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RESEARCH SUMMARY:

Transitioning from a Staff Augmentation Model to a Managed Services Model

Services globalization has created new opportunities for companies to manage their internal and client service requirements. Where organizations were once confined to the staff augmentation model for growth, they can now engage managed services – a model that can allow organizations to grow without hiring additional employees (and increasing costs proportionally to growth).

In making the choice to transition from a staff augmentation model to a managed services model, a number of important questions may arise, including:

- What are the unique advantages and disadvantages of each model?
- Is there some optimal combination of staff augmentation and managed services?
- What is the best-practices approach to transitioning from a staff augmentation model to a managed services model?

> Organizations that engage a managed services model can transfer risk to the service provider, leverage provider flexibility and grow without hiring additional employees.

neoIT INTELLIGENT TRANSFORMATION

The Staff Augmentation Model

Traditionally, companies managed their growth by adding employees or contractors where they needed to increase output. But many organizations are coming to realize that staff augmentation may not be the most optimal model for support operations management.

The staff augmentation model does have its unique advantages, including:

- The organization retains the ability to control all its resources in-house
- It is a simple, quick, and effective means for addressing support deficiencies
- Compared to the managed services model, staff augmentation doesn't typically meet with high internal resistance
- It doesn't require the organization to create large contract structures
- It is relatively low-risk

But the staff augmentation model also has significant disadvantages, including:

- Costs increase (generally) proportionally to growth in the business (as the amount of support required increases)
- Economies of scale benefits are relatively low
- It's unable to address important time-to-market and geographic-reach issues
- Training periods for new employees are often long
- It can be difficult for the organization to manage attrition
- The risk of replacing staff is borne entirely by the organization
- It's unable to rapidly address issues of system complexity and obsolescence
- New technology deployment requires specifically-selected new resources (or sufficient time to train existing resources)
- Skilled employees' learning and training takes time and is not scalable across the organization
- It can introduce unpredictable, disruptive personalities into the system

The disadvantages inherent in the staff augmentation model drove many organizations to believe that it is no longer the best way to manage the organization's growth.

Those organizations sought an alternative that would be scalable, secure, and highly reliable – one that would minimize management overhead and ensure adherence to service levels. For many organizations, that alternative is managed services.

The Managed Services Model

Managed service is a model within which client organizations outsource the management and operation of support systems to external service providers.

Although the nature of the engagement may vary in terms of assets and staff, third-party managed services alleviates many of the client organization's burdens by taking over operations – including management, monitoring, and maintenance of systems and datacenter infrastructure.

As Figure 1 demonstrates, one of the significant advantages of the managed services model over the staff augmentation model is that the relative cost increase as scope of services increases is much smaller under the managed services or comprehensive outsourcing models than under the staff augmentation model. (Comprehensive outsourcing refers to the globalization of a broad range of services, while managed services may refer to the outsourcing of a single service).

