

Rethinking Managed Services

Leveraging the Dynamic Delivery Model for Competitive Advantage

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Background

The US economy has entered a period of unprecedented upheaval, staggering businesses and consumers around the globe. Organizations of all sizes have reacted instinctively to this wide-reaching financial turmoil by contracting, stalling or even eliminating many planned investments while their management teams struggle to adjust budgets to meet rapidly changing revenue forecasts. Business leaders are under tremendous pressure to conserve resources, and many consider planned infrastructure-related expenditures as low-hanging fruit in their urgent cost-cutting exercise.

This process is wreaking havoc with the budgets of Corporate America's CIOs. Spending choices are being actively challenged across the board. Budgets are being cut back to levels which barely allow enough funds to manage status quo. Support for the growth needs of their businesses is clearly in doubt.

This stagnation will suffocate organizations' ability to leverage technology for innovation at precisely the time when it can make the most difference.

CIOs need alternatives to displace the costs associated with core IT services that are not also contributing to unique business services. That is, they must find a way to deliver maintenance services for commodities like corporate e-mail, back office infrastructure and help desk services at dramatically lower prices. Traditional Outsourcers and Managed Service providers with long-term contracts are locked in to infrastructure costs and do not typically include dynamic pricing models.

The following pages explore the shortcomings of the current service provider model and explain how a new breed of service providers is solving these challenges by leveraging disruptive technologies to deliver flexible services at a game changing price.

To be successful, these newly evolved service providers must have the following characteristics:

- rapid deployment with well-managed transition
- ability to drop solutions into current environment with little impact to current users
- improved quality of service
- significantly lower cost levels than equivalent functions delivered in-house or via traditional service providers, with no large, up-front costs.
- pay for use model – scale dynamically to fit the rapidly changing landscape of the businesses

Innovative companies who embrace this new breed of managed services will benefit by significantly improving their operating model, while freeing scarce resources to focus on core business issues. Leaner, more nimble companies will be well positioned to respond quickly to dynamic markets, and thrive in the post-recession world.

Fear of the economic meltdown has resulted in knee-jerk cut backs and paralysis in the board room.



Most Fortune 2000 companies have built and run their own data centers, call centers, technical service arms, and software. These internal support functions often drain scarce resources away from an organization's core business

The Need for Innovation

In the last year, many former power houses of economic development have come crashing down – companies like GM and Ford would be bankrupt without government assistance. Major financial institutions, including Bear Stearns, Lehman Brothers, and Merrill Lynch have disappeared, while several of the largest remaining players, including Citibank and Bank of America teeter on the edge of insolvency. Market values have been cut in half, unemployment is approaching 8% and the housing crisis continues to drive fear into the heart of the economy.

In order to survive and prosper in the future, businesses must focus more on their core business and innovate at every level. They must also learn to operate more efficiently, partly through innovation, and partly through strategic sourcing of commodity services.

History provides an interesting analogy. At one time, many large companies owned and operated their own power plants because power from the fledgling utility industry was too unreliable for their needs. As the power industry progressed from being unreliable to becoming the commodity it is today, successful companies adapted their business practices and closed their proprietary plants, realizing excellent efficiency gains by leveraging a centrally managed utility. Companies that failed to adapt to the commoditization of power suffered losses or failed completely.

Over the past 50 years, many companies have effectively “built their own power-plants,” this time with technology systems and services rather than with power. While these systems were once necessary for lack of a better solution, they no longer are; services that were unique and differentiating are now a commodity. Many of the business services fulfilled by corporate technology units are non-differentiating non-core services. Supported by a hierarchy developed in the last several decades, these internal support functions often drain scarce resources away from an organization's core business and impede its ability to operate effectively.

Rapid flexibility and cost for consumption are key to success – The ability to consume services in a variable model and dynamically scale to meet rapidly growing or contracting business needs will provide competitive advantage

Traditional managed services providers built an “operation-centric” approach to providing their service, as opposed to a customer-centric approach.

