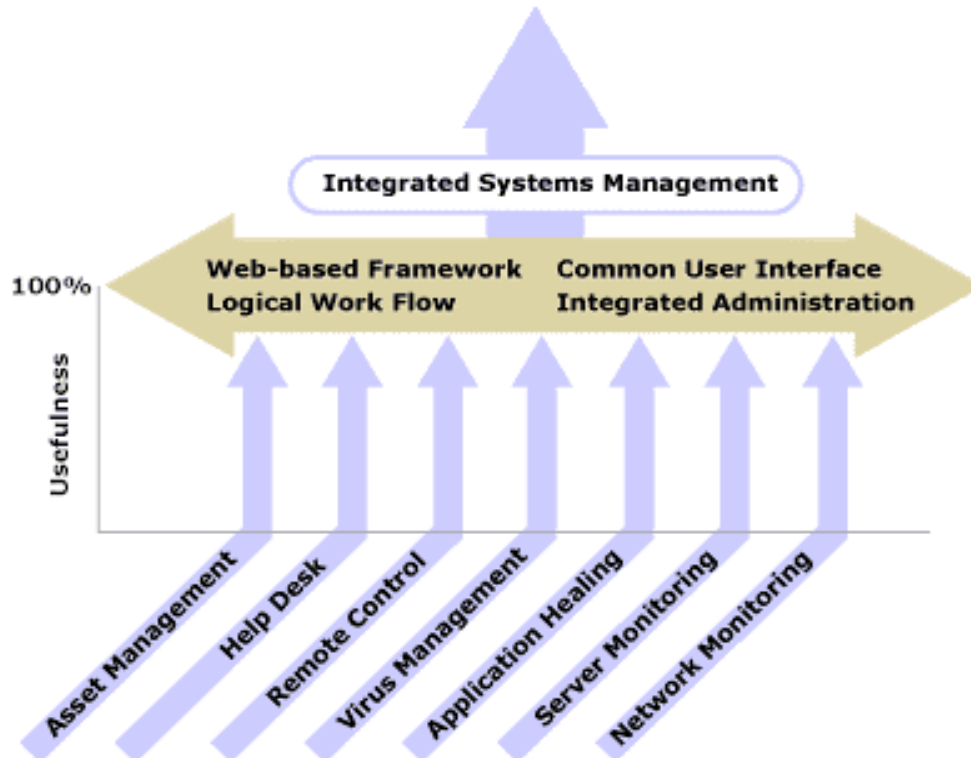


# The Emergence of the Management Service Provider (MSP)



## Integrated Systems Management in IT Outsourcing

Fortus Management Partners Whitepaper

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## **INTRODUCTION**

The purpose of the white paper is to discuss the trend towards outsourcing of comprehensive infrastructure deployment and management and the emergence of a new class of service providers called Management Service Provider or MSP, to address this market. MSPs offer significantly more than traditional integrators and Information Technology (IT) outsourcing companies and are seen by analysts as the future of end-to-end IT consulting, design, development and management outsourced services provider.

## **THE TREND TOWARDS IT SYSTEMS MANAGEMENT OUTSOURCING**

Outsourcing in IT design and management is seen as a huge and growing market. According to a survey by the Cutter Consortium, nearly three quarters (74%) of companies either outsource some projects today (54%) or plan to in the near future (20%).

The analyst firm, IDC, also sees huge opportunity in the IT outsourcing market. They project worldwide spending on outsourcing information technology services will nearly double by 2005, driven by competitive strategies, not just cost cutting. IDC predicts that spending on IT outsourcing globally reached \$56 billion in 2000 with a lion share in the US market, and is expected to surpass \$100 billion by 2005. The United States will continue to spend the most on IT outsourcing services, accounting for 44 percent in 2005. Western Europe is the second-biggest spender, with IT outsourcing spending increasing at a compound annual growth rate of 10.3 percent, from \$16 billion in 2000 to more than \$26 billion in 2005.

## **WHY OUTSOURCING**

The appeal to enterprises to embrace IT deployment and management outsourcing is the elimination of the need for companies and individuals to buy, maintain or upgrade IT infrastructure management systems, which typically require a major capital expense, highly technical expertise, and a considerable investment of time. This model appeals in particular to small and mid-size companies who prefer not to invest in a large IT staff. This trend has been accelerated by the need for high network stability and availability and the transition of mid-sized enterprises to e-businesses, requiring the need for new solutions and expertise from access to hosting to design, and service level agreements.

