

Enterprise Network Services Outsourcing in the U.S.

Summary

Network services outsourcing is becoming increasingly attractive for companies of all sizes. Recent trends include moves toward partial outsourcing, generic service provider models and services for smaller businesses.

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Outsourcing within the IT and telecommunications industries has had a long history, stretching back to facilities management, service bureaus and managed network services. At a basic level, it is attractive to corporations wishing to concentrate on core competencies and willing to offload increasingly complex infrastructure management issues to companies specializing in those areas. Network services have become an increasingly important part of IT infrastructure, and network services outsourcing has generally been difficult to separate from other infrastructure components.

In the early days, IT outsourcing followed a model in which firms such as IBM took over the entire IT facility and ran it for the client enterprise. On the telecommunications side, the major telcos would provide a managed data and communications service involving leased lines and services, such as virtual private networks (VPNs), X.25, asynchronous transfer mode (ATM) and frame relay. Both of these models are still in use, particularly at larger corporations, but they are being joined by a wide range of additional outsourcing models made possible by increased availability and the lower cost of high-bandwidth communications, plus the lower cost of IT infrastructure components.

In particular, recent years have seen the rise of the generic service provider (XSP) model, begun with application service providers (ASPs) who provided single applications on a metered basis from a central server as a modern day replacement for the service bureau. From this, further refinements to the basic model yielded management service providers (MSPs) that provided network and IT management services, again from a centralized location; storage service providers (SSPs) that provide storage service, including backup and recovery; managed network service providers (MNSPs); Web service Providers (WSPs) supplying Web-hosting management and e-business facilities; and, more recently, enterprise service providers (ESPs) that may be either a re-branding of a facilities management approach or a large internal IT department turned into a revenue center through outsourcing of its capabilities.

Network management is central to IT outsourcing solutions, because this is an area that is rapidly growing in complexity and in sophistication, and it also provides services that are fundamental to almost all outsourcing services. The ASP model requires network management to ensure availability, and management services provision is one of the strongest sectors of the XSP range. Facilities management includes a strong network management component, because this is one of the most critical parts of the IT infrastructure. Business process outsourcing (BPO) requires network management services to ensure that the required services can be delivered.

Network services outsourcing exists within a general outsourcing market, which has the following characteristics:

- Outsourcing is growing, with more organizations seeking outsourcing options every year.
- Outsourcing is fragmenting, with a tendency emerging to outsource only part of the IT and telecom structure.
- Companies using outsourced services are looking for stronger service-level agreements (SLAs) and better service guarantees.
- Outsourcing is moving down from the enterprise level toward small and midsize businesses (SMBs), with these companies providing the greatest current opportunities for growth.

Outsourcing in general incorporates over 60 different segments, including legal and manufacturing services, advertising and business payrolls. Analysts have variously defined the market. For the IT sector, this problem is exacerbated by the fact that most outsourced services and facilities include a strong IT and network management component.

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Types of Outsourcing

Network services outsourcing includes both data and telecommunications services. As is often the case, a barrier continues to exist between the two areas, despite convergence on a technical level. Call center outsourcing is an increasingly important part of the outsourcing sector, for example, and it is related to help desk outsourcing, although seldom included in XSP discussions. IT is an integrated part of an organization's production chain and permeates every business function. The convergence of data and voice is generating a demand for new services and helping to change the landscape.

An important development is the increasing importance of BPO, which includes outsourcing of a variety of specific functions ranging from accounting and human resources (HR) services to customer relationship management (CRM) and call centers. This area includes a large IT and networking services component, although it is not always included in analyst breakdowns. The most important and fastest growing area of BPO is, in fact, CRM and call center outsourcing, which frequently involves telecom, networking and IT services.

Call center outsourcing is an area of particular importance to an understanding of network services outsourcing, since this is the central focus of voice/data convergence. Call centers are migrating toward Web-based interactions, voice over IP (VoIP) and sophisticated data networking and IT infrastructure.

