

# Infrastructure Management Outsourcing

## The Emergence, Adoption, and Growth of Infrastructure Management Outsourcing

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## Executive Summary

Infrastructure Outsourcing (IO) has matured over more than 40 years and has entered a period of slow growth. The emergence of Infrastructure Management Outsourcing (IMO) is a recent trend prompted by improved technologies, advanced management tools, and increasing flexibility in requirements from buyers of IO. IMO is likely to invigorate the IO marketplace, as it strips the labor from assets in outsourcing deals.

IMO can offer a more gradual framework for IT transformation, requiring a lower degree of buyer commitment and featuring a risk-reward profile that appeals to buyers who prefer to exercise tighter control over IT assets, possess scale in IT infrastructure, and require increased flexibility.

Market demand for IMO is projected to stay robust, making it a desired field for an increasing number of suppliers. Multiple global suppliers are now competing with traditional outsourcers, leading to emergence of specialized global sourcing locations.

Depending on buyers' acceptance, several adoption scenarios are possible going forward (i.e., basic labor arbitrage and IMO-enabled IT transformation).

This paper discusses:

- Current state of the infrastructure market
- Likely development and predicted growth of IMO
- Factors that prompt the forecasted growth

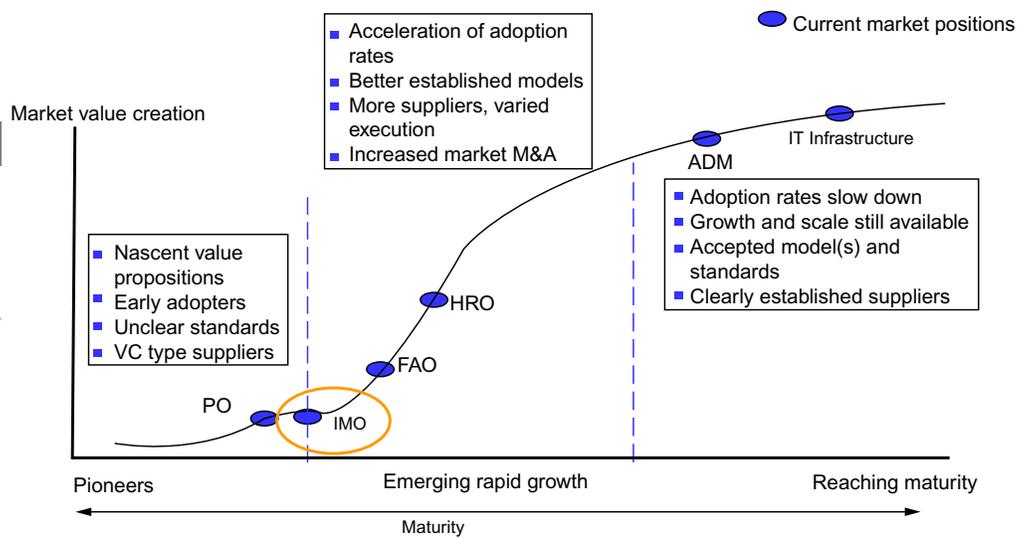
### The Infrastructure Outsourcing Marketplace

Information Technology Outsourcing (ITO) accounts for nearly two-thirds of the global services outsourcing market, almost equally divided between IO and Application Development and Maintenance (ADM). With the worldwide outsourcing market estimated at around US\$400 billion<sup>1</sup>, we estimate the size of the IO market to be approximately US\$140 billion.

Exhibit 1 illustrates that while the IO market is clearly mature, companies did not start offering remote delivery of infrastructure management as a separate product (rather than a part of the traditional outsourcing offering) until recently.

