

Leveraging Capex-Free Managed Hosting



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by Gary Chen | June 2008

Executive Summary

Over the years, small and medium businesses (SMBs) increasingly have adopted various IT technologies to satisfy customer demands, and to compete against large enterprises and savvy smaller competitors that all have leveraged technology and the web to gain a business edge. The phenomenal growth of the internet and the World Wide Web has presented a wealth of new opportunities, as well as challenges, for businesses that desire to leverage this new medium. Although the web provides unprecedented reach and efficiencies for conducting commerce and marketing, it also requires robust infrastructure and experienced staff to provide the rich and responsive experience that customers demand.

As SMBs adopt more technology, they also struggle more with managing it. The high capital costs and expertise required for many solutions are formidable barriers for a medium-sized business. Far too many SMBs are forced to make do with outdated IT infrastructure, which limits their use of technology to support their fast-changing business needs. SMBs are also generally lacking robust business protection against disasters and security threats, which increases their risk. A do-it-all-yourself approach to managing IT has simply become unmanageable for many businesses.

The advent of IT hosting provides an effective alternative whereby hardware, software and support are provided as a service. IT hosting providers can offer enterprise-class web infrastructure to SMBs, preserving valuable capital that a small business can use instead for customer acquisition and innovation. A hosted IT service also allows a company to focus on its core business and strengths, and allows IT to become more strategic rather than tactical.

For SMBs to determine if managed hosting is the right choice for them, they must first assess the importance of web infrastructure to the business, as well as the depth of capital and IT staff available. They must realistically examine the past performance of IT in supporting the business. How many projects were left undone due to lack of budget? How much downtime has occurred as a result of disasters or security breaches?

SMBs should consider managed hosting providers as extensions of their IT staff. They should look for a provider that will work with them to effectively plan, implement, manage and scale their infrastructure to meet their unique needs. Service and support must be highly responsive and follow an agreed-upon playbook. Customers should look for signs of proactive support as well. Does the provider implement robust protection and redundancy, and follow best practices to prevent problems and maintain service levels? Don't be afraid to make the hosting company prove in detail that it has a well-established methodology.

By leveraging the economies of scale, expertise and technologies of managed hosting providers such as Planet Northstar, web businesses can eliminate their IT capital cost requirements, increase efficiency while reducing labor costs, focus on their core competencies, reduce risks and level the playing field to compete more effectively with much larger organizations.

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Table of Contents

- I. Background 2
 - IT Struggles to Keep Up with Business Demands 2
 - Business Protection Is the Top Concern 3
 - Driving Toward the Capex-Free SMB. 3
- II. Managed Hosting 4
 - What Is Managed Hosting? 4
 - Why Web Businesses Turn to Managed Hosting 4
- III. Recommendations. 5
- IV. Conclusions 7
 - A Capex-Free Future for Web Businesses 7

I. Background

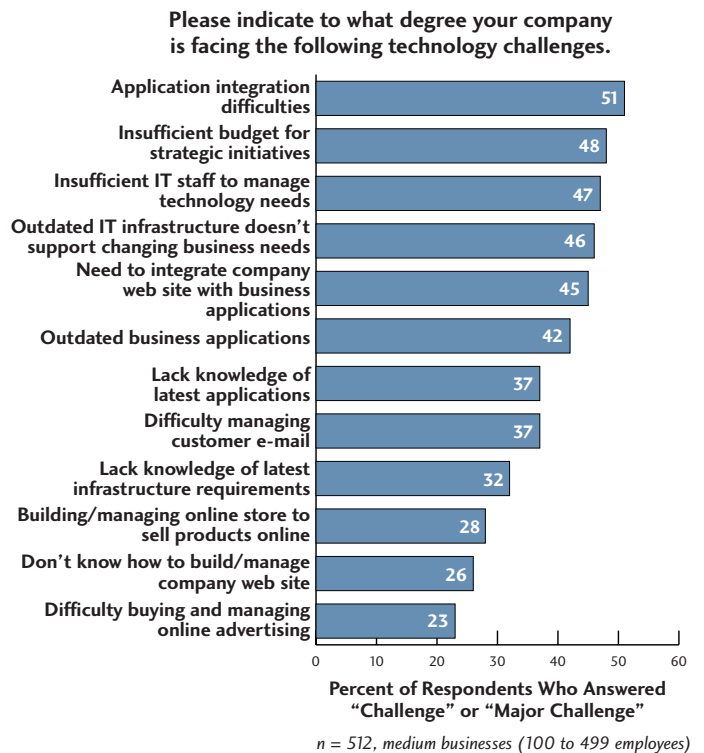
IT Struggles to Keep Up with Business Demands

