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EVOLUTION OF IT SERVICES OUTSOURCING MODELS IN THE e-BUSINESS ENVIRONMENT

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ABSTRACT

Outsourcing is a business solution or a model in which one organization leaves control over a part or even over the whole business process to another organization. In many cases, but still not always, the e-business concept may be considered as well-suited for outsourcing. The implementation of a particular outsourcing model may significantly improve business performance, although there are rather many examples of failure of such efforts. Modalities of outsourcing are numerous and changing in time. Today, business process outsourcing (BPO) and application service provider (ASP) models appear to be among of the most popular forms of outsourcing. Both of them imply building business partnerships or alliances supported by the Internet. The article examines the applicability of outsourcing models in various circumstances and situations.

KEYWORDS

information technology, outsourcing, business process outsourcing, application service provider.

INTRODUCTION

About three decades ago major forms of outsourcing were facilities management and time sharing. Since then, the nature of outsourcing is permanently changing, and it can be expected for this trend to continue in the future. Today, in the e-business environment, outsourcing takes place when an organization transfers the ownership of a business process to a supplier. It implies the transfer of control from buyers to suppliers, since the buyer does not instruct the supplier how to perform its task but, instead, focuses on communicating what results it wants to buy. The buyer leaves the process of accomplishing these results to the supplier. Modalities of outsourcing are numerous and changing in time. With the beginning of the Secured Socket Layer (SSL), established by Netscape in 1994, websites developed the capability to encrypt sessions, thus making credit card transactions over the Internet safer. With a converted connection between a company's server and a client computer, credit numbers could be screened so they could not be seized by a third party, thus making theft of card information less likely. This confidence led to an increased number of businesses offering products for sale via the web. Today, business process outsourcing (BPO) and application service provider (ASP) models appear to be among of the most popular forms of outsourcing. Presently, e-business series from simple sites providing commercial information to sites offering goods and amenities for sales online. Inventive uses for new voice and video communication technologies include online language tutoring. Large commercial information repositories are growing and use of the Internet for research is now common. Online sales from web-based storefronts endure to grow. Sales of digital information, in the form of eBooks and digital music files, are more current offerings by e-businesses like Apple, Amazon, and Barnes & Noble.

OUTSOURCING - AN OVERVIEW

As it was mentioned in the introduction to this article, outsourcing is a business solution or model in which one organization leaves control over a part or even over the whole business process to another organization. The reason for doing so is found in lower costs, since the organization in such circumstances faces no need to procure rather expensive equipment and employ a lot of skilled workers and specialists to develop firm's own software, process data and maintain data bases, as well as to administrate computer system operation and protect data from loss, damage or theft. All of this is done by the other organization. Outsourcing is not a synonym for contracting; these two terms are often confused, but they are not the same at. Contracting, namely, takes place when an organization (buyer) purchases goods or services from another organization (supplier or vendor). In this situation, the buyer "owns" and controls the process. In other words, the buyer tells the supplier exactly what he wants and how he wants the supplier to perform these services.

The supplier has no freedom to vary from the buyer's instructions in any way. If he does so, he is violating the contract and will be bearing appropriate consequences, i.e. sanctions. The buyer can replace the supplier quite easily by breaking the contract. In outsourcing, the buyer switches the control ("ownership") of the process to the supplier. The buyer tells the supplier what results he expects the supplier to achieve, but the supplier decides on his own how to accomplish these results. The supplier has to have enough expertise in a certain process (such as finance, or logistics, or human resources), and he can exercise the benefits of economies of scale. If the buyer were to dictate to the supplier how to do the job, as it is the case in contracting, he would be destroying the most important aspect that makes outsourcing work - the value created by using the supplier's expertise and the economy of scale.

