WHITE PAPER

Why Managed Services and Why Not Staff Augmentation?

Ensuring companies derive the most value, including flexibility and skill access, from IT service providers

In recent years, many information technology (IT) departments have sought to increase their agility, overcome short-term capability deficiencies, and/or accommodate the impact of hiring restrictions by utilizing staff augmentation arrangements with IT service providers or by contracting directly with independent contractors. As a temporary strategy, this approach has a number of advantages compared to the alternative of directly hiring staff.

Under a staff augmentation model, the cost of hiring for temporary requirements and disengaging once those requirements have been met can more than offset the higher cost of engaging more permanent resources. Moreover, staff augmentation requires minimal contracting effort, has a simple cost model (rate times hours worked), can scale up or down quickly and has minimal impact on the existing operating model of an IT organization.

Staff augmentation, however, can become problematic when it morphs into a permanent operating model. As a long-term solution, it has none of the benefits of alternative long-term external sourcing models, such as managed services (outsourcing) and, in fact, can create a number of serious risks and potentially destroy value.

Staff Augmentation Model

- Benefits as a temporary solution
  - Rapid access to missing capabilities and skills
  - Accommodate staff shortages due to unexpected events
  - Avoidance of hiring / de-hiring costs
  - Costs scalable to demand
  - No impact on operating model
  - Easily contracted
  - Cost model transparent

- Issues as a permanent mode of operation
  - Higher cost
  - Fosters a management style that does not plan
  - No service level commitment
  - All issues attributed to insufficient staffing
  - Increase overhead managing individual subcontractors
  - Knowledge vested in the individual (as with internal staff, but less control)

FIGURE 1

Benefits and issues of a Staff Augmentation Model

DISADVANTAGES OF STAFF AUGMENTATION AS A LONG-TERM SOLUTION

By its nature, staff augmentation represents higher labor costs. Contracting organizations must add overhead and margin to their labor costs and, while some of this can be avoided by contracting directly with individuals, this too entails higher administrative costs internally, as well as some inherent risks. When used as a long-term solution, the natural offset that staff augmentation provides to higher labor costs through the avoidance of hiring/de-hiring is lost.

More significantly perhaps is that reliance on staff augmentation as a permanent model tends to foster a management style that does not plan for resource consumption. Resources are too easily accessed. The consequence is gradual “staff creep” and an unrecognized “head count” that slips under the organization’s human resource governance radar.

Contractors are added continually or become embedded in the organization as high cost permanent staffing. Because staff augmentation has no associated service level commitments other than hours available to work, the linkage to value derived is unclear and seldom measured. The response to any service issue is generally (and conveniently) attributed to insufficient staffing, adding to staff creep.

Perhaps most significant is the loss of knowledge control. As contractors become embedded in the organization, they accumulate information and capabilities upon which the organization is functionally dependent. With no contracted service commitment or requirement to document knowledge in a transferrable manner, contractors can and do often hold organizations hostage, perpetuating the permanency of their engagement.

ADVANTAGES OF A MANAGED SERVICES (OUTSOURCING) MODEL

If an organization is involved in a staff augmentation engagement, transitioning to a managed services (outsourcing) model can yield all of the benefits of flexibility and skill access it seeks, while overcoming the major disadvantages associated with staff augmentation described above. The managed services (outsourcing) model differs from staff augmentation in a number of ways.

Comparing the Models

Managed Services Model (Outsourcing)	Staff Augmentation (Out-tasking)

• Supplier assumes control of all or part of the execution component of IT
  • Service delivery commitments expressed as "service levels"
	• Supplier commits to providing resources of defined capability at a price
	  • No Service delivery commitments relative to outputs

• Committed scope and term	• Limited commitment
• Pricing tied to service levels and volumes where appropriate	• Pricing tied to hours worked and availability
• Supplier managed delivery model; processes and tools	• Customer manages the delivery model (including individual subcontractors); process and tools
• Impacted employees; assets and contracts may be transitioned to supplier (supplier needs to acquire or have the capability to deliver)	• No change to customer operating model
• Knowledge must be documented and transferrable	• Knowledge vested in the individual
• Supplier assumes the risk of transition and operations	• All delivery risk remains with client
Commitment to deliver an outcome	***Commitment to provide an input***

FIGURE 2

Comparing the models - Staff Augmentation (out-tasking) vs. Managed Services (outsourcing)

The essential difference between the two models is that under a managed services model (outsourcing), the provider is committed to delivering an "outcome" at a defined price versus an "input" as under the staff augmentation model. An input is simply the performance of an activity with no commitment that the activity will result in the desired outcome. The managed service model drives a measure of value based on planning, as the organization must define the requirement on a service and performance criteria basis.