Data from the Yankee Group *Anywhere Enterprise—Small and Medium: 2007 US IT Infrastructure Survey* reveals several major technology challenges faced by today’s medium-sized businesses (see Exhibit 1). Not surprisingly, the lack of budget is near the top of the list. Nearly half (48%) of respondents cited insufficient budget for strategic initiatives as a major concern. Cash flow is always tight in any growing business, and many IT initiatives require a significant upfront capital investment that can be difficult to obtain.

The lack of IT staff is also a major challenge. Medium businesses with 100 to 499 employees have on average only 10 full-time IT staff according to the Yankee Group *Anywhere Enterprise—Small and Medium: 2007 US Managed IT and Communications Services Survey*. This lack of budget and staff is reflected in the current state of SMB technology. According to the Yankee Group *Anywhere Enterprise—Small and Medium: 2007 US IT Infrastructure Survey*, 46% of medium businesses are facing challenges with their outdated IT infrastructures not being able to meet their rapidly changing business needs, and 42% are dealing with outdated business applications.

Exhibit 1
Top SMB Technology Challenges

Source: Yankee Group *Anywhere Enterprise—Small and Medium: 2007 US IT Infrastructure Survey*



Business Protection Is the Top Concern

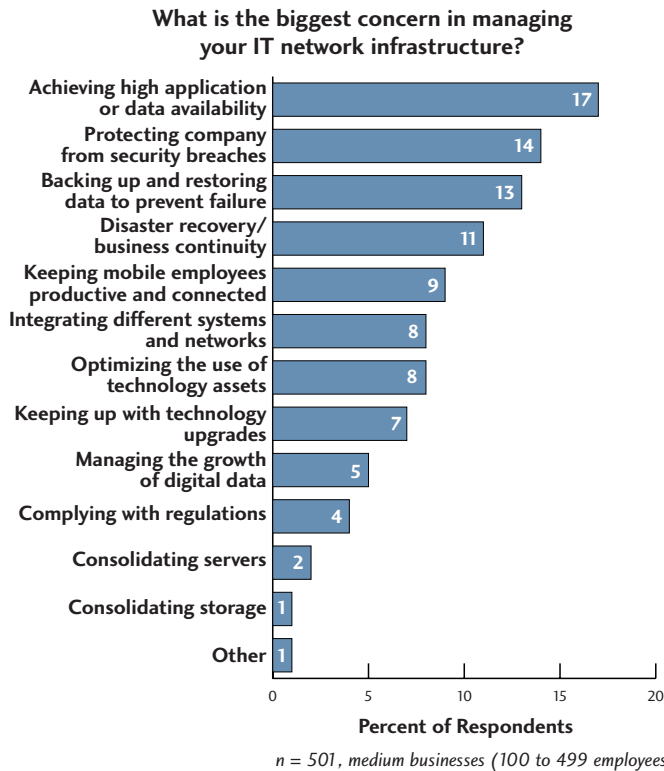
According to the *Yankee Group Anywhere Enterprise—Small and Medium: 2007 US IT Infrastructure Survey*, protecting the business is a leading concern among medium-sized firms today (see Exhibit 2). Protection ranges from simple backup and recovery to protection against lost or damaged data, from high availability systems, to the full recovery of networks and servers from a catastrophic failure. Security breaches are also a major concern, since they are really just another aspect of reliability.

High-performance applications in a globally competitive environment require highly reliable and robust IT systems to support them. With the ubiquity of broadband internet connections, customers and business partners are growing increasingly impatient with web sites, demanding always-on availability and fast response times. Failure to satisfy these expectations can quickly put a company at a competitive disadvantage.