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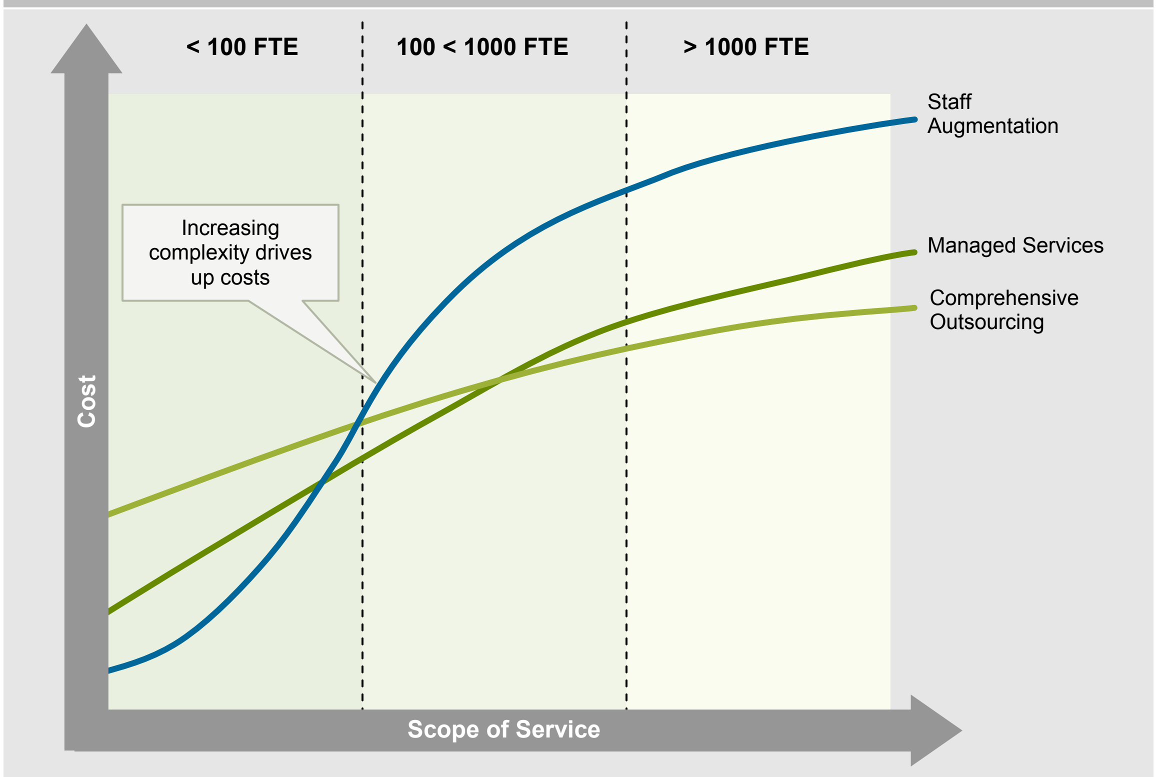
The other advantages of the managed services model include:

- Economies of scale allow the supplier to provide services at a lower cost than the client organization could in-house
- The client organization shares infrastructure costs with the supplier's other clients
- It offers the potential for labor-cost arbitrage (especially when the supplier is located offshore)
- The client organization's liability is reduced
- It is the supplier's responsibility to maintain a pool of employees with the required skills and expertise
- It offers added flexibility
- Efficiency is improved
- Services can be performed more quickly
- The client has access to cutting-edge tools and best practices within the supplier organization (because the supplier is an expert at providing services)
- Client organizations may find a higher level of quality with an external supplier than in-house
- The centralization that accompanies managed services allows client organizations with multiple locations to achieve consistency in service as well as standardization of processes
- The client organization is no longer solely responsible for maintaining service levels
- It allows the company to focus on its core competencies
- The client organization has ready access to well-managed team-based talent pools (especially for high-demand skill sets)
- It's fully scalable

Figure 1: Cost Relative to Scope of Services



Source: neoIT

Driven by the advantages of the managed services model as well as by decreasing communication and bandwidth costs, organizations are leveraging the managed services model – turning to external vendors to manage their IT operations and business processes – at a rapid rate: demand for managed services is increasing at just over 16 percent per year, according to IDC.

Staff augmentation may also be important in reducing the risk inherent in a transition to managed services – by filling in roles that the service provider is having difficulty providing within the desired time frame.

To optimize the benefits of both models, the client organization should balance its use of staff augmentation and managed services.

Striking a Balance between Staff Augmentation and Managed Services

But even as organizations are becoming increasingly globally sophisticated – leveraging managed services to an increasingly larger extent – abandoning the staff augmentation model altogether is not the best choice.

