



The Future of IT Outsourcing

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Introduction

IT outsourcing has been a part of many large companies' IT strategies for the last decade. In the current tough economic climate, it has gained renewed attention particularly for its ability to deliver perceived short-term cost savings.

But can IT outsourcing really deliver the promised benefits to businesses in the longer-term? If not, why not? Are there any alternatives? Where, for example, does the current trend for cloud computing fit into this model?

This report examines the challenges associated with IT outsourcing, as well as the latest industry thinking on other options. In the same way there is no longer a "one-size-fits-all" model for customer service, there is no longer a one-size-fits-all dimension to outsourcing either.

On the contrary, if there is any future in IT outsourcing, it is in the domain of tailored services sustained by long-term and close relationships between clients and vendors.

Traditional IT Outsourcing

The operational savings in relocating large swathes of IT services from high-cost Western-resourced centres to low-cost "offshore" locations such as India, China and former Soviet countries can be immediate and attractive. However, the case for the longer-term benefit to the business is still far from proven.

The most common complaint on the impact of outsourcing relates to degradation of service quality. For users of IT within a company this can impact efficiency. For customers interfacing



with this outsourced service - such as through call centres – this perceived degradation can be terminal for the business relationship. The savings introduced by outsourcing can quickly be negated by other losses to the business.

Worries do not end with the service quality to customers or end users, but can often affect the sustainability of the outsourced service itself. In February 2010's "Communications of the ACM", Nikhil Mehta and Anju Mehta write, *'The IT outsourcing industry landscape is dotted with broken contracts - results of unsuccessful client-vendor (C-V) partnerships. Approximately 78% of C-V partnerships fail in the long term, inflicting high transition costs on clients.'* Companies are quick to focus on the potential cost-savings of IT outsourcing, but rarely highlight the cost of outsourcing relationships which have broken down.

It is also worth highlighting that the traditional IT outsourcing model – moving whole departments or even centres from West to East - has predominantly only been open until now to Blue Chip companies whose size of organisation and massive operational costs might seem to justify such a move.

Developments in technology and more sophisticated best-of-breed approaches, however, now open up opportunities for smaller and mid-sized companies who also want to look at reducing IT service costs whilst trying to avoid the pitfalls of traditional outsourcing. Blue Chips can equally benefit from a more savvy approach, learning the lessons of the last decade of IT outsourcing failures.

'High-End' Consultancy and Service Partners

A counter-approach to the low-cost IT outsourcing model is to turn the tables in favour of high-end, "onshore" service partners, where quality is more likely to be assured. Blue Chips have long used Western-located large IT service partners and consultancies for outsourcing certain services they do not want to keep in-house. But these services come with a much higher price tag – on paper at least - than outsourcing to the East.

Yet where service quality levels have been maintained, higher priced outsourced service contracts have often been sustained as a consequence. Even in today's cost-conscious environment there is an argument for leaving things that way. Indeed, large companies looking to outsource for the first time to the East, might do well to bring in 'high-end' consultancy partners to first examine the cost of outsourcing over the full lifecycle of a service and share the lessons learned of low-cost outsourcing failures over the last decade. The results of such a study might point to outsourcing instead to higher-priced but higher quality onshore partners, even if the short-term cost savings are not as apparent.

But, again, the cost of Blue Chip consultancy and service partners is out of the reach of many small and mid-sized companies, so what are their alternatives?

Niche Consultancies and Service Partners

Smaller onshore consultancy and IT service partners can often deliver just as good quality support to businesses looking to outsource certain elements of their IT services. They will come with a cheaper price tag than high-end consultancies and can often deliver even better results because they have specialised knowledge within their specific business niches. Whilst they may not have the capacity to sustain large requirements from Blue Chip customers, they can often be an ideal outsourcing alternative for small and mid-sized businesses.

For larger businesses to tap into this option, they need to rethink their outsourcing approach. Instead of a single outsourcing partner, they should consider obtaining the services of a number complementary niche partners instead.