The need for impeccably functioning systems and networks, fueled by the burgeoning Internet economy, continues to raise expectations and requirements for robust performance. At the same time, the gap between demand and supply of skilled IT personnel, coupled with the increasing complexity of the IT infrastructure landscapes and the high expense of specialized system management applications, creates a formidable challenge for the administrative staff who are held responsible for efficient system operations. For mid-sized IT organizations, the MSP delivery model makes systems development and management available with low prices, rapid time to benefit and high impact that have never before been available.

Many small and medium sized companies have trouble hiring and retaining critical IT staff. Most IT shops now face economy-driven budget cuts, competition-driven demand for new systems, and a severe IT labor shortage. This lack of skills is the most important driver of outsourcing adoption, stronger even than economics. The skill gap is particularly prevalent in areas requiring network- or Web-based technologies. Opportunities therefore abound in areas like LAN management, WAN management, security, Web site setup and maintenance.

While one of the most fundamental reasons for enterprises to move from in-house development and monitoring to outsourcing centers on the savings derived in specialized headcount not associated with core business of the target enterprise, enterprises are also turning to outsourced solutions for factors including technology savings (i.e., software apps and platforms), system monitoring (i.e., security), system fault-tolerance (i.e., sharing of robust/redundant platforms) and risk mitigation (i.e., low upfront costs, etc.)

Because integrators perform this service for multiple clients, the provider can accumulate management experience that promises to translate into superior quality service at a lower price than the customer could attain on its own. The integrator can spread the cost of budget-breaking technology or services among multiple customers, add instant expertise to in-house staff and fill other needs that are otherwise beyond the reach of an individual enterprise.

Table 1

Why Organizations Outsource
29%—difficulty hiring skilled IT professionals
20%—lacked in-house skills
14%—budget
12%—business changes
12%—CIO/senior management mandate
7%—Reorganization
2%—Downsizing
2%—Other
Source: Cutter Consortium

Table 2

<b>Factors Influencing Outsourcing Attitudes</b>	
Staff utilization/expertise	82%
Budgetary concerns	77%
Project priorities	51%
Technological advances	45%
Security concerns	27%
Business process improvements	25%
Customer service improvements	25%
Competitive advantage	20%
Mergers/acquisitions	13%
Increasing sales revenues	6%

