

IT OUTSOURCING EXPANDS AROUND THE MIDDLE (MARKET)



By Samantha Joseph

Highlights for Children was facing a situation most mid-market companies encounter at some point.

The Honesdale, Pa.-based publisher of the Highlights for Children magazine since 1946 had grown to include catalogs, Web sites and other ventures. Circulation was up to 2.5 million, the company was handling 25 million transactions a year and the IT department was beginning to wonder whether it was wise or cost-effective to handle the entire IT function on its own.

After careful analysis, the family-owned company decided to outsource its data center. "We felt we could permanently lower our costs due to the inherent economies of scale and convert a portion of our costs from fixed to variable," explains Elmer Meider Jr., president and CEO of Highlights for Children. "A bigger factor, however, was that we felt it would provide greater flexibility and place at our disposal technical knowledge and resources not available internally."

The move has also freed up Highlights' 76-person IT staff to work on application development and network support and provided the company with new business continuity processes, to boot.

Once thought to be the exclusive domain of Fortune 500 companies, IT outsourcing has gained favor in the mid-market. More than half of all midsize companies use outsourcing to meet their IT needs to a certain degree, according to the Yankee Group.

It makes sense. Midsize companies in particular stand to gain a lot from outsourcing various IT areas. Done right, it can provide skills a smaller company may not be able to afford to keep on staff at a lower total cost of ownership. And as is the case with any size company, outsourcing non-core activities (like HR administration or network services) can free up a middle market firm's IT staff to focus on more strategic efforts.

And today, the middle market is moving beyond just the bare bones in terms of IT outsourcing. IT managers at midsize companies who got a little nervous a few years ago just outsourcing telecom services are now looking to outsource many of the things the big boys have been farming out for some time—from enterprise application development and maintenance to security to 24x7 help desks.

So why did it take midsize companies a bit longer to open up to the full spectrum of IT outsourcing? According to analyst Mika Krammer of Stamford, Ct.-based Gartner, the reasons vary.

Some think that an outsider will never be able to understand their businesses as well as they do. Others are reluctant to give up control. And sometimes there's an inability within a midsize company to agree on what is a core IT function that provides competitive advantage versus what is fair game for outsourcing.

As a result, more than 70 percent of small and midsize businesses misallocate funds to non-core IT activities, such as telecommunications or infrastructure maintenance, that could be sourced elsewhere, freeing up resources and improving productivity in house, says Krammer.

But although they weren't the biggest believers in strategic IT sourcing in the past, the mid-tier players are getting religion, inspired largely by current economic conditions. Although only single-digit growth in mid-market IT is expected in 2003, observers say we will continue to see increased interest in and a growing number of IT outsourcing options from midsize companies as they look for ways to do more with less.

Selective Sourcing

Because of their size and their potential for growth, you won't see many mid-market IT leaders outsourcing the entire IT function to one vendor—a la the big multi-billion dollar deals of the mid-90s. "Mid-market companies like to control their destiny," explains Jeffrey Balentine, global leader for Deloitte & Touche's Technology, Media & Telecommunications Group in San Jose, Ca. "Their businesses can and

do change quickly and having control and not being tied to a big contract gives them more flexibility.”

Instead, midsize companies are selective about what IT work they send out. “A Fortune 500 enterprise might outsource an entire process or department, but mid-market customers take a modular, hybrid approach to IT outsourcing,” Krammer explains. In fact, the Yankee Group found that just over 10 percent of small to midsize businesses use outsourcing exclusively to handle all of their IT functions. And more often than not, says Balentine, mid-market IT leaders outsource an activity because they have to, not because they choose to.

The list of IT functions ripe for mid-market outsourcing is growing. Among the most popular areas in IT for mid-market outsourcing include:

Telecommunications

One of the first areas midsize companies were comfortable sending out, outsourcing voice and data lines continues to be a relatively easy sell to these firms since it’s clearly not a core competency and not an area of strategic advantage, unless you’re a telemarketing company for example. In addition, in most cases, it’s a cost-effective way for medium-sized businesses to provide telecom services without adding staff, according to Balentine.

Connectivity

Along with telecommunications, connectivity was one of the first areas mid-market companies started farming out. Anecdotal evidence shows these companies have had high levels of satisfaction outsourcing the networks (LAN and WAN) so this continues to be a popular outsourced function. Today those companies who may not be able to afford to invest in new equipment can take advantage of technological advances like virtual private networks (VPNs) and wireless local area networks (WLANs) by outsourcing.

Security

As focus on the importance of IT security has increased, many mid-market companies have found that the only way to meet this new demand (often for non-stop monitoring) is to send out the work. This new area includes services like intrusion detection and fire walls and staff to keep an eye on things.

Servers

This is one of the rare areas in which outsourcing is more accepted within the mid-market community than among Fortune 500 clientele.

As companies grow larger and more sophisticated, server outsourcing drops off, according to Krammer.

Application development and maintenance

Over the past few years, there's been a marked increase in outsourced application development and maintenance in the mid-market, Krammer says. Many mid-market companies have found that application service providers enable them to afford to implement and run the kinds of enterprise applications that were once only available to large corporations.

E-commerce/Web hosting

As the dot-com bomb proved, creating an e-commerce infrastructure and developing Web-based services can be an expensive and tricky proposition. That's particularly true for mid-market companies that can't afford to have all the necessary skills (from web strategy design to QA testing and traffic analysis) on staff. The Yankee Group estimates that mid-market businesses have become the largest users of outsourced Web hosting (accounting for 59 percent of the total \$14.4 billion market in 2003).

Business continuity and disaster recovery

The importance of IT business continuity and disaster recovery was brought into sharp focus after the events of Sept. 11. And many midsize companies see this as a good activity to outsource not only for cost savings but for the reliability and much quicker deployment that a dedicated outsourcer in this area can provide.

Desktop Management

Increased productivity in the IT department and 24x7 availability are the two big reasons mid-market companies are increasingly outsourcing the relatively non-strategic task of desktop deployment and management.

Special Needs

Though midsize companies may outsource some of the same IT activities as their billion dollar-plus brethren, they're definitely looking for different types of relationships with their vendors. Whereas Fortune 500 companies tend to focus on service levels and delivery, mid-sized companies value flexibility.

It's important for mid-market companies and their service providers to be culturally compatible. That's the reason why Highlights for Children ultimately selected Verizon Information Technologies to handle its data center. "Those outsourcers that met our requirements were interviewed extensively but in the final analysis, compatibility of

cultures, trust and a feeling that we could work together were key determinants,” Meider explains.

Contrary to popular belief, outsourcing should be viewed less as a supplier-customer relationship and more as a collaboration, particularly at the mid-market level. “The key to being middle market and having success with your vendor is to develop a working partnership with them,” says David Womeldorf, chief technology officer of IMI Bevcore, a \$35 million provider of beverage and foodservice parts and services based in Osseo, Mn. Womeldorf chose to outsource the implementation and maintenance of 34 PeopleSoft application via PeopleSoft’s ASP model.

“You have to think of them as an extension of your company and your department--not as a vendor but as a coworker--and your employees have to act that way and think that way,” Womeldorf adds. “A partnership is the most difficult of the types of relationships a company can have but it can pay off.”