Pricing is tied to the outcome. Should the service requirement diminish or disappear, the associated costs react in kind. This provides the "scalability to demand" often sought in a staff augmentation model, but scalability that is tied to service.

Linked to managed services is a service commitment. Under the staff augmentation model, the only service commitment is hours of work. Under the managed services (outsourcing) model, the provider assumes all of the risk of meeting the service commitment.

The value creation is huge. As the provider assumes the delivery risk at a fixed cost, the provider is highly incentivized to establish productivity measures required to meet the service commitment. This manifests itself in the implementation of tools and processes, as well as extensive documentation, as the provider cannot afford to risk not meeting the service commitment by relying on individuals.

Documentation and process rigor also allow the service provider to move work through a global delivery structure with ease. Through the application of documentation, tools and processes, the service provider is able to deliver services reliably with fewer, more productive resources. The managed services (outsourcing) model therefore is structured to deliver a commercially viable, low cost service offering to the organization.

From the standpoint of what an organization really wants from IT, the managed services (outsourcing) model delivers the following advantages: a predictable low price/cost service/outcome; scalability based on business demand; fewer delivery risks; and operational performance metrics tied to process excellence, documentation and outcomes.

Managed services organizations are generally large and serve multiple clients from multiple locations. As opposed to smaller staff augmentation organizations (or individual contractors), managed services organizations have the capability of delivering a wealth of skills and capabilities. Client organizations have access to a broad base of skills, solutions and knowledge to meet evolving requirements.

A managed services (outsourcing) model delivers all of the skills access and flexibility of a staff augmentation model. Because the model relies heavily on management and process rigor, clients generally experience an elevated capability themselves.

INHIBITORS TO TRANSFERRING TO A MANAGED SERVICES (OUTSOURCING) MODEL

With all of the benefits of a managed services (outsourcing) model, why do organizations retain long-term staff augmentation sourcing arrangements? There are multiple reasons.

Transforming the Model (Addressing the Inhibitors)

- The bias towards staff augmentation
  - No impact on IT organization operating model
  - Heightened perception of control and staff management
  - Simple and benchmarkable pricing model
  - Perception of being more cost effective
  - Easily contracted within IT organization
  - Partnership not an issue

- Value alternative in managed services
  - Permits IT organization to focus on requirements not execution
  - Enhanced control through service levels and reporting metrics
  - Pricing scales to output; equally benchmarkable
  - Partnership is key to success. Contracting models increasingly commoditized and standard

FIGURE 3

Inhibitors that prevent companies from moving to a Managed Services (outsourcing) alternative

A key value of the managed services (outsourcing) model is that, with execution commitments secured, the IT organization can reduce in size and focus on the strategic management of IT. Historically, the lack of strategic management is the prime value destroyer in IT. Many of today's IT leaders have a technology, not a business, background and, quite frankly, prefer to manage the execution. The staff augmentation model allows these types of IT leaders to overcome the hurdles of staff limitations and retain operational control. The value of the managed services (outsourcing) model is generally very clear at the senior management level, but often resented at the level of IT management.

Pricing in managed services is opaque compared to staff augmentation in which pricing is little more than a rate card (as the commitment is no more than availability to work on an hour by hour basis). The staff augmentation model therefore appeals to procurement driven departments that can issue requests for rate cards to multiple vendors and select accordingly. This bypasses the value element of service commitment entirely, but it is simple.

Pricing for managed services requires that the parties agree on defined outcomes and the pricing is tied to those outcomes. A mechanism can easily be put in place to ensure that the value is retained over time. Granted, the process is more complex, but the value opportunity substantially justifies the effort.