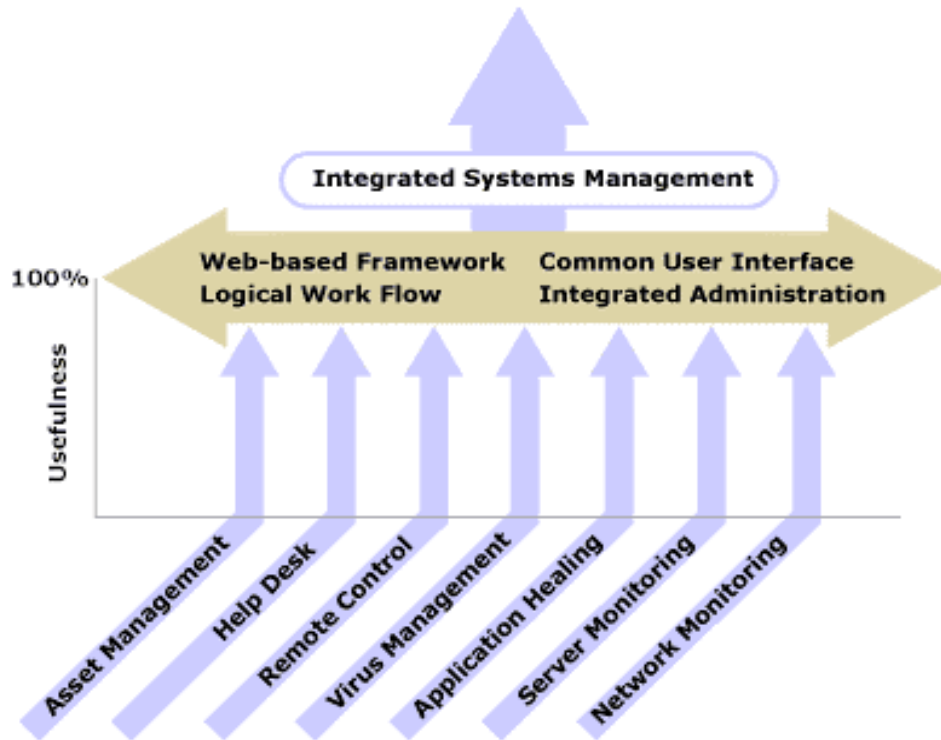
BCR Annual Survey, January 2002

## **WHAT SERVICES ARE ENTERPRISES OUTSOURCING**

Multi-service IT outsourcing contracts provide the process and the people along with the technology to the customer. Offerings include, among others:

- IT Consulting (strategy, planning and security analysis)
- LAN/WAN design, installation and management
- Application development and maintenance
- Data center operations
- 24x7 operations service and support
- Desktop management
- Comprehensive infrastructure services that automate the scaling of software, hardware, storage, network, hosting
- Help desk support
- Disaster recovery services and security monitoring
- Internet and e-business services.