**EXHIBIT 1**  
**The Emergence of IT Infrastructure Management Outsourcing (IMO)**

Source: Everest Research Institute 2006



<sup>1</sup>Bernstein Research estimate

## The Development of IMO

Multiple models of Infrastructure Outsourcing emerged over time. Today, IO can be categorized into four models based on:

- Contract scope
- Size and length of contract
- Assets and resources transfer requirements

The four models in today's marketplace are:

- Infrastructure outsourcing – the most mature and commonly known trend that assumes transfer of a complete IT tower to an external supplier
- Application hosting – based on transferring IT assets and functions related to certain applications to external supplier; most often large enterprise applications (e.g., ERP)
- Infrastructure Managed Services (IMS) – assumes transfer of the end-to-end infrastructure functions to an external supplier
- Remote Infrastructure Management Outsourcing (RIMO) – based on provision of remote infrastructure management tasks from a supplier's locations, often offshore

IMS and RIMO trends are very similar, differing primarily in the way they are viewed and positioned by suppliers. As IMS increasingly continues to take advantage of offshore labor arbitrage, the distinction between RIMO and IMS blurs even further. Therefore, for the purposes of our research, we view IMS and RIMO together in a single combined category, Infrastructure Management Outsourcing.

As IMO matures and offshoring of infrastructure functions becomes more common, many of the differences between IMO and traditional IO will start to disappear, including the scope, size, length, and asset-ownership requirements.

- Scope of contracts – IMO contracts are likely to grow in scope taking advantage of cross-tower optimization approaching the size of traditional IO deals
- Size/length of contract – decrease in contract size and length in traditional IO, coupled with increasing level of comfort with IMO, will eliminate the differences in contract size and length
- Asset ownership - decrease in asset-ownership transfer is an ongoing trend in IO contracts; at the same time there is an indication in the market that IMO suppliers, over time, will likely ease their stance on "no assets onshore"

Everest Research Institute estimates that in the next two to three years it will be possible to deliver ~60-70% of the benefits of IT infrastructure outsourcing remotely without ownership of the underlying IT assets, which will further accelerate adoption of Infrastructure Management Outsourcing.

Multiple factors serve as catalysts of IMO emergence and adoption today.

**Technology**

- The emergence of distributed computing (fueled by interoperable platforms) allowed platform flexibility and increased management complexity
- The wide availability of open-source code prompted a value shift from software licensing to software support

**Remote-management tools**

- Remote infrastructure management, diagnostic, and troubleshooting tools (e.g., IBM Tivoli, ipMonitor) matured and are now the norm in IT organizations
- The emergence of virtualization (server and storage) and back-up tools with automated functions that historically required proximity to the assets

**Organizational changes**

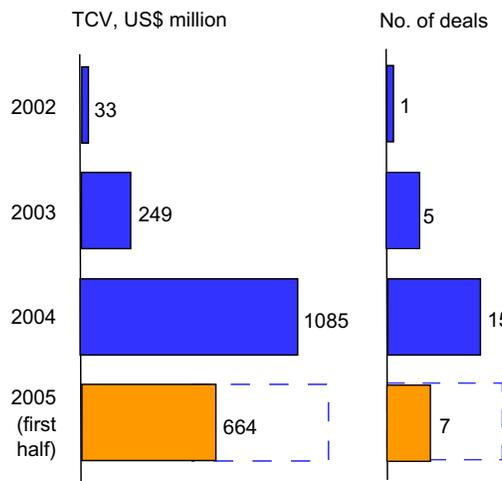
- Business focus on IT cost-saving efforts increasingly led to the centralization of the IT infrastructure, making IT infrastructure labor more transparent and susceptible to outsourcing

**EXHIBIT 2**

**Adoption of offshoring in the infrastructure deals**

Source: Everest Research Institute. Based on a sample of 28 IT infrastructure outsourcing transactions between 2002 and 2005 with an exploration of offshore infrastructure management

Infrastructure management with offshore component



Key Industry adopters  
No. of deals (2002-2005)

