The *Connected* Business

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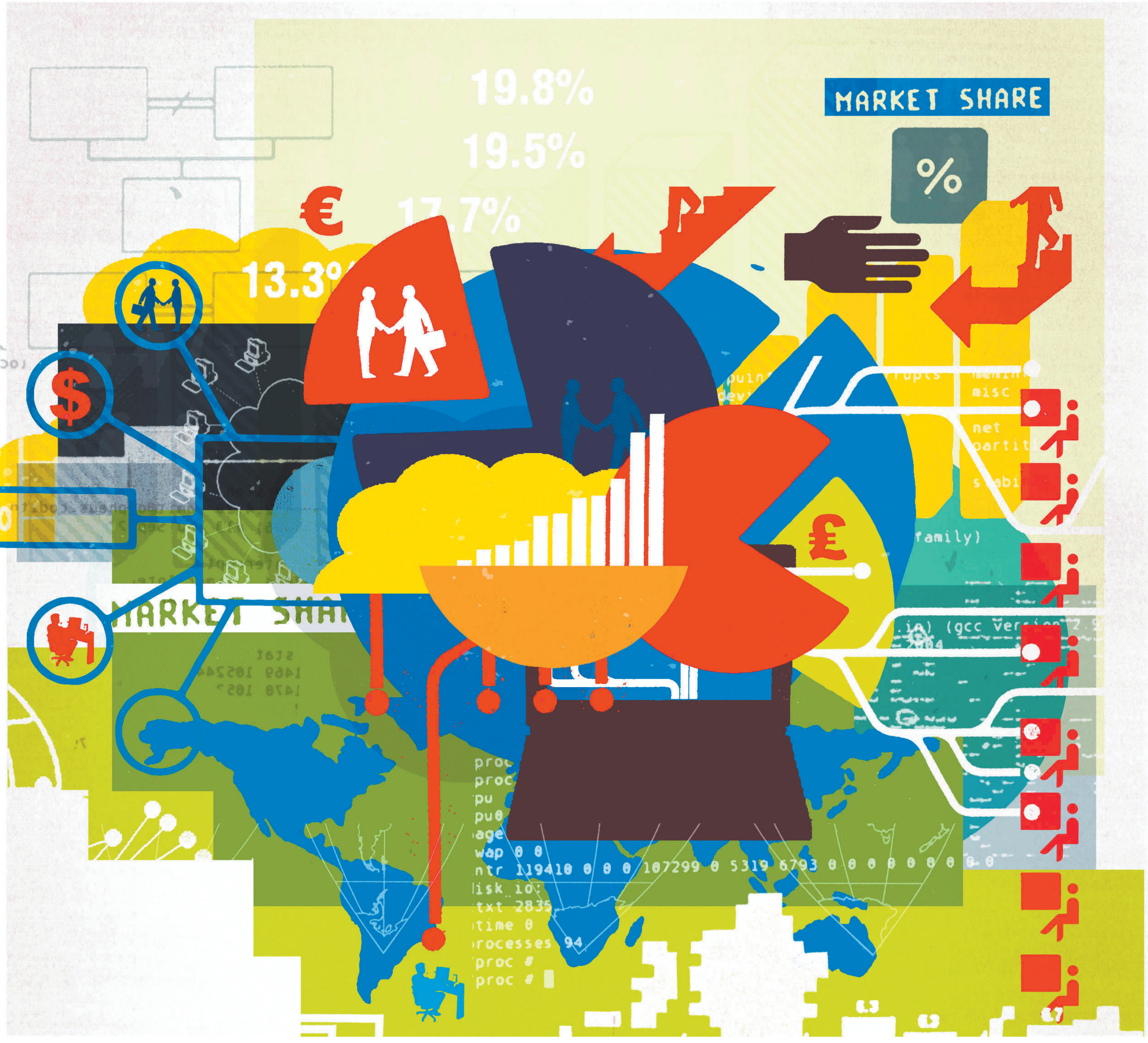
Model that works even in turbulent times

Paul Taylor introduces a focus on outsourcing – used for flexibility, to harness new skills and cut costs



In the 25 years since such western multinationals as Eastman Kodak, GE, Citibank and American Express began to outsource their IT operations, the global IT services industry has grown into an $820bn behemoth and outsourcing has gone mainstream.

"Outsourcing is no longer a novel business tactic where companies are forced to farm out a function they cannot manage internally," says Jagdish Dalal, managing director of the 110,000-member International Association of Outsourcing Professionals.

"Outsourcing is providing companies with alternative business models, whereby they can manage a small but market-differentiating core while engaging expert third parties to perform the necessary work.

"This 'atomic' business model is helping them not only weather the [economic] storm, but create a market advantage – even in these turbulent times."

Companies, big and small, also use outsourcing to give them flexibility as they expand their markets.

In March, Royal Haskoning, an Netherlands-based engineering and environmental consultancy, signed a multiyear, multimillion IT infrastructure outsourcing deal with India's Tata Consultancy Services.

TCS is providing a full suite of IT infrastructure services, including a multilingual service desk, datacentre hosting and management, end-user computing services and application support services.

"Royal Haskoning is planning to grow, not only in our home countries but across emerging markets," explains Eric Overvoorde, chief information officer.

"We face interesting challenges, so consistent experience of service delivery is essential for us to be successful."

With TCS taking care of Royal Haskoning's IT infrastructure, its management will be able to focus on business performance and international growth plans in Europe and elsewhere.

As Royal Haskoning demonstrates, IT outsourcing is no longer the preserve of big multinationals.

The market has expanded to embrace relatively small and medium-sized companies.

In the UK, for example, Everest, a provider of double glazed windows, wanted to upgrade its network and IT infrastructure but did not want to commit to a long-term deal.

"Initially, we needed a supplier with system expertise but with flexibility in its approach," explains Dave Gordon, IT services manager. Last year, Everest selected Calyx, a US-based independent managed service provider for the project.

"We agreed a one-year contract with Calyx that had the merit of minimal set-up costs," says Mr Gordon.

"Once we had worked with Calyx for a while, its team's ability to innovate while retaining a flexible approach in day-to-day operations was obvious.

"We have been pleased with the team's input and extended the managed services agreement and this is helping us ensure enhanced wide area network (WAN) capabilities for our departmental users."

In the past, outsourcing has focused on IT services, but one of the fastest areas of growth over the past decade has been business process outsourcing (BPO).

As with IT outsourcing, there are many reasons why companies such as Microsoft, the US software group, and pharmaceutical companies including AstraZeneca have chosen to hire external help with business processes.

