Everest Group®

Outsourcing Pricing Trends in a Post-Pandemic World

March 18, 2021

Introductions

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Our convictions

1 Enterprises are pursuing aggressive cost take-out, targeting immediate relief and structural savings

2 Significant supplier rationalization and RFP activity is underway, focused on Agile and managed services

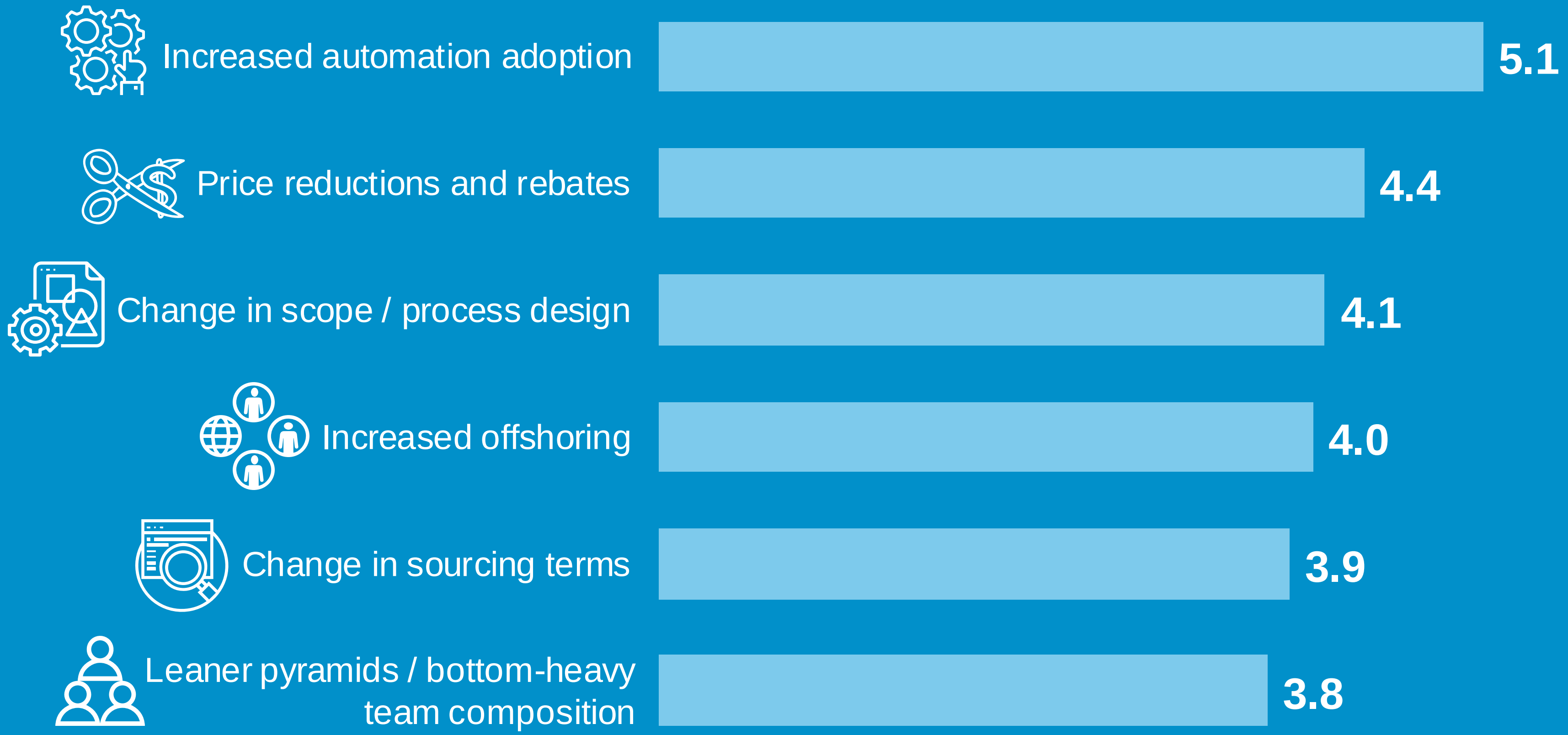
3 The window of opportunity for extracting deep concessions from suppliers is closing rapidly