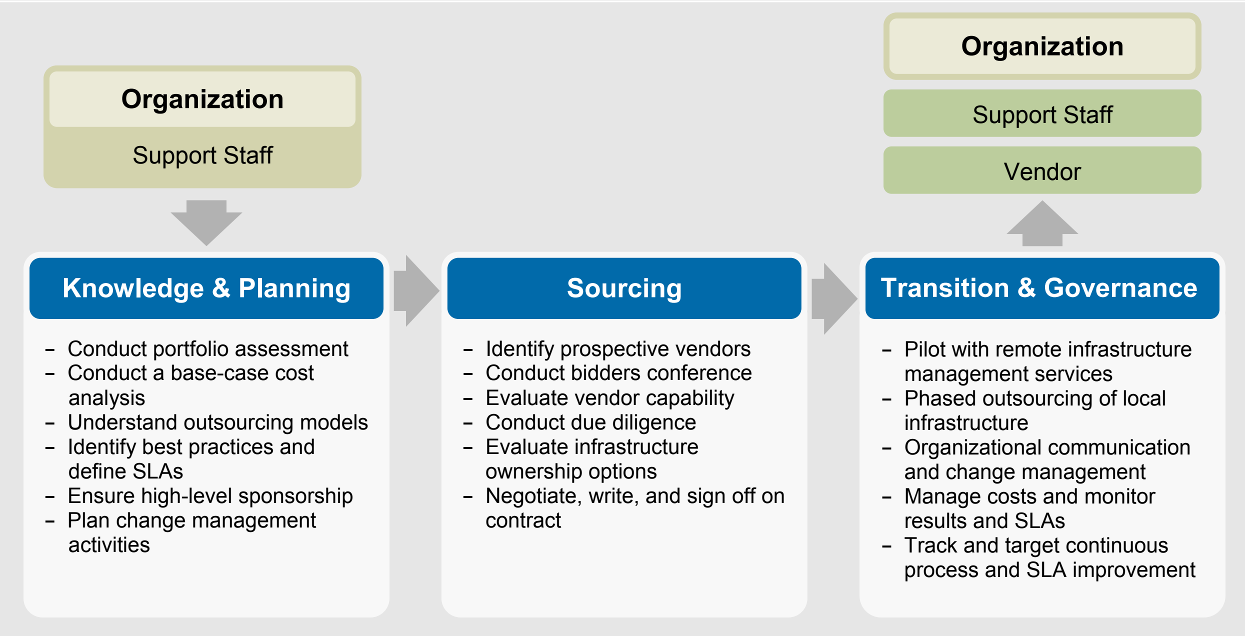
The requirement for premium skills sometimes makes staff augmentation preferable, as staff augmentation allows the organization to use those premium skills across the organization – by sharing knowledge and best practices.

Transitioning from a Staff Augmentation Model to a Managed Services Model

Transitioning from a resource supply model that is based predominantly on staff augmentation to one that includes managed services is best completed in three phases: the knowledge and planning phase, the sourcing phase, and the transition and governance phase.

Following a carefully-outlined, three-phase transition plan will help the organization mitigate the risks inherent in outsourcing processes to a third party.

Figure 2: Transitioning from Staff Augmentation to Managed Services



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Phase 1: Knowledge and Planning

The knowledge and planning phase involves gathering the knowledge required to adequately plan for a successful transition – including knowledge about managed services models, suppliers, and best practices as well as knowledge about the client organization and its processes.

Deep knowledge about the client organization's own processes is an important part of understanding the potential benefits in managed services. So the knowledge and planning phase begins with an assessment of the organization's portfolio and an identification of processes that could be managed externally. That assessment should include a list of the factors that affect the processes' suitability for remote management as well as an assessment of the offshoreability of each process.