Diagram 1



Source: TriActive

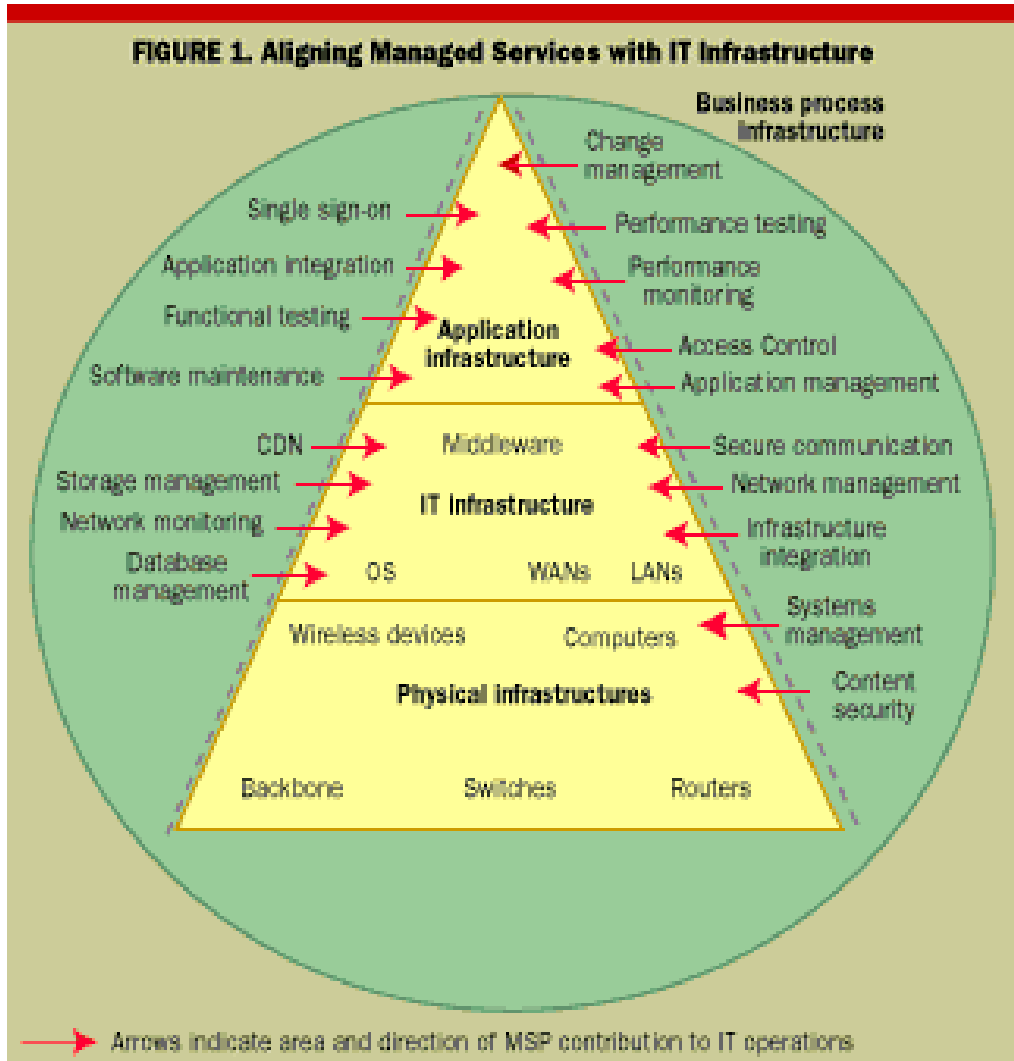
## THE RISE OF THE MANAGED SERVICE PROVIDER - MSP

As mentioned above, there is a broad category of IT outsourcing companies that offer an integrated solution, called a Management Service Provider (MSP), which is dramatically capturing market share from traditional integrators. Market analysts expect the demand for MSPs to grow exponentially as an attractive alternative to internally run IT management applications. Analyst projections estimate \$10 billion in revenue for MSPs by the year 2004.

These second generation MSPs offer all the service of traditional IT integrators (LAN/WAN development, monitoring, security/virus control, etc) but also offer enterprise customers information technology (IT) infrastructure management services to multiple customers over a network on a subscription basis. Like integrators they also provide consulting services and expertise that are not found within enterprises in developing and implementing complex front and back office enterprise and e-business solutions to the client.

To paraphrase a report issued by AMR Research (May 2001), “Watch for second-generation MSP players to enter the market with very strong business models and with benchmark and

analysis services that help determine how an organization can better optimize its infrastructure performance.”



**Source: Business Communications Review**

MSPs address Managed Services on three layers of IT outsourcing areas (see Figure 1 above)

1. Application Management Services
2. IT Infrastructure Management Services
3. Physical infrastructure Management Services

Similar to Application Service Providers (ASPs), MSPs deliver their managed services via networks that are billed to their clients on a recurring fee basis. Unlike ASPs, which deliver business applications to end users, the audience for the new MSP market is broader, consisting mainly of IT managers who want to ensure infrastructure performance at reduced costs. MSP customers consequently are internal IT departments of corporations and organizations.

The new MSP delivers more than just development, monitoring, and reporting they also deliver process discipline. In fact, the overwhelming majority of in-house IT project failures, both internally and e-business, result from flaws in process and methodology, not from inadequate infrastructure or management tools. This is especially true for larger organizations with extensive, multi-tiered enterprise and e-business environments. The greatest value-add a MSP can provide to a client is strategic process and change management methodologies that stem from their expertise and experience in implementing best management practices.

As with the ASP and IT integration models, using specialists to deploy and maintain complex technology allows companies to focus on their core competencies and to tap right away into high-quality expertise as needed. This is particularly true with enterprises with multiple remote offices who now lean heavily on MSPs to integrate the multiple offices into a single meshed network.

There are variations in the model -- some MSPs provide tools and services, others services only, some target corporations and some are oriented toward end-user support. The goal for MSPs is to offer a complete end-to-end IT outsource solution to enterprise customers.

IT organizations can gain significant advantages through the use of Management Service Providers. Major benefits include:

- **Low Upfront Costs** – IT software and hardware is “leased” on a pay-as-you-go basis, there is no large initial cash outlay. The MSP model allows customers to access comprehensive, simple systems management with predictable costs that fit comfortably within the operating budget. No lengthy capital expenditure approvals are required and no hidden training, maintenance or upgrade costs emerge to bust the budget.
- **Reduced Risk** – The MSP assumes the risk of operations, including staffing, maintenance, and upgrades
- **Improved Time To Value** – Reduced initial costs and faster implementation result in a rapid return on investment
- **Reduced Internal Skills Required** – The MSP staffs the Network Operations center with expert employees in a variety of disciplines, reducing the need for customers to hire, train, and retain individual applications experts
- **Improved Implementation** – The MSP brings its experience to bear in the implementation process, which leads to quicker deployment
- **Rapid Installation And Proficiency** - Enterprise systems management tools and reporting is available to customers’ IT staff within hours or days, rather than weeks or months with traditional implementation models. The simple Web-based interface allows IT staff to be productive on the tools immediately, without the need for expensive training and certifications.

