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Standard Delivery of IT Services Drives Significant Benefits

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INTRODUCTION

The increasing viability of virtualization and cloud technologies is enabling the implementation of a utility service model that defines a new standard of operational excellence. For business organizations, this represents a fundamental step change in the way IT services are managed and delivered.

The opportunity is significant. Traditional improvement initiatives drive incremental efficiency gains within the existing operational environment, typically resulting in savings of between 10 percent and 20 percent. A transformational approach to improvement establishes a new, optimized IT delivery model that fully leverages the benefits of utility computing, often producing overall cost savings of 40 percent or more.

This white paper examines recent developments in IT management strategies, specifically as they relate to the standardization of IT service delivery and utility computing. The potential benefits of this emerging approach are discussed, as are challenges and obstacles to transforming the IT environment. Keys to a successful utility initiative are outlined.

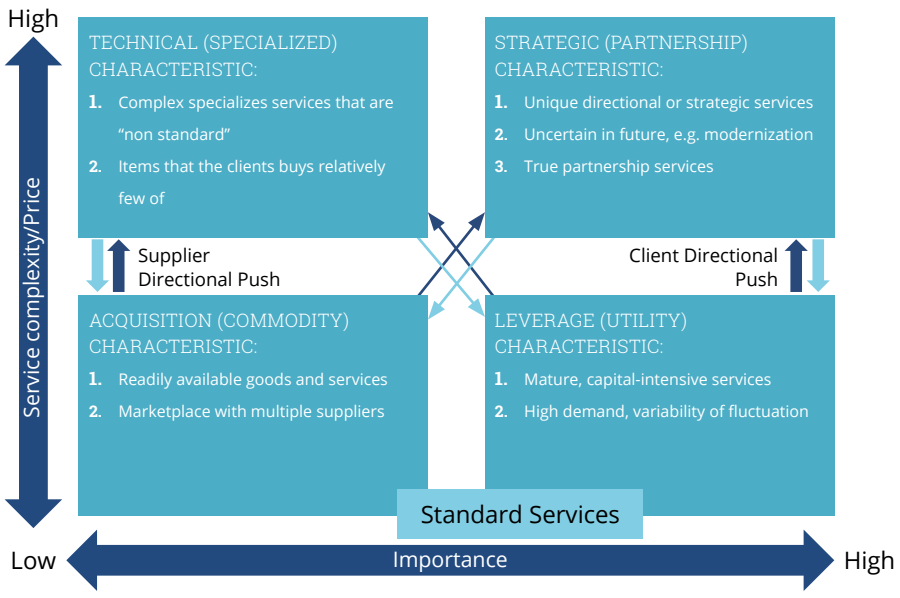
STANDARDIZATION CHARACTERISTICS

A utility service delivery model is characterized by clearly defined service levels and units of IT functionality that address both the scope and quality of a business' IT requirement in generic terms. These definitions reflect industry standards and a comprehensive database of how services – whether outsourced or retained by the business – are built and priced. Standardized definitions and pricing of IT functionality help internal or external service providers to drive significant economies of scale through a "virtual" environment or utility service.

The result is pay-per-use, on-demand access to IT resources – the realization of the longstanding potential of utility computing.

This approach to service delivery is becoming increasingly viable, thanks to growing business acceptance of the proposition that up to 90 percent of the IT requirements of most organizations can be addressed through standardized services. In other words, while a bank's activities are obviously very different from the activities of a retail manufacturer, the basic IT functionality that each business requires to support critical processes and systems is largely identical.

Portfolio of Services



Once an organization recognizes that most of its IT requirements can be addressed through standard services, it can develop and implement appropriately tensioned pricing mechanisms that create incentives to drive appropriate use of IT and increased efficiency.

For example, in a traditional environment, a client pays a service provider a specified amount per server. The service provider seeks to install additional servers, as that generates additional revenue. Under a tensioned pricing mechanism, meanwhile, the client organization pays a specified amount for a CPU minute. This creates an incentive for the service provider to drive efficiency in the delivery of that CPU resource, as greater efficiency equals higher margin. The customer organization, meanwhile, has an incentive to utilize CPU resources more wisely, as every CPU minute consumed has a cost attached to it.

To illustrate further, consider the pricing of desktop PCs, which is typically negotiated on a per box basis. For a large organization, this approach creates the risk of paying for thousands of unused PCs. In a tensioned model, pricing is utilization-based, so that invoices show how much each desktop is being used. This allows the business to simply return – and not pay for – any unneeded desktops. And now, the service provider is incented to implement the best practice of maintaining an effective asset management system, for the simple reason that it's necessary to generate invoices and receive payment.