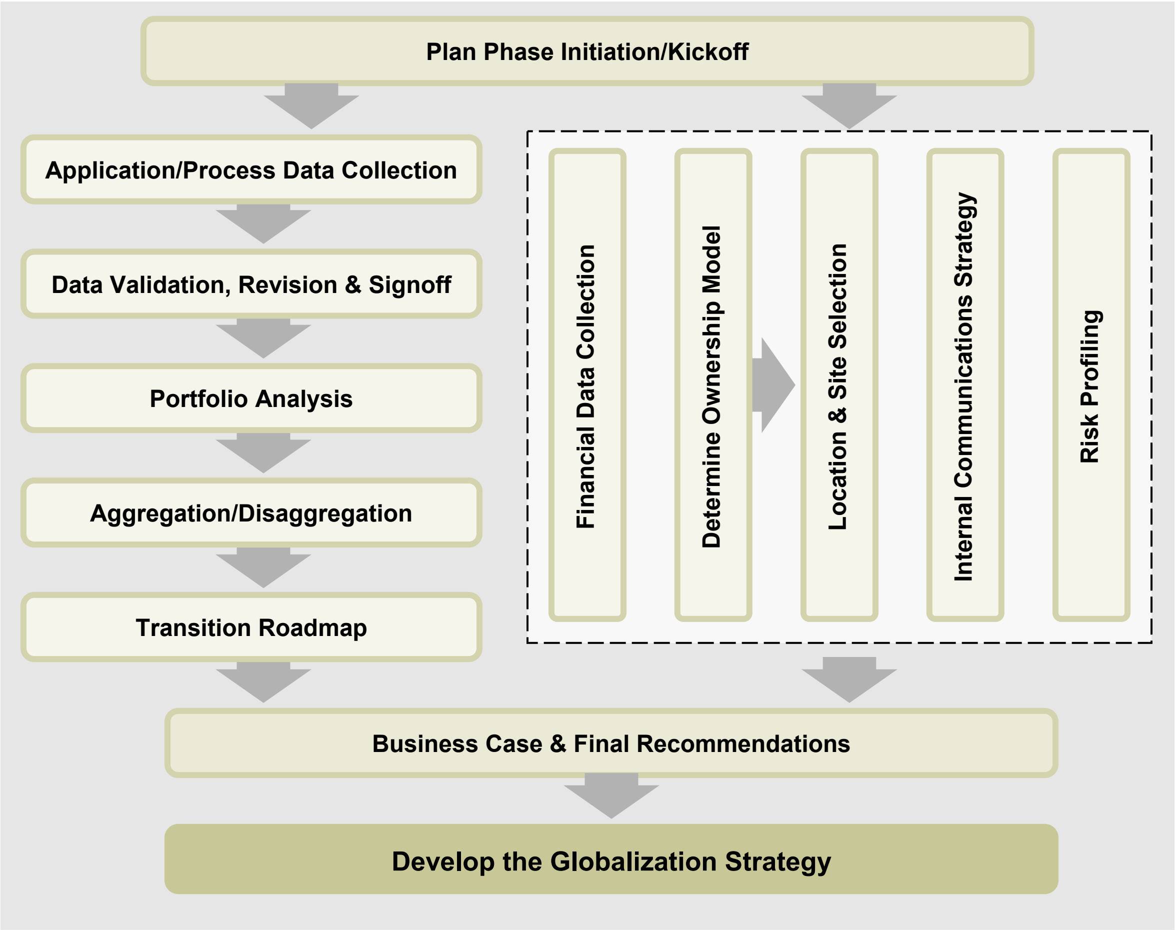
The next step is to conduct a base-case cost analysis and list potential cost-saving opportunities within the organization. Combined with the portfolio assessment, this information will help the organization determine which processes could be outsourced beneficially.

Then the organization must gain an understanding of the various outsourcing models and how they work (including operations, cost structure, and engagement methodologies) as well as an understanding of the differences between onshore and offshore suppliers. A visit to suppliers can be helpful in this phase.

Next, the client organization should look within its industry for best practices in outsourcing and use that information to define service level agreements. If the organization has its own experience with managed services models, it should draw on that experience to understand the reasons behind its successes and failures (in order to maximize future successes).

Once the client organization has gained the knowledge it needs, it can move on to the planning step, which includes engaging high-level sponsorship for the transition to managed services as well as planning for change management.

Figure 3: Phases of Global Strategy Development



Phase 2: Sourcing

The first step in the sourcing phase is to select and notify a group of candidate suppliers; the next steps are finalizing requirements and issuing RFPs. Once suppliers have submitted responses to the organization's RFP, the organization must conduct its due diligence in determining which supplier could best fill its service needs. Figure 4 details the proposal-request-response process, which iterates until a set of qualified vendors have been identified.

In evaluating the capabilities of potential suppliers, it is often useful to visit the supplier – especially if the supplier is offshore (then the organization is conducting due diligence with regard to the location as well as the supplier).

Based on that evaluation, the client organization should choose a small number of finalists and enter contract negotiations. At this point the organization will also need to determine which ownership model it will select (third-party, joint venture, captive center, etc.). Organizations without significant experience with managed services typically do best at first in third-party arrangements (until they have developed the experience and maturity necessary to handle increasingly complex arrangements). The sourcing phase ends once the client organization and its chosen supplier have signed off on the contract.