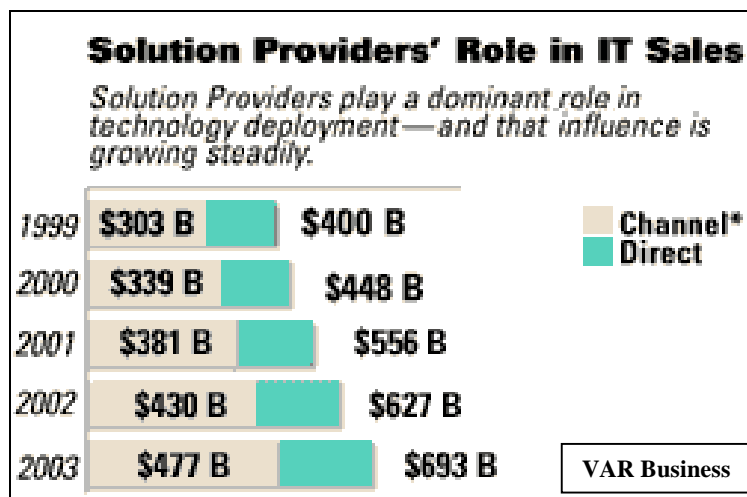
- **No Maintenance Or Upgrade Headaches** - Updates and new releases are installed by the MSP operations staff at its NOC, which is then available to the customers via their normal portal access. Customers receive advanced notice, on-line documentation and release notes, and they don't have to worry about installing new software or patches, timing the upgrade efforts, and the ongoing costs of maintenance contracts.
- **Seamless Multi-Office Integrations** – Because the MSP by definition is a remote service provider expert in monitoring and maintaining multiple networks simultaneously, they are ideally positioned to integrate multiple offices into a single meshed network (similar to TLS or Transparent LAN Services in the 1990s).

## SIZE OF MARKET

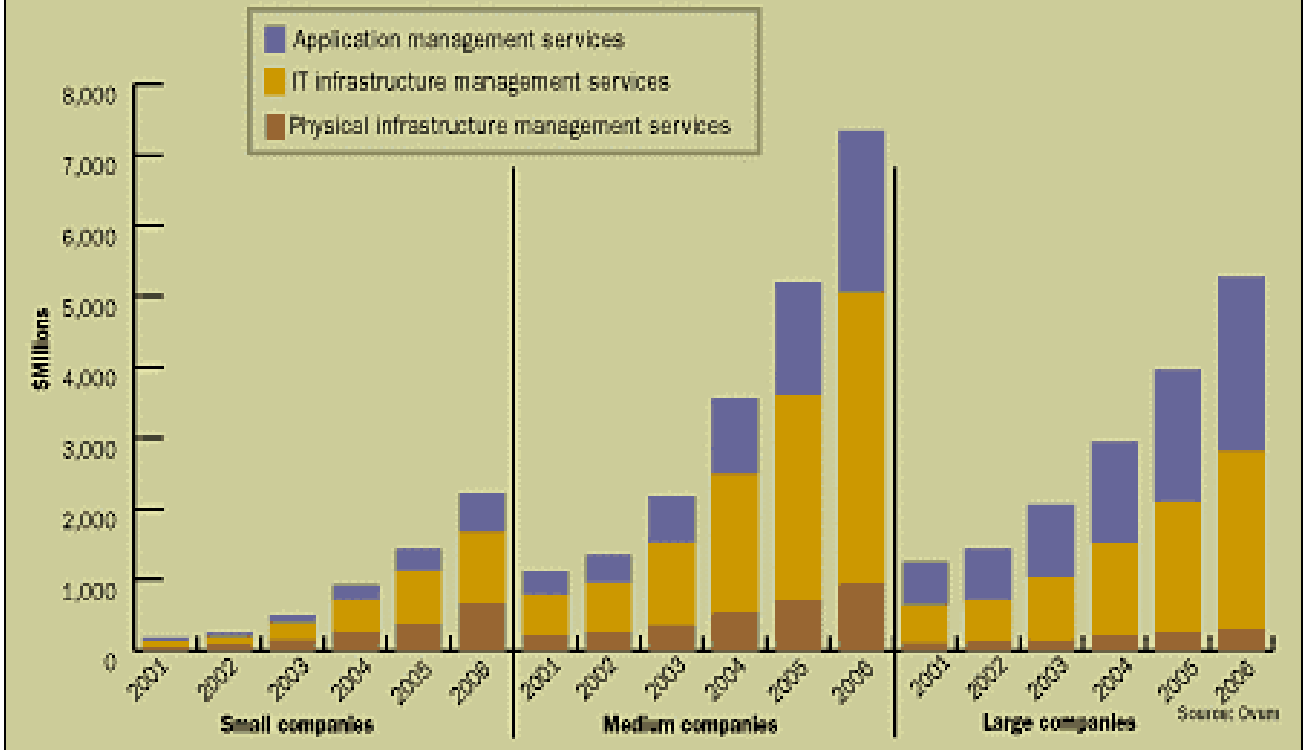
**THE META GROUP** - Meta Group believes all Global 2000 companies will engage at least one MSP by 2001/2002, and a majority of small and medium sized enterprises will engage multiple MSPs by 2002/2003. By 2004/2005 it is expected that the overall MSP market will exceed \$10 billion.

