



Horizons Inquiry 2013 The Multi-Sourcing and Service Integration Challenge



Executive overview

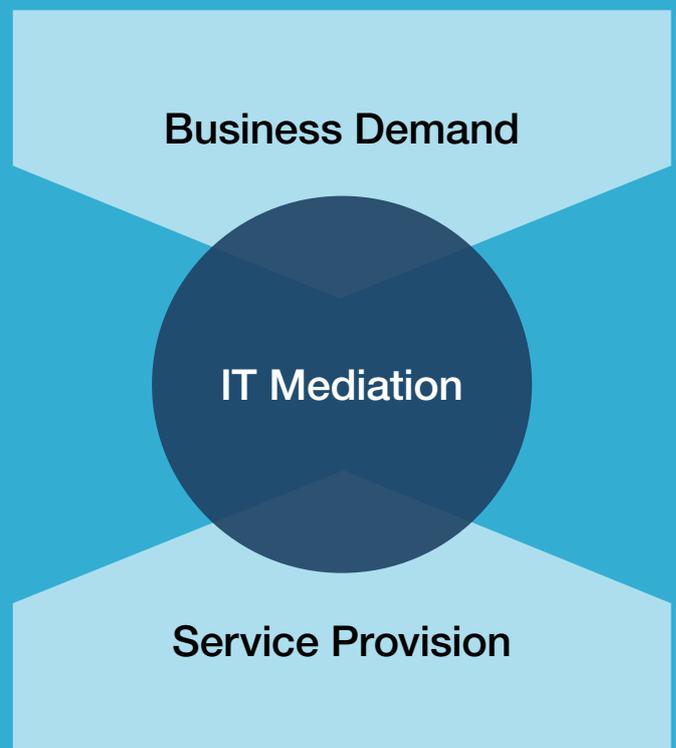
In response to growing CIO concerns about multi-sourcing and service integration and management (SIAM), CIO Connect has undertaken a six-month research project to ascertain the views of thirty leading IT executives and twenty IT vendors. The study has found that all IT organisations have adopted some level of multi-sourcing and service integration, but these approaches seem insufficient to cope with the rapid changes taking place in regards to the business demand for IT services and within the IT supply sector itself.

Our findings suggest most IT organisations continue to focus the majority of their efforts on maintaining back office systems of record, such as Oracle and SAP. The emphasis, here, is on efficiency and stability. In stark contrast, front-end business investment in digital technologies involves emerging areas such as data analytics, mobility and social media. Front office IT applications require solutions in weeks and months, rather than years or decades, and attract an entirely different breed of vendor, such as public Cloud providers and next generation application development houses.

Many CIOs express strong views confirming such trends, but few if any have an appropriate operating model that spans both back and front office. Most traditional IT vendors are in a similar position due to their dependence on business models based on long-term annuity revenues. Entrepreneurial vendors who are prepared to work with the new generation of public Cloud and applications houses are few and far between. Only the UK government seems to understand the problem, putting in place a strategy to respond to the new digital environment.

Our survey concludes that the large majority of CIOs must adopt new IT operating models to bridge traditional and emerging business requirements for IT. Such models should embrace a far greater diversity of vendors, ranging from the traditional hardware suppliers and system integrators such as IBM and HP, to next generation Cloud providers such as Amazon, Google and Salesforce. CIOs recognise that successive generations of outsourcing have depleted their internal resources to the point that a full replenishment of skills, processes and tools will be necessary to create a future-proof operating model.

In this report we seek to answer the key emerging question of how CIOs can equip themselves to mediate in the new demand/supply environment for IT solutions and services. We examine the changes taking place across the demand/supply IT landscape, and conclude that an entirely new operating model is required. This new model will have SIAM as its core capability, enabling organisations to source all IT services and systems as commodities and on a much more flexible basis.



A revolution in digital business – from inside-out to outside-in



The majority of the CIOs admit they are pre-occupied with large-scale systems of record – or inside-out systems that support back and middle office functions, such as finance and supply chain. Only a few blue chip businesses have integrated inside-out systems across

different parts of the world to align with global operating models. Large manufacturing and service organisations refer to ‘regional systems’ that are globally incompatible, despite having a common software heritage such as SAP or Oracle.

Managers are, therefore, frustrated in their attempts to standardise the core business processes and functions that are supported by systems of record. The majority of IT effort is consequently focused on integrating these large systems so that the business can capitalise on its ERP investments. In the words of the CFO of a global oil and gas company: “We need to harvest our multi-billion dollar investment in SAP before embarking on new IT programmes”.

