Update

Business Technology Strategies
Executive Update Vol. 17, No. 9

Outsourcing to the Cloud

by Dr. Sara Cullen, Senior Consultant,
Cutter Consortium

The cloud concept is not new, although its name has changed as it has matured and evolved. Time-sharing a centralized resource was the first outsourcing model back in the 1960s. In those days, you often sent a batch of commands from a local terminal and then waited in a queue for processing by the remote mainframe. There were no KPIs in those days, so the wait could be hours or even days. You could pay more, of course, and book a period for the resource to be made available. Time-sharing disappeared as the ever-lowering cost of technology made having your own resources more attractive than the very painful queuing.

Cloud emerged again briefly during the 1997-2000 dot-com bubble, when it was known as application service provider (ASP), with providers hosting applications or renting standard applications over the Internet. ASP collapsed when the bubble popped. Although clients liked the idea of renting rather than owning resources, providers had difficulty generating revenue. The value of contracts were too small, the duration too short, the marketing costs to educate clients about ASP too steep, the margins from reselling propriety software too thin, and the transaction costs of serving so many needy clients too high.[1]

Today, as we'll explore in this *Executive Update*, cloud services are the reincarnated, super-charged version of ASP. In the current decade, cloud has proliferated into many derivatives of XaaS, or "anything as a service" (e.g., SaaS — software as a service, PaaS — platform as a service, IaaS — infrastructure as a service, and DRaaS — disaster recovery as a service). The derivatives of XaaS are many and increasing daily. There are so many forecasts, it's impossible to determine the market size and growth trajectories. Early this year, a *Forbes* contributor more accurately describes the cloud as a tornado, rather than a fluffy white floating object, due to its extraordinary growth.[2]

This time, the cloud looks to be here to stay, and quite possibly will overtake all other forms of outsourcing. Even the low-cost model of offshoring can't compete; no labor is cheaper than free labor.

Increasingly, many new enterprises are simply "born in the cloud." It's hard to justify acquiring infrastructure before revenue comes in, so investors expect startups to acquire IT capabilities as a service. But it isn't just cost; it's also scalability and speed to market. Piecing together a package of cloud services isn't easy even for the most cloud-literate, but it is still dramatically quicker than building an environment from scratch with the ability for rapid scalability.

Legacy organizations are making the move to the cloud as well, but in a less dramatic fashion. It may be in the form of a pilot as part of a larger staged process, or on a piecemeal basis (a bit of infrastructure here, an app there), or as part of a refresh. As one of the many examples of this trend, Australia-based airliner Qantas has moved its massive frequent flyer program from its 22-year-old Fortran-based system to a cloud-based platform. Qantas intends to better target loyalty promotions and rapidly introduce new loyalty program partners, which was difficult with the older system.[3]

Some unique practices are emerging when one outsources to the cloud as compared to more traditional outsourcing, which we'll explore below.

WORD-OF-MOUTH BUYING

First is the way in which organizations acquire the services. With the cloud, word-of-mouth references about potential providers are everything. A study currently underway, led by the University of Missouri–St. Louis, has so far found that the traditional competitive tender process has been jettisoned.[4] Trusted sources, which have experienced the actual reliability and performance of various providers, are the main source of information. Companies prefer well-known brand names (e.g., Amazon, Google, Microsoft) because they see them as less risky.

We saw a similar pattern when outsourcing began in the late 1980s. It wasn't until there were enough reputable brands competing for outsourcing work that competitive tenders became normative.

SKIPPING THE RELATIONSHIP

Another interesting aspect of outsourcing to the cloud is how little the relationship matters as compared to other forms of outsourcing. The outsourcing maturity model emphasizes a move from a cost-saving and master-slave orientation to a relationship orientation. Even offshore providers have had to react to the customer's relationship needs by having onshore relationship managers but offshore engine rooms. I've lost count of the times a legacy organization has asked me to name the best domestic providers of offshored services — they wanted the cost savings, but also someone local they could talk to. However, if you want to be loved and listened to, the cloud will be a lonely place for you.

The very definition of the cloud emphasizes the lack of party relations. Cloud computing is defined by the US National Institute of Standards and Technology as:

> ... a model for enabling ubiquitous, convenient, on-demand network access to a shared pool of configurable computing resources (e.g., networks, servers, storage, applications, and services) that can be rapidly provisioned and released with *minimal management effort or provider interaction* [emphasis added].[5]

Large organizations with large spend are likely to get an account manager, others for various reasons may get a bit of one, but few will qualify for that investment by the provider. Regardless, most interactions between the parties are online.

Being a little fish in a big pond has been an issue with traditional outsourcing for small and medium-sized enterprises (SMEs), and many choose smaller providers to obtain greater attention. This brings its own issues in that the provider's dependence on the client can make the relationship more parental rather than keeping it at arm's length. Outsourcing to the cloud, however, is a bit different in that SMEs appear to accept their "little fish" status from the start, rather than hunt down small ponds to play in.

PIGGYBACKING

Like those experienced with the implementation of ERP systems, organizations will find it much easier (and cheaper) if they conform to the purchased cloud service rather than attempt to tailor it to their specific requirements. While there are private clouds (a ring-fenced virtual data center inside your firewall), the growth is in public clouds (shared resources).

In this way, you are one of many piggybacking on a much larger platform. If a certain inhouse-developed app gives you a competitive advantage, put it on a private cloud. For the rest, however, better to become cloud agile and informed rather than try to become its master. This leads to the last major difference: the difference in competencies required.