**GARTNER GROUP** - The market for MSP services draws from the traditional network and systems management software market, which the Gartner Group estimates at \$14 billion in 2000, with approximately \$4 in service spent for every \$1 in software. Gartner also predicts a 133 percent jump from \$90 million in 2000 to \$3.26 billion by 2005.

**DATAQUEST** - Solution Providers will sell a projected \$400+ billion in IT products and services in 2002. 69% of all technology dollars move through the SP channel.



### Global Market Forecast For Managed Services



Source: Business Communications Review

## COMPETITIVE LANDSCAPE

There is a huge opportunity in the IT service vendor market space for a national, service rich end-to-end provider of IT services with an MSP model. While there are a number of major vendors in the IT outsourcing market, as a group they only account for less than 20%, with the remaining 80% of the market served by small regional and local players (See Table 3 below). As a result there is significant space for emerging national, full-service MSPs to successfully gain market share. With so many small players there exists the potential for industry consolidation.

Table 3

<b>Top IT Services Vendors (\$Millions)</b>				
Company	1999 Revenue	2000 Revenue	2000 Market Share	1999-2000 growth %
IBM	32,163	33,148	5.0	3.1
EDS	18,620	19,224	2.9	3.2
Fujitsu	12,565	13,299	2.0	5.8
CSC	9,200	10,448	1.6	13.6
Accenture	9,121	10,000	1.5	9.6
CapGemini(EY)	8,164	7,772	1.1	4.8
Xerox	8,045	7,718	1.1	4.1
Hewlett-Packard	6,159	7,290	1.1	18.4
Compaq	6,623	6,696	1.0	1.1
NTT Data	5,708	6,686	1.0	17.1
Others	490,182	543,589	81.6	10.8
Total Market	606,982	665,870	100.0	9.7

Source: Gartner Dataquest



## SUMMARY

As network managers increase their dependence on complex back office, infrastructure and network-based applications, they are increasingly looking to outside providers to design, implement, manage and monitor their IT projects (LAN and WAN) rather than doing it in-house through the hiring of expensive and hard to retain specialists whose skills are not needed on a regular basis. IT outsourcing is here to stay and growing strong.

However, there is a dramatic evolution in the services definition of those companies offering outsourced IT services. As enterprises look beyond IT design and development to now outsourcing infrastructure and user management services and strategic solutions, there has emerged a new category of IT outsourcing company, called a Management Service Provider or MSP. MSPs are rapidly capturing market share from traditional integrators. In fact, market analysts expect the demand for MSPs to grow exponentially as an attractive alternative to internally run IT management applications and traditional IT outsourcing. Analyst projections estimate \$10 billion in revenue for MSPs by the year 2004.

These MSPs offer to the market a complete, end-to-end technology outsourcing company that not only addresses customers' hardware/software and monitoring needs but also provides the customer with values added strategic insight necessary for enterprise success in the marketplace. MSPs will succeed because they reduce the cost, risk and high failure rate

(more than 60%) of premises-hosted system management tools. MSPs also introduce management functions that the customer could not perform internally, such as thorough monitoring of Web sites and constant delivery networking.

It is our contention that in order for existing IT integration companies to maintain or grow their market share, as well as increase their billing per client (see chart below), they must reposition themselves as a full service, end-to-end Management Service Provider.