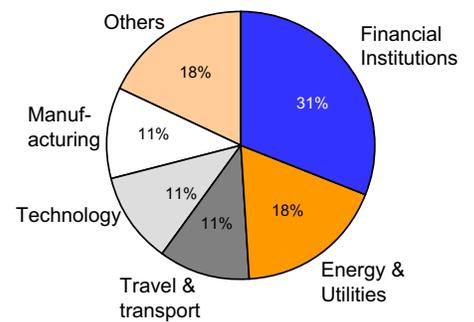


EXHIBIT 3

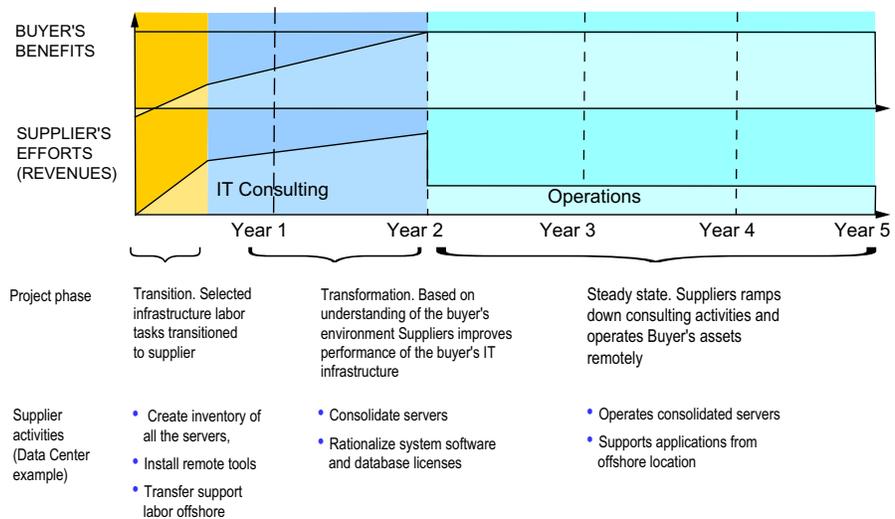
IMO combined with IT consulting can enable IT transformation

Source: Everest Research Institute 2006

IMO as an Enabler of IT Transformation

Combined with IT infrastructure consulting, IMO offers an alternative approach to IT transformation, but with a more favorable risk profile. This is made possible by moving the outsourced tasks to a supplier, with the buyer retaining the IT assets and critical operational functions in house. In addition, IMO minimizes the buyer’s commitment (compared to IO) due to shorter contract timeframes of IMO engagements and easier transition of the functions back in house.

CONCEPTUAL



In future years, buyers might see additional benefits of IMO prompting them to consider IMO as an alternative to full-scale infrastructure outsourcing. Such benefits include:

- When used in conjunction with the input-based pricing model (e.g., price per employee as opposed to price per server), IMO can deliver a lower degree of misalignment of supplier incentives around cost-cutting and assets-reduction
- IMO allows a buyer to retain IT assets but still enjoy the advantage of productivity improvement and labor arbitrage
- The asset-light nature of the IMO model makes it more applicable to support new and emerging technologies, particularly where technology changes quickly and the change is difficult to predict

## IMO Adoption Scenarios

Going forward, IMO is likely to develop in accordance with one of two scenarios

- **Pure Labor Arbitrage Play**, in which IMO as a service line will remain limited to delivering pure labor-arbitrage-driven cost benefits without added value
- **IMO-enabled IT Transformation**, in which IMO will establish itself as a viable alternative to enabling IT infrastructure transformation

In a **pure labor arbitrage** scenario, the choice of engagement model (e.g. supplier vs. captive) and the remote location (e.g., offshore, nearshore, or onshore) will become the primary decisions for the buyers that would like to consider IMO. Labor arbitrage will become the integral part of the infrastructure service delivery, much like it became a key trend in ADM outsourcing.

In the **IMO-enabled IT Transformation** scenario, the possibility that it may be seen as an alternative to enabling IT infrastructure transformation will support additional growth of IMO. Packaged with consulting, it will help drive an increase in overall market size. For buyers, IMO offers a more gradual framework for IT transformation requiring a lower degree of buyer commitment and featuring a risk-reward profile that is likely to appeal to certain buyers who prefer to exercise tighter control over IT assets.

Multiple offshore players have begun to establish a presence in the IO market through IMO. The traditional infrastructure service providers (e.g. IBM, Accenture, EDS, and CSC) still dominate the IO market, though there are a number of emerging suppliers (e.g. HCL, TCS, Wipro, and Infosys) that are challenging the traditional players' domain.