Microsoft set out to re-engineer its global finance processes and operations under its 'OneFinance initiative', launched in 2006.

As part of this effort, the company outsourced back-office finance transactions in 95 countries to Accenture, the consultancy, under an agreement designed to promote a commitment to "mutual gains and performance improvements".

More recently, in 2009, Genpact (the Indian BPO company that was spun out of GE) signed a five-year contract with AstraZeneca to provide the pharmaceutical group with global finance and accounting services, which it did not consider to be a "core competency".

Tony Glynn, AstraZeneca's senior director for transformation global transactional finance, explains:

> 'As the cloud grows, it will steal more attention from traditional outsourcing models'

"We had entered into a period when the whole pharmaceutical industry was changing and getting ready for greater competition, more uncertainty around patent expiries and so forth."

Mr Glynn initially identified some six BPO providers that could offer the transactional finance processing services that he was looking for and finally chose Genpact.

"We signed a contract in November 2009, and we are now about 80 per cent of the way through the transition of our activities across to Genpact," he says.

Like most other big pharmaceutical companies, AstraZeneca has also outsourced much of its IT.

"We have also signed a contract to outsource some of or human resources work, and we've already done some selective outsourcing of some of our R&D work," explains Mr Glynn.

Mr Dalal points out that the pharmaceutical industry is full of examples of companies that outsource their R&D activity for drug development.

On the other hand, he says: "real estate outsourcing provides companies with options for conserving their capital instead of investing in a building." And IT departments have long used outsourcing to provide innovation and fill skills gaps.

"Manufacturing outsourcing [also] provides many examples of converting fixed cost base for production to a more variable cost basis," he says.

A recent survey of more than 2,500 chief information officers conducted by PA Consulting and Harvey Nash, the recruitment business, reached similar conclusions.

While cost reduction was the rationale most often given for outsourcing, companies reported that the second most important reason was to to access skills not found in-house.

The same survey also underscores the growing popularity of IT outsourcing.

Almost a third of CIOs said they would spend up to a quarter of their entire IT budget this year on outsourced activity and more than one in 10 said they will spend 50 per cent of their budget on outsourcing.

Software application development remains the most popular outsourced activity, although external help/service desks are now being used by 40 per cent of CIOs worldwide.

Do companies also have an eye on the growth of enterprise cloud computing?

"Cloud computing is one form of outsourcing," says Daryl Plummer, of Gartner, the research company.

"The difference is in the types of contracts and terms applied.

"In cloud computing, there is one contract that is applied to all customers in the same way."

Mr Plummer believes cloud computing and traditional outsourcing will both continue to exist side by side.

"Some companies need the customised delivery of services that traditional outsourcers deliver.

"Some need more commoditised services at the large scale that cloud computing delivers.

"But as the cloud model continues to grow, it will steal more attention away from traditional outsourcing models."

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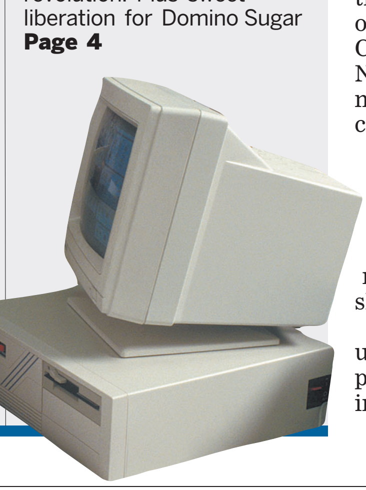

Get Connected online

Internet is industry Achilles heel

Security

There is confusion between cloud computing providers and clients about who is responsible for security, says **Maija Palmer**

Recent high-profile hacking attacks, such as the theft of more than 100m customers' details from Sony and a four-day data centre outage at Amazon that took down thousands of websites, have done nothing to reassure companies about the security of cloud computing.

Hacking is one of the biggest concerns for companies considering outsourcing IT functions to an external provider. A recent survey by the Cloud Industry Forum found that 64 per cent of companies named this as their chief worry in moving to a cloud-based IT model.

Although the majority of businesses – one recent study put this at about 90 per cent – are taking steps to outsource IT, their approach is often hesitant and limited to transferring less critical business functions such as e-mail and data back-up.

About 41 per cent of companies outsource their e-mail, but only 11 per cent process their payroll through an external service.

Ryan Rubin, UK head of security and privacy at Protiviti, an IT security company, says: "There aren't many people putting mission-critical data in the cloud. The crown jewels – customer records, for example – are still very much embedded in the organisation."

A director at one London investment bank says: "We use the cloud for things such as e-mail. We would never put our client services on it."

Fears about cloud computing are not entirely justified, says John Walker, a member of ISACA, the security advisory group.

Companies are more likely to lose data if they run their own data centres, he says, than if they entrust the information to a professional outsourcing company.

There is a long list of companies whose corporate data has been compromised by hacking, lost laptops and USB sticks left on trains and in taxis.

"A lot of organisations who say they don't trust the cloud should look at how they operate their own IT department," Mr Walker says. "Datacentre companies provide technology and well-trained staff better than the average company does."

Last year, when Anonymous, a group of hackers, began attacking the systems of companies that had

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Standardisation is the way to save

Industry trends

Providers look for work that is scalable and repeatable. They avoid complexity and systems that need customising, discovers **Jane Bird**

The first wave of business process outsourcing (BPO), 20 years ago, enabled many organisations to cut their costs by up to a third. Outsourcing companies could be more efficient and achieve economies of scale by performing similar back-office tasks – typically HR, finance and procurement – for a number of clients.

By the turn of the millennium, outsourcers had begun offshoring to India and the Philippines, where cheaper labour enabled them to deliver further significant cost reductions.

But since 2007, the potential cost savings of outsourcing have been shrinking. In that year, 87 per cent of US and European organisations reduced their costs by at least 10 per cent, according to research by Gartner, the consultancy.

In 2010, just 58 per cent of companies managed this. The financial advantages seem to be flattening out, says California-based Robert H. Brown, Gartner's research vice-president, BPO.

Not surprisingly, some outsourcers have struggled to survive. Convergys wrote down $273m at the end of 2008 on a business with $60m revenue. And in March last year it sold its HR management arm for about $100m to NorthgateArinso of the UK.

Hewitt Associates, a UK consultancy, which bought Exult, an HR outsourcing company, in 2004 for $613.5m, found the contracts it was signing difficult to fulfil. Within three years it wrote down almost $920m.