This process of driving standard service delivery throughout the enterprise also makes it possible to highlight the truly business-specific requirements that do exist and that can only be met through specialized IT services. By identifying the cost of specialization, the business can make value-based decisions and support comprehensive demand management.

In addition to driving cost savings by eliminating payment for idle or under-utilized services, a standard services model allows a business to respond effectively to dramatic spikes in demand for IT resources.

Growing acceptance of the utility computing model is due in part to technology advances related to virtualization and cloud environments. But even more important is the recognition by business that defining IT requirements in consumption-based, utilitarian terms yields a critical competitive advantage.

As such, utility computing is less a technical innovation than it is a reflection of a maturing marketplace that produces more effective commercial agreements for the delivery of services.

It's also important to make a distinction between utility computing and standardization on the one hand, and cloud computing and virtualization on the other. Although often used interchangeably, from the ISG perspective the terms mean quite different things. Specifically, virtualization and cloud are vehicles or platforms for delivering utility computing or standard services. However, cloud-based or virtualized solutions are not prerequisites for a utility model – which can be implemented via traditional sourcing models or retained services. Similarly, a cloud solution does not necessarily deliver a utility or standard set of services.

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IMPACT ON SOURCING

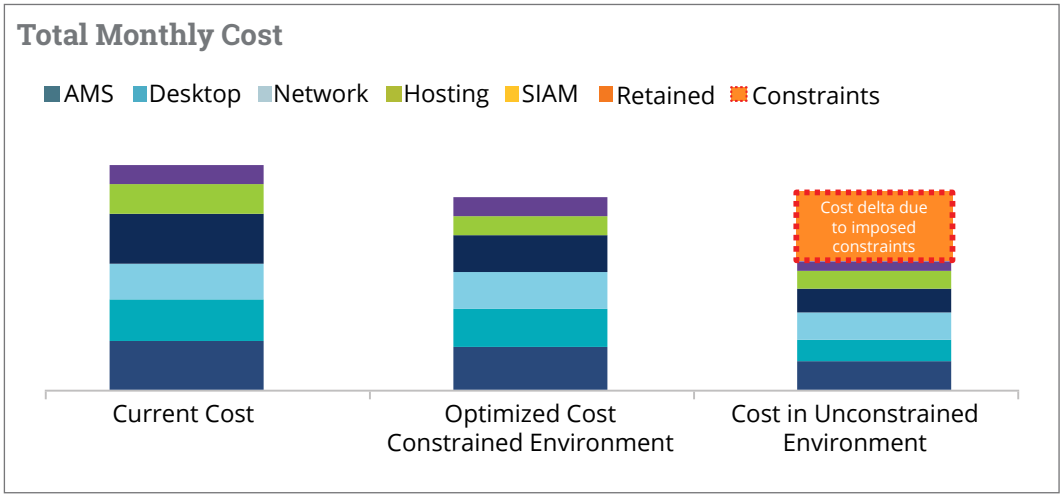
This emerging model is having a profound impact on sourcing strategies and relationships. Increasingly, key sourcing decisions will no longer be around outsourcing, offshoring, or repatriation, but rather, around how best to drive standard service delivery and utility-based consumption of IT. In some cases, outsourcing will be preferable. In others, where, for example, in-house incident management capabilities are more mature than the service provider's, or if assets are already owned by the client organization, a retained approach will prevail. Since the move to utility computing models reduces costs and outsourcer revenues, won't service providers resist the change? Surprisingly, many vendors are in fact embracing the concept, because it provides them with greater control to leverage economies of scale and their expertise at efficiently delivering IT services. Coupled with the increased incentive to drive efficiency, this creates a significant opportunity to grow profit margins.

In addition, the savings generated through a utility exercise are likely to be re-invested by the client organization into new initiatives, which can be new opportunities for the service provider to generate revenue and strengthen the relationship.

That said, it's certainly true that approaches to sourcing negotiations and contracts will have to adjust, as account managers are typically compensated by revenue or size of the deal. Moreover, client organizations must be more open to improving their internal processes to drive optimization, rather than putting the onus solely on the service provider to deliver savings.

THE OPPORTUNITY

Our data shows that traditional improvement initiatives drive incremental efficiency gains within the existing operational environment, and typically produce annual savings of 10 percent to 20 percent. Meanwhile, transitioning to a utility-based model and a standard service platform can produce savings of 40 percent and more. (See chart below.)



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In other words, rather than tightening the screws on the way things have always been done, IT leaders are establishing a new and significantly better way of doing things – a clean slate that fully leverages the benefits of standardization and utility computing.

The improvement reflects both increased delivery efficiency from the supply side, as well as improved commercial management from the demand side.