Suppliers' offshore delivery capabilities vary significantly based on the type of services required. While their capability to provide offshore IT infrastructure management services is less proven, it is improving rapidly.

Though infrastructure remains a small percentage of revenue share (at around 3-5% for the new global Indian players<sup>2</sup>), it is a hot new market space. More suppliers are offering offshore IMO solutions and many buyers are demanding an offshore component in their IO deals.

<sup>2</sup>HCL recently reported 11% of the total revenues coming from Infrastructure Outsourcing

## Recommendations

### For buyers of outsourcing services

Offshoring is quickly becoming an integral part of the infrastructure service delivery, much as it did for ADM outsourcing. Therefore, even when contracting with a traditional supplier, offshore infrastructure management should be considered as a savings lever which can achieve savings beyond typical asset-driven savings.

IMO suppliers are likely to enhance their service offerings by moving into IT the transformation space and offering an alternative to traditional asset-based IT outsourcing. Key factors to consider in deciding between IO and IMO models are:

- Importance of asset ownership to the buyer
- Required level of IT flexibility
- Organizational alignment
- Maturity of the outsourced assets

### For suppliers of outsourcing services

Today, labor arbitrage in IO is a reality. Remote infrastructure management is nothing new for traditional outsourcing companies; however, coupled with labor arbitrage and increased interest in asset-light outsourcing from buyers, it has potential to lead to a realignment of forces in the IO market. Whether a traditional IO or a new IMO supplier, labor arbitrage is a critical lever of value creation.

ADM provided a valuable lesson for traditional suppliers on the power of labor arbitrage; many of these suppliers are already building offshore infrastructure capabilities to compete with IMO pure-plays. Therefore, IMO suppliers must plan on moving beyond labor arbitrage and into IT transformation sooner rather than later. This move will require them to build IT transformation consulting capabilities.

## About the Everest Research Institute

**Everest Research Institute** ([www.everestresearchinstitute.com](http://www.everestresearchinstitute.com)) serves as a central source of strategic intelligence, analysis, and actionable insight for corporate buyers, service providers, and investors in the global business process outsourcing and information technology outsourcing marketplace. The Institute is dedicated to providing the global outsourcing community with the information it needs to build highly productive outsourcing relationships and programs, focusing on the drivers that are continually reshaping the industry landscape and analyzing how they impact member organizations and the success of their outsourcing strategies. The Institute's distinguished Board of Advisors, all senior executives and thought leaders in global outsourcing, oversee the Institute's research agenda to ensure that it fully supports the business information needs of corporate buyers, service providers, and investors.

Everest Research Institute members gain unique and highly personalized analytical and advisory services, not available elsewhere, including:

- **Unlimited analyst access** – In addition to a full-day strategic planning session for in-depth, face-to-face discussions, Everest analysts are available for ongoing consultation to address members' immediate issues and concerns. Such access is unprecedented in the industry, and gives members a distinct competitive advantage as they seek to take advantage of emerging opportunities, changing market conditions, and unforeseen developments.
- **Visionary research with actionable insight** – Members receive in-depth reports on major outsourcing topics, supplemented by quarterly updates and monthly research notes on market-shaping events, including regulatory developments, technological advancements, and emerging sources of risk and value. These forward-looking reports not only cover important trends and developments, but also project future scenarios and outcomes of outsourcing decisions made today. This comprehensive interpretation of data provides members with actionable insights to support decision-making.

- Wealth of knowledge and experience – Members benefit from the domain expertise and perspectives that come from Everest's direct involvement in structuring and negotiating more than 530 ITO and BPO transactions and more than 800 best practice case studies. Everest analysts have intimate knowledge of the strengths and weaknesses of service providers in different markets, processes, industries, and geographies. They also have a first-hand understanding of how buyers approach the vendor selection process and, ultimately, of the factors essential to outsourcing success. In addition, the Institute has tapped multiple market sources and collected proprietary information to assemble the industry's most comprehensive database.

**Everest Research Institute** was established by the Everest Group, which provides strategic advisory services that help companies harness the power of outsourcing. Since its formation in 1991, Everest Group has served as business advisors for hundreds of IT and business process outsourcing transactions worldwide.

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For More Information

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