more outsourcers having increased access to enterprises' business processes, protecting intellectual assets and customer privacy becomes even more challenging and mission-critical. These security concerns are exacerbated in remote delivery models, with providers being either truly offshore or at multiple locations with a global delivery footprint. Enterprises must ensure a holistic security architecture that accommodates "more cooks in the kitchen."

Of course, when enterprises outsource to multiple providers, narrower service contracts are going to be a consequence. But the need for consistent service delivery will create global deployment opportunities. For example, Electronic Data Systems Corporation (EDS) was once General Motors' sole outsourcer, but GM is now moving toward outsourcing contracts with multiple service providers, each responsible for delivering a targeted set of services on a global basis.

Thus, even a GM desktop contract is going to be very large—when issued on a global basis. And narrower, more tightly scoped partnerships should reduce operational risks and better utilize specialized capabilities offered by "best-of-breed" providers, translating into higher operating margins for outsourcers.

Achieving best-of-breed service requires outsourcers to invest proactively in their capabilities—not just in the people, but in standards-based IT infrastructure and business processes as well. By defining service interfaces and providing rich management tools, they can share platforms, seamlessly integrate enterprise business processes in real time, and scale services more efficiently—all for faster time to value. In order to partner successfully with innovators like GM, EDS (Agile Enterprise™), HP (Adaptive Enterprise™), and IBM (OnDemand™), all leading outsourcers are building the foundation to deliver and integrate their discrete managed service offerings. Outsourcers can also use standards to their pricing advantage as they gain greater cost-structure visibility. Such arrangements can create significant upside opportunities for new, innovative solutions, producing a self-reinforcing relationship dynamic.

2. How Do You Invest in the Partnership?

Under the new model, orchestration begins with a common enterprise architectural blueprint. The blueprint provides the vision and roadmap for implementing and integrating business processes and the technological infrastructure to deploy these processes. The enterprise must own the blueprint and periodically update it to reflect changing business needs. Third-party providers can contribute, however, especially with regard to breakthrough solutions such as IP telephony and new technology generations such as mobile computing devices. An enterprise retailer such as Wal-Mart, for example, that deploys radio frequency identification (RFID) would greatly value an outsourcer who can intelligently route an RFID message indicating low inventory to Wal-Mart's enterprise resource planning (ERP) and supply-chain applications. Other outsourcers, in turn, could manage these applications to translate the RFID signals into replenishment requests, which would feed data directly to suppliers. Such real-time, intelligent routing of inventory levels can dramatically accelerate time to replenishment, improve sales cycle times, and lower operating costs.

For outsourcers and enterprises, common security and messaging systems will also be critical. No enterprise can afford disruptions in the delivery of mission-critical applications or customer transactions. Consistent security must, therefore, be built into each networking device; management tools must enable end-to-end visibility and provisioning; and integrated network intelligence must optimally handle enterprise interactions (person to person, person to device, and device to device). Enterprises and outsourcers must also agree on common reporting standards and embrace Web services to eliminate the costly integration and lengthy reconciliation of conflicting reporting systems.

Finally, governance plays a large part in the overall success of the partnership. The enterprise should establish executive oversight to monitor and report on business returns and to prioritize investments for ongoing improvements. Cisco, for example, invested in common reporting and

performance tracking systems within its front-line call centers to identify and proactively address any customer satisfaction issues in a timely manner, rather than waiting for monthly reports from partner operations. Outsourcers need to participate actively as equal partners in this planning and prioritization. In addition, enterprises and outsourcers should build organizational competencies to resolve quickly any partnership issues and evolve partnerships to meet changing business needs and market conditions.

3. How Do You Invest in Innovation?

The enterprise's IT team must focus on innovation for competitive differentiation and increased cash flows. Stanford University Medical Center exemplifies the innovation focus. After out-tasking routine break-fix transactions, its IT team was able to invest in partnering with the hospital functions to transform patient management and clinical processes. For example, the IT team is now exploring innovative imaging and wireless communications technologies to improve patient care dramatically while reducing operating expenses. A reduced focus on day-to-day operations also enables the CIO to take a more proactive leadership role in helping the executive team understand and drive relevant technology-enabled innovations that accelerate business outcomes and help sustain the hospital's premier position.

Enterprises and outsourcers should also use productivity benefits and cost savings achieved early in the contract to fund future investments in innovation. Accenture and the British food retailer Sainsbury's, for example, agreed to maintain a level IT budget and to reinvest the freed-up cash flow in upgrades to the retailer's network and communications infrastructure. Cost savings from network convergence also funded higher-margin consulting and systems integration services.