The benefits of an optimized environment result from squeezing out the deeply ingrained operational constraints that characterize most existing enterprises. These constraints typically fall within two different categories:

Contracted constraints with suppliers: Clients often dictate a specific solution or design (or multiple designs) that prevents the supplier from leveraging standard capabilities. Another example: Demands for unusually complex and inappropriate reporting, service management, and governance. In other instances, service levels are misaligned – either against actual business requirements, the scope of services being delivered, or what would normally be found in contracts delivering similar services to similar businesses.

Non-contracted constraints with suppliers (or supply teams): Unclear boundaries of responsibility often result in significant duplication of effort. In addition, the client teams (architecture, project, or service management) can influence the supply teams and prevent them from leveraging standard capabilities.

In a utility environment, the business subjects these various requirements to appropriate value- and cost-based reviews. These assessments are conducted discretely, so their cost is not blended into the standard services model. Once the cost is clearly quantified, the business appropriately assesses the requirement.

Although the transition to a standard IT service delivery model yields significant and often dramatic savings, the "transformational" aspect of the change is rarely dramatic in terms of impact on or disruption to business activities – in contrast to traditional business process re-engineering initiatives. Indeed, an IT standardization program involves the transformation of the IT environment – not the business functions that environment supports.

CHALLENGES

Although the potential benefits are significant, organizations face a number of challenges in implementing utility computing.

According to a recent poll conducted by IDC, IT executives view security, performance, availability, and ease of integration as the main concerns surrounding a cloud environment. Again, while the two terms should not be considered synonymous, cloud environments are typically associated with a utility model.

Security concerns go beyond simply protecting data from hackers, and include the service provider's roles and responsibilities in identifying and investigating breaches. The nebulous nature of the cloud or virtual delivery model makes IT executives uneasy about possibly sharing hardware with a competitor. Another concern is that the privacy laws governing an offshore provider may not measure up to the client organization's requirements.

Regulatory or legislative restrictions on third-party data sharing may make solutions untenable for some enterprises, unless they address all requirements or deliver robust end-to-end encryption.

Additional questions surround performance, availability, and reliability. Examples such as Amazon's EC2 service outage in December 2009 or Microsoft Azure's outage in March 2009 indicate that the concerns are real. Although SLAs can include penalties for downtime, they don't account for lost revenue or clients.

Another barrier is compatibility issues between different virtual service providers, as well as between providers and internal IT shops. This is a concern for enterprises that may want to switch between providers, retain control of applications and services, or migrate their data if a provider goes out of business.

That said, none of these general concerns are unique to cloud-based environments. In fact, cloud-based service providers could argue that they can provide enhanced security by leveraging inherent economies of scale to employ the best security experts and latest security tools.

Moreover, as indicated, a utility or standardized environment is more a function of the commercial relations between the business and the IT supplier, than it is a function of the technology architecture used to deliver services.

Still, the conservative tendency of many enterprises could be a barrier to deploying cloud-based solutions; specifically, the concern that any problems resulting from a move to the cloud would be seen – justifiably or not – as a reflection of the new model.

KEYS TO SUCCESS

An effective standardization initiative is characterized by the following elements:

A consistent shared vision: Both the client and service provider organizations need to understand and accept the concept of a standard IT services delivery model and its characteristics. Accordingly, all parties must agree on the need for pricing mechanisms that create incentives to drive efficiency and eliminate operational constraints.

Identifying the target: A benchmark exercise quantifies the current state and the "size of the prize" of an optimized environment. With the target identified, the roadmap to the standard delivery model can be charted. The characteristics and complexity of the existing environment help define the type of business team that will be needed to manage the change initiative.

A detailed plan: The implementation plan is characterized by a detailed analysis of existing constraints and inefficiencies. Around this, the services framework and pricing mechanisms that drive out the constraints and implement utility delivery can be built.

Further, the plan ensures that potential benefits are delivered throughout the change process. This allows the implementation to be self-funding, as the benefits realized along the way can be invested in driving further efficiency and improvement.

ABOUT THE AUTHOR

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Nigel leverages more than 20 years of experience in service development, change management and sourcing strategy to help his clients save money and discover the long-term benefits of operating IT commercially. Nigel works with companies around the world and across a variety of industry sectors helping enterprises move to agile delivery models based on the delivery of standard services and the exploitation of emerging technology in both IT and business operations. Nigel's expertise includes the use of benchmarking techniques and scenario analysis as the basis to drive informed change. He has an MBA and a BS in Mathematics, which he utilizes to analyze companies for opportunities to save money and time. He is recognized as a thought leader on service catalog construction and TBM.

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