4 Contract simplification focusing on committed impact and outcomes is becoming a consistent theme

5 Ongoing focus on keeping pricing tenets current will be critical for enterprises

Key Solution Levers Buyers Are Using to Renegotiate Outsourcing Contracts

Average extent of use on a scale of 1 (low) to 7 (high) from March 2020-21



The Window Is Closing to Lower Outsourcing Contracting Pricing

Top areas of pricing contraction
March 2020-21

1. Business Process Outsourcing (BPO)
2. Infrastructure
3. Application management
4. Consulting / professional services
5. Application development

Context setting

Focus of this webinar

- Are you continuing to pay the same as you did back in 2020?
- What should you focus on – rates negotiation or changes in commercial models?
- How do you plan for the coming months?

Sources for today's webinar

- Everest Group's recent sole-sourced and competitive deal advisory experience
- Perspectives from recent mid-tenure contract and strategic engagement reviews
- Discussions with multiple enterprise strategic outsourcing stakeholders

Discussion points for today

What has changed in the past year?

- Supplier rationalization initiatives
- Aggressive enterprise negotiation posture
- Increased use of market intelligence and benchmarking

The impact on pricing

How to plan for the coming months

Q&A

Enterprises have used the past year to extensively drive vendor portfolio rationalization…

Top 5 typical objectives behind these efforts

Control cost

- Better pricing due to competitive tension and spend concentration
- Reduced overheads and flexible contract terms
- Commitment to price certainty and commercial risk absorption

Access preferred skills and IP

- Preferred access to skill pool and associated IP
- Faster scalability across multiple geographies

Implement new operating/delivery models

- Engage with partners that are aligned on strategic objectives
- Implement new-age delivery models such as Agile and DevOps
- Move to managed services with *"skin in the game"*

Improve service integration

- Significantly fewer providers
- Lower vendor management effort
- Common processes and reporting mechanisms

Manage risk considerations

- Current exposure and criticality
- Reduce concentration and transition risk
- Cater to specific business requirements

...and on a related note, have made significant efforts to drive *simplification* and elimination of ambiguous commercial models

Reshaping of commercial models to keep pace with business needs

Innovation

1. Quantified view of innovation – clarity on % of TCV investment, the plan, and specific buckets
2. SLA metrics tracking the # of innovative ideas brought forth and implemented

Committed efficiency improvements

3. Improvements front-loaded into Year 1 and locked into the fee profile
4. Clarity on levers, associated dependencies, and sensitivity impact should any factors change

Business model changes

5. Ease of adding or removing services, with minimal impact on deal-level improvements
6. Ability to absorb wider volume shifts and change service level metrics as needed

Competitive landscape

7. Platform-as-a-Service providers offering services that compete with traditional suppliers
8. Clarity on who does what and best ways to drive orchestration as lines are blurring

Negotiation objectives have – for most part – moved from balanced to hypercompetitive

Supplier financial performance is looking up in terms of revenue growth and profitability

Enterprise clients are using it as a basis for tough deal posturing

Enterprise perspective

- Aggressive cost reduction targets in place for 2021 across enterprises
- Use of RFPs and real-time eAuctions to drive down pricing to the level needed to meet those targets
- Want to lock pricing in before it starts going back up again

Supplier perspective

- As expected, strong pushback from suppliers
- Leeway exists for some clients, but others may already be closer to the bottom range of market pricing
- Open to look at win/win themes to help drive transformation/change rather than straight haircuts

This tougher stance has been made possible by use of market comparables/benchmarks *even in competitive bid situations*

