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Offshore Management Service Providers

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Infrastructure and application management functions are increasingly becoming standardized and commoditized, which is driving greater amounts of outsourcing. Moreover, just as offshore outsourcing has expanded for other IT functions, it is also entering the management arena. Whole offshore management services are generally solid and inexpensive, but cost savings may be less than expected.

Management service providers (MSPs) are organizations that offer infrastructure and application management as a service, rather than as a product (see SMS Delta 887). Basic infrastructure management (e.g., monitoring) has become a commodity. Like any commodity, tools are plentiful and mature, and they are becoming less expensive. Internal organizations are becoming increasing concerned about good maturity levels with their monitoring processes. The combination of commoditization, increased quality expectations, and offshore labor costs is creating the opportunity of offshore MSPs.

IT organizations (ITOs) considering offshore MSPs have increased markedly (200%-300% since 2002), with actual purchasing lagging by 6-12 months. Such growth in interest does not yet indicate mass adoption but provides a strong forecast for 2004. Offshore MSPs report a 30%-50% increase in revenue from 2002 to 2003. The year 2004 will be a time of acceleration from the early adopters to the early stages of mainstream acceptance, with a 50% increase in revenues over 2003. Through 2005-08, growth will taper off but remain strong (20%-30% per year).

The growing exuberance for offshore outsourcing resembles a fad, and some ITOs are pursuing this option because it is in vogue. This is a terrible reason to explore offshore options. Offshore services are not a fad, but rather a fundamental cog in the global economy. Their gradual and selective infusion into our businesses is inevitable, but organizations must consider all aspects carefully before embarking on an offshore partnership.

India is the epicenter of this movement because the large Indian outsourcers (e.g., HCL Technologies, Infosys, TCS, Wipro) are the beneficiaries. The outsourcing behemoths (e.g., EDS, IBM GS) hope to capture some of this business by moving operations offshore. A few smaller established MSPs (e.g., SiteLite) also offer a hybrid model. Despite this competitive landscape, we believe that the India-centric vendors will gain share and that the overall MSP market will ultimately diverge into two camps: offshore vendors and pure domestic vendors.

Most ITOs attempt to drive infrastructure and application management costs as low as possible while maintaining service levels. It is difficult to assess internal efficiencies because they are determined by existing operational maturity. Well-refined organizations will achieve less benefit than chaotic operations, where any form of outsourcing — offshore or not — will offer significant fiscal benefit. Internal refinement is nearly always preferred because outsourcing incurs additional cost and risk.

Cost savings is the dominant driver for offshore outsourcing, though organizations should not blindly chase a panacea of cost improvement. Although savings are probable, they are not guaranteed and will likely be less than expected. Other factors, most notably those that can modulate costs, include the following:

- Intercontinental communications (both verbal and electronic)
- Physical presence
- Cultural differences

META Trend: Through 2005, offshore outsourcing will remain a distinct outsourcing market dominated by pure-play offshore firms, with increasing market penetration by domestic firms. Vendors will increasingly emphasize operational functions such as command/control centers, and network operating centers will increasingly move offshore. During 2005/06, regulatory labor restrictions will compel pure-play offshore vendors to adopt new operating models and shift to domestic citizens for on-site work. By 2007/08, global resourcing (a.k.a. leveraging an array of nearshore and offshore capabilities) will be a delivery model and not a distinct outsourcing industry.

Our research estimates a cost/benefit breakeven point at 20% savings, below which offshore options become unattractive. Realistic cost savings range from 30%-50% below pure domestic MSPs. Not surprisingly, such savings are realized due to lower offshore labor rates.

Cost modulators skew actual savings. Two prominent modulators are automation and wage inflation. Any cost-effective management service employs an extremely high degree of automation. This applies to internal as well as outsourced services. As automation increases, the dependence on human intervention and resulting labor-rate influences decrease. This is why offshore MSP savings are less dramatic than other offshore functions, where heavy human reliance accentuates the labor-cost disparity. As this market continues to evolve, the main competitive differentiator will become automation efficiency, not labor rates. Eventually, this will alter the geographic distribution of services, but labor costs will linger as a potent driver for several years.

For the foreseeable future, India will retain its central role, but long-term prospects will differ. Rising labor rates are slowly changing the economic dynamics of this market. Basic laws of economics, largely beyond human control, are fueling talent competition in India and other offshore labor markets. Any notion of equilibrium between these areas and domestic labor are implausible for many years, but low-cost markets will shift geographically. A historical example is the shift in the offshore manufacturing of low-cost goods, where a distinct transition from Japan to Taiwan and now to mainland China is evident.

Intercontinental network performance and availability continue to pose a potential threat to the performance, accuracy, and reliability of management services. Communications links to the major offshore centers have improved to a reasonable level (e.g., Bangalore), but domestic services will remain superior. Organizations should always inquire about networks to offshore sites because not all sites enjoy high reliability. This issue is often highlighted as a risk by offshore opponents, but actual risk is relatively low. Offshore providers mitigate risk by offering a hybrid of offshore and domestic capabilities. Technology fault tolerance is clear if management data centers are physically located closer to customers, but the human presence is even more compelling. In fact, offshore options without some domestic presence are discouraged. We are accustomed to personal interaction and have come to expect close ties with our business partners. The majority of the actual work (e.g., tool and process development, monitoring, report processing) can be accomplished offshore, but ITOs will need some local presence for sales contacts and especially for more advanced services such as on-site maintenance. This need for broad geographic presence imposes a daunting barrier to smaller vendors. There is usually little need for MSP customers to locate staff in the offshore locale, though some vendor oversight can be achieved by doing so.

One misconception sometimes noted about offshore providers centers around the quality of their services. Opponents try to disparage offshore vendors as puny “IT sweatshops” that thrive solely due to their cost structure. This may be the case for some smaller vendors, but the major MSPs are impressive suppliers. They are large and stable, and all boast strong processes and automation systems that would be the envy of most IT groups. Even in markets with cut-rate labor, operational efficiency remains paramount.

MSP services are highly tactical. As such, contracts with MSPs should be flexible and explicit. Short-term contracts (e.g., annual renewal) offer the customer a reasonable escape option should the situation dictate termination. MSPs with good technology and processes will not balk at such terms, because their services should be easily and quickly able to adapt as needed. Vendors always prefer longer contracts, but strong resistance to short contracts should serve as a warning. Roles and responsibilities must also be clearly articulated in the contract. Precise definition of details such as monitored devices and systems, escalation procedures and personnel, and SLA commitments will eliminate many of the ambiguities that can cripple a relationship and cause cost overruns. Integration with internal processes and management technologies is desirable, but much of this is still unrealistic. Any effort to hand off process execution and information to a partner and then return control to the internal organization requires high levels of internal process maturity, including well-defined processes. This is often not the case, so organizations must expect to invest some process and tool development to enrich this capability.

Bottom Line

Offshore management services are a viable option for operational monitoring. Cost savings are likely, but organizations must consider all economic, tactical, and political factors before committing.

Business Impact: Offshore operations reduce costs. However, huge savings are not guaranteed.