Such an inside-out focus appears congruent with the fact that the majority of IT organisations report through the finance function, where the driving measures for back office IT performance are cost efficiency and stable performance. This focus is in contrast to IT related developments in other areas of many organisations that focus on gaining competitive advantage and growing market share i.e. systems of differentiation.

Businesses have experienced a dramatic shift in strategy and operations in the aftermath of the 2008 financial crisis. IT consumerisation has become an enduring way of life during this period. A decade after the failed promise of the early 2000s dotcom boom, e-commerce has finally penetrated into every aspect of our working and social lives; Silicon Valley, the epicentre of digital innovation, is acknowledged as a potential Death Star for many established industries in the coming decade.

Against this background of dramatic change, executives have pursued a range of IT strategies and techniques to ensure their companies remain ahead of competitors. These have led to a rapid uptake of new digital applications and public Cloud services in the front office. In many cases, the IT organisation has provided input into such outside-in solutions, but CIOs admit that a growing proportion of IT investment is now taking place outside the influence or control of the IT function. This decentralisation is likely to lead to a fragmentation of systems and data that bares remarkable similarities to the era of end user computing in the 1980s.

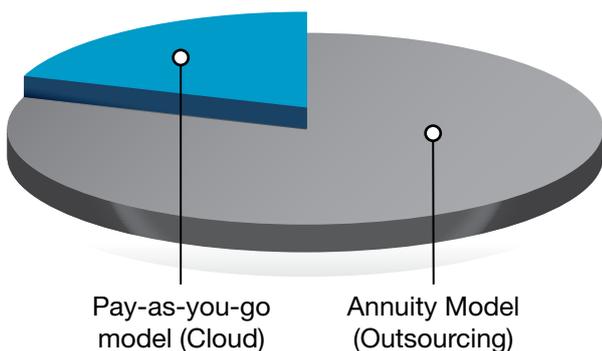
In this new outside-in digital world, IT must respond to a different set of performance parameters, including: creating business value (such as revenue growth), achieving business agility (responding in weeks rather than months or years) and having an appetite to take risks (preparing to fail as well as succeed). CIOs believe their business peers expect to see tangible business benefits in the first weeks of a new IT project, promoting a much faster approach to system development compared to the traditional cascade approach. To quote one CIO: “A 60% solution delivered in days or weeks is better than a 100% solution delivered in months or years”.

The prospect of growing fragmentation between back and front office systems sends alarm signals to CIOs and board members. Such fragmentation could create insurmountable problems, as data is unable to cross boundaries, which in turn restricts how organisations can use commercial information. The IT community must act now to drive coherence across front and back office systems. CIOs must inform business partners of the imminent dangers of fragmentation and establish new forms of corporate governance that deal with the emerging Cloud environment.

A changing vendor world

Just as business demand for IT is undergoing a quiet revolution, so too is the supply-side community. The dominant IT vendors, such as Accenture, CGI, IBM, HP, Oracle, and SAP, have business models based on long-term annuity revenues, including outsourcing contracts and software licences. Such annuity revenue models correspond to large-scale systems of record, or inside-out solutions. These traditional vendors boast huge revenues and still account for 80%-plus of corporate IT expenditure. But as IBM's recent results demonstrate, revenues are declining gradually at 3% to 5% per annum, mirroring the internal cost efficiencies demanded by CFOs across core software and hardware platforms.

Current IT Spend



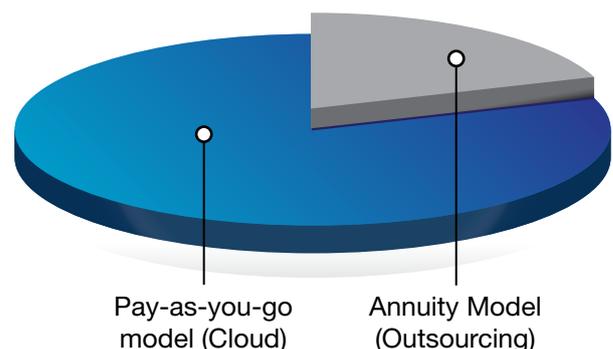
In contrast, spend on outside-in IT solutions is exploding. The annual revenue growth of public Cloud providers and independent application specialists can be as much as 40% or higher. This growth is reflected in the dotcom style revenue-based market valuations of Cloud providers like Workday, Salesforce and ServiceNow. Analysts predict that public Cloud services will account for 20% of the global IT services marketplace by 2016. By 2025, Cloud could be the dominant channel for all IT and business services, eclipsing the oligarchs of today's IT sector.

