Outsourcing Enterprise Network Services in the U.S.

Summary
Enterprises that choose network services outsourcing to offload increasingly complex infrastructure management issues must evaluate options carefully when selecting a supplier and defining the contract.

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Outsourcing

Outsourcing is attractive to corporations wishing to concentrate on core business activities and willing to offload increasingly complex infrastructure management issues to companies specializing in those areas. Initially, Information Technology (IT) outsourcing followed a model in which firms took over the entire IT facility and ran it for the client enterprise. On the networking side, the major network service providers (NSPs) would provide a managed data and communications service involving leased lines and network services, such as virtual private networks (VPNs), X.25, asynchronous transfer mode (ATM) and frame relay (FR). Network services have become an increasingly important part of the IT infrastructure and as a result, network services outsourcing is a fast-growing component of broader IT and business process outsourcing contracts.

The Network Effect in IT Outsourcing

Public network services are a critical component of the IT infrastructure and business process and are increasingly bundled within outsourced IT infrastructure contracts. These include the management and operation of public network assets as well as responsibility for the desktops and servers. Typically, in this type of contract, an external service provider (ESP) specializing in IT manages the IT responsibility and subcontracts the networking components to an NSP. However, recent contract wins illustrate a move toward a single-supplier approach, whereby one provider handles both the IT and network outsourcing components.

Outsourcing is available in varying degrees of risks and responsibilities. In a more traditional model, network-outsourcing contracts transfer ownership of wide-area network (WAN) assets (equipment and services) and staff to the outsourcer. Managed network services are a “lighter” form of outsourcing under which enterprises hand over the management and operation of WAN equipment and network services but retain ownership of assets and staff. Often, these market offerings are referred to as selective sourcing in addition to managed service. This area of the market is growing as enterprises seek to rid themselves of repetitive management tasks such as WAN fault isolation and remediation. Systems Integrators (SI) and IT Outsourcers (ITO) are moving to dominate the North American managed network services market, while the NSPs are the prime contractors for managed network services (MSN) in Western and Eastern Europe. Gartner believes that SIs and ITOs will mount increasing competitive pressures in managed network services and will gain significant market share from NSPs in 2004.

Trends in the Network Outsourcing Market

The biggest and most important market segment for network services outsourcing lies within the larger midsized to very large enterprises within North America. Some outsourcers have begun to penetrate smaller businesses, where there remains plenty of room for expansion through product extension in this historically under-served market segment. Product extension is achieved by offering selective sourcing opportunities as an alternative to traditional outsourcing agreements. Success across all business segments will hinge on whether outsourcers are able to reduce expenses (capital and operations) while speaking to future proofing network architecture for growth and the accommodation of new business models. Historically, outsourcing services have been scaled and priced only for large enterprises.

Another interesting element of recent network outsourcing deals is in technology migration, specifically migration to the Internet Protocol (IP). Enterprises have been requesting phasing out their legacy premises telephony systems (private branch exchanges [PBXs] and key systems) with newer IP telephony solutions. Network outsourcing agreements are also requesting technology refresh/evergreen agreements for customer premises equipment (CPE) and premises network infrastructure (PBXs or key
systems to IP-PBX and contact centers to IP contact centers). In the WAN, several contracts include migration from the more mature transport technologies such as frame relay or asynchronous transfer mode (ATM) to IP-based virtual private networks (VPNs). In certain configurations, IP-VPNs can be less expensive to deploy and manage than legacy data network services. A gradual migration to IP may be a better solution for an organization that wishes to methodically transition their existing investments in legacy premises equipment or legacy WAN services to maximize the useful life of the infrastructure.

Making the Decision for Network Outsourcing

Companies outsource network services for a variety of reasons, the most important of which are to reduce capital and operating costs to reduce the added burdens of managing IT and personnel to better focus on the core business.

Opportunities

- **Cost/Risk Reduction:** Outsourcers leverage negotiated prices with NSPs and network manufacturers to reduce capital costs. The scale and scope of the outsourcer’s resources can improve the speed and efficacy of the network implementation. This enables organizations to avoid the escalating costs of an in-house network, or the high cost of upgrading an existing network or building a new one. Network outsourcing contracts are typically three to five years long.

- **Focus on Core Business:** Companies may not have networking expertise available and may not wish to develop and manage these skills since they are not related to the company’s general business focus. Additionally, certain vertical markets, such as the financial services sector, may experience a competitive edge by upgrading to a higher-speed network and sourcing its management and operation.

- **Improve Speed to Market:** Building support infrastructure takes time, and this option may not be available for companies introducing new products. The capability to make rapid changes, as provided by outsourcing, speeds time to market and enhances the capability to innovate.

- **Technology Refreshment/Evergreen Contracts:** Many enterprises lack the financial capital to refresh their networking environment. Outsourcers are constantly refreshing their technology selections, and these options could be especially beneficial to key verticals such as financial services, life sciences and discrete manufacturing.

Threats

- **Poor Communications:** Most outsourcing projects fail due to miscommunication between supplier and client.