An ongoing innovation agenda helps align the enterprise and outsourcer on specific innovations. The roadmap for innovation deployment is a crucial facet of this agenda; it includes measurable milestones that the two parties should build into an operational contract. While enterprises should own their innovation agenda, outsourcers should actively influence its design, especially because new innovations can greatly expand the outsourcer's share of wallet.

The Investment Is Worth It

Returns from the new model will be significant. Standardization, for example, can reduce total cost of ownership by as much as 25 percent[6]. Centralizing and virtualizing assets will also drive dramatic savings by increasing asset utilization and labor productivity. Cisco, for example, avoided over $225 million in storage costs by virtualizing its data center storage needs and raising utilization from an industry-average 25 percent to 51 percent[7]. Cisco saved another $85 million in IT costs by centralizing its data center management and greatly reducing the time required to upgrade IT applications like Active Directory and Cisco Unity® voice mail. Similar order-of-magnitude returns are being realized by other leading IT practitioners.

[6]Sage Research, 2003

[7]Cisco company analysis based on 2.2 petabytes of storage at a cost of $0.20/MB

Section III: Enterprise Actions

The Strategic Out-Tasking model defines key actions to help enterprises deliver on their operational accountability and accelerate deployment of innovations. Enterprises should identify and deploy new services, manage these services, and accelerate each service's lifecycle.

1. Identify and Deploy New Services

We believe that to adapt effectively to changing business conditions and drive innovation, enterprises should:

- Prioritize mature, standalone services to out-task
- Retain intellectual aspects of service creation and management
- Select partners for reasons not limited to cost
- Keep a small fraction of operations for out-tasked services in-house

1.1. Prioritize Mature, Standalone Services to Out-Task

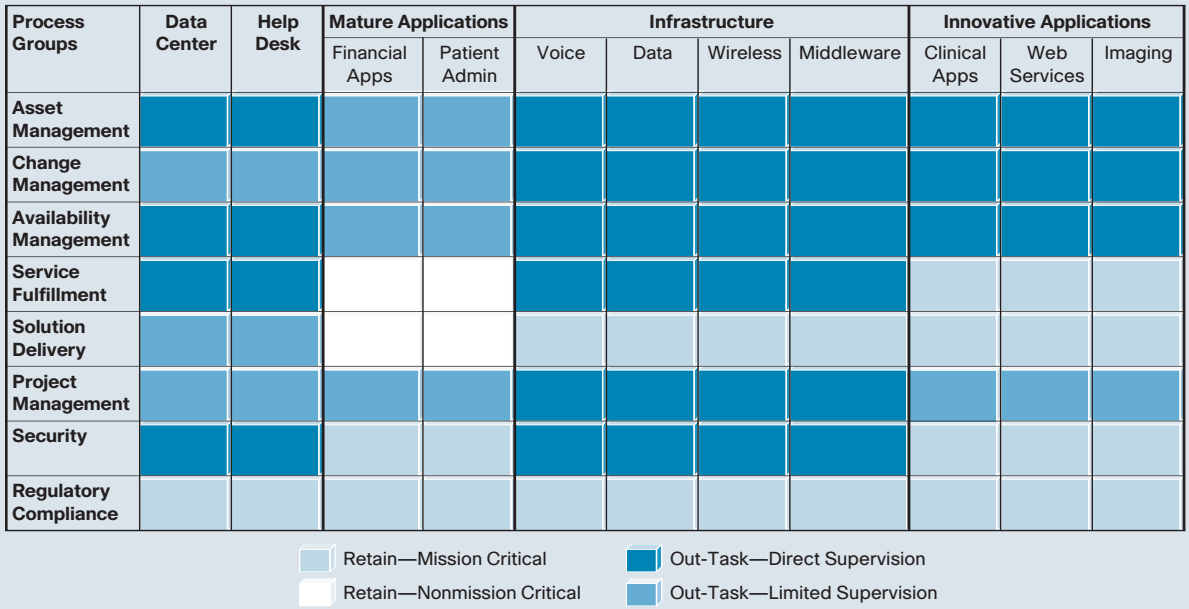
Enterprises cannot expect outsourcers to streamline or fix suboptimal operations without substantial investment from the enterprise. We recommend that enterprises prioritize for out-tasking mature or well-understood services that are offered by multiple third-party providers as price-competitive, standards-based solutions. These services, such as the help desk, are often standalone in nature and can be out-tasked with minimum impact on the rest of the enterprise's operations. Also, business outcomes from mature services can be readily expressed as industry-accepted SLAs. Even when enterprises need to out-task many of their IT services (for example, due to an urgent need for financial capital), they may execute a phased rollout, out-tasking more mature services in the earlier phases.