Mike Gammage, vice-president for product marketing at Nimbus, a software company, agrees that BPO cost-savings are dwindling. But this does not mean it is on the way out, he says. "Providers such as IBM, Accenture, HP, Capgemini, Tata Consultancy Services, WNS and Wipro are making money and expanding."

Moreover, process management has become fashionable. "It used to be seen as a boring back-office, career limiting overhead, whereas now it's become worthy of attention," Mr Gammage says.

Seeing the cost-benefits of BPO in isolation is misguided, because it depends what an organisation is trying to achieve, says Tim Palmer, who leads PA Consulting's BPO services. "Some companies use BPO because they can't afford to invest in, say, an HR application. By outsourcing they save on the wage bill, but the main advantage is that they don't have to build and maintain the system themselves."

Other motivators include a desire to shed non-core activities, or to access specialist knowledge. "The latest wave of cost cutting is in the creation of 'service centres' that can run standard applications for a number of companies," says Mr Palmer. These often include learning-administration, HR helpdesk, performance management, payroll and accounts payable.

Cloud computing is seen as the latest big opportunity to cut costs, by enabling BPO to be provided online, on demand. "This is the next generation of thinking, but is not yet a reality, although some companies do claim to offer it," Mr Palmer says.

Saving money with BPO now tends to mean working in a more standardised way. Outsourcing companies look for work that is scalable and repeatable. They avoid complexity and systems that need customising for individual clients.

This was the experience of Mike Dunlop, when, as HR director of Sun Microsystems, he signed a five-year global contract in 2005 with Hewitt Associates. It worked well for standardised processes, he says, but proved more difficult in areas such as employment relations, where regulations vary between countries.

"The scope of the initial contract was too ambitious and both sides realised it, so we brought some back in-house," he says. "Many outsourcing contracts hit similar problems after a couple of years."

Renegotiating contracts in these circumstances can be expensive, says Mr Dunlop. "The big question is where you draw the line about what you give to somebody else and what you continue to do in-house.

Big multinationals still have many legacy terms and conditions, practices and policies that make it hard for them to take advantage of the outsourcing opportunities, says PA's Mr Palmer.

"Smaller, more nimble companies are better able to do so," he notes.

The continued focus on financial savings by BPO buyers is driving providers to look at other low-cost areas such as central America, says Gartner's Mr Brown.

Other providers, such as Cognizant of the US, are investing in automation. They are using software to take humans out of the equation, replacing call-centre staff with interactive voice response to drive more efficient process management.

BPO providers should make processes better rather than cheaper, says Mr Brown. "The focus needs to be on analytic services and knowledge processes, not about cost reduction, but getting better insight."

By 2000, outsourcers began offshoring to India and the Philippines, where cheaper labour offered much lower costs Getty

First, ask 'why are we doing this?'

Business case

Only well run IT functions should be delegated, finds **Charles Batchelor**

For many chief executives, outsourcing IT functions came to be seen primarily as a way of cutting costs during the recession.

Businesses that had signed contracts scrambled to renegotiate deals, extending terms and scrapping non-essential features to reduce their annual outlay.

But outsourcing IT should never be seen solely or even mainly as a means of reducing outgoings, according to experts.

The decision on what to delegate needs to fit into a broader corporate strategy based on what is crucial to the success of the business and what is routine.

"In the first place, you need to know why you are doing it," says Alistair Maughan, a London partner at Morrison & Foerster, a law firm. "It seems obvious, but you would be surprised how many organisations go into it without a clear, consistent idea as to why."

Outsourcing can be used to allow management to concentrate on the company's core business; to access people with specialist IT skills they could not otherwise find; to improve business performance by upgrading the operation of vital computer-based services, or to spread the operational risks of running an IT department.

"We are in transition – back from the recession, when saving costs dominated everyone's thinking – to a broader spread of reasons," comments Mr Maughan. "Companies should do it to improve their business rather than cut short-term costs.

"But whatever set of reasons predominates in driving outsourcing, they should be shared by the chief information officer, the chief executive and the finance director."

Before outsourcing any IT functions, management needs to ensure they are well run to start with.

"A business can't outsource its problems," says Neil Louw, chief technology officer at Dimension Data Europe, an IT services vendor. "If it attempts to use outsourcing to fix a broken business process or to standardise processes across different parts of the organisation, it will almost certainly fail."

Jo Stanford, group IT director at De Vere Group, the hotel operator, says that if a business decides to outsource, it needs to carry out thorough due diligence on its potential partner. "You need to look for full financial security, and at the vendor's expertise and ability to deliver." Previous experience of IT service providers going into administration was "a nightmare", she says.

"Vendors can offer a fantastic price, but you need to drill down to the after-sales care that they provide and get references from other customers. This is a connection that requires more than the traditional supplier relationship."

De Vere's web-based booking system is hosted by Claranet, a provider of managed IT services.

In the past, managers were often too eager to outsource functions that they should have kept under their own direct control.

"Historically, clients have outsourced too much: elements that were absolutely critical to the organisation," says James Cockroft, associate director at Xantus Consulting, an IT specialist.

"The client ends up having to take responsibility and has to bring in more people to fill the gap. It can end up costing you more than expected, because you need to backfill certain roles."

Companies have run into difficulty because the IT service provider has failed to keep an up-to-date inventory of the number of computers being used, so it fails to maintain enough software licences.

Successful outsourcing deals may even lead to greater spending by the client. "A well managed deal will reduce your unit costs, but will not necessarily reduce your overall spend," says Mr Maughan.

"If it works well, it should support more of your business. You spend more because you are investing in higher quality services."

Alistair Maughan: Outsource to improve business, not to cut costs

In the early days of outsourcing, a contract would often be with a single supplier that would take on responsibility for the entire IT function.

However, as the market has matured, management teams have realised that individual vendors have specialist skills, so they have allotted different sections of IT to different service vendors. However, this too can bring its problems.

"You have to make sure that the different parts are technologically joined together and are managed," explains Graham Beck, outsourcing specialist at PA Consulting.

"What tends to happen is that management of the integration is left high and dry. If clients fail to recognise the issue, they have problems along the service chain and individual vendors say: 'That's not my bit.' Staff at their desks are not concerned about who supplies the service. They just want the end-product."

Outsourcing IT does not mean a company's management can forget about it. The relationship will still need to be managed from the client side and staff who have been retained to do this will need to feel motivated.

"The skill set required is very different," says Mr Cockroft. "Some people see it as more of a management than a technical position, but others feel their ability to make a difference has been taken away and they become frustrated."

External fund administration 'We would not consider bringing it back in-house'

Cost saving was not the main reason for European Credit Management's decision to outsource its fund administration activities.