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In these turbulent economic times, success requires the ability to adapt to change quickly. Companies must be able to scale up or down, and to integrate with new systems without the traditional costs associated with infrastructure and large technical organizations.

Companies that re-think their business models, leverage virtual capabilities to build a dynamic organization, and focus their best resources on mission critical core capabilities will have a competitive advantage. The ability to move to service providers who can deliver secure, high quality service at a significantly lower price point will prove a huge advantage.

The question is: which business service providers can deliver on this model?

Traditional Managed Service Providers

Operation-centric model: The data center outsourcing business evolved from hardware providers who ran data centers “better” than other firms, because they knew their own operating systems and hardware. The “Big 6” firms added a classic professional services model. Today, outsourcing firms operate in the same manner as traditional data-centers, and they realize profit by adding margin to their hardware and projected workforce utilization costs.

Technical SLAs: Managed Services contracts rarely include business metrics. Contract discussions are focused on hardware and network speed, data costs, and system uptime, help desk and responsiveness and FTE equivalents. At least half of the negotiations for services contracts is focused on operational aspects, often ignoring the business needs (current and future) the managed service will support.

Fixed costs, fixed service: Typically, managed service vendors buy network, hardware, and CPU, and depreciate their costs over three years. They then add (often fractional) head count for each technical discipline to their pricing equation. Most models include Service Level Agreements, and most vendors add margin for risk to cover their potential SLA exposure. The managed service provides a monthly price equal to the sum of the parts plus risk and margin.

Customers typically realize initial savings, and can receive higher services from “operation-centric” providers. However, these managed service providers have very little ability to change their service once the contract has been created.

The first cuts are normally to client-facing roles rather than support roles. This behavior results in a loss of customer focus, a lack of thought leadership and eventually, lower quality.

In most cases, the financial risks of staffing cuts (i.e. SLA misses) are balanced against the costs. In effect, the price of quality often outweighs the cost of margin pressure.

Variable service, higher costs: Changes to the service are usually financially painful for the customer. Added services require additional hardware purchases with accelerated depreciation, so amendments are coterminous with the original contract, resulting in higher costs. Reductions in service are only possible by paying off the remaining depreciation with lump-sum payouts.

Lock in the savings, but at what price? (quality):

Traditional managed service provider contracts typically provide measurable savings. As the contract matures, the vendor focus shifts to improving the efficiency of internal operations. However, when a provider comes under margin pressure, the fixed nature of their cost infrastructure leaves them few options to respond. Having very limited ability to change out the hardware (it is being depreciated), or reduce facilities costs, when faced with difficult finances, the traditional managed service provider must do more with less by cutting head count, or “commoditize” their underlying services by co-sourcing base functions such as help desk, or network. Eventually, they eliminate “optional” services – most often the very “value add” items that differentiated the providers in the selection process.

What is their real business? The classic managed service provider is spending at least 50% of their focus running a data center, taking on the characteristics of a hosted service provider. Instead of focusing on the customer, they are distracted by the complexity of running a data center. The same issues facing a CIO (rising energy costs, lack of space or power, etc...) consume much of the management focus of a typical service provider. As a provider moves from application specific focus to data center focus, the quality of the application service offering degrades.

Lack of flexibility: Managed service providers lack the ability to respond to changing business demands, or to provide pricing based on seasonal demands, due to their fixed infrastructure. When additional storage or compute capacity is required, it takes weeks (or months!) to install and implement. The provider’s internal procurement process often delays delivery time by additional weeks.

This lack of responsiveness and flexibility impacts customers in two ways. First, they often require additional managed service vendor oversight. Second, they may hinder the business’ ability to move quickly (for instance in the event of a merger or acquisition.)

A New Model for Managed Services

The solution to the shortcomings of the traditional service provider model described above is a model architected from the ground up to avoid these pitfalls. By actively leveraging new technology and delivery methods, it is possible to create a flexible infrastructure that can be continually right-sized, at a price that is significantly below current benchmarks. Forward thinking companies will use these flexible services and the resources they conserve – time and money – to drive competitive advantage.