Traditional use of market comparables and benchmarks

Contract-mandated benchmarking
Once every 18-24 months, jointly paid for by both parties and as per the benchmarking clause

Median as the typical good
Most enterprises would settle for an overall market median level as acceptable

Standard rates-focused benchmarking
Focus on the P, i.e., the price part of the equation

Current use of pricing analytics to drive decisions

Alternate viewpoint in RFX situations
Independent viewpoint before embarking on an RFX initiative to be one step ahead

$10^{th}/20^{th}$ percentile the new good
For tough negotiators, the 20^{th} percentile of market could be the starting point now

Interest in understanding sizing metrics
Added focus on the Q, i.e., the quantity of service units or resources required

What is the level of Work From Home (WFH)-related price adjustment being passed on to you?

- Increase of >10% - **2%**
- Increase of 6-10% - **7%**
- Increase of 1-5% - **2%**
- No change (0%) - **63%**
- Decrease of 1-5% - **16%**
- Decrease of 6-10% - **7%**
- Decrease of >10% - **2%**

As WFH norms and processes have stabilized, enterprises are expecting the cost benefit to be passed on to them

TYPICAL RANGES – COULD VARY PER SITUATION

Levers that impact cost	Real estate infrastructure		Technology infrastructure		Other savings		
% cost impact	↓ 6-8%	+	↓ 0-1%	+	↓ 1-2%	=	**7-11%**
Components	• Suppliers have repurposed real estate leases to align with the hybrid delivery model • Up front investment in adding new campuses/more space has declined materially		• The additional cost of laptops/VPN and high bandwidth connections has stabilized • Some savings are accruing through lower office technology expenses on printers, desktops, etc.		• Lower cost on transport, facilities management, utilities, and team entertainment • Some support function requirements have also declined due to hybrid model		

Suppliers are passing on savings of 5-8% based on the positive impact of hybrid WFH operating model

Discussion points for today

What has changed in the past year?

The impact on pricing

- Material drop in rates for certain role types
- Use of granular pricing units for selected IT infrastructure services
- Aggressive BPO deal TCV reduction commitments

How to plan for the coming months

Q&A

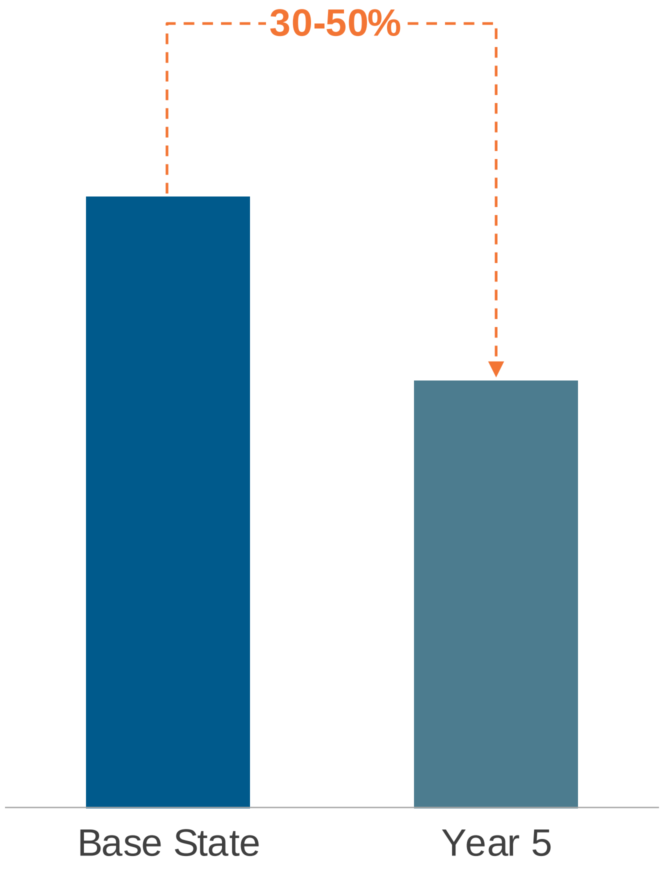
Significant reduction **in day rates for selected IT and consulting roles**