Shedding "non-core" activities was another important motive for the London-based institutional asset manager.

"Our business is fixed-income investments – we manage $14bn of investor funds," says Steven Blakey, ECM's chairman.

"We wanted to focus on that, rather than on fund administration. Managing complex securities and derivatives requires significant in-house infrastructure Given the changing environment, we felt it was time to outsource."

Using an independent third party was also a way to provide transparency to investors, as required by regulations after the Madoff investment fraud and the financial crisis. In addition, ECM thought moving to an outsourcer would expand career opportunities for middle- and back-office staff, who had been with the company since it was founded in 1999.

In 2009, ECM invited 10 outsourcing companies to bid for the full outsourcing of administration, including infrastructure and 50 staff.

After a nine-month evaluation, ECM chose GlobeOp, which offered potential savings of several million pounds over the first few years.

The decision was not driven by price alone, says Mr Blakey. "Fund administration for our asset class is complex and involves a degree of expertise which the larger providers didn't necessarily offer."

ECM also liked GlobeOp's "entrepreneurial nature and record of adopting sophisticated technology to serve the hedge fund industry".

Although ECM has outsourced most of its business processes, it has kept eight managers in compliance, HR and marketing

Hans Hufschmid, GlobeOp's chief executive and co-founder, describes the company's technology as "integrated, scalable and industrial strength."

Its central database, in two US data centres that mirror each other, can be sliced and diced in different ways for individual clients, for example, showing all trades between Brazil and Russia over the past two months.

GlobeOp was keen to expand its workforce and recruit personnel – the ECM staff represented a large new resource. "This type of team lift-out is cutting-edge," says Mr Blakey at ECM. "Not many service providers pitch to take on 50 specialists in this business. At GlobeOp they can move to working on other projects," he says.

ECM's fund administration and data systems are handled by GlobeOp's operations in London and Mumbai, India, not at ECM's offices in London's Mayfair district.

Although ECM has outsourced the vast majority of its business processes, it has kept eight managers in compliance, HR and marketing, who report to the chief operating officer and chief executive. This offers a level of protection against the risk of fully outsourcing key business processes.

Wells Fargo, ECM's major shareholder, also outsources some of its fund administration. It is quite an industry norm, says Mr Blakey.

"Our move to outsourcing is intended to be permanent. We would not consider bringing it back in-house."

Jane Bird

Internet is proving to be industry's Achilles heel

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withdrawn support from the WikiLeaks website, those companies that used cloud providers for their IT fared better than those who ran their systems in-house, he says.

"I have yet to see a genuine cloud security incident," agrees Andy Burton, chairman of the Cloud Industry Forum.

The Achilles heel of outsourcing IT, however, is dependence on the internet.

"The internet is a free-for-all environment, which was never designed to carry commercial traffic." Mr Walker says.

In 2008, for example, Dan Kaminsky, a computer enthusiast, was widely reported to have "broken the internet" when he stumbled on a security flaw at the heart of the system.

It would have allowed him to reroute anyone's mail, take over banking sites or simply disrupt the entire system.

Fortunately, he reported the flaw, but it was only patched, never fully fixed and has raised the spectre of when the next serious problem will arise.

"In the industry, we call the internet an untrusted network," Mr Burton says.

There is also confusion between clients and cloud computing providers about who is responsible for security.

A survey by the Ponemon Institute, a privacy research group, found that a majority of cloud providers believed it was the customers' responsibility.

Cloud providers allocate 10 per cent or less of their operational resources to security, and most do not have confidence that their customers security requirements are being met.

Industry experts say companies must be very specific when negotiating cloud contracts, asking questions about disaster recovery plans, security provision and insurance.

"Cloud providers don't often offer a lot of guarantees on what they will do if they lose your data," says Daryl Plummer, a cloud expert and Gartner research fellow.

"If you want something in a contract, you will have to negotiate for it."

Companies may also have trouble auditing their data-outsourcing provider.

With thousands of businesses springing up to offer services, it can be hard to judge whether a particular company is an experienced operator with a well thought-out contingency plan.

Some companies will hire security experts, such as Protiviti, to "kick the tyres" on an outsourcing company to check if it has security and disaster recovery in place.

But such due diligence can cost anywhere from £5,000 ($8,000) to £100,000.

The Cloud Industry Forum is trying to simplify matters by setting up a scheme to certify service providers that meet certain minimum standards of security, confidentiality and service.

"Many vendors have charters, but it is more a marketing statement of what they hope to do.

'The internet is a free-for-all environment that was never designed to carry commercial traffic'

"We are trying to create an independently verified process, doing spot checks to make sure that they are providing the level of service they promise," says Mr Burton.

Mr Burton believes increased accountability will help ease security fears. But even he believes the market will always be a hybrid.

"There will always be some tasks on the premises, some in the cloud."

It may also be a question of calibrating expectations. Andy Singleton's business, Assembla, which offers services for open-source projects, was hit by the April outage at Amazon.

He has moved some computer functions in-house but Mr Singleton has not been put off Amazon. A highly experienced technologist, he never expected it to be perfect.

"The Amazon outage does damage confidence in cloud computing. But it is a lot less damaging for people who have seen a lot of hosting services and have seen that these outages are pretty common.

"Squirrels chew through fibre optic cables. Data centres can catch fire. It happens all the time," he says.

However, he says, it is well within the realms of "acceptable risk" for businesses that are prepared.

Amazon outages shake faith in the cloud: www.ft.com/connected-business

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Governments vie for work in offshoring beauty parade

Service location

The leaders of large outsourcing companies are shopping for locations in a buyer's market, says **Jessica Twentyman**

In the race to grab a slice of the market for offshored services, it seems almost every country in the world is hoping to become "the new India", or at least to create its own version of India's dazzling success.

Twenty years ago, India had a still largely agrarian economy. Today, while agriculture still employs just over half the workforce, it contributes just 16.1 per cent of gross domestic product. Industry contributes 28.6, while the services sector accounts for 55.3 per cent.

The jewel in India's services crown is its $76bn IT and business process outsourcing (BPO) industry, fed by a large pool of low-cost, but highly skilled English-speaking workers.

That workforce, along with India's hefty first-mover advantage, has kept the country at the top of the latest AT Kearney Global Services Location Index (GSLI), a biennial ranking by the management consultancy firm of 50 outsourcing locations worldwide.

Johan Gott, co-author of the report and AT Kearney global policy manager, explains that each country is evaluated as an attractive destination for service delivery using 39 measurements in three categories: financial attractiveness, people and skills availability, and business environment.