BPO players include consultants and IT integrators, process specialists, ASPs, pure-play BPOs and IT platform outsourcers. BPO is significant in that it represents a fragmentation of the outsourcing market and an avenue for new offerings for established vendors. BPO expands market opportunities by incorporating revenue for services beyond just managing technology. But it also requires special expertise in the process areas. CRM and, specifically, call center outsourcing is expected to be the fastest-growing BPO segment in the coming years.

One recent issue of note is that BPO and traditional IT outsourcing are now being combined in single contracts, with BPO often primary in decision making.

Outsourcing Models

There are a number of basic models that can be used by outsourcing companies to provide services. These are:

- Service provision and management
- Business process outsourcing
- ASPs and managed application services

Service provision and management make up the largest portion of IT and telecom outsourcing. In this model, a complete service, such as an IT or telecom service is simply provided and managed by a major vendor, such as IBM or EDS. This is the old facilities management model, which continues strongly in the large corporate sector.

BPO means outsourcing specific business processes, such as financial activities, HR activities, purchasing, document management and so forth. This has two key differentiators from service provision: first, individual processes are outsourced, rather than complete departments, and secondly, that the processes outsourced may include IT and may require special linkages with IT and telecom infrastructure, but the processes themselves may be from any sector.

A third and growing area is the remote management and service provision sector, which includes the ASPs, MSPs, SSPs and the like. This type of outsourcing takes advantage of high-bandwidth networks

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and the economics of mass provision to make services available from a central source, which might include applications, network management, storage management or other areas. Like BPO, it represents a fragmentation of the monolithic facilities management model to provide more easily customizable services to smaller enterprises.

Finally, a distinction may be made in terms of location. Outsourcing may be done locally or on premises, as in the facilities management model; remotely in a centralized location; or overseas, taking advantage of reduced labor costs. Outsourcing overseas can result in large cost savings and is increasingly popular with call centers. There are special concerns here, of course, with respect to communications, training and cultural differences. However, the savings are potentially so huge that many companies are taking advantage of offshore outsourcing in areas such as software development, transaction processing, help desk operation and similar areas in addition to call centers.

Outsourcing Market

The outsourcing market in general continues to grow, although there has been a recent slowdown in the IT infrastructure services sector as a result of the current economic climate. Mergers and acquisitions continue, despite a poor economy, with the principle drivers being the need to gain market share, broaden services and accelerate revenue growth. Some examples include the acquisition of KPMG Consulting by Atos Origin SA, Software Logistics Corp by CMGI, PWC Consulting by IBM, Condor Technology's Government Solutions Group by CAC International, Aegis Research by Mantech International, ADI Technology by Perot Systems and Netigratez by the Casey Group.

Major outsourcing suppliers within the IT infrastructure sector — which includes major enterprise network services — remain the large operations of IBM, EDS, CSC, Accenture, ACS, Unisys and similar operations. These generally provide facilities management services to major corporations. Second-tier suppliers specialize in handling niche markets, either vertically within an industry or horizontally across a range of services. In the telecom and call center outsourcing area, the major players are the legacy telcos, although there are a number of important niche players.

The next level of suppliers are those that focus specifically on enterprise network services, starting from outside the corporate firewall. AT&T was the earliest provider in this sector. Other telecoms, including Sprint, WorldCom and Qwest, participate in this niche and have also added ASP, MSP, hosting service provider (HSP) and data center services. Even as the telecoms move into the outsourced networked management market, IT outsourcers such as CDC, ACS and EDS are beginning to offer telecommunications services and call center support as part of their outsourced offerings.

Current trends are toward providing services to smaller businesses, where there yet remains plenty of room for expansion, as well as in product segmentation. Segmentation means providing a range of service possibilities rather than taking over the entire IT operation.