Role types	**Support roles** (Application support, DBA, application operations, etc.)	**Digital focused roles** (Data scientist, scrum master, RPA, etc.)	**Consulting** (Technology consulting, Business consulting, etc.)
Average change in offshore rates (since Mar 2020)	↓ **7-9%**	↓ **4-5%**	↓ **6-8%**
Average change in onshore rates (since Mar 2020)	↓ **3-4%**	↓ **3-4%**	↓ **5-6%**
Comments	Commoditized roles, often contracted for on a long-term basis coupled with good availability. Enterprises have used competitive tension to drive down rates.	Skill availability has improved materially, and suppliers can no longer charge the kind of premiums they used to.	Mostly discretionary spend, which came under strict scrutiny during most of 2020 and has stabilized at lower rates than a year ago.

Consulting rates dropped even more severely from April through September 2020, but that was a temporary phase; discounting of ~15-25% was common

30-50% productivity and efficiency related savings over a 5-year deal term appears more like the starting point

% ACV reduction over 5 years



Higher offshoring

In the last 12 months, we have observed overall offshore leverage increasing from 80-85% to 90-95% in many deals. In some cases, it has even been as high as 98-99%.

Implementation of advanced automation solutions

Service providers are proposing advanced automation and self-heal solutions to provide better year-on-year savings.

Bottom-heavy team pyramids

We have also seen service providers leaner and bottom-heavy team pyramids.

Lean governance layer

In many recent deals, we have observed a very lean onshore governance layer comprising a few focal resources to optimize the overall deal pricing.

Instances of “unreal” commercial offers on deals have become a common occurrence

Hyper-competitive pricing

In the past 12 months, we have observed a few instances in which providers offered extremely competitive pricing (~9-16% lower than the 20th percentile of the market benchmarks). In these cases, the providers often made low single-digit or negative margins in the initial couple of years with a about a two-year payback period.

Key characteristics of these extremely aggressive commercial offers

>55-65%
5-year deal ACV reduction via automation, analytics, and process improvement

Zero
Zero transition fees (considered an investment by the service provider)

>4-5%
Investment into an innovation fund by the service provider through the deal term

High-risk service credit regime
>300% severity weight and >15% fees at risk

Within IT Infrastructure, traditional services are seeing price pressure, yet others are seeing healthy demand and price uptick

Service types	**Traditional infrastructure services** (Traditional compute, storage, DB administration, etc.)	**Digital workplace services** (Endpoint support, onsite break fix, messaging and collaboration, etc.)	**Cloud and security services** (Hybrid cloud, cloud migration, cloud security, etc.)
Average change in rates in USA (since Mar 2020)	7-9%	+/- 0-2%	4-7%
Comments	Even though underlying resource rates remained steady, the impact of discounts and delivery efficiency was passed on in the form of lower unit-based pricing (per server, per call, etc.).	Remote working boosted the demand for collaboration platforms and greater adoption of advanced digital experience management platforms, so the unit rates remained steady.	Pricing for cloud and security services has increased – in spite of COVID-19 – as enterprise clients continued to spend on large-scale technology transformation projects.

For next-generation infrastructure services, discrete granular pricing metrics have emerged to maintain better controls on spend drivers

Resource unit-based pricing in cloud and infrastructure services contracts has become significantly granular and business aligned for most services such as Cyber-security

	THEN	NOW
Business-aligned and contextual RUs	Fixed fees for managed PaaS services	Price per Lambda function Price per DynamoDB table Price per Kinesis data source Price per Azure AKS pod
Black-box fixed fees into discrete RUs	Fixed fees for security services	Price per EDR endpoint Price per user for CASB platforms Price per EPS (for SIEM) Price per Grey Box Pen Test

How do your IT Infrastructure services rates compare?