The reason for such exponential growth is simple. Public Cloud services can be adopted in weeks or months by business executives and provide common standards around the world. The CIO of a leading insurance broker commented that an HR Cloud service such as Workday is the only practical and cost effective means of achieving a global standard across a twelve month period. Public Cloud providers frequently bypass the IT organisation and sell directly to business executives. This is creating a proliferation of Cloud providers across larger organisations, with little control or visibility from within IT.

Traditional system integrators recognise the threat of a new generation of IT service providers, but they have great difficulty transforming their complex organisations. Public Cloud threatens long term outsourcing and software licencing contracts, yet in the words of one leading CEO: "It is hard for a \$100 billion corporation to turn on a dime!". CIOs of traditional IT organisations and their strategic vendors are becoming locked in a deadly embrace. A radical change, rather than an incremental movement, must take place if the CIO is to remain as the primary mediator between IT supply and demand.

Most traditional IT vendors promote private Cloud solutions that help large organisations optimise their estates by consolidating data centres and applying virtualisation techniques. However, this private Cloud approach is a stopgap and offers little in the way of outside-in solutions. Vendors must recognise that an entirely new paradigm is emerging, namely the consumerisation of IT services through the emergence of global IT utilities that are based on concepts such as Open Compute. Companies such as Facebook and Google are setting the trend here, removing the middleman by building their own hardware and achieving a quantum improvement in efficiency. Some of the large global banks are adopting similar tactics.

2025 and beyond



Most CIOs will see the gradual erosion of private Clouds as they transmute into public IT utilities. This move will destroy outsourcing models and create significant challenges for traditional vendors, unless they too build and operate public IT utilities on the scale of Amazon and Google. Microsoft appears to be the front-runner in recognising such a reality with its launch of the Azure platform and Office 365. The future will be all about providing IT and business services in a more flexible and agile manner, rather than through mega-contracts based on 5 year terms and fixed prices and it will create a new economic order within the IT sector.

Assessing the gaps in today's IT organisations

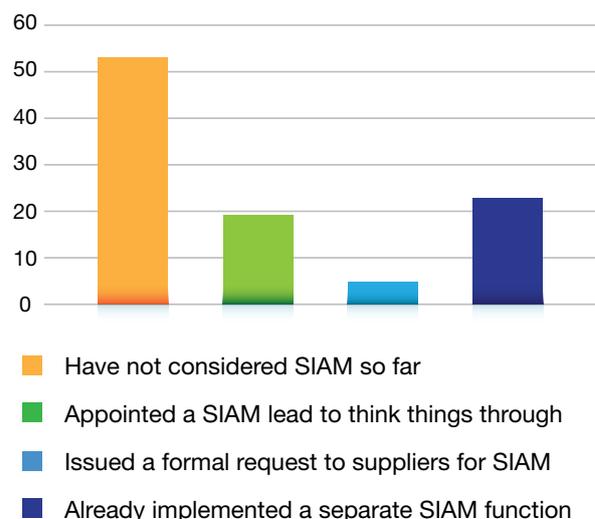
Virtually all IT organisations in our research have chosen the outsourcing route as the preferred means of operating IT platforms. Most CIOs admit such arrangements have been far from perfect, falling far short of original expectations. Sourcing advisors such as Quantum Plus state that over 80% of outsourcing contracts fail to deliver against the stated business case and our observations suggest 25% of these failures result in premature contract termination or renegotiation. Many outsourcing vendors commit to innovations during the lifecycle of each contract, but few have delivered on such promises. In short, outsourcing has run its course and is in need of radical surgery.

The progressive dependence on third parties over the last few decades has depleted IT organisations in areas such as skills, methods and tools. Most internal resources are now dedicated to managing external vendors, rather than responding to business requirements. To refer to the comments of one leading utility CIO: "Today, 80% of my IT resources are involved in operational tasks and 20% in responding to business requirements. In five years' time, I would expect the reverse to be true". In short, a fundamental transformation will take place from running legacy IT, or systems of record, towards the creation of new platforms focused on systems of differentiation. Businesses expect their IT organisations to have skills that support both the front and the back office. This split implies a very different way of operating on behalf of IT, with much greater emphasis on fast prototyping and flexible sourcing. IT should be the enabler of business change, especially in the emerging digital era. The CIO should provide the vision to architect the digital business in association with his/her peers. One CIO suggested a change in job title to Chief Connection Officer is appropriate.