Suggesting the supplier how to do the job also eliminates accountability on part of the supplier, which is also an important element in successful outsourcing relationships. Let us consider one simple example that illustrates the differences between contracting and outsourcing: Contracting - The buyer says he wants the supplier to produce 50,000 copies of music CDs. He tells the supplier how to achieve the sound quality needed, how to package CDs, how to label them, in what time the job is to be done, how to dispatch CDs to retail stores, etc. Outsourcing - The buyer say he wants 50,000 copies of music CDs of the needed sound quality, properly packaged and labeled, produced at a cost that is lower than what it costs the buyer to do it in-house, and accomplished faster than it could be done by the buyer himself. The supplier is the one who decides how to achieve the needed sound quality, lower cost, higher speed, which type of packaging and labeling to apply to CDs, what channels to use to dispatch them, and so on. Obviously, the degree of freedom the supplier enjoys in the case of outsourcing is much higher, but the control over the complete process is in his hands and exclusively he is the one assigned the responsibility of completing the whole task. On the other hand, the buyer must not worry about how the job is done, but he has to pay adequately for his convenience.

Three issues seem to have a crucial impact on the contemporary nature of outsourcing: The imperative of services quality improvement; the fact that operations are viewed as a commodity and thus frequently outsourced; Possibilities to build partnerships based upon extranets and extraprises in which outsourcing can take place. The imperative of service quality improvement is to be viewed as a part of the Total Quality Management (TQM) concept. As it is well known, TQM is seen primarily as a change in an organization's technology and its way of doing work. In the human services, this means the way clients are processed the service delivery methods applied to them and ancillary organizational processes such as paperwork, procurement, and other procedures. But TQM is also a change in an organization's culture - its norms, values, and belief systems about how organizations function. And finally, it is a change in an organization's political system:

decision making processes and power distribution. For substantive change to occur changes in these three dimensions must be aligned - TQM as a technological change will not be successful unless cultural and political dimensions are attended as well. As far as the second issue is concerned, in recent times, it can be often observed that corporate managers tend to look at some operations as a commodity, i.e. something that can simply be bought or sold. A lot of companies, for example, are outsourcing telecommunications, system operations, management of PCs and computer infrastructure, because having or performing these operations in-house is too expensive. Some are going so far to outsource even strategic planning, probably because they themselves have not enough expertise to accomplish it fairly. The third issue - building partnerships or alliances via extranets or extraprises -maybe is the most important factor having impact on the contemporary nature of outsourcing, and, because of this, it will be discussed in a separate chapter of the paper.

Of course, outsourcing is not to be viewed as a panacea for all critical business situations and problems. It is, namely, based upon fundamental principles and, if those are applied at the outset of a relationship, the parties will most likely have a successful and effective relationship. But, if parties enter into an agreement that is not based on such principles, the result will probably be an unsatisfactory partnership and potentially lead to an early termination of the outsourcing contract. The first of these basic principles is for the buyer to determine the scope of services and metrics (for the performance level) he wants from the supplier. This is the only way a buyer can achieve a needed comfort with turning over his transactions or processes to the supplier and be sure to get value for money paid. A certain cause of failure in an outsourcing relationship is for the buyer to let the supplier dictate what the services and performance levels will be. Another potential cause for failure is for the buyer not to completely describe the scope and boundaries of every aspect of the service. This can lead to a supplier not providing something the buyer expected to get for the price he is paying, or maybe the supplier providing something that was not agreed upon and then charging a premium for it. Many problems and disappointments can be avoided if the basic principles of outsourcing relations development, mentioned above, are strictly respected.

BUSINESS PROCESS OUTSOURCING

In the meanwhile, the term business process outsourcing, or BPO, has come into use. It is the term that has evolved over the years, and each time it develops further, its definition has changed. Some people have not kept up with its evolution and, therefore, refer from time to time to old definitions or explanations of BPO. But, it is not simply another word for outsourcing. In business process outsourcing, as compared to outsourcing solutions, strategic value through outsourcing is derived creatively examining the process and changing the way it is actually performed. It is more than just who is performing the process.