1.2. Retain Intellectual Aspects of Service Creation and Management

Enterprises must continue to define what outsourcers will deliver, and thus should retain the processes of identifying opportunities and designing new services. In addition, IT management should maintain all client relationships, including the tracking and reporting of business returns. Retained processes vary based on each service's relative importance and where that service is within its lifecycle. For example, we recommended that a leading medical services provider retain fewer processes for its standalone services (such as the help desk), and a greater number of processes to enforce operational and managerial control over customized, business-critical services such as innovative imaging solutions (Figure 4).

FIGURE 4

Process-Oriented Analysis: Healthcare Provider



Source: Cisco IBSG, 2005

1.3. Select Partners for Reasons Not Limited to Cost

While cost savings remain important, enterprises should base partner selection on criteria supporting their broader business goals. This would require the enterprise and the outsourcers to agree on a common set of metrics to track and optimize. For example, when Cisco out-tasked its front-line call centers, it selected partners who could increase customer satisfaction. Because customers prefer to reach call-center agents who work during their regular daytime hours, Cisco adopted a "follow the sun" approach: instead of selecting primarily low-cost offshore providers, Cisco chose partners who could support multiple locations around the world and provide infrastructure for transferring calls to locations with appropriate agent skills and operating schedules.

1.4. Keep a Small Fraction of Out-Tasked Operations

We believe that enterprises should retain 10 to 15 percent of operations in-house, even when the service is out-tasked.[8] The advantages are threefold. First, the enterprise can better monitor and, perhaps, even collaborate with the outsourcer to improve performance. Cisco front-line call center agents, for example, use online collaboration tools to help partner agents address complex customer issues.

[8]The 10- to 15-percent guideline is driven by the enterprise's need to attract top talent for its retained operations and to offer viable career and professional development options. Source: Cisco IBSG, 2005

Second, the retained operational knowledge is critical for structuring superior contracts in the future. And third, enterprises can use this knowledge to bring operations back in house, if and when it becomes necessary to do so. While difficult, such course reversals may be essential in extreme cases, such as when new innovations make previously out-tasked operations central to competitive success. For example, during the mid-'90s, Internet technologies transformed order entry into e-commerce to allow companies to acquire customers efficiently and rapidly, yielding breakaway competitive advantages to the leading practitioners. Companies that had outsourced their order-entry functionality now needed to build internal e-commerce capabilities rapidly in order to remain competitive.

2. Manage Deployed Services

Enterprises should implement the following to manage deployed services effectively:

- Maintain operational visibility over out-tasked operations
- Provide the appropriate partner incentives
- Provide resources and systems to help partners succeed
- Create governance structures to optimize returns