The most important industry association in this area is the Strategic Sourcing Advisory Council (SSAC). The SSAC was launched in June 2000 as the MSP Association. It is a global, nonprofit organization committed to supporting quality service management standards. Among its objectives are broadening awareness and educating the market on managed services and outsourcing solutions, and improving quality-of-service delivery with best practices.

The community involved with the organization has matured with the MSP market, moving toward a broader vision of IT outsourcing that encompasses a wide range of possibilities. These possibilities now include:

- Managed services

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- Web hosting
- Security services
- Storage services
- Web services
- Application services
- Consulting services
- Strategic sourcing thought leadership

Making the Outsourcing Decision

Companies outsource for a variety of reasons, the most important of which are to reduce operating costs and to focus on the core business without involvement in the increasingly complex and arcane worlds of IT and telecom network management.

With the growing trend toward partial outsourced solutions, management will have greater flexibility in meeting needs. Outsourcing permits the company to focus on its core competencies and lets remaining IT and telecom staff focus on core competencies that are unique or of special interest to the business.

Specific advantages include:

- Cost/Risk Reduction
 - Outsourcers can take advantage of mass delivery to reduce cost, and their experience can speed implementation, particularly in the world of e-business where expectations for rapid development are high. E-commerce software is also growing in cost and sophistication, making it difficult for companies to keep up.
- Focus on Core Business and Core Competence
 - Companies may not have general IT expertise available and may not wish to develop and manage these skills since they are not related to the company's general business focus. For companies that have strong IT departments, focusing on critical software or unique skills may make it preferable to outsource general IT processes.
- Improve Speed to Market
 - Building support infrastructure takes time, and this option may not be available for companies introducing new products. The capability to make rapid changes, as provided by outsourcing, speeds time to market and enhances the capability to innovate.
- Compensate for Shortage of IT Personnel
 - Global IT shortages continue, despite the dot-com bust. This will continue, particularly in specialized areas, which can be more efficiently provided by outsourcers.
- Improve Access to Equipment
 - Investment in IT equipment, software and infrastructure can be staggering. Startups may have no option but to outsource. This also protects the investment and ensures up-to-date technology.
- Buffer from Changing Environment

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- Outsourcing mitigates environmental change, since the outsourcer can provide expertise and manage upgrades.
- In a fast-moving technology environment, outsourcing helps a company to avoid large capital investment and still remain up to date with technology. The outsourcing supplier handles plans and manages the obsolescence issue.
- Outsourcing ensures that skills are available, even if they are infrequently used. The outsourcing supplier can afford to employ individuals with special skill sets that can be utilized on an occasional basis throughout its customer base.
- Routine, high-cost services such as maintenance can be offloaded, taking advantage of cost savings available from the service provider's wide customer base and deep experience.
- Outsourcing provides flexibility in changing market and technology conditions. Network infrastructure and services can be changed or upgraded more easily using the service provider's resources.

Outsourcing makes it possible to provide services for both data and telecom in areas that may be distant from the home office or in remote locations, if the supplier provides a global service.

There are some downsides to an outsourced solution, however, and for many organizations they may be significant. For one thing, projected cost savings are often overstated, and contracts can lack flexibility. Many companies are also hesitant to share sensitive information and toolsets with third parties who might have competitors as customers. (The supplier may be trustworthy, but what if one of their employees leaves the firm?) Fitting the outsourced operation into a company's operations can also create tensions among remaining staff and can be difficult to fully integrate with established systems and operations:

- Staff may become concerned about potential layoffs, and key personnel may leave before final arrangements are made. Employees leaving as a result may lose valuable experience.
- There may be conflicts between the outsourcing operation and the company with respect to hardware, software or procedures — or in relations with other vendors.
- Costs can easily be underestimated, and the cost of overseeing the outsourced operation is frequently ignored. Evaluating bids for services is notoriously difficult in the shifting terrain of today's network services sector.
- The outsourcing supplier may have insufficient knowledge of the customer's business, resulting in unacceptable performance or outcomes that might endanger relationships with customers.
- The customer may get locked into an outsourcing supplier's technology, systems or contractual obligations.
- Businesses perceive their information as a competitive advantage. Moving it outside the enterprise is seen as a threat, risking exposure and loss of control, particularly if an outsourcer also works with competitors.
- Long-term contracts may lock the client in to dated technologies. It can be difficult to modify contracts and almost impossible to change outsourcing vendors.
- Placing responsibility for IT with an outsourcer inherently involves some loss of control in how solutions are delivered.