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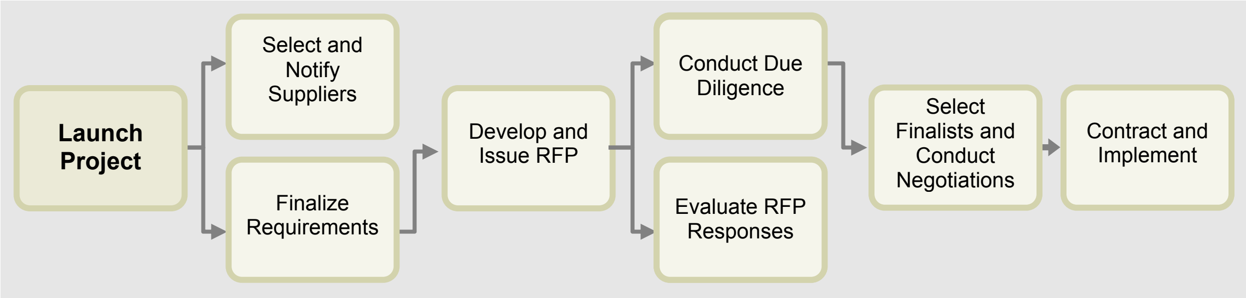
Figure 4: Steps in Sourcing



Phase 3: Transition and Governance

Before rollout can begin, the organization must carefully plan for the transfer of knowledge. The organization should use the process inventory it created in the knowledge and planning phase to ensure that knowledge is appropriately transferred for each process that will be outsourced. Effective knowledge transfer also requires the roles and responsibilities of each individual involved to be clearly defined.

Often, rollout is best initiated with a pilot. First, the organization launches a pilot with remote infrastructure management services where the infrastructure remains at the client location and is managed remotely by the vendor. This will help the client organization safely assess the supplier's capabilities. Once that pilot has been successfully completed, the management of local infrastructure is transferred to the vendor in phases.

That phased transfer should begin with shadow support, where primary management responsibility remains with the client team. Next, the transfer should graduate to primary support, where increasingly complex processes are managed completely by the vendor at the client location. Finally, the transfer culminates as management control is given to the supplier at the supplier's location.

The organization should apply the lessons it learns during the pilot to subsequent phases of the transition. Once rollout begins, the organization should be engaging its organizational communication and change management plans as well as diligently monitoring the results of the initiative (an important part of cost management). Adherence to SLAs should be closely monitored.

Figure 5: The Transition Stage

	Knowledge Acquisition	Shadow Support	Primary Support	Offshore Support
Activities	– Application understanding – Maintenance and technical documentation – Process and metrics definition – Roles and responsibilities	– Secondary support – Low priority service requests – Simulate primary support	– Primary support – Simulate offshore support	– Pilot run – Complete transition
Deliverables	– Application inventory – Transition guide – SLA definitions	– Updated transition guide – Support services	– Updated transition guide – Performance reports – Validated resource plans	– Service execution process – SLA metrics and milestones report

Case Study: Succeeding with Managed Services

A leading software vendor's transition to managed services illustrates well that the best transition is made in steps, with steps refined as the organization grows and matures in its experience with and understanding of the managed services model.

The organization began with two difficulties: first, its demand for human capital fluctuated significantly throughout the product development cycle. Second, the company was rapidly expanding and needed employees to support that expansion. So the organization turned to staff augmentation – contract labor – to meet its fluctuating (but rapidly growing) labor needs.

But augmenting its staff with contract employees created other difficulties for the company: the high number of contractors reduced knowledge retention and commitment, and the company was fielding labor lawsuits from contractors and part-time employees. So the company decided to utilize an offshore service provider for the quick ramp-up, lower cost, 24/7 support, and decreased turnaround times that the supplier offered. The company was able to trim its own staff base without sacrificing its growth opportunities.

Eventually, the service provider set up dedicated offshore development centers (ODCs) for the client organization, which offered the client firm greater control over information access and physical security at the site (which was physically separated from the supplier's other operations) as well as greater control over the employees at the center. The arrangement also reduced the overhead cost of resources such as software licenses (as an extension of the client organization, the ODC was able to share the client's resources).

Though the ODC arrangement helped the client provide 24/7 support and reduced turnaround times, the client organization was still unable to trust the supplier with sensitive intellectual property; products that were near completion couldn't be sent to the ODC due to piracy concerns. Moreover, rising salaries and a shrinking gap between demand and supply were eroding the benefits of offshore outsourcing.