The devolution of operations to third parties has also reduced internal visibility and control of key processes that lie at the heart of any successful IT organisation. Such processes have become widely distributed amongst external service providers, leaving the host organisation to plug any gaps with manual interventions and Excel spreadsheets. This artisan approach is both costly and untenable when attempting to provide a consistent level of customer service. In the words of a financial services CIO "The IT organisation needs its own ERP system to monitor and manage performance".

A wholesale development of a new SIAM function is required that contains the key skills, processes and tools to cope with the emerging supply/demand IT environment. However, our research suggests CIOs are approaching this critical issue slowly. Some 50% of CIOs have not considered SIAM as a standalone function. A further 20% have appointed a lead SIAM manager to develop plans, but only 23% have implemented a full SIAM solution.

SIAM Adoption Cycle



Future IT scenarios – a parting of the ways

Our research suggests blue chip (more than 50,000 staff) and mid-sized (circa 10,000 staff) companies are taking very different approaches to the emerging supply/demand IT landscape. At the very top end of the scale, financial services companies who spend upwards of \$10bn to \$15bn on IT services recognise they can opt for their own Open Compute environments, where they create global IT utilities of a similar scale to Amazon and Google. This approach enables them to cut out the hardware suppliers and system integrators, reducing costs by as much as 50%. Such organisations are adopting a flexible ‘bring your own device or application’ policy that represents a ‘walled garden’ or ‘private apps store’ within the global utility.

At the next level down, CIOs of global firms and large government departments that spend in the region of \$1bn to \$5bn on IT, expect to retain strategic vendor relationships, despite admitting to shortfalls in the current outsourcing model. Key IT vendors typically subdivide into infrastructure providers, such as HP, Fujitsu and IBM, and applications providers such as Accenture and TCS. The approach here is to select a ‘best in breed’ partner for each service tower, creating a small ecosystem of qualified operators. Many CIOs operating in this multi-sourced world seek to enhance their own internal service integration function that binds the ecosystem together. This approach encourages greater flexibility of supply, with the ultimate goal of complete commoditisation of the primary towers. It also increases visibility and control over costs and performance.

The overwhelming majority of CIOs at mid-sized firms have given up any hope of dealing with their traditional strategic vendors due to a complete lack of day-to-day account management and support. They expect such providers to cover all needs, from back office to front office.

Our research suggests 42% of organisations intend to stay with their strategic IT vendors, with each occupying a single service tower. Only 13% intend to open up individual service towers for multi-sourcing between vendors. The rest (45%) intend to abandon large players in favour of agile suppliers, especially public Cloud providers.

Many Cloud providers are consequently moving rapidly into end-to-end business services, such as finance, human resources and supply chain. Leading CIOs of mid-sized organisations are increasingly considering themselves as fully-fledged business, rather than IT, service providers. They expect many aspects of operational IT to be embedded in the business services they buy off the shelf. One CIO of an energy company was surprised when asked whether he outsourced his service towers. He no longer has sight of such towers, given that they are integral to the business services he buys from external Cloud vendors.

A future target operating model for IT services

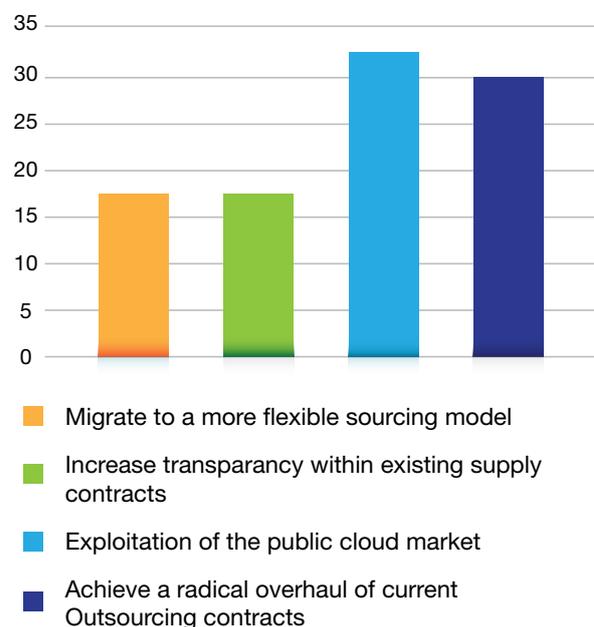
CIOs consistently suggest that the multi-sourcing of ‘best in breed’ IT services will remain core, even if the partnerships evolve from long-term outsourcing contracts to short-term tactical relationships with next generation public Cloud suppliers. Only a few CIOs recognise that the IT department is evolving into a business service organisation. However, most CIOs admit that they are not prepared for the transition and believe a complete transformation is necessary to achieve a more flexible approach to IT sourcing.