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Most of these problems are caused by either a lack of understanding between the two parties based on optimistic projections and the lack of a firm SLA that spells out expectations on both sides. If the decision is made to outsource, you must determine what processes and services would best benefit from outsourcing and the service model that should be provided. You can then assess the probable impact on established systems, on business processes and on your own employees.

Selecting a Supplier

Outsourcing demands careful evaluation from the beginning. Options should be evaluated by a team that includes representatives from all affected departments. A thorough business case analysis needs to be created, taking future needs into account. Once the decision has been made to outsource, the specific services and infrastructure areas that can best benefit from this approach need to be identified and an outsourcing vendor or vendors must then be selected. A plan can then be drawn up with the vendors to transition to the outsourcing arrangement.

Selecting an outsourcer requires careful evaluation. Important things to look for include:

- Demonstrated expertise in the areas of most interest to the client, including past work for similar firms.
- Reasonable cost structure and a clear definition of services on offer.
- Compatible infrastructure, including hardware, software, management tools and network facilities.
- Good references from clients with similar needs.
- Organizational strength, including size, time in the business and reputation.
- Adequate staffing and management structure to handle normal operations as well as emergencies.

Defining the Contract

Before you begin to evaluate an outsourcing provider:

- Obtain a copy of the outsourcer's service catalog, which provides detailed terms, describes its services and describes how the provider measures its services.
- Find out what process or methodology is used to deliver the service and manage IT infrastructure operations.
- Find out what is to be automated and what is not. Automated processes improve efficiency, and a mature outsourcer will have developed these in a number of areas.
- Find out how the outsourcer will meet the deliverables to ensure that adequate processes are in place.
- Determine what measurement system is in place, or needs to be in place, to attain appropriate service.
- Set up a firm SLA.

The SLA is critical to developing a good relationship with the outsourcer. Some issues for setting up effective SLAs:

- Ask for only what you need, and be certain that it is cost-effective. Perfect security, for example, is extremely expensive. However, protection of strategic areas from certain risks can be achieved at a reasonable cost.

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- Protect important items such as critical servers by providing special requirements in the SLA.
- Define terms of the agreement carefully, and specify how they will be monitored.
- Demand continuous improvement.
- Set realistic rewards and penalties.
- Carefully model service requirements to your own business requirements.

Market Leaders

The network services outsourcing market is highly fragmented and involves numerous players. Defining leaders is heavily dependant on which sector of the market is the central focus. Leaders in some areas are not necessarily involved in others.

IBM Global Services

IBM may be considered the overall leader in this sector, due to scope and sales volume. IBM's Global Services provides business innovation services, integrated technology services and strategic outsourcing services. IBM focuses on managing processes that complement a company's mission-critical activities.

IBM offerings:

- Transformational Outsourcing (outsourcing as an aid to restructuring for e-business)
- Application Management Outsourcing
- E-business Hosting Services
- Data Center Outsourcing
- Desktop Outsourcing
- Network Outsourcing
- Managed Storage Services

AT&T

AT&T is primarily a network services provider, now offering a wide range of managed services and outsourced management services. Unlike the IT outsourcers, it comes from the telco environment and has grown into data services through a background in providing leased lines and WAN connections. Its network offerings do not overlap IT services as extensively as the IT-based providers.