Get a complimentary price check for selected Output Based Resource Units
(for enterprises only)

2 Resource Units
from a set of 6 IT areas

- Workplace services
- Server management
- Service desk
- Storage and backup
- Private cloud
- Public cloud

Across 3 geographies

- Onshore
- Nearshore
- Offshore

Day rates for BPO services have been stable or have decline slightly, but there is an aggressive focus on TCV reduction

Underlying rates (P) have been relatively stable…

Minimal change (+/- 0-2%)
- Complex F&A services
- Category sourcing services
- Supply chain BPO services
- Banking back-office services

Minor reduction (2 - 4%)
- Voice-based customer support
- Transactional F&A services
- Procurement operations services
- Insurance claims services

…but significant impact on Q and structural changes are impacting TCV

For any upcoming BPO new deals or renewals, how important is moving to some kind of unit-based pricing?

- Not important at all – **9%**
- Early stages of consideration – **27%**
- Advanced stages of consideration – **24%**
- Decided on unit-based pricing – **15 %**
- Already the de-facto mode for us – **25%**

For new (high-volume) BPO deals, there appears to be a distinct pivot to use of more output- and outcome-based pricing…

NOT EXHAUSTIVE

Output-based pricing trends

Unit-based pricing becoming common for large, multi-geography deals with significant **scale** and relative **standardization**

Many enterprises **avoid sharing current FTE numbers** and provide only service volumes to bidders

Proliferation of **multiple resource units** for pricing, many of which could be **bespoke** – making it complex to benchmark!

While there are some instances of enterprises moving back to FTE-based, it is more of a **correction (chose wrong processes)**

Outcome-based pricing trends

For **pure outcome-based** pricing models (direct monetary impact), supplier willingness to reduce any fixed part of the fee

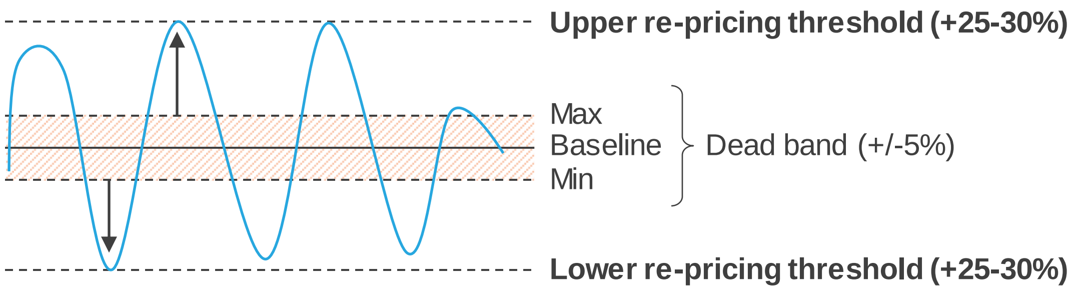
Stronger, more direct linkage of fee at risk to **CSAT** or other **user experience metrics**

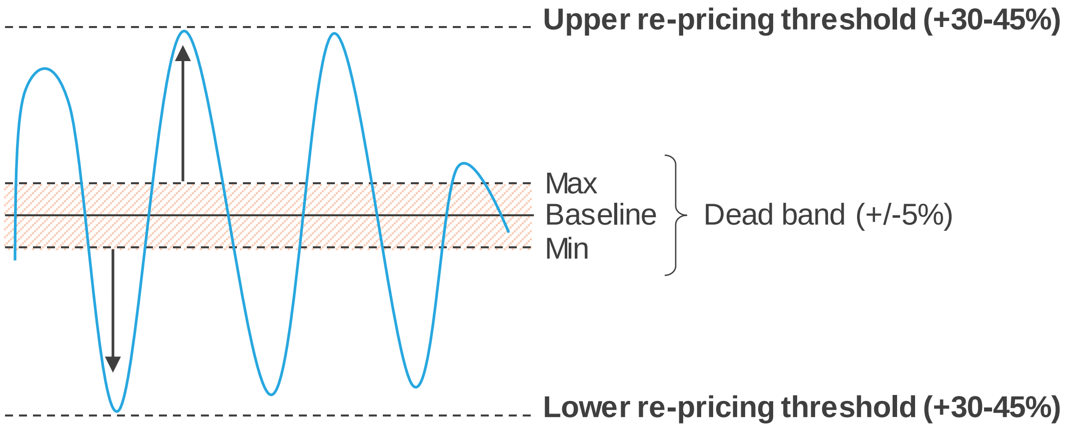
Gradual increase in % fee linked to any **improvements** or **milestones** (DSO reduction, better reporting compliance, etc.)