BUILDING XaaS COMPETENCE

A client contemplating its first-generation outsourcing arrangement is considered immature. Because of the lack of necessary competencies, clients believe either far too much of what they read in marketing brochures and hear from providers pitching for work, or are far too disbelieving and skeptical of what to expect. Either approach has proven not to be a sound basis for entering into outsourcing of any form.[6]

Mature buyers of traditional outsourcing get the balance of contract and relationship management right, have secured the right internal capabilities to manage it well, and are focused on leveraging the relationship and collaborating with their providers.

Mature cloud clients are a bit different. They know what cloud services can do, but also their limitations (tricks and traps too numerous to mention here). But most importantly, they invest in cloud integration as a core competence with their own people. This is the ability to rapidly set up, integrate, and remove any XaaS — which are, for the most part, unfortunately nowhere near the plug-and-play simplicity of other utilities such as electricity or water, despite the claims of cloud's more giddy proponents.

This is, in part, a technical skill not yet universally taught in computing degrees. But it is equally a communication skill in being able to simplify complex information in a manner useful to stakeholders, users, and customers. Some organizations are able to buy this expertise, but for most, it will be the same hard-learning approach that occurs with traditional outsourcing. Organizations have to learn for themselves, through experience, what others already know.

The upside is that the traditional outsourcing learning curve can take decades depending on how long the contracts are and how much the switching barriers were addressed (disengagement and handover clauses and plans, intellectual property clauses and recording processes, asset purchase and transfer mechanisms, to name just a few). With the cloud, though, switching barriers are far less. The learning curve can be as fast and furious as you can handle.

Related to this, it is interesting to note that research has established that the main switching barrier with traditional outsourcing is client inertia, and that is something we're seeing with the cloud as well. Organizations are staying with incumbents past the initial contract term, as they commonly do with traditional outsourcing.

CONCLUSION

If the predictions pan out and cloud outsourcing does overshadow all other forms of outsourcing (really, once the security concerns are addressed), then it will indeed be a radical change for buyers and sellers alike. The most far-reaching change will be the ease of switching when plug-and-play capability matures — both technologically speaking and in regards to clients' competence and willingness. The heightened cloud competition will yield constant innovations and new services from providers, which in turn will allow clients to do the same. The winner will likely be all of us.

ENDNOTES

[1]Kern, Thomas, Mary Cecelia Lacity, and Leslie P. Willcocks. *Netsourcing: Renting Business Applications and Services Over a Network*. Prentice Hall, 2002.

[2]McCue, T.J. "Cloud Computing: United States Businesses Will Spend $13 Billion on It." *Forbes*, 29 January 2014 (www.forbes.com/sites/tjmccue/2014/01/29/cloud-computing-united-states-businesses-will-spend-13-billion-on-it).

[3]For more examples, see: Willcocks, Leslie P., Will Venters, and Edgar A. Whitley. *Moving to the Cloud Corporation*. Palgrave, London, 2014.

[4]The initial findings have been published. See: Lacity, Mary C., and Peter Reynolds. "Cloud Services Practices for Small and Medium-Sized Enterprises." *MIS Quarterly Executive*, Vol. 13, No. 1, March 2014.

[5]Mell, Peter, and Timothy Grance. "The NIST Definition of Cloud Computing." US National Institute of Standards and Technology (NIST), Special Publication 800-145, 2011 (http://csrc.nist.gov/publications/nistpubs/800-145/SP800-145.pdf).

[6]Cullen, Sara, Mary Lacity, and Leslie P. Willcocks. *Outsourcing: All You Need to Know*. White Plume Publishing, 2014.

ABOUT THE AUTHOR

Sara Cullen is a Senior Consultant with Cutter Consortium's *Business Technology Strategies* practice. She is the Managing Director of The Cullen Group, a specialist organization offering consulting, training, and publications regarding commercial agreements. Dr. Cullen is a Fellow at the University of Melbourne and a Research Associate at the London School of Economics and Political Science. She was former national partner at Deloitte in Australia, where she ran the outsourcing consulting division and was the Global Thought Leader for outsourcing.

Dr. Cullen specializes in the design and management of outsourcing agreements for buyers and sellers alike. She has consulted to more than 140 government and commercial sector organizations, spanning 51 countries. Dr. Cullen is a widely published author; her books include *Outsourcing: All You Need to Know*, *The Outsourcing Enterprise*, *The Contract Scorecard*, *Toward Reframing Outsourcing*, *Intelligent IT Outsourcing*, and *Outsourcing: Exploding the Myths*. She has conducted research with various universities, including the London School of Economics, University of Melbourne, Oxford University, and University of Warwick. Dr. Cullen's expertise is globally recognized and she performs peer reviews regarding outsourcing research for *Harvard Business Review*, *California Management Review*, *Journal of Information Systems*, and *European Conference on Information Systems*. She earned a bachelor of science degree in accounting from St. Cloud State University (US), was awarded a master's of management (technology) degree from Melbourne Business School, and earned her PhD in the area of contracting from the University of Melbourne. Dr. Cullen is also a Certified Public Accountant, a Certified Mediator, and a Certified Trainer. She can be reached at scullen@cutter.com.

Cutter Consortium
Access to the Experts

IT Executive Education +
ESTRATEGIAS EXITOSAS PARA EL OUTSOURCING EN LA NUBE
Workshop con Sara Cullen
Junio 29 y 30, 2016 - Ciudad de México

Rumbo a la Nube ... un taller que se enfoca en los aspectos organizacionales y de negocio que realmente son de interés y causan dudas entre los tomadores de decisiones.

Executive Education on IT leadership and emerging trends.

INFORMES:
Cutter Consortium América Latina
Tel. 55-5336-0418 ext. 111
eventos@cutter.com.mx
www.cutter.com.mx
http://training.cutter.mx/outsourcing/