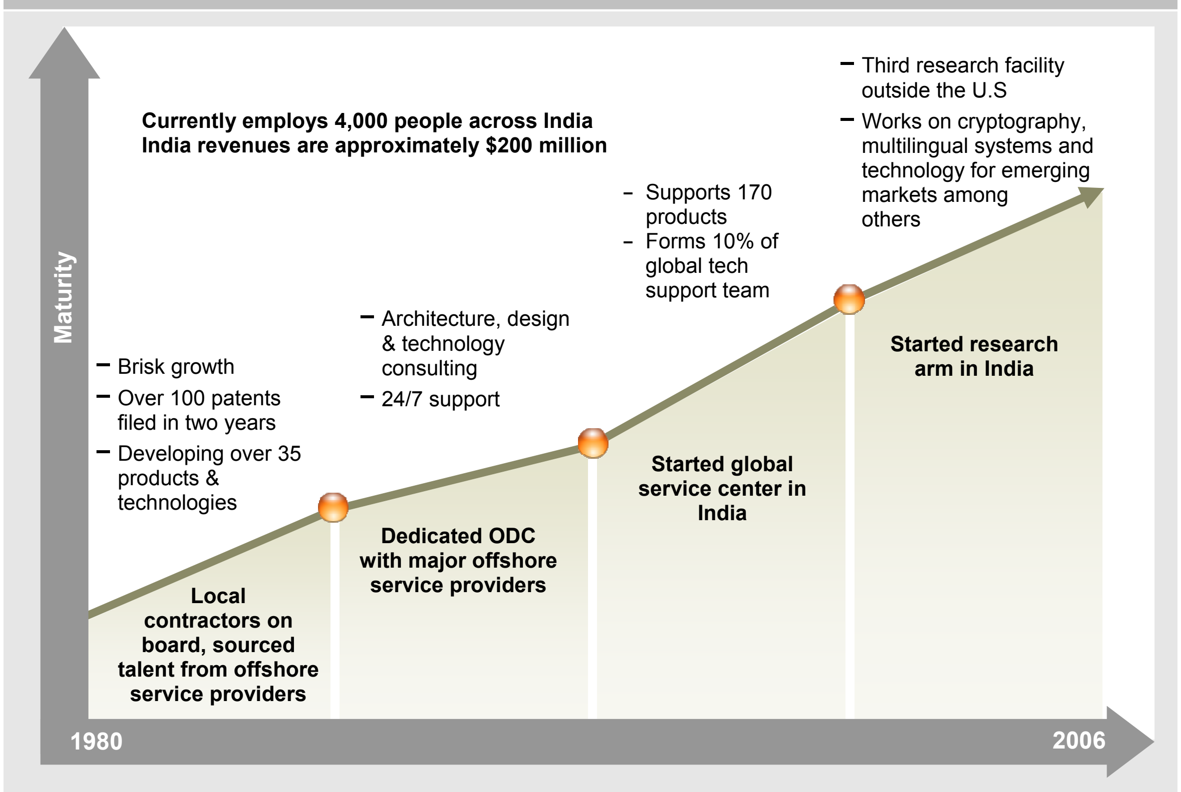
Consequently, the client organization built its own captive center in India. That center supported more than 170 products and handled 10 percent of the organization's tech-support requests. Sourcing to a captive center helped the organization significantly reduce operating costs and focus on more strategic activities – such as product management and marketing – from its onshore corporate facility.

Now, the client organization has the IP protection it requires as well as lower operating costs and the ability to focus on more strategic activities at its onshore facilities.

Since opening the offshore captive center, the client organization added a development, sales, and marketing center there, which supports product localization and local sales and marketing of the company's products.

The client organization also added a full-fledged research and development facility at the captive center. The unit works on cutting-edge technologies and has been generating substantial intellectual property patents for the organization.

Figure 6: Maturity over the Years



New Trends in Managed Services Outsourcing

The most significant trend emerging in the managed services market is the increasing number of companies that are leveraging the managed services model as an alternative to staff augmentation. And while many companies are just beginning to explore the outsourcing option, others that have already outsourced large portions of their non-core business processes are moving toward a more comprehensive outsourcing strategy (often involving strategic partnerships between the client organization and the vendor). Some client organizations are looking to strategic partnerships as a way to share risks and rewards with their suppliers.

And ownership models – within which the outsourcing firm owns a stake in its supplier – are becoming increasingly popular. Within partial ownership models, the supplier's objectives are aligned toward the client's overall strategy (as the supplier gets assured business when the client takes partial ownership). Within total ownership models, the client has assured information security and intellectual property protection. Figure 7 illustrates the trend toward increasingly mature outsourcing models – the more mature models with higher value capture and greater control are all variations of an ownership model.