Clear rivals to India are emerging. In the latest ranking, China and Malaysia lag not far behind, followed by Egypt and Indonesia.

The remaining countries in the top ten are Mexico, Thailand, Vietnam, the Philippines and Chile. The full top 50 ranking, meanwhile, reveals that currency movements in recent years have helped to boost states where cost levels had previously kept them far down the list, including the Baltic states, the UK, Mexico and the United Arab Emirates.

The GSLI is intended as a measure of each location's potential, not its productivity, says Mr Gott, but provides some useful clues as to where many of the big outsourcing providers will look to establish global centres.

In recent years, for example, Infosys, Wipro and TCS have all established operations in Chengdu, China, alongside western technology companies including Intel, IBM, Cisco, SAP and Microsoft. The first three also have operations in Mexico.

Picking the right spot is not easy, says Vineet Nayar, chief executive of HCL Technologies, the Indian outsourcing company. Numerous considerations need to be taken into account: cost, social responsibility factors, cultural alignment and also time-zone alignment with established and emerging markets, as this is what determines speed of response. Macroeconomic factors, political stability and, of course, available skills are also important, he says.

There is no room for short-term experiments, says Hansjoerg Siber, head of global operations at Capgemini, the consultancy. "We don't want to set up lots of small locations all around the world, just to see which ones work," he says.

"We monitor a specific location over a number of years and think a lot about what might change there, from the political parties in power to the currency exchange rate."

Egypt and Russia may have much to offer as low-cost, high-skills base locations, for example, but they will not be viable targets, says Mr Siber, until Egypt's political stability is more certain and the Russian government does more to fight corruption.

Luckily for the leaders of large outsourcing companies, they are shopping for locations in what is effectively a buyer's market. Policymakers hoping to transform their countries into outsourcing hubs have to work hard to attract their attention, often by means of regional development grants and tax subsidies.

Vineet Nayar of HCL Technologies: picking the right spot is not easy. State subsidies are an important factor but not the only one

HCL Technologies, for example, has received more than £5.5m ($9m) in funding from regional development agency, Invest Northern Ireland, since it set up a call-centre in Belfast in 2004 and acquired another in Armagh the following year.

This kind of incentivisation is not new, Mr Nayar notes. It is no coincidence that the IT services business in India thrived in the 15 years that it operated under a zero-tax regime, where generous subsidies were offered on land acquisition, he says.

"But it only thrived because, in return for subsidies, companies like ours were prepared to invest in building infrastructure, training people and bringing in foreign business."

"Now, other governments are saying to us: 'We want to attract you to our country, to help you build the skills base and to get our people into work – and we're prepared to subsidise you for that,'" he says. "It's an important factor . . . but it isn't the only one."

To present the most attractive package in this nation-by-nation beauty parade, governments must increasingly be prepared to offer "long-term, mature subsidy frameworks, not short-term rewards", says Michael Rehkopf, partner and director at TPI, an outsourcing advisory company.

At a recent outsourcing industry meet-and-greet in China, he was surprised to discover that other US attendees were public-sector workers, representing a number of cities and states. They wanted to understand how subsidies were being packaged in China, so that they could do something similar back home.

But how much does geography really matter for customers? "For many mature outsourcing customers, offshore services are simply part of their global supply chain. They're not particularly interested in where the services are based, only in output and outcome," says Alex Blues, an outsourcing specialist at PA Consulting, the management consultancy.

"At the other end of the spectrum, there are companies that insist that their managers go and 'kick the tyres' of every city their provider suggests."

Best practice lies somewhere in the middle, he says: "Smart outsourcing customers leave the choice of location to the supplier, but give them some rules that define where they're happy for specific services to be based and provide guidance as to the maximum amount of service that should be provided from any one location."

Waiting for an update: older-style outsourcing contracts made few provisions for moving to new technologies Alamy

Keep your strategic decisions on IT in-house, say experts

The IT department

Organisations that slim skills down to the bare minimum can find it hard to respond to change, says **Stephen Pritchard**

With a plethora of suppliers queueing to provide IT services – from hardware maintenance to running complex software applications – keeping any IT expertise in-house may appear to be an unnecessary luxury.

Some businesses, mostly start-ups or smaller firms, are reporting that they have achieved significant cost savings by outsourcing all their IT. But the fact that these companies lack an IT department does not mean there is no one looking after technology.

"In an SME that is not very technical, and doesn't make great use of IT, there still needs to be someone ensuring that it is run effectively and who manages the third-party providers," says Jonathan Cooper-Bagnall, head of PA Consulting's shared services and outsourcing practice.

"In mid-sized firms, even if there is not a chief information officer, there is likely to be someone in a mid-management role or a higher IT manager role who looks after the portfolio of suppliers, provides some support to the business and sets the direction.

"Even if there is no IT department, someone still has to be accountable, even if that accountability sits with the chief financial officer, or an operations director."

In larger businesses, the size and scope of the IT department will depend on company policy on outsourcing and will also be an important factor in whether or not it is a success.

Although some have been able to drive down the operational costs of IT through outsourcing, others have found that this has come at a price.

Unless it is managed well, outsourcing can result in less flexible services and business processes. Organisations that have slimmed down their internal capabilities to the bare minimum and have handed control to an outsourcer, may find that their technology is no longer as able to respond to change.

For example, many older-style outsourcing contracts made few provisions for moving to new technologies, and adding capabilities can be costly.

Although companies are able to outsource services, they obviously cannot outsource all responsibility for IT – or its strategic direction.

"A lot of discussions [about the role of IT] are triggered when the IT department has not delivered, or the business feels it is not getting the response it needs," says André Christensen,

> 'There still needs to be someone ensuring IT is run effectively and who manages the third-party providers'

a principal with McKinsey & Company, the consultancy.

"But there are things you need to keep in-house, such as managing demand, and shaping your requirements. You can't outsource that." Outsourcing the role of the CIO, he says, "is very seldom the right answer".

The more a business relies on IT for its competitive advantage, the more important it is to keep a core of IT capability in-house, to set strategy and to translate business requirements into IT supply contracts. Companies now need CIOs to be far more business focused.

"There are different levers you can pull in a business and IT is one," says McKinsey's Mr Christensen. "You don't just hand over your business requirements to an outsourcer, and expect them to deliver."

BAA 'A change in culture and a change in style'

By 2013 BAA, which owns six airports in the UK including London Heathrow, will have spent £400m ($657m) modernising that airport's IT. A large part of that is being spent with outsourcers.