2.1. Maintain Operational Visibility over Out-Tasked Operations

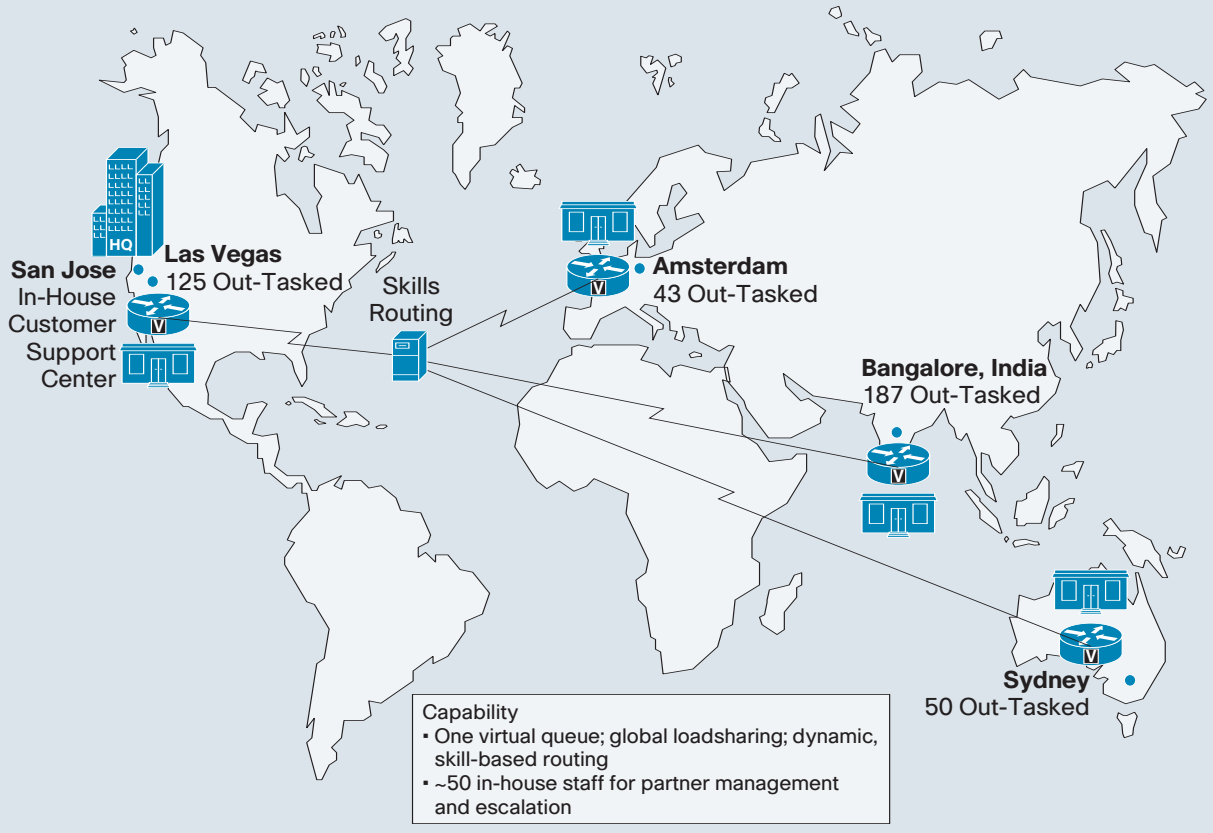
To step in and make changes as needed, enterprises should retain timely visibility over out-tasked operations. For its front-line order-entry call centers, for example, Cisco maintains a single call queue that internal and partner locations share. Using this queue, the Cisco manager with overall front-line support responsibility optimizes the response to customer queries (Figure 5). The manager can view customer satisfaction scores and is motivated by personal performance bonuses to move calls away from busy or poorly performing sites to superior locations with unused capacity.

2.2. Provide the Appropriate Partner Incentives

Contractual incentives and desired business outcomes should correlate. However, enterprises struggle to identify the right metrics even for well-understood services such as the help desk. When enterprises base incentives on call-handling times, for example, partner agents may conclude customer calls without either completely addressing customer issues or alerting customers to lower-cost self-service options they can pursue. Cisco partnered with a number of its customers to define reasonable metrics for well-established services. For a federal agency, we established metrics such as first-call resolution and time to resolution to track customer support at the agency's help desk (Figure 6). The partner incentives and bonus payments should be aligned to meet or exceed mutually agreed-upon targets, such as 2 to 4 percent bonus payouts to front-line call-center partners for meeting or exceeding "stretch" customer satisfaction targets.

FIGURE 5

Coordinating Partner Operations: Cisco Order-Entry Call Centers



Source: Cisco Systems, 2005

2.3. Provide Resources and Systems to Help Partners Succeed

The long-term benefits of superior partner performance far exceed any contractual bonus payments. Enterprises should, therefore, invest in providing partners with the resources and tools to deliver superior customer service and business performance. Cisco, for example, offers its call-center partners access to Web-based diagnostic and resolution tools and training programs that Cisco's own employees use. In addition, Cisco retains dedicated teams to help partners benchmark and improve their operations. Cisco call-center partners, for example, uniformly use a common set of industry best practices to track and reward agents for superior customer interactions.

2.4. Create Governance Structures to Optimize Returns

To enforce operational accountability, enterprises should assign supervisory and project management roles to oversee the out-tasked operations. In addition, we recommend executive oversight: specifically, a primary executive sponsor (likely the CIO) supported by a broader executive council. Such councils provide the advisory guidance and corporate championship necessary to engage

FIGURE 6

Coordinating Partner Operations: Common Goals and Metrics

Metrics	Cisco Benchmark	How to Measure
Time to resolution	P2 – 4-hr. resolution P3 – 8-hr. resolution P4 – 16-hr. resolution P5 – 40-hr. resolution P6 – scheduled resolution	Case management tool
Issue resolution rate	90% call closure within the target timelines	Case management tool
Consumer satisfaction	= or >4.7 customer satisfaction	Customer satisfaction survey
After-hours support	P2 after-hours support	Case management tool
Average speed to answer (Tier 1)	30-second average speed to answer	ACD, IPCC
Call abandonment (Tier 1)	<5% abandonment rate	ACD, IPCC/switch
First call resolution	45%	Case management tool
Compliance with SLAs	Service-level objective is not to miss SLAs 3 consecutive months; 90% compliance	Case management tool/ outsourcer reports

Source: Cisco Systems, 2005

fully with partners. The councils also offer checkpoints to monitor returns, validate the overall strategy, and modify directions as appropriate. The supervisory and project management capabilities typically exist within a CIO's organization and also serve to align the partnership operations with accepted company practices.