In BPO, supplier not only takes on the responsibility to take over the function or business process, but also reengineers the way it is done. That will include either putting in new technology to accomplish the task, or applying the existing, mature and well-known technology in a new fashion to improve the process. In BPO, something about the way the process is currently being done gets fundamentally changed. Often, it involves taking into consideration how a particular process in buyer's organization affects and interacts with other processes or functions simultaneously done in the organization. Business process outsourcing tends to increase organization's shareholder value (Accenture, 2002). Increasing shareholder value is the bottom line in BPO. It makes the difference between the leaders and the followers. No matter the size of a company, they share the same problem - limited financial, human, material, and other resources.

By leveraging resources, intellectual power can be focused on what a company's customers buy from it. When BPO is the approach to leveraging resources, shareholder value is increased - not because revenue has been increased, but because BPO increases bottom-line profits. Often, a business process that has been reengineered creates a life of its own, with revenue sharing or a greater revenue capability that is an alternate revenue stream to the firm. Namely, shareholder value is in cost structure and overhead for non-core functions as much as it is in stock price, products and competitiveness. Economies of scale are a competitive advantage of large companies. The small firm has the advantage of speed to market and flexibility. BPO supported by the Internet is now allowing small firms to get the leverage, buying power and critical mass of large companies. So larger companies are beginning to recognize that they have to change what they are doing. It can be concluded that business process outsourcing is a management tool to recreate a company and allow it to really accelerate its ability to compete on the market.

BUILDING PARTNERSHIPS AND ALLIANCES

The client/server architecture of the Internet enables businesses to develop extranets and extraprises. An extranet is a semi-private Internet-type network serving as an infrastructure for secure information exchange and transactions processing among co-operating companies. This kind of a network structure forms the basis for creation of an extraprise consisting of a given firm itself and its customers, suppliers and partners connected in the virtual organization, alliance or community. The goal of the extraprise is creation of the new market value derived from value-added information. The ability to build and manage business partnerships or alliances may be the key to outsourcing success in a knowledge-based economy. One characteristic of the new economy is that the knowledge a buyer needs to survive and thrive in the new economy is not available at one firm. To craft the solutions buyers need, they must work with many firms with differing competence and strengths. The major business challenge is finding the way to bring all these players together to work as a harmonious whole.

Companies must create supply chain partnerships with complementary companies. That can be a powerful outsourcing paradigm in the knowledge-based economy. Outsourcing is changing on the vendor side, too. The Internet and extranet philosophy has also given rise to vertical service providers. These suppliers have a deep knowledge of one industry and can deliver a range of services to this specific market, what is a strong incentive to move to alliance-type relationships. These joint ventures will end up blurring corporate boundaries. Historically, outsourcing vendors had a clear idea of where their firm ended and the buyer's began. In the new outsourcing alliances these boundaries bleed together. But, it is fairly difficult to get a solid business relationship established and defined in a contract, and also allow for the required need for change. By their very nature these arrangements tend to lean towards defining very specifically what is going to happen, and assign penalties and rewards if they do not. This it conflicts with flexibility, which is extremely important to develop a good partnership or virtual alliance.

Thus, it is important to devise an outsourcing contract that focuses on how the relationship will change in time, rather than defining what the businesses are doing today. Another important thing is for the organization to understand exactly what they want to achieve by outsourcing in the alliance. It is not rare that people who are in charge of constructing the deal do not understand the firm's objectives. Partnerships often begin the relationship thinking that the two (or more) sides can write a contract and define a process easily because they have the same goals. But, it happens that it is never true. For example, if one partner, as the client, is an insurance company, its goals are quite different from an IT vendor's goals. The two companies need to come to terms with the fact that the goals are conflicting.