AT&T offerings:

- Managed Network Services
- Web Hosting Services
- Data Center Outsourcing
- Business Continuity Services

Computers Sciences Corporation (CSC)

CSC is a leading provider of IT services to commercial and government entities worldwide. It offers a broad range of services, including consulting, outsourcing and systems integration.

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CSC offerings:

- Business Process Outsourcing, which focuses on energy industry offerings, financial services, health services and HR services
- IT Infrastructure Outsourcing
- Network Management Outsourcing
- Application Outsourcing

Affiliated Computer Services (ACS)

ACS is a *Fortune* 1000 information technology provider with operations in North America, Central and South America, Europe and the Middle East. The company provides a full range of services, including technology outsourcing, business process outsourcing and professional services to more than 10,000 clients worldwide.

ACS offerings:

- Business Process Outsourcing (including accounting, billing call centers and transaction processing)
- Information Technology Outsourcing
- Systems & Integration Outsourcing
- eSolutions Outsourcing

Electronic Data Systems (EDS)

EDS is primarily known for IT facilities management services for a global clientele. Services provided may be broadly categorized into IT solutions, business process management and consulting. IT solutions include network and system operations, data management, field services, applications development, Internet hosting and Web site development and management. EDS serves more than 9,000 accounts around the world.

EDS offerings:

- Applications Services Outsourcing
- Enterprise Application Hosting
- Extended Enterprise Integration
- Application In-Sourcing
- Business Process Outsourcing (including HR, Finance, CRM)
- eBusiness Outsourcing

Unisys

Unisys focuses on delivery of e-business solutions to customers in 100 countries around the world. More than 70 percent of the company's sales come from consulting and integration services, mostly for niche customers in the United States.

Unisys offerings:

- Business Process Outsourcing

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- IT Outsourcing
- Managed Application Services
- Network Services Outsourcing (including security infrastructure)

Accenture

Accenture is a major provider of outsourcing services, with an approach based on transformation of business processes. The company has 350 clients in 21 industries on six continents around the world. Outsourcing ranges from single, customized solutions to “netsourcing,” or providing standardized solutions to multiple users over the Internet.

Accenture offerings:

- Business Transformation Outsourcing
- Business Process Outsourcing
- Applications Outsourcing
- Technology Infrastructure Outsourcing

Insight

Network services outsourcing represents an increasingly popular option as networked systems become more commonplace, skill shortages continue and infrastructure requirements become even more complex. The market is moving away from the total outsourced facilities management model toward selective outsourcing and BPO, which provide more flexibility and are more attractive to smaller organizations.

For companies considering an outsourced solution, there are several important factors to bear in mind:

- Don't overestimate the cost savings benefits of outsourcing. While savings can be found, they may be difficult to quantify and difficult to prove. There may also be substantial financial risks in long-term outsourcing contracts.
- Know your own costs before considering outsourcing. This makes it much easier to benchmark and provide reasonable goals when a contract is in place.
- Establish a strong SLA with objectives, including incentives for superior execution and penalties for subpar performance.
- Reexamine the outsourcing solution often, and survey users to see how satisfied they are with results.
- Start slow and build, rather than putting the bulk of your IT in an outsourcer's hands at once.

Successful outsourcing demands careful attention to contract details and development of a strong business case. Other items to look for:

- Make certain there is an exit route should the vendor experience problems, including items such as source code escrow provision, available alternate suppliers and a transition policy that can be put into place.

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- Make certain you can identify hidden costs. This includes the cost of finding a vendor and establishing a contract, which may run as high as \$500,000. Transition costs, including an overlap period in which duplicate services are provided, can run to \$300,000 annually.

Network services outsourcing clearly represents a strong trend for the future, despite some recent setbacks, as the market seeks to define itself. The current economy has tended to sharpen the focus on selective outsourcing, rather than complete facilities management, and it has impacted some of the major players as companies seek to renegotiate long-term contracts and redefine services to reduce expenditure. This is likely to strengthen the trend toward mergers and acquisitions in this sector as the economy recovers.