Evolving Technology: Recent enhancements to traditional technologies and delivery models provide enormous efficiencies and potential for outstanding savings. These developments include:

- stable virtualization of physical compute resources
- flexible delivery models led by cloud computing, and
- the disruptive cost reduction effect of open-source software

Evolving Business Model: Businesses are moving away from low-level involvement in the service provider's decision-making process. In other words, most forward-thinking CIO's are less concerned about the hardware, operating system, or software their service is built on, and more concerned with the service levels, quality of service, flexibility, innovation and thought leadership delivered by their service providers. To the extent that a service provider can securely leverage these new technologies, they can provide a truly meaningful change to their customer's strategic sourcing solutions.

Disruptive solution: By leveraging new technologies, including cloud computing, and the current generation of open-source software, the new managed services model will be disruptive to the traditional model in three ways:

- First, the price of service will be significantly lower than traditional managed services providers, based on the efficiency of the underlying technologies. Cloud computing costs are significantly lower than traditional data costs. Resource management is reduced by over 1,000%, and infrastructure staffing (head count) is reduced by over 50%. Furthermore, by leveraging open source software for both applications and running the virtual services (i.e. Help desk and monitoring,) significant cost savings are realized.
- Second, on demand delivery of services tailored for a business' needs – scaling up and down due to random economic or cyclical changes in demand. Because the model leverages the cloud for delivery of services, it is both variable and scalable. By continually improving the software and the physical environment, the traditional 3 year invest and refresh cycle is permanently broken.
- Third, the new managed services model will provide higher quality via variable and responsive delivery infused with thought leadership. This model has a true consultative “thought leadership” focus. Because the new managed service entity is focused exclusively on proving the highest quality service, as opposed to running a data center, the new managed service provider becomes a Virtual Department. Business goals, not operational concerns dominate the agenda.

Innovative companies who embrace this new breed of managed services will benefit by significantly improving their operating model, while freeing scarce resources to focus on core business issues. Leaner, more nimble companies will be well positioned to respond quickly to dynamic markets, and thrive in the post-recession world.

Introducing OC4

We created a disruptive services model to provide application management services to the enterprise market, beginning with end-to-end enterprise electronic communication services. Over the past two years, we have invented and refined a business model that delivers high quality, secure business services at a superior price point. Our business is unique in the following ways:

- **Infrastructure.** Our infrastructure is based on cloud computing, which provides significant advantages of cost, scale, and speed.
- **Software.** Our offerings are built Open Source Software, minimizing licensing costs and providing additional cost advantages.
- **Organization.** Rather than approaching the market as an “outsourcer”, we are approaching the market as consultative managed services organization.
- **Security.** Our systems are designed to be compliant with Department of Defense security requirements for Top Secret Data. By providing military grade encryption to all data written to the server, we achieve a level of security that is impractical to achieve in a traditional data center model.

From our client’s perspective, we provide highly secure, world class, enterprise electronic communication services with well-defined service levels at a compelling price point. Because we are leveraging lower cost infrastructure, and open-source software, our total cost of service is 30% - 50% of traditional models. Our infrastructure supports rapid growth, extreme variability and scale because we leverage the cloud as a delivery vehicle. As we expand our customer base, we plan to extend our offerings beyond email into ERP (Enterprise Resource Planning).

We envision the company of the future will leverage highly specialized managed service providers to deliver high-quality business services as a service. By eliminating the cost, complexity, and inefficiency associated with traditional operating models, the successful CIO of the future will thrive. By providing exceptional service through a network of well-managed business services, scarce technical resources can focus on key business priorities.

Summary

Founded in 1998, OC4 is a leader in building carrier class email systems. After 17 months of research, and an iterative series of proof of concepts, OC4 has launched a service provider model we call “Business Services as a Service”.

Combining cloud computing, rapid development using open source software, and an efficient managed services model, we have invented a new model that provides the next generation of managed business services.

OC4 is headquartered Connecticut. To learn more about OC4 and our capabilities, visit www.OC4.com, or e-mail us at info@OC4.com.