Zero-investment transformation (truly self-funded, or as a digital FTE) models being piloted to deliver value in cash-crunched times

…coupled with flexibility in commercial tenets to easily handle volume fluctuations and service level change requirements

Enterprises want a much higher ARC/RRC re-baselining threshold than the typical 25-30%; asking the suppliers to be able to absorb wider swings in service volumes





Contract flexibility to incorporate elements such as service level changes without complex renegotiation

Contract change note (or other easy mechanism)

- Addition of new metrics
- Removal of existing metrics
- Redistribution of service credit allocation percentage
- Demote critical service levels to key performance indicators and vice versa

Discussion points for today

What has changed in the past year?

The impact on pricing

How to plan for the coming months

- Don't let pricing go out of market range
- Challenge pockets of price inefficiency and align incentives
- Explore targeted supplier rationalization

Q&A

Ensure a constant review of commercial competitiveness, as milestone-based benchmarking could be sub-optimal

Pitfalls in one-time, milestone-based benchmarks

Enterprises could be in permanent catch-up mode compared with market norms

- Significant cost and time investment to select benchmarker and execute
- Enterprises could overpay for years before an objective correction/recalibration happens
- Even after that, the gap is rarely closed, and it is down to the discussions between both parties

Why an ongoing focus on pricing is needed

Contracts and associated engagement/pricing models are constantly evolving

- Multiple change requests and addition of scope instances during a contract's tenure
- Constant requirement for quick validation on topics such as indexation, skill premiums, etc.
- Significant value capture opportunity at multiple points as the contract progresses

Adopt a seamless mechanism to constantly gauge where the market is and use it to constantly adjust terms with the suppliers. The longer the delay, harder it is to correct!

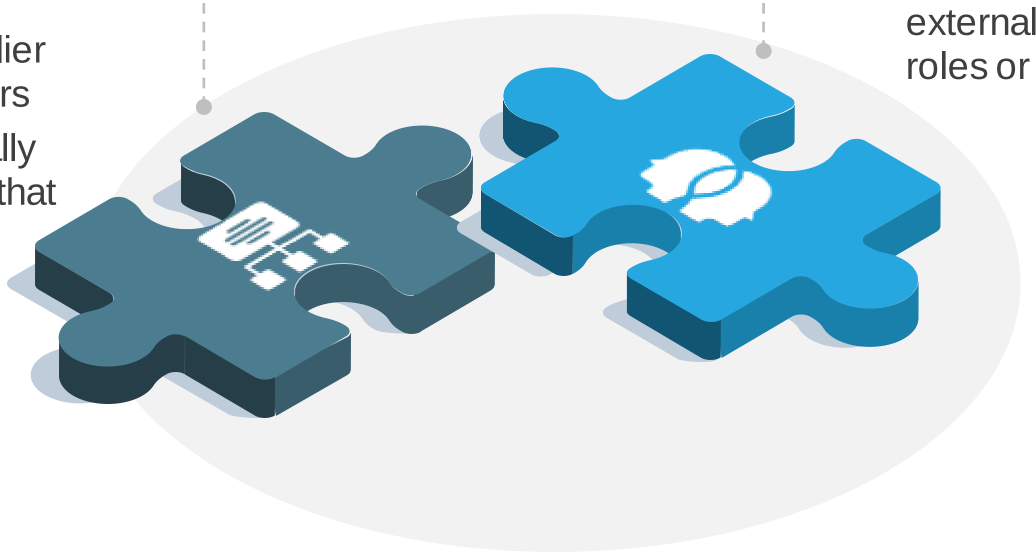
Challenge the status quo – pockets of well guarded high pricing could be the key reason for portfolio spend bloat