In March, BAA signed a £100m deal with Capgemini. The technology services firm will become the primary supplier of day-to-day IT for Heathrow; up to 200 BAA staff are expected to move to Capgemini during the contract.

Deals of this size and scope fell from favour during the recession, but according to Philip Langsdale, the chief information officer, it makes sense for BAA.

"There were three clear drivers for the outsourcing decision," says Mr Langsdale. "We wanted to improve the quality and robustness of the service to IT users – we would not have contemplated it without better service quality. The second is a reduction in cost: we have achieved very significant reductions in operational costs and will continue to do that, as part of the outsourcing contract.

"And the third was a strong desire to transform our ability to improve Heathrow through the use of IT: we will provide more bandwidth and more capabilities."

BAA has been reducing its own IT headcount for some time. The department employed 800 people not long ago, but with the Capgemini contract, this will drop to about 100.

Part of the reduction stems from the disposal of Gatwick – the UK's second largest airport – sold by BAA in 2009. Capgemini was involved in helping BAA to separate Gatwick and BAA's IT systems – and the move to use smaller, more nimble technologies at BAA's smaller UK sites.

But BAA says the reduction in staff numbers also reflects its view that the internal IT department should be about planning, sourcing and delivering, rather than building and running IT.

"Outsourcing is changing the skills profile of the internal IT organisation. We have to become a much more intelligent client, with much stronger strategic leadership," Mr Langsdale notes.

Strategy is partly driven by BAA's regulatory time frame, based on five-year plans.

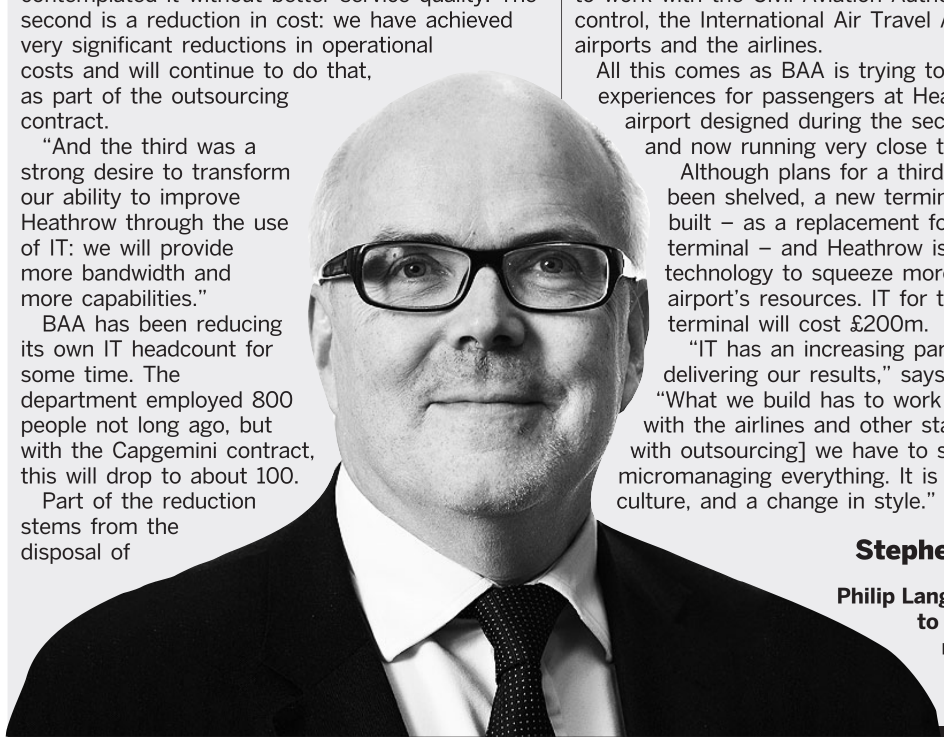
Mr Langsdale's team is currently working on the plan for 2013-2018. In addition, the company has to work with the Civil Aviation Authority, air traffic control, the International Air Travel Authority, other airports and the airlines.

All this comes as BAA is trying to improve experiences for passengers at Heathrow, an airport designed during the second world war and now running very close to full capacity.

Although plans for a third runway have been shelved, a new terminal is being built – as a replacement for an existing terminal – and Heathrow is looking to technology to squeeze more out of the airport's resources. IT for the new terminal will cost £200m.

"IT has an increasing part to play in delivering our results," says Mr Langsdale. "What we build has to work in conjunction with the airlines and other stakeholders [but with outsourcing] we have to step back from micromanaging everything. It is a change in culture, and a change in style."

Stephen Pritchard



Philip Langsdale: we have to step back from micromanaging

Innovation is an important part of the deal

Procurement

Wise customers will hammer out terms with providers, writes **Jessica Twentyman**

How can outsourcing IT services help chief information officers to juggle conflicting priorities of keeping costs low while increasing the business value of IT? Recent research from Gartner, the market research company, suggests that procurement and IT leaders give these aims more or less equal ranking, with a slight emphasis on value over cost.

Claudio Da Rold, a Gartner analyst, says that while there are many ways to reduce the cost of delivery and increase the value of IT, from the sourcing perspective, increased polarisation between two approaches is emerging in the market.

The first approach, he says, will see companies embrace the trend towards industrialised, low-cost IT, in which they trade non-essential customisation for better (and less expensive) services.

These might include cloud-based e-mail, for example, or infrastructure-as-a-service offerings, where storage or processing power are provided on an on-demand, pay-per-use basis.

The second approach, according to Mr Da Rold, will see organisations embrace "business-value-added services", designed to help expand – or even better, transform – their businesses.

At Dollar Thrifty Automotive Group (DTG), the US-based rental car company, Rick Morris, the CIO, hopes to cover both approaches with a recent three-and-a-half-year, $72m outsourcing deal with Hewlett-Packard.

The deal, a continuation of DTG's existing 14-year relationship with HP, focuses largely on infrastructure management.

"From a cost perspective, we're offloading a great deal of the complexity involved in managing largely commoditised services within the Dollar Thrifty technology stack, so that internal staff can focus on business needs, without having to worry about server provisioning and patching, or data back-up and restore processes, or service-desk operations," Mr Morris explains.

At the same time, innovation is an important part of the deal. "I need to be able to look to my provider – in this case, a much larger and deeper-skilled organisation than our own – to help bring ideas to the table, ones that will add real business value," he says.

"If I don't do that, then it's a waste of a tremendous opportunity for Dollar Thrifty. I need every member of my technology team – whether they're an HP employee or a Dollar Thrifty employee – to play an active role in the creative process."