3. Accelerate the Services Lifecycle

Enterprises should view out-tasking as a strategy with long-term goals encompassing the entire services lifecycle. Thus, they should build the competencies to establish and evolve superior partnerships that will adapt to changing business conditions. Specifically, enterprises should:

- Explore out-tasking earlier in the services lifecycle
- Develop vendor management competencies
- Maintain the networked enterprise architecture
- Create an ongoing innovation agenda

3.1. Explore Out-Tasking Earlier in the Services Lifecycle

Enterprises should consider using outsourcers to scale services, even when these services are in the early stages of their lifecycle. Internal resources can then focus on accelerating innovations through their maturity curve. For example, enterprises often partner with telecom providers who possess large geographic footprints to prime and coordinate the delivery of a remote access solution. Such solutions identify and eliminate "productivity deadzones" to provide ubiquitous connectivity. For providers, the partnership creates a new market through value-added services such as unified messaging. Similarly, an international provincial government that used out-tasking to "bridge its digital divide" partnered with service providers that had the local resources and knowledge to offer broadband services to remote communities across a vast geographic territory.

Enterprises can even engage with outsourcers during the design phase of a service for assistance with production readiness, a practice that Japanese automakers perfected in the late '80s and early '90s. At the same time, enterprises must be careful not to out-task any service before it is mature and well adopted, and they must not compromise their intellectual assets.

3.2. Create Competencies for Next-Generation Vendor Management

Partner management is at the heart of long-term, profitable out-tasking arrangements. We, therefore, recommend that enterprises nurture a talent pool with savvy relationship management skills and a deep understanding of partner economics. Many enterprises consolidate these competencies into shared vendor management centers that can help the broader IT organization optimize partnership arrangements. The vendor management center can offer services that include:

- Prequalifying partners for future partnership considerations
- Evaluating and selecting partners to support multiple business objectives such as cost savings and access to new innovations
- Negotiating contracts to meet a comprehensive set of business alignment criteria
- Resolving outstanding partnership issues
- Maintaining relationships with partners at their executive levels
- Evolving partnerships to support changing business needs and market conditions

3.3. Retain Control over the Networked Enterprise Vision and Roadmap

Enterprises must maintain their architectural blueprint and convince partners to implement it. Cisco, for example, created the Business Process Operations Council (BPOC) to execute specific cross-functional transformational initiatives. Over time, the BPOC may set enterprisewide process standards and work with internal functions and partners to enforce them.

To guide successful process transformations, enterprise IT teams also require organizational competencies to partner more effectively with internal business functions and external providers. Recognizing this organizational need, a leading automobile manufacturer is redesigning its job families and creating career paths and professional development programs to upskill its team. The organizational roadmap specifies recruiting external talent to bridge key skill gaps and serve as role models for the transformed enterprise.

Finally, an integrated architectural approach limits the security risks often created when the enterprise and its partners use proprietary interconnections.

3.4. Create an Ongoing Innovation Agenda

While enterprises should own their innovation agenda, they should also actively utilize outsourcers' R&D investments and innovation insights. Innovation must be a critical criterion for partner selection, and out-tasking contracts should offer innovation incentives. Above all, enterprises should maintain dedicated resources to acquire and pilot emerging technologies (such as server virtualization and seamless mobility); but as these technologies mature, the enterprise may look to its outsourcers to scale these capabilities and integrate them into the overall operations.

Our direct customer work confirms that it is difficult to scale successful pilots—especially disruptive technologies such as new infrastructure generations—within mainstream out-tasked operations. The process can require significant upfront infrastructure and financial capital investments, and the outsourcer also may not have the competencies to implement and operate these newer capabilities. One of our customers is circumventing these issues by considering specialized third-party resources to transition the enterprise to a next-generation infrastructure solution. Once the transition is completed, the incumbent outsourcer will be given the option to operate in the new environment, minimizing any operational disruptions for the enterprise and reducing transition costs for the outsourcer.

Section IV: Leading Outsourcers Will Rise to Meet New Enterprise Requirements

The previous section details how enterprises achieve the benefits of the new outsourcing model. As stated before, however, the Strategic Out-Tasking model is about the win-win. Outsourcers can benefit as much as enterprises from Strategic Out-Tasking. The winning delivery model has three key components:

- A shared, standards-based delivery model
- A time-to-value sales model
- Sophisticated tools for integrating with enterprises and partners

1. Build a Shared, Standards-Based Delivery Model

When building an out-tasking delivery model, the key questions are "where do we start?" and "which outsourcing services do we provide?"