The important thing is that the team that manages the function has the same goal, which is the delivery of effective services at an economical price. They are both working for that purpose even though they are reporting to separate bosses. That is how the partnership is formed. The insurance company continues to market and sell insurance and the IT vendor continues to look for new clients, but the IT team is the group that is there permanently and must work at their partnership. Ch. Rosen describes alliances in this way: "The basis for successful alliance is the harmonization of partners' goals, so that the success of the one means also the benefit for another. It is important to create circumstances from which both can profit" (Gutzman, 2000). Once the contract is negotiated and agreed upon, and the governance model is in place, the contract needs to be put in a drawer. What should be put in place is what should be brought out and referenced, and if the client and vendor are not following prescribed measurements or they are not working satisfactory, then the measurements need to be flexible enough that they can be changed.

APPLICATION SERVICE PROVIDER MODEL

I. EMERGENCE AND MAJOR CHARACTERISTICS

The Application Service Provider (ASP) model is undoubtedly the most popular IT outsourcing model. According to ASP Industry Consortium, an advocacy group with over 400 members, ASP is defined as "a business that delivers and manages applications and computer services from remote data centers to multiple users via the Internet or a private network" (ASP Consortium, 1999). They allow companies -ranging from small businesses to multinational and global enterprises - to render a wide variety of software applications, from e-mail to e-commerce and enterprise resources management (ERP). Services they offer are usually based

upon the software acquired from the third or even multiple sources. The role of ASPs is, in fact, the Internet version of service computing centers that were very popular in some past times.
The difference comes out from the fact that earlier service computer centers did not support online real-time connections with organizations to which they provided their services and today the Internet is used to overcome this drawback. The first ASPs designed to work in the Internet and e-business environment emerged in 1998. They had been initially viewed as ideal solutions for small and mid-size firms, but later many larger companies accepted this approach. There are many good reasons for businesses to use ASP-type services. For example, Gartner company reports (Gartner, 2000) that the ASP value-proposition includes: Faster ramp-up time; Software for rent; No up-front capital cost; lower ongoing total cost of ownership; Full-cycle application services; Simplified pricing; subscription model or usage-based; Limited customization only; Industry-specific implementation; extensive tempting; Leap-frog to top-tier applications. Another survey by International Data Corporation (IDC, 2001) asked corporate managers to rate the reasons for signing up with an ASP. Some interesting results are:

- Shorter implementation (51.6%)
- One-stop shopping and support (51.4%)
- Avoid capital investments (49.0%)
- Scalability for business growth (48.1%)
- Lower cost of entry for applications (46.6%)
- Predictable fees to simplify budgeting (39.9%)

These are clear indications of the enterprise value proposition for ASPs. But, in addition, there is one other reason for using ASPs - experimentation. An ASP allows the company to try-out various solutions quickly, fail-fast, and decides on what works and what does not. For example, signing on with an e-commerce application service provider delivers a significant benefit for enterprises that still have no experience with the e-commerce concept implementation and need to build e-commerce competence quickly.

CONCEPTUAL APPROACH TO ASP SELECTION

Selecting an ASP is a complex decision that is fraught with economic, technical and even emotional issues. Clearly, a potential user of ASP services is interested in cost. Price of service, payback periods and savings are all-important economic factors. Unfortunately, many ASPs assume that the decision process pretty much stops at this point. But, money is not the only element of the ASP selection puzzle; businesses seek the help of an ASP for many other reasons as well. ASPs provide key applications but with the market in flux, best practices for choosing them are hard to find, so users are applying widely different selection strategies. However, most companies today select an ASP because it offers the applications the company needs. That selection method will change over time, because, after a company develops a working relationship with an ASP, it will ask the supplier to add new applications the buyer needs. Interpersonal relationships are, thus, steadily taking precedence over software. But, there are at least two important caveats buyers must consider when selecting an ASP:
• First, the ASP market is rather new, so that almost everyone is in a learning mode. The lack of experience might cause some troubles.
• Second, the delivery of the application is over a network that rarely operates 100 percent of the time. This is a technical issue buyers must factor when outsourcing applications through an application service provider. The path a buyer should take in selecting an ASP depends on the buyer's intent to use of the outsourced application. Namely, the buyer could use an ASP to host a full-range integrated application set, or he could use it as an automation tool for a simple application that does not need to pull information from external systems. Despite the intended use of the application, there are three crucial characteristics to seek in an ASP supplier:

- Ability to customize and integrate
- Commitment to buyer needs
- Profitability

One of the reasons ASPs are so popular is that they allow companies to get applications up and running in minimal amount of time for a minimal investment. If time to market is the primary objective of the company, the ASP strategy is an effective solution. However, the application must be one that is "self-contained" and does not have to play with anything else in the enterprise. What can happen is that the application can become such an important business process for the buyer's organization that the application will need to be integrated into other systems.
How to accomplish that integration will depend on the supplier. But, something is sure: any customization or integration work is going either to "eat" a great portion of the ASP's profit, or it will drive the buyer's costs significantly higher. Commitment to buyer needs. An ASP's level of commitment to meet customer needs can range from the application infrastructure, to security mechanisms. One of the buyer's top priorities should be to ensure that all components of such commitment and level of service quality are clearly contracted with supplier. The experience shows that it often happens that the supplier uses a contract template and standardized service levels and metrics. Obviously, the buyer must insist for his needs and interests to be incorporated into the agreement and contract with the supplier. The business model's profitability and viability of the ASP is probably the most important characteristic of the promising relationship between users and ASPs.
When a company enters into an agreement with an ASP, it needs to state an exit plan, should something change along the way - such as the ASP being acquired by another company, or a change in the ASP's core business. The plan should slate whether the buyer will migrate to another ASP or will need to bring the application in-house. Buyers have reference points from which to judge the capabilities of the company. The key question is: where did the ASP come from? They all basically evolved from three core groups: Internet service providers (ISPs); Independent software vendors (ISVs) and Data center hosts. Each one of these groups brings a particular competency on the table, which a buyer can use to determine the ASP's level of ability to provide for his needs and to meet his profitability expectations (Landgrave, 2002). On other hand, ASPs themselves are looking for profitability. To become profitable in this market, they must follow four basic rules (Rama, 2000):

- Rule 1 - Know your options.
- Rule 2 - Understand the rules.
- Rule 3 - Use an anchor strategy.
- Rule 4 - Watch the horizon.

To put it short, Rule 1 pinpoints the fact that "since ASPs came on the scene in 1998, a ton of players have crowded the space, so that the ASP must decide not only what kind of ASP he wants to be, but what kind he can be. Rule 2 refers to the fact that "different market segments create different challenges, so that the ASP must become an expert in that arena". According to Rule 3, "an anchor strategy is the reason a customer is interested in doing business with a particular ASP", while the Rule 4 requires from ASPs to ask themselves whether they are prepared for a new world where customers will pay for applications based on use instead of availability"

ASP EVALUATION

When evaluating an ASP, a buyer is supposed to apply at least four basic evaluation criteria: Service evaluation, Support evaluation, Scalability evaluation, Security evaluation. The service evaluation should address several important questions of ASP services quality as; a buyer must examine what, if any, service guarantees or agreements are offered by a particular ASP. Such guarantees should be very specific about service levels at different times of the day, week, month or year, as application demand may vary or oscillate. In general, these agreements should be more quantitative than qualitative. It is not unreal to expect nearly hundred percent uptime. A buyer must consider what penalties are assessed if the ASP fails to meet guarantees he has promised. A guarantee itself is not worth much if the ASP does not give some compensation to the buyer in the case of failure. Although most ASPs must offer service guarantees of some kind, an ASP will usually offer compensation for the time the application was not available, but will not cover any business losses incurred during an outage.