Steve Ranger's article "Under a Cloud" in November 2009's "Director" magazine notes, *'The trend is towards multi-sourcing or a best-of-breed approach, where a variety of outsourcers take on different parts of the infrastructure. One supplier could manage data centres, another telecoms and a third software development or security. Alternatively, some projects or services are outsourced while the internal team runs others.'*

Cloud Computing

The current buzz-phrase within IT Strategy is “Cloud Computing”. Improved network infrastructure, online service offerings and new virtualisation technologies mean companies can now lease “Software As A Service” (SaaS) from a third party provider. With SaaS, the vendor provides access to an application through the internet for a monthly fee and in the process takes full responsibility for sustaining the service, updating the software, and maintaining the hardware upon which it runs.

SaaS and other cloud computing options present an opportunity to outsource not just high-cost resource but almost the entire IT organisation and associated infrastructure and applications. In particular, they offer a realistic ‘outsourcing’ option to many smaller and mid-sized organisations for the first time. And the leasing costs are often likely to be lower for a smaller organisation than maintaining their own IT infrastructure and services in-house.

Selecting a range of SaaS providers to provide all essential business applications could be the standard approach to outsourcing in the future. For all its benefits, however, there are issues too.

Any outsourcing presents risk of a loss of control of key business services, which can be catastrophic – as with traditional IT outsourcing – if the outsourcing provision does not work out as intended. Leasing services across the internet potentially increases the risks of network downtime too and, worse, it is beyond the control of a company’s own IT department to fix such issues when they do occur. Security issues still need to be bottomed-out as well, which is preventing many larger companies from more widely adopting the SaaS model today.

Do Nothing – Keep It In-House

Steve Ranger adds in his “Director” article, *‘Companies should also be aware of the recent trend for insourcing. Some high-profile organisations believe that their forays into outsourcing have not produced the benefits required and have decided to pull IT back in-house. All of which means*

those directors who hope outsourcing is a chance to forget all about the IT department might end up a little disappointed.'

For all the outsourcing options now available to companies of all sizes, doing nothing and keeping services in-house remains a valid approach. The risk of losing control and security concerns can often be managed much better in-house. Communication and cross-cultural issues are also less likely to be a problem.

But the downsides remain too – and these are the reasons companies often look to outsource in the first place. Keeping IT services in-house potentially means the company is not open to benefitting from outside specialist knowledge. Services and quality can suffer from a lack of in-house competence, just as much as by outsourcing to the wrong partner. In-house also means there is the risk of 'job hoarding' to protect roles – ultimately leading to higher staff costs – plus the usual challenges of staff management. Further, the potential savings of outsourcing some operations and running a leaner in-house operation are no longer available.

Conclusion

So what is the solution? There are more outsourcing – and insourcing – options available to all businesses than ever before, yet all come with the risk of significant downsides if not implemented and managed correctly. This, in fact, is the key point.

The debate is not so much about traditional outsourcing vs niche partners vs cloud computing – although these options all have to be examined in the first place to establish the appropriate needs for each organisation. Instead - once the approach has been established - the focus needs to shift immediately away from the 'what' to the actual relationship with the chosen third parties (or in-house staff).

A decade of traditional IT outsourcing has already demonstrated the high-likelihood of a long-term failure of the relationship between the client and vendor. Outsourcing will continue, though, with the advent of cloud computing or opportunities to engage a range of niche partners for IT support. But more than ever, this highlights the importance of properly managing a range of client-vendor



relationships and the centrality of close communication with outsourcing and SaaS partners. Frank Ridder, research director for IT services analyst Gartner, states, *'More and more organisations are looking at having a best-of-breed approach. In the long run, when companies really buy into cloud computing, vendor management will become even more central.'*

How to manage so many relationships is the new challenge for today's generation of IT managers and directors. In the past, even where outsourcing was used, there were generally only one or two vendors to manage. Niche consultancies and IT service management experts can play a key role in helping to establish and manage these relationships on an ongoing basis, but they too are also a relationship for IT managers to sustain. *'The IT department of the future may be smaller but it will become more important...it will switch from delivering services to managing relationships,'* says Steve Ranger.

IT is undergoing a new massive transition and the debate about the various outsourcing options is at its core. Those IT managers who succeed in navigating the uncharted waters ahead will not be so concerned with the technicalities of the underlying technologies involved. They will be focused on how relationships are managed with an array of service partners and dedicated to improving communication and dialogue on service management.

As Nikhil Mehta and Anju Mehta conclude, successful IT managers will now recognise *'the importance of...relational investments...Greatest outsourcing benefits accrue to the clients that actively participate in developing an interactive relationship with the vendors.'*