1.1. Where to Start

To begin the transformation, outsourcers must standardize, modularize, and virtualize.

- **Standardize**—Hardware and software, architectural design, and operational processes all must be standardized. This does not mean remaining undifferentiated against competition, but rather being standardized across an outsourcer's own operations. Outsourcers start by selecting technology vendors that are willing to share roadmaps and risk. Then, they identify best-practice processes and extend them throughout their customer delivery teams. IT management drives this organizational change. Success requires incentives to sell the "standard offer" and metrics that hold delivery teams accountable for best-practice performance levels.
- **Modularize**—Under the new model, each outsourcing service is a reusable component that may be delivered separately or as part of an integrated bundle. To be bundled, a service must have a clear description, documented interfaces, SLA parameters, operational processes, dependencies, business rules, and a cost factor.

  For example, as discussed in Section II, storage is becoming a modular component of the broader data-center set of services. Enterprises that want to reduce their costs (by utilizing outsourcers' scalability) or improve their performance (with real-time database mirroring, for example) are looking to third-party providers for storage on demand. Storage services, however, must also integrate with application management services. For example, enterprises that purchase Exchange e-mail hosting services may add an e-mail archiving service to help them comply with regulations. But, for instance, with IP Web-conferencing services, the customer may request the same provider to archive Internet messaging chats with a different security and retention policy. The outsourcer will, therefore, need to design its storage services as modules within the application management service, enabling easier management, faster provisioning, and streamlined billing and payment processes.
- **Virtualize**—The network layer has long been a virtualized resource, with multiple applications, sites, customers, and so on sharing routers and switches. As leading outsourcers develop next-generation architectures, networking and virtualization software is enabling whole new areas of shared resources. Mainframe users have long enjoyed virtualization, but storage and other applications are well on their way. Computing (down to the processor level), security appliances, and other services will soon follow.

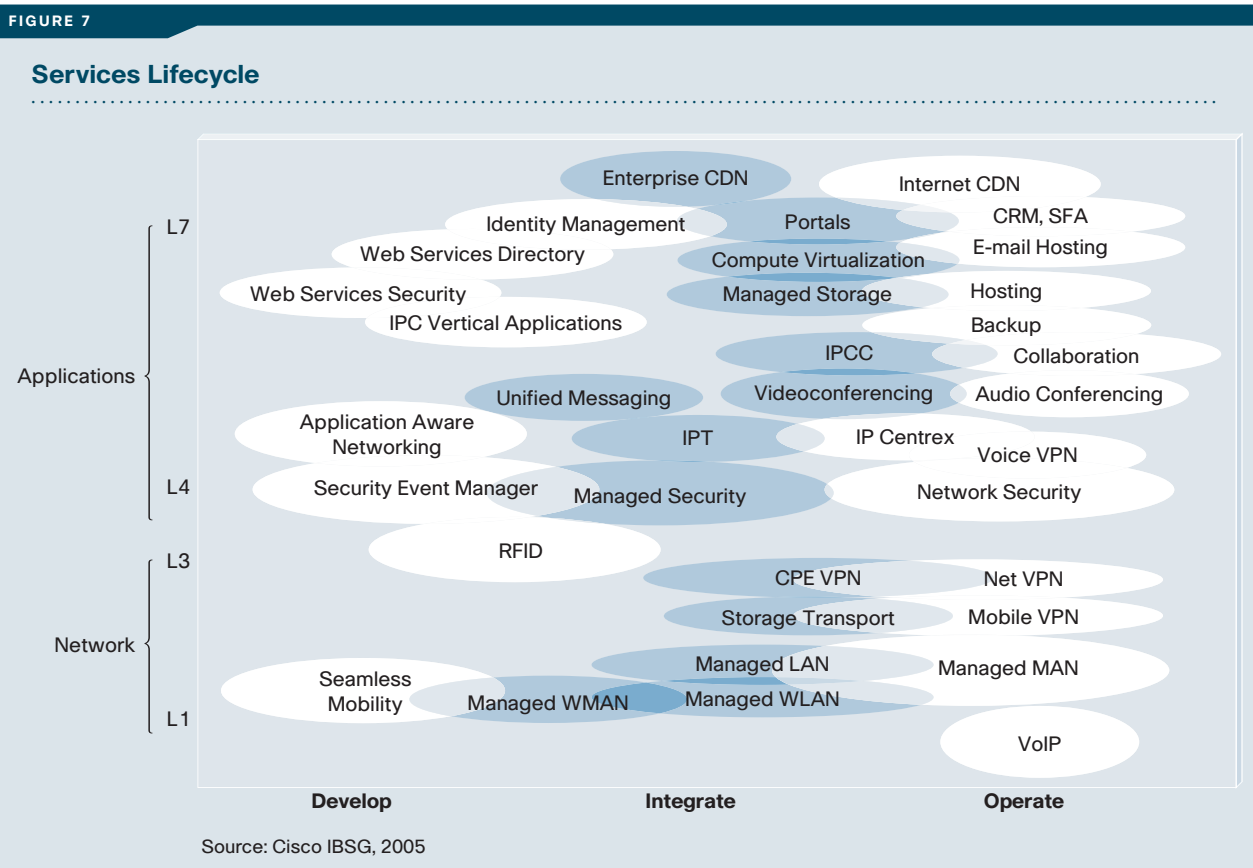
1.2. Which Outsourcing Services?

