



Cure-all, or catch-all?

As IT becomes more things to more institutions, outsourcing may become a more attractive alternative to doing just about anything yourself. All the more reason to be cautious.

BY RICHARD JACIK

Recently I watched as a campus executive recollected his school's first project with an application service provider (ASP). He described all the pain, suffering and, ultimately, the benefits of getting the puppy out of his house and into the (good neighbor's) yard.

The audience, a group of executives from peer institutions, could be segmented philosophically into three groups. One group was familiar with the pitfalls and perils of entrusting applications, servers, software and sometimes staff to an outsourcer.

A second group saw the possibilities as a quick-fix for political, technical and organizational problems that seem to be getting worse over time. They were fascinated by the thought of "getting rid of the whole IT mess" through outsourcing. The third group, by far the smallest, just didn't seem to care very much.

The point being, it's not just for technologists anymore. Almost everyone involved in higher education administration is struggling with an ever-increasing set of hardware, software and support issues.

Could become addictive

Outsourcing, originally seen as a way to relieve the headaches of operating and running a data center, has grown up as the apparent, though none-too-intuitive, cure for all the hard problems of IT. Add the internet, shareable applications and the software-as-service paradigm—and the outsourcing drug is too tempting not to be gulped down to deal with the symptoms of IT fatigue.

To be sure, IT is a headache for higher education. As a utility it lacks definition and closure. It goes beyond even the business-critical technologies for teaching, learning and research. And IT falls between the cracks of all the campus organization models that can be managed pretty well.

The fed-up executive, perhaps tired of getting the run-around from a well-meaning but ultimately ineffective IT staff, sees the envisioned benefits of an ASP or outsourcing model as almost too good to be true. Not only are there cost reductions and improved performance, but there are as staff reductions. Plus, there's someone else to deal with the intractable problems of technological change and security.

What's good about it?

From a provider's standpoint, the ASP model is a largely untapped market with long-term contracts and steady revenue streams. In addition the provider becomes intimately involved with a customer's technologies and strategies, and can identify new project opportunities early.

From the customer's standpoint? "Universities are impressed by the same factors that impress businesses: the value of focusing on your core mission, leaving IT management to the experts, and not having to spend every waking hour keeping top-notch technical staff away from the high-tech recruiters," says Joe Chalmers, president and founder of Insight Advisors, which helps higher education clients figure out whether outsourcing makes sense.

There is another compelling factor that is more higher education specific. "The high cost of, say, an Oracle database administrator can be challenging for any organization, but on a campus it may be necessary to pay a DBA more than the average faculty member, and that's very difficult politically," Chalmers explains.

Different strokes

Outsourcing configurations come in a dizzying variety. Data-center outsourcing might allow a campus already bursting at the seams to avail itself of a powerful network and not waste valuable real-estate to house a machine room.

This configuration spawned co-location, where you own the equipment, but it sits in a giant machine room, probably in Virginia or Silicon Valley near a convenient internet on-ramp. You are responsible for the administration of the servers but you don't have to run a wire, worry about air conditioning, raise a floor or configure redundant power supplies.

From there it's just a short hop to the ASP model—a full marriage of responsibility for hardware and the application systems that run on the hardware. Before the dot-com crash, ASP became the business model *du jour* for outsourcing alumni like IBM and EDS as well as nimble startups like Exodus and FutureLink, who counted on a web presence and venture capital to tide them over to profitability. Even firms like Qwest, SAP and Intel, fearful that the trickle of interested customers would turn into rushing revenue streams for someone else, tried to get in on the act.

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Making the most of it

The data center outsourcing business model is simple to understand and predict for both the provider and the client. For an outsourcer the contract's first year was a loss-leader. The transitioned operations staff gave their new boss a try-out. Service improved for the client, simply from the added pressure of new management and the application of some industry standard approaches and metrics.

The second year was the breakeven year for the outsourcer, as operations improved and staff—especially expensive staff—were trimmed. By year three the honeymoon ended and the outsourcer

was making enough profit to make up for year one, year two, and then some.