A buyer has to determine has the ASP accounted for data and network redundancy, as well as disaster protection. It is not meaningless, for example, to ask whether the ASP has installed a fire protection system in the room where the buyer's data are stored. For a buyer, it is important to know what delivery methods the ASP offers: for example, can he deliver the application securely over the Internet or over a virtual private network. He should also find out what future delivery methods the ASP plans or does he have a bandwidth plan for unexpected traffic surges. It is extremely important for a buyer to evaluate how long it will take him to become productive. Maybe this time span will depend on how many users are served with the application or on how frequently the application is to be updated. There are no rules of thumb here, since applications vary in nature and complexity, but the ASP should be able to get the buyer a definite date and a guarantee associated with this date. A buyer has to know does he have a choice of network providers for application delivery, or is limited in this choice. This may not be that important if the buyer obtains a "hermetic" agreement, but is always worth checking out the actual network service provider's qualifications. From the potential future growth of buyer's business point of view, it is interesting if the ASP can deploy applications globally, or they are limited for use on the regional or even local markets. If the buyer has branch offices abroad or is planning some, he must consider whether it is more convenient and effective for him to outsource applications from the ASP that has free approach to global markets or to engage some local ASP. For example, in countries where established relations prove key to doing business, like those in Latin America, a local partner remains an essential component (Argall, 2000).

The support evaluation has to be made to assess the level of support and help a buyer can expect from the selected ASP. The buyer must gain some knowledge about the following issues: If there is a problem, who does the user call for help? The ASP should specify what kind of support contacts he will provide and what an acceptable turnaround is. A buyer should insist on 24/7 coverage and a single point of contact who is ultimately responsible for his support contract, i.e. someone who will come in and resolve any problems. What will happen if a buyer's application needs change? The buyer should require the ASP to be as flexible as his business demands. If the buyer comes from a particularly fast-moving, dynamic and growing industry, his applications needs are likely to change frequently. Because of that, he must evaluate how the ASP intends to cope with such change, and what that coping will cost him.

A buyer must obligatory evaluate is he able to bring the application in-house if he chooses to terminate the ASP contract. This may depend in part on the third-party company that developed the application, but the buyer should check up front as to whether he would have the option of bringing the application in-house at a later date. The major aim of the scalability evaluation is to examine can the ASP handle a significant increase in number of his clients and amount of data. A buyer should also find out what adding more clients will cost him, in addition to getting sense of the ASP's ability to scale without serious service interruptions. The purpose of the security evaluation is to find out what has the ASP done to guarantee data security to his clients. Security is often the number-one concern of IT managers thinking about the ASP solution. A buyer must feel as comfortable with the ASP's solutions as he would having developed and deployed the application with his own stuff.

CONCLUSION

Generally, outsourcing is a promising approach for many companies in the e-business environment. It can save money, because the organization in such circumstances faces no need to procure rather expensive equipment and employ a lot of skilled workers and specialists to develop firm's own software, process data and maintain data bases, as well as to administrate computer system operation and protect data from loss, damage or theft. But, the term "generally" implies that there are some exceptions from the rule. In other words, outsourcing must not be viewed as a panacea for all business problems or a recipe for a certain success. In recent times, outsourcing evolves into outsourcing business processes (BPO). In BPO, supplier not only takes on the responsibility to take over the function or business process, but also reengineers the way it is done. That will include either putting in new technology to accomplish the task, or applying the existing, mature and well-known technology in a new fashion to improve the process. "Simple" outsourcing, as well as outsourcing business processes, is very close to the idea of partnership or alliances into virtual communities. The ability to build and manage business partnerships or alliances may be the key to outsourcing success in a knowledge-based economy. One characteristic of the new economy is that the knowledge a buyer needs to survive and thrive in the new economy is not available at only one firm. To craft the solutions buyers need, they must work with many firms with differing competence and strengths. Probably the most popular outsourcing model today is the application service provider (ASP) model. Since many ASP model variations have been developed, selecting the most appropriate one appears to be the crucial thing for the organization to do. In this process, answers too many conceptual and practical questions are to be found, and these are discussed in the paper.

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