Only when a technology and its automation and management tools mature can outsourcers build managed services with high profit margins. Jumping in too early increases the customization-to-standardization ratio and results in lower margins for systems integration services.

A Services Lifecycle Framework is helpful when evaluating outsourcing services (Figure 7). It provides a roadmap of a technology's maturity and readiness for deployment as a discrete, managed service.

The framework has three phases. In the Development phase, new enterprise requirements are identified, and hardware and software vendors develop point solutions. (Do-it-yourself solutions are also common.) These solutions compete as enterprises refine their requirements. The proliferation of customer relationship management (CRM) applications in the mid-1990s is a good example of this early phase of the framework.

FIGURE 7



Source: Cisco IBSG, 2005

In the Integration phase, a standard feature set prevails, the technology moves beyond early adopters, and network and systems integrators help enterprises manage complexity and integrate the technology into business processes.

In the final Operation phase, the technology and management tools are mature and enterprises view third parties as potential service providers. Well-defined features allow outsourcers to invest in standardized platforms that scale to serve a large customer base.

Many outsourcing services are only just reaching the Operation phase. LAN and WLAN management, for example, do not yet enjoy rich provisioning and management tools. On the other hand, Web hosting is highly automated, enabling much higher margins.

2. Develop a Time-to-Value Sales Model

Telephone companies (telcos) illustrate the risks and rewards of the out-tasking model. They deliver well-defined services from highly scalable, shared platforms. Telcos do not develop a service until enterprise requirements converge around a common feature set and the technology matures to ensure reliability and scalability. The benefits of this approach are clear—operating margins that are often three to four times IT outsourcing margins.[9]

At the same time, most telcos focus too much on standardization. As a result, they struggle to differentiate their services and develop loyalty from enterprises. Outsourcers have a built-in advantage by engaging with enterprises at the application and business process layers, but they must still avoid commoditization. A business-led sales model is an essential complement to the out-tasking delivery model.

Based on IBSG's work with leading telecommunication service providers, including British Telecom, France Telecom, and AT&T, and global outsourcers such as IBM and EDS, we believe three key go-to-market initiatives will help outsourcers succeed in a managed services world:

- Develop business process selling capabilities
- Build innovation into the contract
- Expand share of wallet

[9] Company 10-Ks for AT&T, MCI, SBC, and BellSouth

2.1. Develop Business Process Selling Capabilities

Many outsourcers exhibit strong business selling capabilities through their in-house management consultancies, industry practices, and business process outsourcing (BPO) operations. They must strengthen the link between those capabilities and their IT services, however, and infuse those skills into the broader selling force.

Organizing along industry verticals is one key ingredient. Industry verticals orient the portfolio and sales organization around the business needs of their customers. Outsourcers must also force closer ties between the IT and BPO portfolio teams. An outsourcer's BPO call center service should be able to select from clearly defined services such as IP telephony, storage, and hosting. Outsourcers must reinforce vertical organizational structure through a product management process that approves only business solutions with clearly defined business processes and technology enablers.

Sales incentives can encourage the BPO and information technology outsourcing (ITO) organizations to sell jointly. The partnership fails, however, if outsourcers react only to customer requests, which generally are already parsed into a specific technology or business function. Instead, outsourcer sales teams must identify a customer's business needs proactively. Sales incentives can encourage them to expand share of wallet (in addition to profitability and contract performance) with separate sales targets for the BPO and ITO organizations (so that sales teams cannot reach their targets too easily).