- **Poorly Written Contract:** Having a well-defined and thorough contract is key to achieving a successful outsourcing relationship. In most cases, the pitfalls of outsourcing can be avoided by negotiating through specific issues during the contracting phase. The risk of a poor contract can be minimized by having a “true” third-party expert draw up the contract. Enterprises that fail to properly negotiate their contracts will most likely end up disappointed.

- **Staff may become concerned about potential layoffs, and key personnel may leave before final arrangements are made.

- **The customer may get locked into an outsourcing supplier’s technology, systems or contractual obligations.**
Loss of Control: businesses perceive their information as a competitive advantage. Moving it outside the enterprise is seen as a threat, risking exposure and loss of control, particularly if an outsourcer also works with competitors.

Service Levels: enterprises must rely on the outsourcers to provide consistent and satisfactory service levels. Although service-level agreements (SLAs) provide some level of compensation for service-level degradation, businesses could suffer severe losses in the event of a major outage or dramatic decrease in service quality.

Selecting a Supplier

Network outsourcing demands careful evaluation from the beginning. Options should be evaluated by a team that includes representatives from all affected departments. A thorough business case analysis needs to be created, taking future needs into account. Once the decision has been made to outsource the network, the specific services and infrastructure areas that can best benefit from this approach need to be identified, and an outsourcing vendor or vendors can be considered in preparation for a request for proposal (RFP). Making the bidding competitive will help toward selecting the appropriate provider. Selecting an outsourcer requires careful evaluation. Important things to look for include:

- Demonstrated expertise/experience in the areas of most interest to the client, as well as knowledge/experience of applications and the like, inherent to the enterprise’s industry.
- The vendor should be financially viable and stable. In cases where the chosen provider has had a troubled financial past (or is present in a difficult financial situation), the contract should include clauses relative to conditions under which termination may occur.
- Competitive pricing and a consistent definition of services on offer across bidding providers.
- Accessible customer references, preferably from a similar industry.
- A focus on customer service.
- Organizational strength, including size, time in the business and reputation. Conduct an audit of personnel and relevant expertise/certifications.
- Adequate staffing and management structure to handle normal operations as well as emergencies.
- Partnerships and Alliances, as few organizations possess the experience or scale to successfully handle global contracts.

Defining the Contract

During request for proposal (RFP) development, the following requirements should be met for vendor consideration:

- Obtain a copy of the outsourcer’s service catalog, which provides detailed terms, describes its services and describes how the provider measures its services.
- Find out what process or methodology is used to deliver the service and manage infrastructure operations.
- Find out what is to be automated and what is not. Automated processes improve efficiency, and a mature outsourcer will have developed these in a number of areas.
- Find out how the outsourcer will meet the deliverables to ensure that adequate processes are in place.
Determine what measurement system is in place, or needs to be in place, to attain appropriate service.

Set up a firm SLA.

And the most important component: recruit expert assistance to develop the contract.

The contract should be flexible to an extent, in order to adapt to changing business requirements, and to accommodate technology advancements and declining prices. Some issues for setting up effective contracts include:

- Define deliverables carefully, and specify how they will be monitored and measured. Include specifics regarding scope (what is included versus what is not included) of the agreement.
- Request a project timeline, with rewards or penalties tied to achieving specific milestones. Specify actions to be taken in the event of nondelivery.
- Carefully model service requirements to your own business requirements.
- Request yearly benchmarking studies that analyze not only pricing, but the overall cost of the network.
- A nondisclosure/noncompetition clause may be necessary to ensure the outsourcer does not share proprietary company information with competitors.
- Define an exit strategy in order to allow for a smooth transition in the case of early termination, or following the completion of the contract.

**Recommended Gartner Research**

“Managed Services Will Drive Data Market,” SPA-21-5090

“EDS and Bank America Focus on Network Costs and Value,” ITSV-WW-DP-0493

“SMB IT Services Buying Trends and Preferences, 2003,” ITSM-NA-UW-0111

**Insight**

Network services outsourcing represents an increasingly popular option as networked systems become more commonplace, skill shortages exist, and infrastructure requirements become even more complex. For companies considering an outsourced solution, there are several important factors to consider:

- Don't overestimate the cost-saving benefits of outsourcing. While savings can be found, they may be difficult to quantify and difficult to prove. There may also be substantial financial risks in long-term outsourcing contracts.

- Know your own costs before considering outsourcing. This makes it much easier to benchmark and provide reasonable goals when a contract is in place.

- Establish a strong SLA with objectives, including incentives for superior execution and penalties for subpar performance.

- Re-examine the outsourcing solution often, and survey users to see how satisfied they are with results.

Successful outsourcing demands careful attention to contract details and development of a strong business case. Other items to look for:
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- Make certain there is an exit route (that is, transition policy, alternate suppliers) should the vendor experience problems.
- Make certain you can identify hidden costs. This includes the cost of finding a vendor and establishing a contract. Transition costs, including an overlap period in which duplicate services are provided, can be quite high.
- For some clients, outsourcing is not the right solution; however, managed services could be a better fit.