NOT EXHAUSTIVE

ARCHETYPE 1

Specific business units / product groups

- Generally, have niche or uncommon requirements (or so they believe!)
- Averse to supplier consolidation
- Tend to have a fragmented supplier base, consisting of small providers
- Highly likely to be paying materially more than market rates for what that supplier tier would be



ARCHETYPE 2

Large incumbent with strong relationships

- Typically operates with minimal competition and is well-versed with the organization
- Open to provide flexibility and ease in ways of working, so generally stakeholders have a good level of comfort
- However, over time, the lack of competition or external objective review could lead to some roles or services being outrageously overpriced

Loyalty *should* be rewarded…so the book of business discounting model should be aligned to contemporary norms

SOME ACTUAL NUMBERS REDACTED

Annual invoice spend (in USD millions)		**Pre-Covid** Market benchmark discount ranges		**Current norm** Market benchmark discount ranges	
		Low	High	Low	High
1	**5**	0%	[redacted]	[redacted]	[redacted]
5	**15**	[redacted]	[redacted]	[redacted]	[redacted]
15	**25**	[redacted]	[redacted]	[redacted]	[redacted]
25	**35**	[redacted]	[redacted]	[redacted]	[redacted]
35	**45**	[redacted]	[redacted]	[redacted]	[redacted]
45	**75**	[redacted]	[redacted]	[redacted]	[redacted]

Enterprises are pushing for a significant change in book of business discount rate

- This is one of the multiple levers for cost control and incentivizes suppliers to put forth a compelling commercial offer in lieu of greater wallet share
- For lower spend ranges, we have seen a net increase in 1-1.5 percentage points from pre-COVID norms
- For higher spend ranges, the net increase has been as high as 3-4 percentage points from pre-COVID norms

While there may be a few exceptions, we are seeing a general trend where service providers are willing to offer higher discounts for more annual invoice spending

Simplify the linkage of incentives with outcomes based on the underlying scenario; do not force-fit!

	Scenario 1: Pure outcome-based models, where the fee can be linked to monetary impact	Scenario 2: Risk-reward mechanisms to drive right behaviors/objectives
Applicability	Very clear and direct linkage of service performed and the achievement of monetary/business benefits by the enterprise client	Can be structured as add-ons to other simple pricing models, as long as some operational efficiency can be codified and attributed to the service provider
Examples	• Fee linked to improved healthcare enrollment rate • Fee linked to # of leads or sales generated • Fee structured as % of RCM revenue recovered • Fee structured as % of recovery for banks or utilities • Fee linked to procurement-driven cost reduction	• Bonus linked to CSAT/NPS improvement • Bonus linked to payout for early completion of a milestone (which impacts UX or time to market) • Gain-share linked to ticket reduction or overall AM cost reduction • Risk-reward approaches for joint investment
	These are high risk and are much harder to implement; trying to apply them to immature/unsuitable situations can backfire	**Relatively lower risk and can be typically applied in a wider range of situations**

Leverage targeted supplier rationalization initiatives to achieve better rates and streamlined contracts