Of course, the managed services (outsourcing) model requires a partnering mentality. It is interesting that in most organizational areas, the concept of long-term partnering with quality providers has been more easily adopted than in the area of IT. Managed services providers have as the core of their business model service delivery excellence and invest heavily in achieving and nurturing that capability. By partnering with a quality managed services provider, organizations allow IT leadership to focus on how to utilize technology to add value to their organizations, secure in the knowledge that effective and efficient execution is under contract. The primary hurdle is the perception that transferring day-to-day operational responsibility is giving up control when, in fact, control is always retained through relationship and contractual commitments.

For IT departments that have become dependent on the staff augmentation model, transforming these arrangements into a managed services (outsourcing) model can create significant economic and service value. The managed services (outsourcing) model is focused on providing “outcomes” (service levels and specific services linked to a volume of activity) for a pre-determined price versus “inputs” at a cost.

This provides price/cost predictability for the client, while shifting the delivery risk to the provider. The costs of meeting service level commitments can exceed price if poorly estimated or managed, so the outsourcing provider is highly motivated to implement productivity tools and operational “hygienic” tools and processes that promote the maintenance and preservation of operational health, both of which ultimately deliver added value to the customer.

The long-term nature of managed services (outsourcing) models means the provider is better able to plan, manage resources, balance workload across its workforce and allocate tasks throughout a global delivery model. The result is a lower cost of delivery for a specific level of service. In general, a service provider under a managed services (outsourcing) model can deliver service at substantially lower cost than the cost of similar services delivered under a staff augmentation model.

Managed Services Model (Outsourcing)

- Benefits as a long term solution
  - Committed services for committed price
  - Provider assumes delivery risk – productivity incentive
  - Lower cost operating model than internal or staff augmentation models
  - Transparent line of site between service and cost
  - Fosters IT planning and documentation of knowledge

- Impact on IT operation model
  - Necessitates focus on planning – must review service demands in line with business needs
  - Operating model necessitates that IT department relinquish execution responsibility to provider
  - Partnership model – long term
  - Provider drives operating model and methods within defined parameters and requirements

FIGURE 4

Benefits of a Managed Services model (outsourcing)

ANCILLARY BENEFITS OF MANAGED SERVICES

Beyond lower costs, the ancillary benefits that can be realized through a managed services (outsourcing) model can be substantial. Price discussions for staff augmentation typically center around rate cards and are decoupled from productivity and service dimensions beyond hours worked and capability classifications.

In contrast, because price is based upon defined service levels linked to business objectives, discussions on price in the outsourcing context tend to focus on value and the alignment between service levels with business requirements. It is not unusual to observe that non-outsourced IT departments have over-engineered service levels in pursuit of IT targets of excellence (e.g., the belief that if a service level of 99.0% is good, then 99.99% is better), which often adds unnecessary costs in the process.

By creating a clear line of sight between service, business need, and cost, outsourcing tends to shift the focus from rate cards and resource utilization to optimizing the cost/service equilibrium. Indeed, once this line of sight is established, we frequently observe clients requesting service levels lower than what has been previously delivered and reducing their IT spend accordingly.

The managed services (outsourcing) model can address other value destroying factors that typically plague IT departments as well. In a managed services (outsourcing) model, value capture for the provider is linked to the ability to move work to the best resource/best location, which requires that the provider document knowledge. Since this documentation contractually belongs to the client, the risk of knowledge loss is minimized for IT departments.

Finally, because pricing is fixed under a managed services (outsourcing) model and many provider costs are driven by client behaviors, the provider is incentivized to help the client resolve key issues that impact performance, such as unnecessary complexity/diversity and a lack of adherence to standards.

CONCLUSION

Staff augmentation has its place in an IT department’s arsenal. Even in a managed services (outsourcing) model, staff augmentation is often utilized for selected services at specific points in time. However, when staff augmentation becomes the de facto operating model for an IT organization, it constitutes an ineffective form of outsourcing that involves high cost, low commitment and high risk.

IT departments utilizing staff augmentation in this manner should recognize that they are already “sourcing externally” and should seek to adopt a true managed services (outsourcing) model to maximize value.