For many companies, however, that cannot happen until they develop a useful working definition of the term "innovation", says Ilan Oshri, author of six books on outsourcing and an associate fellow at Warwick Business School in the UK.

"While innovation has been explored and prized in businesses for decades, it is a relatively new topic in the context of outsourcing," he says. "As such, the perceptions regarding what innovation in outsourcing is, what inhibits or enables innovation in outsourcing, and what client [companies] are willing do to ensure they benefit from it are still being defined."

Given that many companies' definitions of innovation will differ in terms of final business outcomes, it makes sense for customers to spend time with prospective suppliers hammering out their terms on the subject long before any deal is signed. But many still do not, says Jonathan Cooper-Bagnall, head of the shared services and outsourcing practice at PA Consulting.

It's a question of focus, he says. "If you think about it, when you first start outsourcing IT services, what you're most interested in is quickly establishing stability for those services. As a customer, you're not much interested in innovation, in doing new things, or in doing old things differently," he says.

"What the provider learns from that is that your company isn't interested in innovation. That misconception quickly starts to devalue the relationship between customer and supplier – unless there's a concerted effort early on by the customer to address it."

> 'I need to be able to look to my provider – a much larger and deeper-skilled organisation than our own – to help bring ideas to the table'

Reaching a workable definition is just the start, warns Mr Oshri. A customer and their outsourcing partner will also need to work out how to measure the innovation delivered.

In a recent survey he conducted of 250 CIOs and chief financial officers across Europe, commissioned by outsourcing company Cognizant, 64 per cent of respondents said that they never measured or did not know whether they measured the innovation delivered by their outsourcing providers.

At UK pub and restaurant chain Mitchells & Butlers (M&B), managers attend a monthly forum with their top 10 suppliers, overseen by an independent third party. Among the attendees are the company's beer supplier, its logistics provider, its butcher, its property services supplier and its IT outsourcing provider, Fujitsu.

"Like most companies, we have typically dealt with outsourcing providers at arm's length in the past," says Robin Young, commercial director at M&B.

"Now, the intention is that we open the door to our suppliers and give them the responsibility for engaging us on ideas and innovation."

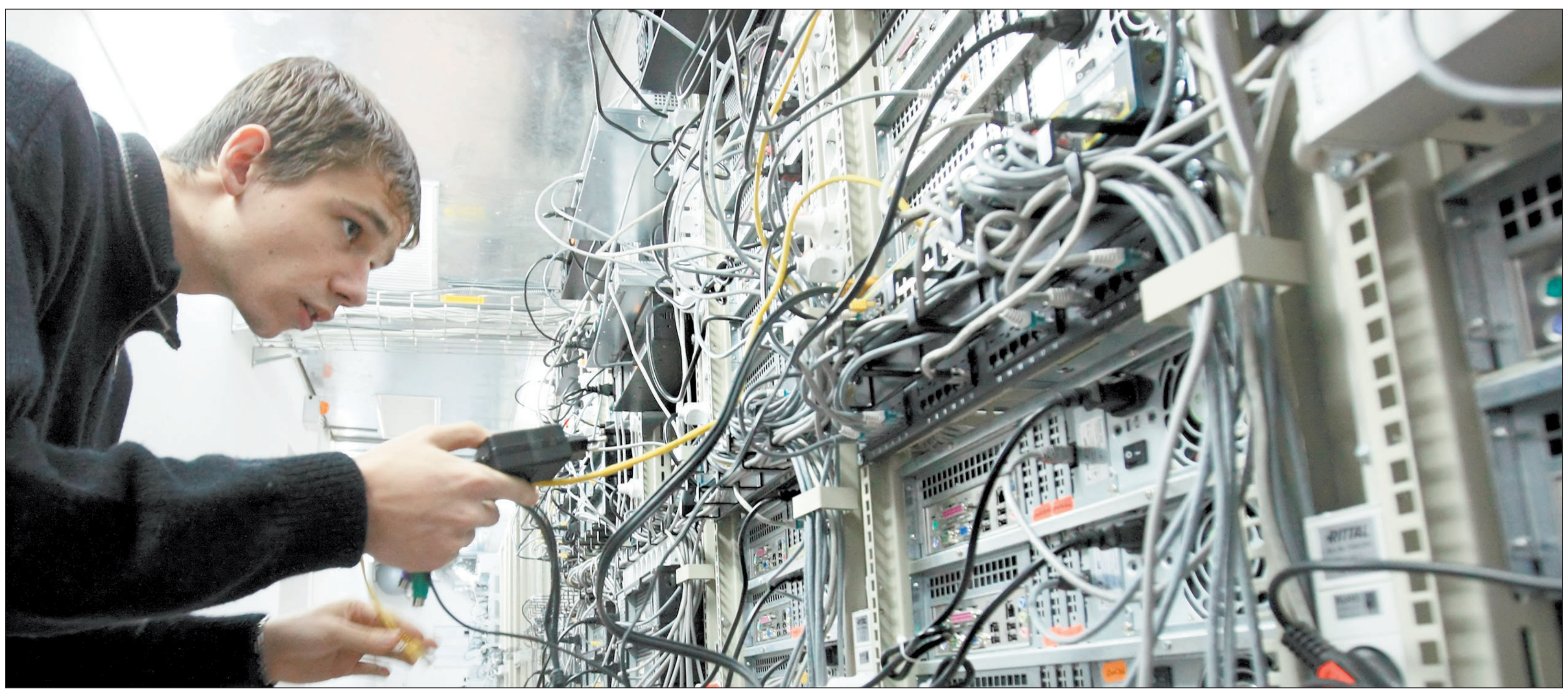
The next meeting of the forum will focus on M&B's strategy for its pubs and bars, everything from general kitchen management to providing wireless access for customers and processing their payments.

"We believe Fujitsu's representatives will have a great deal of skills and experience to offer here," says Mike Sackman, the CIO at M&B. "In fact, it's what we expect of them."

Retro styling, not revolution

IT cycles

Jane Bird on the development of pay-as-you-go computing power



Forward to the past: data centres are the core of cloud computing in the same way that centralised mainframes used to sit at the hub Dreamstime

Like cars and clothing, computing seems to have gone in for some retro styling, with a return to the 1960s.

Then, centralisation was the name of the game, with mainframe computers in air-conditioned rooms and dumb terminals for users. The advent of the personal computer brought a switch to "distributed" computing, with desktop machines managed by clusters of local servers.

Now it is back to the centralised model, with cloud computing hosted in remote data centres, this time often run by third parties.