With application hosting, volume is the name of the game, and the honeymoon is abbreviated. For ASPs, the cost of building giant machine rooms, buying lots of servers and licensing expensive software doesn't leave a lot of financial wiggle room. If an ASP can't fill up its capacity, it is unlikely the firm will be around for the last year of a 5-year contract.

Keeping the customer satisfied

ASP vendors are always in a sticky position. Should they charge enough to make a profit, and help ensure

they'll be around for the long haul? Or should they low-ball the price in order to encourage a critical mass of customers to sign up?

Capers Jones, an authority on software productivity and measurement, reports that two years after the start of an outsourcing contract, some 70 percent of the projects receive "unsatisfactory" ratings from customers. Jones does not differentiate between data center outsourcing (longer honeymoons) and application hosting (shorter honeymoons).

Meanwhile, most outsourcers and ASPers serving higher education report a 90+ percent customer retention rate. Despite their complaints, perhaps customers are unwilling to go through the pain of contracting with and migrating to a new provider. Satisfaction with a new service provider is far from guaranteed, and the costs of a change would have to be budgeted and expended again.



It's an "e" world

Long before "e" became a common prefix, it had its own meaning to service providers. An "e" was an "extra" or add-on piece of work, something that fell outside the scope of an existing arrangement with a client—and therefore something that would provide additional revenue and additional opportunities for profit.

A vendor's best, most punctilious contract managers could be counted on to quickly identify out-of-scope requests (even when based on urgent client requests) and to get a change-order in front of the client in a hurry. The best customers quickly learned

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that managing the “e”s, like limiting impulse buying at the grocery store counter, is as important to overall financial success as is careful management of the base contract.

Holding on

Will your outsourcer be around to finish out year 5 of your contract? Good long-term relationships are rarer in turbulent markets. As companies are acquired and merged, outsourcing and ASP contracts are sold, bartered, and exchanged at a velocity that would make the home mortgage market envious.

While outsourcing contracts have been shortening from 10-year, to 7-year, to the now-standard 5-year term, it isn't that easy to swap service providers. A good first choice is more and more important. Customers should invest a lot of time, energy, and effort in forming partnerships with their providers. The pain of repeating a procurement effort of the size and complexity of outsourcing or ASP engagements is daunting.

More than a few customers have re-internalized the functions that they had been paying outsourcers and application service providers to perform. However, ending an outsourcing contract and bringing those systems and operational capabilities in-house is at least as problematic as keeping operations external and switching providers.

An unsettled market

The press releases and rumors of deals done and undone, of companies entering the market and of others exiting are abundant and growing in number. To name just a few, Pandesic, Exodus and FutureLink all ceased operations during 2001. For once, the inclination to go slow and make conservative tech choices may serve higher education well.

For the ASP/outsourcing model to be successful, a set of *profitable* market leaders must emerge and provide some sense of comfort that they will survive a long-term relationship. In higher education, that may be a year or two away yet.

Meanwhile, application service providers continue to fail at an alarming, though declining, rate. Even those supported by deep-pocketed

technology companies are running scared. The failed Pandesic was an Intel/SAP joint venture, for example. In fairness, many ASPs do not *expect* to be profitable until some time in 2002. However, entrusting business critical applications to companies that are a year from profitability is risky.

The next step

While you're waiting, you can spell out what your institution really needs from an ASP or outsource deal. If you are trying to dramatically improve service and technology support, then don't count on saving a lot of money. If it's cost-savings you're after, think about where you're willing to draw the line.

According to Chalmers, “Colleges frequently take for granted some benefits they now enjoy. This creates problems when they are not part of the outsourcers service agreement.”

Also take an honest look within. An institution that can't manage relationships, expectations and service levels with internal support organizations is probably not very well equipped to manage similar issues with an external service provider.

More to come

Finally, here's a bright light out in the future. Ultimately, the thought of contracting with a single outsourcer or ASP may become quaint.

Web services will make it possible to extend the software-as-service model to undreamed of lengths. If you are connected to the internet, web services will allow you to lease even the tiniest parts of an application from service providers anywhere in the world.

To round out your functionality, you may be assembling dozens, hundreds or even thousands of web-services from dozens, hundreds or thousands of vendors.

Now, talk about headaches... ■



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