2.2. Build Innovation into the Contract

Innovation must be built into a partnership from the start. Sometimes transformation is at the heart of the contract, as with Accenture's network convergence strategy with Sainsbury's of the United Kingdom. Other times, innovation is merely a built-in schedule of technology refresh, but one that provides the outsourcer with an incentive to share technology innovations. Many other tactics—from benchmarking to technology testing labs—can help ensure that both the enterprise and the outsourcer are consistently evaluating new technologies and best practices.

2.3. Expand Share of Wallet

Over 90 percent of enterprises have outsourcer relationships. An estimated 25 to 50 percent of enterprises outsource all or part of each IT function.[10] Given this deep penetration, outsourcers should shift some resources from acquiring new customers to expanding share of wallet with existing customers. The good news is that 85 percent of IT spend, on average, is still untapped.[11]

Today, too little selling occurs between contract start and finish. Outsourcers must mandate that the top line grow beyond the initial contract. They should reward the managing director for contract growth. And customer sales teams need to develop consultative skills and customer intimacy to identify areas of growth.

[10]Source: Gartner, Inc., "User Attitudes to IT Outsourcing," 2003

[11]Source: Gartner, Inc., "IT Spending and Staffing Survey Results," 2004; Cisco IBSG, 2004

3. Invest in Superior Integration with Enterprises and Value-Adding Ecosystems

Under the new outsourcing model, more services and outsourcers serve each enterprise. The need for integration and operational visibility is heightened. To ensure that their managed services integrate and deliver superior performance when bundled, leading outsourcers invest in technologies that strengthen three key capabilities:

- Infrastructure management
- Data integration
- People collaboration

Consistent tools for device management, provisioning, order to cash, customer care portals, and others will help drive share of wallet and customer satisfaction, as well as lower the outsourcer's own delivery cost. Each new service can be added faster and at a lower incremental cost.

As enterprises selectively out-task to best-of-breed providers, they will also seek integration among multiple outsourcers. Some enterprises will ask outsourcers to comply with enterprise-set standards for data sharing and reporting. Others may simply seek outsourcers who have already formed those code-sharing partnerships. Fortunately, as outsourcers build leveraged delivery models, they also gain a platform with which to build these code-sharing partnerships—partnerships in which services, security, and reporting have been preintegrated for seamless delivery to the enterprise. No outsourcer will have the scale or resources to be best-in-class in all services, but by designing services to integrate easily with third parties, they will gain a significant time-to-value advantage.

Indeed, the promised "on-demand" environments in which services such as computing, storage, applications, and networking vary with enterprise demand will require significant collaboration among vendors and service providers. The outsourcer who successfully orchestrates an ecosystem of partners that is preintegrated with a policy-based management system will indeed gain a competitive advantage.

Section V: A Win-Win Opportunity

Cisco's experiences with enterprises and outsourcers and within our own company indicate that Strategic Out-Tasking is a win-win model. The new model offers three key win-wins:

- Greater enterprise innovation
- Higher outsourcer margins
- Lower operational risks

Strategic Out-Tasking positions enterprises to own their IT strategy and drive the technology roadmap. Enterprises can select best-of-breed outsourcers for each IT service, while gaining tighter integration among in-house and third-party providers. They also free up valuable management resources to focus on strategy and business-IT alignment. With strong orchestration skills as well as supporting contracts and governance in place, innovation for the life of the partnership can be realized.

Outsourcers also win by embracing integrated IT service models and building innovation into their offerings. They will enjoy higher margins from more scalable services and will reduce the operational complexity of numerous custom deployments. Code-sharing partnerships with other best-of-breed outsourcers will also lower delivery costs and win more business through a proven ability to deliver. A strong networking foundation will engender highly secure, yet differentiated services like intelligent RFID or SAP-message routing.

Strategic Out-Tasking mitigates risk for both enterprises and outsourcers. Enterprises continue to drive business outcomes, even if they out-task operational execution. They also purchase services that are highly integrated and secure, reducing the risks of slow deployments, costly integrations, or under-performing providers. For outsourcers, the new model requires more forward investment, but lower one-off delivery costs and variance, and more operational security.

Both parties must have a win-win mindset. Enterprises should view IT out-tasking as a strategic business lever and select partners for reasons beyond cost. Enterprise IT should be clear on what it expects outsourcers to deliver, retaining capabilities in-house to sustain long-term accountability. The IT team can also collaborate with partners to establish meaningful operational metrics and mutually agreed-upon targets. Partner incentives need to reward superior performance, and the enterprise should provide the tools, dedicated teams, and best practices to help partners meet and exceed performance targets. But with over $10 billion to $14 billion of industry bottom-line impact for outsourcers and enterprises to share, Cisco believes that Strategic Out-Tasking will truly be a win-win.

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