Our research suggests the factors that motivate the introduction of a full service integration model include: the need to increase transparency within existing supply contracts (18%), the need to achieve a radical overhaul of current outsourcing contracts that appear to be failing (30%), further exploitation of the public Cloud market (33%), and a wish to migrate to a more flexible sourcing model (18%).

UK government departments often take the lead here, with the public sector digital strategy released in 2012 calling for an independent SIAM function. This independence is recognised as key to enabling a breakup of traditional supply monopolies and the creation of a responsive marketplace for IT services. The Cabinet Office has approved an IT operating model that carefully defines the SIAM components, with thirty key operating processes. Companies such as ATOS, Lockheed Martin and Mozaic Services have already won contracts to help government organisations implement a standard SIAM operating model. Typical savings associated with the SIAM approach lie between 20% and 40% of the current IT budget.

In the UK government’s SIAM model, the service desk and associated operational processes such as incident management are contained within a single function. This separate SIAM function has the skills, tools and processes to ensure that interfaces with IT vendors conform to a defined standard, simplifying contracting and helping to automate operations. New tools are emerging that provide CIOs with dashboards on all aspects of IT services, including both commercial and operational parameters. Here SIAM becomes the core capability of any medium to large scale IT organisation, enabling a higher degree of sourcing flexibility and business agility.

Drivers to adopt SIAM



What are the critical elements of a SIAM-based IT operating model?

“Capgemini is a notable exception here as it is already active globally in providing SIAM services”

Our research suggests the benefits of adopting a SIAM model are heavily biased towards business agility, with 67% of CIOs stating this is the number one benefit. However, an additional 17% believe SIAM opens up possibilities for multi-sourcing through increased commercial flexibility and transparency. Just 10% of CIOs are interested in improving service levels, and 7% in helping speed up the introduction of new suppliers. Discussions with CIOs and vendors clarify the three key aspects of any future SIAM model:

- Internal ownership of the end-to-end processes against which all IT vendors will need to comply
- Internal ownership of a common set of tools that control commercial and operational performance; again, all IT vendors will need to comply with such tools
- Internal ownership of the key skills that are required to define and operationalise a full SIAM strategy

So, how might an IT organisation migrate to a SIAM-based operating model? IT vendors and CIOs suggest a number of different options, ranging from a complete in-house transformation programme to a full outsourcing of the SIAM function. Where an IT organisation has made a decision to retain all aspects of service integration and management, the main activities are likely to include:

- Assessment of the maturity of internal IT capabilities, including a review of skills, processes and tools against a future SIAM operating model
- Design of the future state, including key operating processes within the SIAM function and standard contracting principles for externally acquired IT services
- Re-tooling of the IT management platform, including a migration from legacy systems and vendor relationships to the new operating model
- Hiring and training of appropriate skills to run the new operating model, with a likely reduction in numbers due to increased automation of IT processes

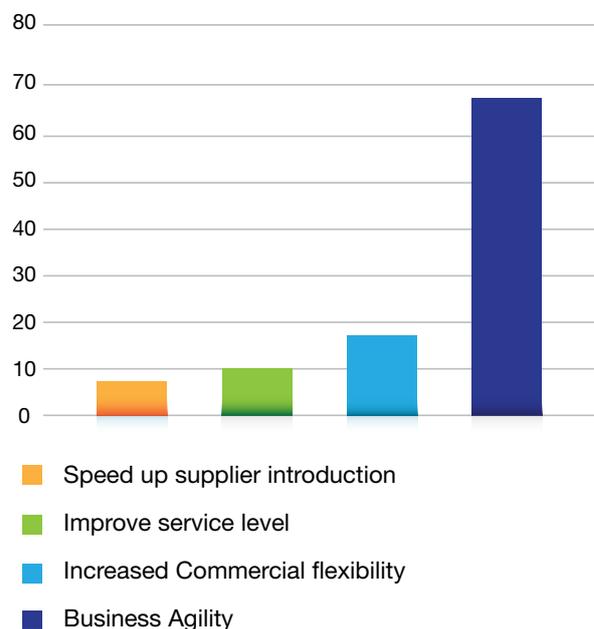
Timing for a full SIAM implementation varies and our research suggests 29% of CIOs expect to start a SIAM implementation within the next 12 to 24 months. A further 28% intend to implement SIAM one or two years ahead of a major re-compete, enabling the organisation to have greater flexibility