So is the cloud just the latest fashion, or is it here to stay? That depends on the finances, says David Wirt, head of managed service for Singapore-based Tata Communications. "It's not really centralised versus decentralised, it's that people want more cost-effective ways to do things," he says

In the 1990s, people moved away from mainframes because they thought client-server systems with PCs would be more convenient, flexible – and cheaper. This proved wrong because of problems such as security, compatibility and data duplication.

Although individual devices were not that expensive, the fact that they were spread throughout organisations made them complicated to maintain, Mr Wirt says. "Connecting them was expensive, so there was a swing back to cost-cutting by centralisation."

The appeal of cloud computing is that it offers huge economies of scale. Organisations no longer need their own computers to hold data and applications, but buy the resources they want on a "pay-as-you-go" basis. Staff and customers access systems via the internet.

But Michael Kogeler, cloud strategy director at Microsoft, thinks there is a danger in relying too much on a centralised, cloud-based approach, because of the risk of internet connections failing.

This is the problem with services from cloud-based providers such as Google and Amazon, he says. "Cloud computing is about leveraging the scale and opportunities of connecting to the cloud, not about moving everything on to it."

Microsoft believes in the importance of intelligent devices that can function on their own.

You see this on aircraft when people with iPhones cannot use their e-mail because they need an internet connection for it to work, says Mr Kogeler.

Microsoft is also working on specialised devices for use in fridges, ovens and cars, that might have intermittent contact with the cloud. A fridge-based device could go online to order fresh milk when you run out; an in-car navigation device might combine its knowledge of who and where you are with internet information on local places.

Although cloud computing may seem like the latest fashion, the concepts on which it is based are not new, says Christian Klezl, IBM vice-president of cloud computing. Virtualisation – sharing workloads dynamically across IT infrastructure – has been around since the 1960s.

Nobody called it cloud computing then, Mr Klezl says. "What we have is more of a long evolution than a revolution – it wasn't created overnight. But there are key differences that make cloud computing 'transformational'."

This is because of developments in technology and behavioural changes whereby people have learnt to use the internet, access data via portals, and use self-service applications.

So, in addition to making businesses more efficient, companies have been able to introduce innovative services and give customers something different by exploiting technologies such as smartphones and tablet computers, Mr Klezl says.

The first to take advantage of these opportunities were smaller companies that wanted to expand fast without having to make big investments in technology. The cloud is particularly useful for applications such as social gaming or promotions, where companies do not know how much response they will receive.

Having servers available at short notice compresses time to market, says Mr Wirt.

"Unlike the dotcom bust, when lots of companies lost money tied up in hardware, the cloud gives virtually instant access to world class technology with a very elastic model."

Larger organisations such as banks face a more difficult challenge, because their legacy systems were not designed for the cloud.

The logical conclusion of the trend to use the cloud to achieve cost-efficiency, is that the world's IT processing capacity will end up concentrated in relatively few large data centres. There will probably eventually be only three to five big participants in the market, says Mr Klezl.

But such centralisation has risks. One problem is "latency" – the time delays involved in long-distance data transmission. This varies depending on the quality, load and capacity of the fibre networks being used. Latency can cause applications to crash.

The affordability of cloud computing also raises the risk of individual departments "going it alone", as happened with PCs. This can create security problems and lead to data inconsistencies and duplication within organisations.

Another problem with the highly centralised model is that regulations governing data privacy vary by country. For sensitive government systems, at least, many countries are likely to want local data centres and dedicated "private" clouds.

One answer is technology that delivers the application performance and reliability of the private cloud but is accessible via the public one, says Wille Tejada, vice-president of application performance solutions at Akamai, an internet infrastructure group. "Creating these hybrid networks – private clouds within public clouds – is the next big challenge."

Sweet liberation Domino Sugar

Don Whittington prefers not to concern himself with technology – he would rather stick to sugar, writes **Jane Bird**.

As chief information officer of Domino Sugar, the US's largest refined sugar manufacturer, he likes to spend his time thinking about business challenges, delegating IT management to others.

Hence his decision in 2009 to transfer all the company's key applications, used by thousands of employees, to the cloud.

It is part of a process that began a decade ago when network management was outsourced to Verizon, the telecommunications company, says Mr Whittington. Next, responsibility for PCs was handed over to third parties. Then an increasing amount of IT infrastructure was transferred to servers in hosted data centres.

The problem was, Mr Whittington still had to concern himself with hardware. "If I decided we needed a new server, I'd have to sign up for three years," he says. "Although we had more flexibility, and I had removed the capital expense, it was still an operating cost."

Now, thanks to a cloud computing service provided by Virtustream, Domino Sugar has no IT capital commitments. Moreover, its bill is calculated according to the computer power used rather than on a specific number of servers, which is traditionally the case with data centres.

"It's incredibly liberating not to have to worry about things like hardware and storage capacity," says Mr Whittington. And the savings have been huge, with the IT bill reduced by 30 per cent a year.

The cloud service has also speeded up the company's applications, which include enterprise resource planning, customer relationship management and payroll among others. Users report response times up by about 30 per cent.

This enables faster development of systems or projects. What previously took up to seven days, can be done in two, says Mr Whittington. He hopes to reduce this to one day.

Given that the company is paying for its computing on a by-usage basis, development can be done at "almost no cost", he says.

Cloud computing also makes acquisitions faster and cheaper. When Domino this year took over the refining operations of Tate & Lyle, the UK food ingredients company, it was able to integrate Tate & Lyle data and applications via the cloud.

"We agreed with the seller that we would create a separate cloud-based area to do the testing," says Mr Whittington.

This enabled the acquisition to be completed in four months, rather than the nine it would typically take. And instead of having to put data on tapes, it could be transferred instantly via the cloud, without the risks involved in physically moving it.

Virtustream is able to make its cloud computing service cost-competitive by combining the efficiencies of a "public" cloud, shared by multiple organisations, with the security of an exclusive or "private" cloud.

Don Whittington: It's liberating not to have to worry about IT

This is done by managing the "virtual machines" that run on its servers at a more fundamental level, called infrastructure units, says Rodney Rogers, the company's chairman and co-founder.

"Companies such as Domino Sugar can take a bigger share of the virtual machines when they need the extra computing power, and release it to the pool when they don't," he says.

Another advantage of the transition involves legacy systems that are kept for historical reference but are needed only occasionally. "Previously, these applications would have required hardware and administration, even though we might only use them a couple of times a year," says Mr Whittington.

"Now, we can spin them up to the cloud when we need them, and back down when we don't. This is the way we have to go with our IT systems, I can't imagine ever going back."