Exhibit 2

Business Protection Tops SMB Infrastructure Concerns

Source: *Yankee Group Anywhere Enterprise—Small and Medium: 2007 US IT Infrastructure Survey*



Driving Toward the Capex-Free SMB

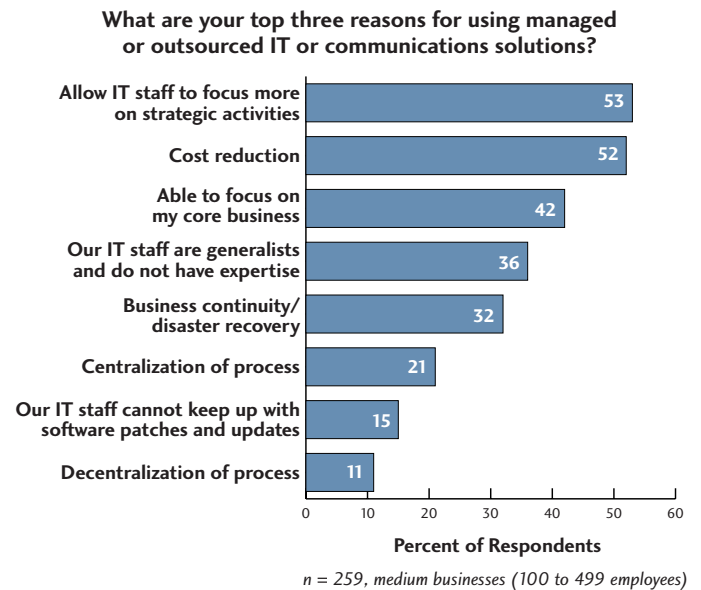
In the past decade, SMBs have become more reliant on IT and web presence to compete more effectively as they struggle to keep up with the demands on their IT infrastructure. As previously shown in Exhibit 1, most SMBs have aging infrastructures along with a lean budget and a lack of manpower to manage it, driving many to consider an outsourced or managed services model for many of their technology needs. Outsourcing IT services is a growing trend, with 31% of medium-sized firms planning to purchase managed services in 2008 to help with their IT needs according to the *Yankee Group Anywhere Enterprise—Small and Medium: 2007 US Managed IT and Communications Services Survey*.

Exhibit 3 indicates some of the key reasons why web businesses are turning to managed services for some or all of their IT functions. Cost reduction is an obvious driver. Managed services allow businesses to purchase functionality that they would not normally be able to implement, afford or manage without adding additional equipment and staff. Managed services enable customers to take advantage of the economies of scale to bring down costs and improve their operations.

Exhibit 3

Drivers for Managed Services Adoption

Source: *Yankee Group Anywhere Enterprise—Small and Medium: 2007 US Managed IT and Communications Services Survey*



Yankee Group has also observed a trend toward leveraging IT as a strategic tool to help grow the business. In the typical SMB, IT spends the majority of its time mired in the tactical and mundane tasks of managing existing technology and putting out fires. The modern web-enabled business needs its IT department to focus on strategic activities that align business and IT goals so it can fully leverage technology to gain a competitive edge. SMBs must identify and focus on their core competencies and strengths, which are innovating new products, applications and business models, and backing their business with superior and personal service. The low-level details of IT can be outsourced to an outside technology expert, allowing IT to focus on higher-level strategic activities to fuel growth.

Technology inevitably becomes more complex, more widespread and more essential. As such, it is logical to assume that there will be a breaking point where it will be impossible for an SMB to engage in IT without some level of managed services. As managed services, software as a service (SaaS) and cloud computing models mature, perhaps the SMB of the future will purchase all IT through these channels. In that scenario, the SMB would own no capital technology assets and retain only a limited business-focused IT staff.

II. Managed Hosting

What Is Managed Hosting?

Several types of hosting services are available in the market today and can generally be classified into three categories: shared, dedicated and managed. Shared hosting is the most basic service and is generally targeted at home-based and very small businesses. It has strong limitations on functionality and scalability.

More sophisticated small or medium-sized businesses generally choose between dedicated and managed hosting. Dedicated hosting provides leased servers in professional data center facilities, with the customer having full control and responsibility for the OS, applications, and ongoing management and administration. Managed hosting, in comparison, provides the same infrastructure as dedicated, but adds the administration and management of the infrastructure as an integrated service—providing a more hands-off experience for the customer. Outsourced expertise is available on an on-call and ongoing

basis. Managed hosting providers assume management tasks that may include design, implementation, updating/patching, monitoring, security protection, backup and performance tuning.