and control over future sourcing options. Some 29% anticipate integrating SIAM into a broader RFP during a major re-compete of existing outsourcing arrangements, such as an infrastructure renewal. Only 14% expect to issue a separate SIAM RFP at this stage. Recent experience of SIAM implementations suggests a 12 to 18 month transition period. This timeframe must be built into any future IT transformation plan. For organisations that are deterred from undertaking a full transformation, the second option is to buy SIAM services. This arrangement can be accomplished at several different levels:

- Purchase a managed service that encompasses some or all of the key SIAM tools and processes; some IT vendors offer managed services already as a 'software as a service'
- Engage a partner to take on, transform and work out the new operating model leaving the CIO in full control
- Outsource the entire SIAM function to a qualified IT vendor, preferably one that is independent of all service towers

In reality, few, if any, of the traditional IT vendors are prepared to take on SIAM independently because of the small revenue flows that are generated when compared to the main service towers. Capgemini is a notable exception here as it is already active globally in providing SIAM services. Some recent deals, such as those signed by Rolls Royce and Astellas, have enabled the SIAM provider to participate in one or more service towers on a Chinese wall basis. The public sector has been more rigid about applying the independence principle, encouraging pure play SIAM companies, such as Mozaic Services, to emerge.

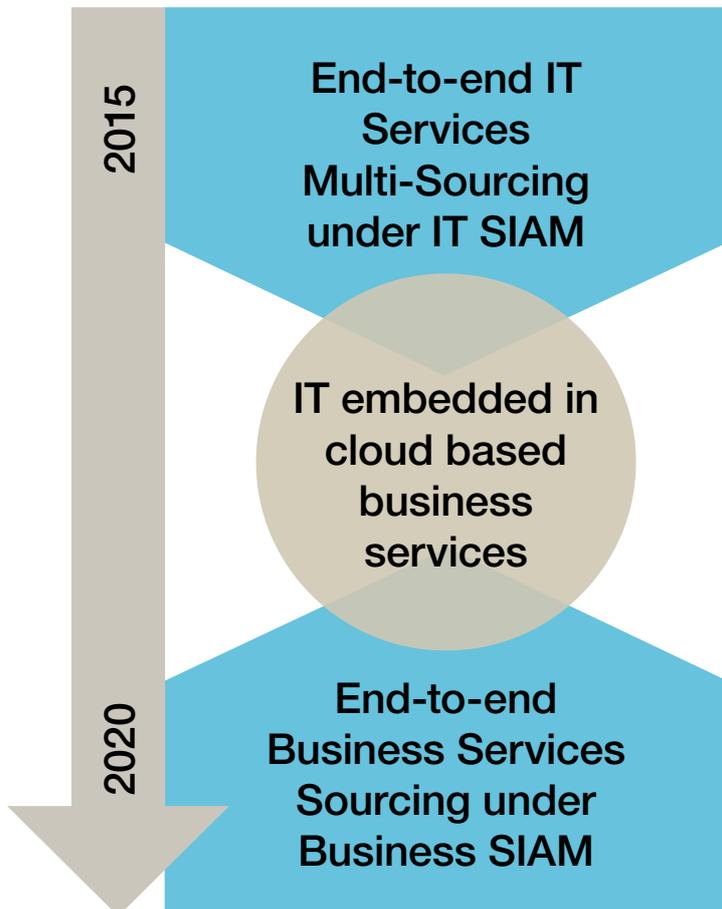
Benefits of adopting SIAM



All roads lead to SIAM

Profound changes are taking place in the provision of IT and business services. CIOs recognise that traditional IT operating models based largely on strategic outsourcing partnerships cannot respond to a rapidly changing supply/demand landscape. Instead, the preferred option is to separate the sourcing of individual IT services from the service integration function, or SIAM layer. IT organisations that make such a move will be able to win back control of IT operations and exploit changes in supply.

Our overall view is that in the mid-term, three to five years, IT will become progressively embedded in end-to-end business services, many of which will move to external Cloud providers. The issue of IT sourcing will gradually be replaced by business service sourcing, as IT is embedded in Cloud-based business services. Service integration will transcend current IT boundaries to become the operating norm across all functions, placing it at the core of the business model.







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