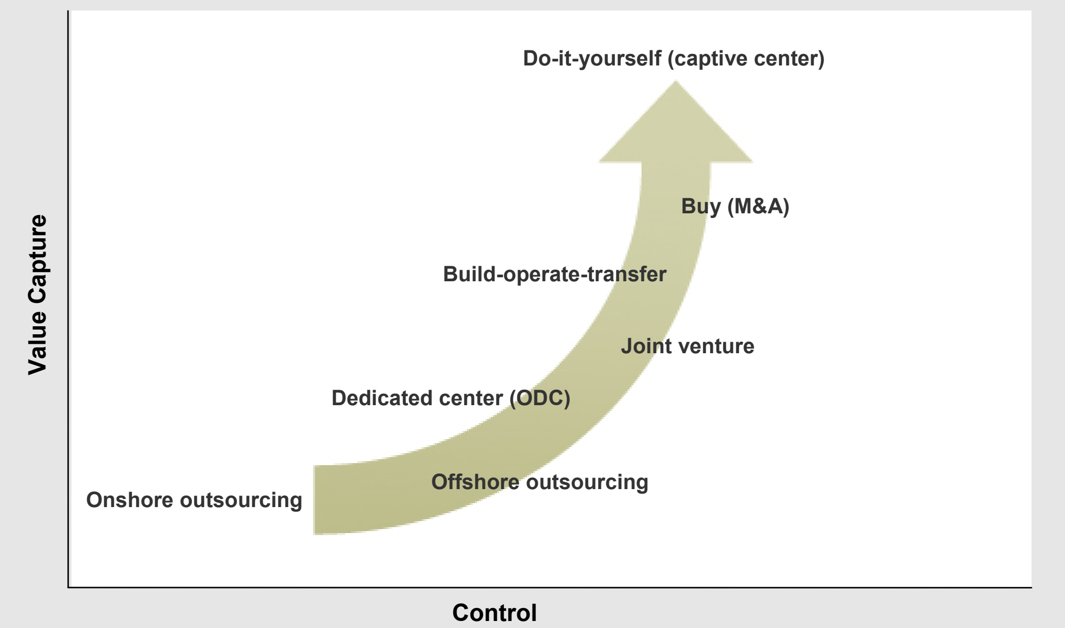
But companies are also looking inward to address the root causes of growing support requirements. Data and cause analysis are now easily available – allowing the client organization to understand the reasons behind increasing support calls and tickets and to identify the processes that need maximum support. That introspection has helped client organizations optimize processes and leverage restructuring opportunities to trim their infrastructure support requirements substantially.

And where companies are leveraging managed services to address increasing support requirements, they are basing those decisions on total cost of ownership (TCO) analyses and industry benchmarking exercises rather than on cost-saving and labor-arbitrage opportunities alone.

There is also a trend toward results-oriented pricing structures. Where contract pricing used to focus on inputs – such as FTEs or hours worked – it's increasingly focused on output. And there is a growing shift towards fixed-bid contracts to increase vendor accountability and reduce the client's financial liability.

Supplier consolidation is an emerging trend among organizations that have been outsourcing in fragments, with each department dealing with its own set of suppliers. Those organizations are beginning to realize the need to exploit synergies between the outsourcing initiatives and are trying to consolidate their outsourcing portfolios in ways that would increase their bargaining power with service providers.

Figure 7: Increasingly Mature Outsourcing Models



Source: neoIT

Conclusion

As cost pressures in business markets increase, an increasing number of businesses are looking to managed services to control costs and maintain their competitive positions. The most significant advantage of the managed services model is that it offers strong economies of scale – allowing the client organization to grow without proportionally increasing its support costs. And it alleviates the burdens of managing, monitoring, and maintaining systems and infrastructure across geographies. It also allows the client organization to focus on its core business activities while receiving a higher quality of service with improved efficiency and access to global talent pools as well as cutting-edge tools and best practices.

But for the managed services model to yield those benefits, the organization must transition from a stand-alone staff augmentation model to a blended staff augmentation and managed services model following the three-phase approach.

Only by diligently engaging the knowledge and planning, sourcing, and transition and governance phases will the organization successfully progress on the path to outsourcing maturity.

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