Why Web Businesses Turn to Managed Hosting

Although many companies turn to IT outsourcing to help cut costs, managed hosting is not just about cost savings, with major drivers such as:

- **Controlling capital expenses:** Choosing a managed hosting model versus a do-it-yourself approach to IT converts IT from a capital expense to an operating expense. This frees up valuable cash for investment in growth strategies and revenue-producing activities. It also reduces large upfront expenditures that can be costly—especially for an early stage business where customer acquisition is key and consumes most of the budget.
- **Reducing risk, improving accountability:** Outsourcing IT shifts technology risks to the managed hosting provider and makes the provider accountable through service agreements. If the firm is not satisfied with the hosting provider's services, it can switch to another provider much more easily than having to rip and replace existing in-house assets or staff. Hosters generally provide a detailed service-level agreement (SLA). SMBs must be honest and ask themselves if they are currently meeting that level of service on their own, and if they could ever realistically achieve that service level given their resources.
- **Gaining enterprise parity to level the playing field:** Most SMBs can never match the in-house IT resources and support enjoyed by much larger companies. Managed hosting helps SMBs play on a bigger playing field by giving them access to the economies of scale, cutting-edge technologies, superior reliability and security, and expertise typically available only to larger enterprises.
- **Leveraging expertise and best practices:** Managed hosting providers can provide access to professionally certified experts with extensive experience that SMBs could never afford to retain on their internal staff. Likewise, developing solid best practices and formalized procedures can take months or even years to achieve—all of which can be provided easily by a hosting provider.

- **Increasing efficiency/streamlining operations:**

Companies that manage IT hardware, software and staffing in-house will wage a constant battle to keep up with the latest technology and still control costs. Historical data has shown that SMBs cannot fully leverage and optimize the technology they have now, much less improve and upgrade it. Managed hosting can help increase efficiency and streamline operations by relieving the burden of mundane tasks to improve IT responsiveness.

- **Reducing staffing/labor costs:** Hiring expert staff and keeping them up to date with training is an expensive and time-consuming process. The best and brightest IT minds are costly and thus are generally the domain of the large enterprises that can afford them. Managed hosting provides access to a large pool of experts and specialized knowledge, while allowing SMBs to either cut staff or refocus existing staff on more strategic activities.

- **Starting new projects and responding to market conditions faster:** Managed hosting enables businesses to kick off new IT projects more easily and complete them faster by assembling the right people, at the right time, for the right purpose. Managed hosting can help businesses respond to sudden changes in customer behavior and market conditions, allowing them to scale their technology rapidly to meet changing demands.

- **Focusing on core business competencies, not IT:** Every business has finite financial and human resources. Managed hosting can help transform IT from an operational cost into a strategic tool. It can allow IT to be more relevant to the business, and enable the business as a whole to focus on its core competencies and competitive differentiators.

III. Recommendations

Given the myriad of challenges organizations face as they go online, Yankee Group believes that working with a professional managed hosting provider like Planet Northstar can provide many benefits and a viable, sustainable IT model.

SMBs should evaluate the following factors to determine if managed hosting is right for their online presence:

- **How strategic is web presence/technology or e-commerce to your business?** The success of the modern SMB will depend on its web strategy. The web has proven itself to be a major sales, service and marketing platform, and is no longer limited to large enterprises. The web is a must-have to compete effectively with competitors both large and small. The web also enables entirely new business models, such as Web 2.0- and SaaS-based companies. SMBs should consider how much of their annual revenue is tied to their web presence, either through direct sales or lead generation. Does the web serve as a platform for delivering some or all of your products or services, either to partners or customers? What is the level of online marketing spend, and how much traffic is driven to the site?
- **Is there never enough capital to fund growth and new projects?** Cash flow is a major barrier to most SMBs solving their technology problems. Does your enterprise have a list of projects that would greatly benefit the business, but there never seems to be enough cash to start them? Most projects require a significant upfront capital investment, which places a large burden on mid-sized firms. There is also significant risk in that investment if the project goes sour or if the business decides to change course. Hosted services allow a company to avoid the large upfront investment and pay monthly over time. They can also acquire and shed services as needed without worrying about previous capital investments.
- **Is your firm struggling to keep up with security threats, data privacy and compliance mandates?** A difficult area for most firms to keep up with is security. Transacting business online is more than just creating an online shopping cart. Online businesses are a prime target for hackers, scammers and phishers, leading to such initiatives as the Payment Card Industry (PCI) Data Security Standard and various regulatory requirements that mandate a minimum level of security. These requirements affect businesses large and small equally. The rapidly changing nature of threats requires a constantly changing and updated security strategy. Data leakage of sensitive information has also grown into a large issue as hackers have pursued financial gain. SMBs must take a very candid look at their security posture. How well defended is your network and data? If you aren't sure, then there are probably holes. How many security incidents did you have and what was the response? SMBs should not take solace if they have experienced no recent incidents.

If no one has targeted your firm yet, it is a sure bet someone will eventually. Also, consider if there were a very stealthy intrusion—do you really have the capabilities to detect it?

- **How much downtime have you had in the past year, and what was the effect on the business?** Avoiding downtime starts with a sound foundation and disaster recovery (DR) plan. A resilient infrastructure heads off downtime associated with system failures, human error and unforeseen events before it can impact the business. Highly available infrastructure, coupled with robust disaster recovery (DR), can be very expensive and complicated even for a large enterprise to implement. Most SMBs don't have fully fleshed out and thoroughly tested DR plans, relying mainly on backups, which are inadequate and too slow in today's always-on, web-connected world. Many incidents can be avoided by simply having highly available and redundant systems. This begins with the actual facilities themselves (cooling, power, etc.) and goes all the way up to the network and servers. How much redundancy do you have in your infrastructure? Can you recover to a secondary site? How often do you really test it? Yankee Group research has found that most SMBs only have an improvisational DR plan. SMBs must also consider the risk of downtime. As customers

and partners begin to do business globally, 24x7 over the web, downtime becomes more costly. How much downtime, if any, can you take before revenue is seriously impacted?

- **How much IT expertise can you afford in-house, and what is your core competency?** SMBs must decide where their core competencies lie and what areas of IT are strategic to their business. For most businesses, infrastructure is not strategic but simply an operational burden. For SMBs to succeed, they must align IT with their business goals. This requires IT departments to stop dealing with the operational burdens of managing infrastructure and instead become more strategic by helping the company formulate and align its online strategy. Exhibit 4 shows the current SMB adoption of various types of managed services.

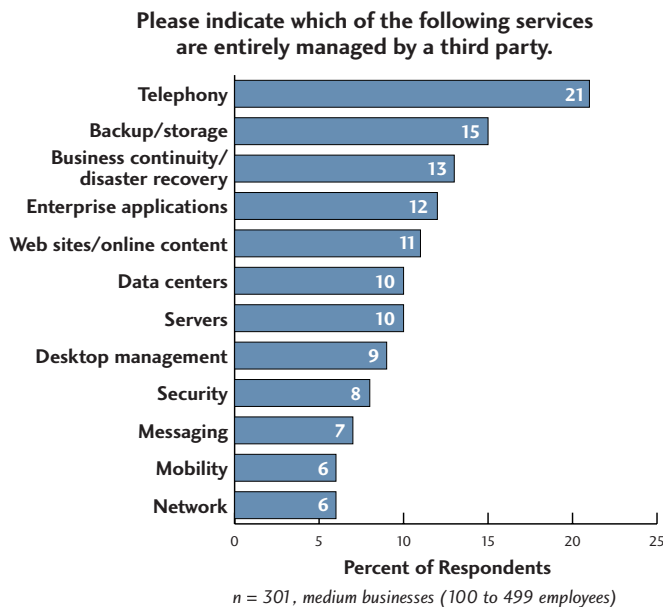
If you've decided that managed hosting is right for you, here are some important things to look for from a managed hosting provider:

- **Does the provider follow a well-defined methodology for how it delivers service?** Simply providing hardware, software and support services is not enough for a hosting provider to become an integrated partner to your business. A truly mature managed hosting provider should follow a best practices framework or methodology when delivering its hosting services. A carefully crafted process will give you confidence that the hosting provider will always follow proven, consistent and documented steps throughout the lifecycle of the hosting experience. Having a methodology is also a sign that the hosting provider is delivering an enterprise-class service that efficiently scales for a large number of clients.
- **Is the provider doing all it can to head off problems before they start?** Anticipating problems before they occur starts with a robust and resilient infrastructure, such as a SAS 70 Type II-certified data center with multiple redundant high-speed links to the internet backbone. Although most customers think mainly of reactive support—which is important, no doubt—proactive support should receive equal consideration. Does the provider have a pre-defined plan for how to scale the online presence and help predict when your infrastructure needs to be bolstered? How much has the provider invested in security and redundancy? How aware is the provider of these issues, and how much detail does it offer? Beware of providers that gloss over the issue and claim that they have great security and redundancy.

Exhibit 4

Current SMB Managed Services Adoption

Source: Yankee Group Anywhere Enterprise—Small and Medium: 2007 US Managed IT and Communications Services Survey



Good providers should be very proud of their resilient infrastructures and should be excited to tell you about themselves. How much experience does the team have with particular environments, and can they easily detail the best practices that they've developed? And of course, ask for customer references to back all of this up.

- **Can the provider function like an extension of your IT staff?** The best providers integrate tightly with their customers and make them feel like they are part of the IT staff. This requires the provider to really listen to the customer and to really get to know their business. Beware of providers that barge in and propose solutions without ever getting to know your business. Inquire about the service and support response times—a crucial factor in customer satisfaction. Does the provider keep you well informed during problem resolution? What level of personnel will be the primary respondents and what is the escalation policy? Does the provider keep an updated run book of processes and procedures on how your environment should be managed? Does the host provide regular account reviews and planning sessions? Is this all backed up by an SLA?
- **Can the host scale up or down with your business?** Scaling is a major problem for most technologies; this is something that a hoster should handle for you. How fast can it expand or adapt your solution if you experience rapid growth or seasonal spikes? Conversely, if the business shrinks or changes strategy, can the provider scale down or refocus easily? Modern infrastructures should be agile, dynamic and on-demand. Providers that can't move quickly enough won't be able to meet the needs of a modern, web-enabled SMB.
- **How flexible is the hoster and what level of customization can it handle?** SMBs will require a wide range of solutions. Many will be fine with an off-the-shelf offering, but many will need some level of customization, ranging from minor to fully custom. Even if you need basic off-the-shelf infrastructure now, as you grow your needs may change. Ask what level of customization is available and the process for managing it. How much expert consultation is available for such solutions? Does the provider really seem to listen and design a solution to meet your specific needs, or are they really trying to force-fit one of its preplanned solutions? Will it provide a level and model of support that will fit into your business plan?

IV. Conclusions

A Capex-Free Future for Web Businesses

With all the competitive challenges and technology demands faced by web-based SMBs today, the possibility of a capital-expense-free alternative for providing world-class IT systems and services is extremely viable. Because the success and growth of these companies is limited most by a lack of capital, providing an alternative to buying, housing and maintaining IT systems through managed hosting provides a competitive edge in a global marketplace.

By offering enterprise-class IT systems and services for a monthly fee, managed hosting helps to level the playing field as well as improve the technical capabilities of businesses that until now could not afford to match their larger competitors. By using the services developed by providers such as Planet Northstar, companies can overcome resource constraints that might have limited them in the past. They can look forward to a future where IT systems can be leveraged for less upfront money and with less risk, to the greater benefit of commerce and presence on the internet.

Yankee Group

Yankee Group has research and sales staff located in North America, Europe, the Middle East, Africa, Latin America and Asia-Pacific. For more information, please contact one of the sales offices listed below.

Corporate Headquarters

Prudential Tower
800 Boylston Street
27th Floor
BOSTON, MASSACHUSETTS 02199
617-598-7200 phone
617-598-7400 fax
info@yankeegroup.com

Europe

56 Russell Square
LONDON WC1B 4HP
UNITED KINGDOM
44-20-7307-1050 phone
44-20-7323-3747 fax
euroinfo@yankeegroup.com

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