Baseline supplier performance	Assess price competitiveness	Introduce market competition	Negotiate and decide on way forward
Identify poor performers	**Highlight value leakages**	**Prepare alternative offers**	**Assess and close**
• CSAT and other experience measures • SLA and key metrics performance • Innovation and business outcomes delivered	• Variable resource unit rates or person rates • Commercial terms & conditions • Justifiability of any premiums or pockets of high pricing	• One large RFP or multiple smaller ones • Get bidders to put forth competitive fee positions • Quantify the transition risk, to tactfully unravel the comfort zones	• Align with business on decision criteria • Negotiate with incumbent and/or preferred challengers • Re-contract or transition (based on the situation) at better terms

Discussion points for today

- What has changed in the past year?
- The impact on pricing
- How to plan for the coming months
- Q&A

Everest Group assists procurement teams in capturing value from their services spend through memberships and focused projects

Memberships

Outsourcing Excellence

*Best-in-class **market intelligence** to maximize value from technology and operations outsourcing*

- Sourcing strategy / provider portfolio
- Solution design
- Risk management

Pricing as a Service

*On-demand **price benchmarks** and performance analytics to maximize outsourced spend reduction*

- Pricing and cost
- Performance management
- Policy and contracting

Projects

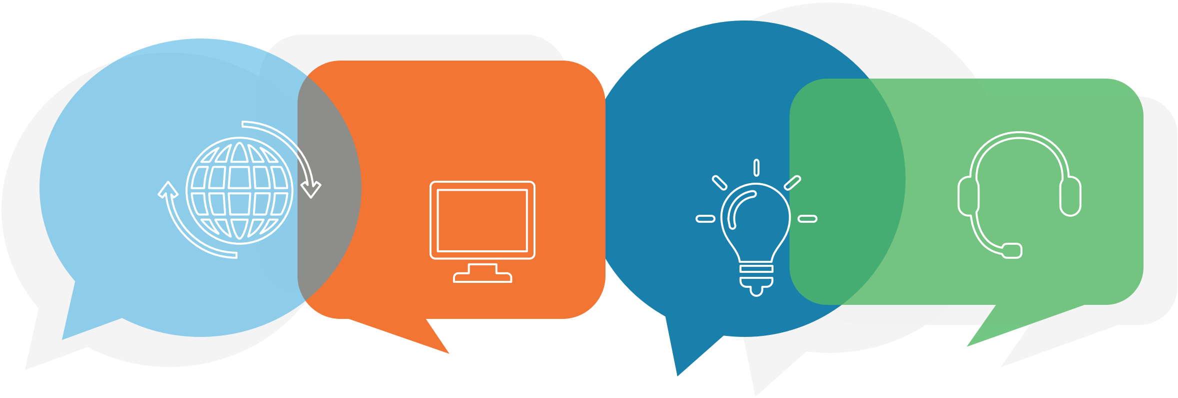
Time to value

Near-term (<6 months)

- Rapid cost take-out
- WFH playbook
- Third-party resource strategy
- Sourcing waste assessment
- Price benchmarking

Medium-term (>6 months)

- Workforce strategy
- Outsourcing advisory
- Location portfolio strategy
- Provider rationalization
- Repatriation / Insourcing



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- Type your question in the dialogue box, then select **Send** to submit the question to our session Organizers/Panelists

- Attendees will receive an email with instructions for accessing today's presentation
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Peter Bendor-Samuel

Founder & CEO

Enterprises Rethinking Approach to Third-Party Service Relationships and Contracts | Blog

JANUARY 7, 2021 | SHARE

After the initial r
provider firms fo
they realized.

Read more in my

Amy Fong

Vice President, Sourcing and Vendor Management

Aligning SLAs with Business Objectives – Four Pitfalls to Avoid | Blog

FEBRUARY 5, 2021 | SHARE

Service-level agreements (SLAs) today should be established to ensure that service provider performance aligns not only with mutually agreed-upon terms but with clear benchmarks and service levels that match a company's business goals. These days, agility and flexibility are central themes for all industries.
These themes als
activities, functio

In this blog, we'll
that companies a
metrics, identifyi
opportunities to

Akshay Pandita

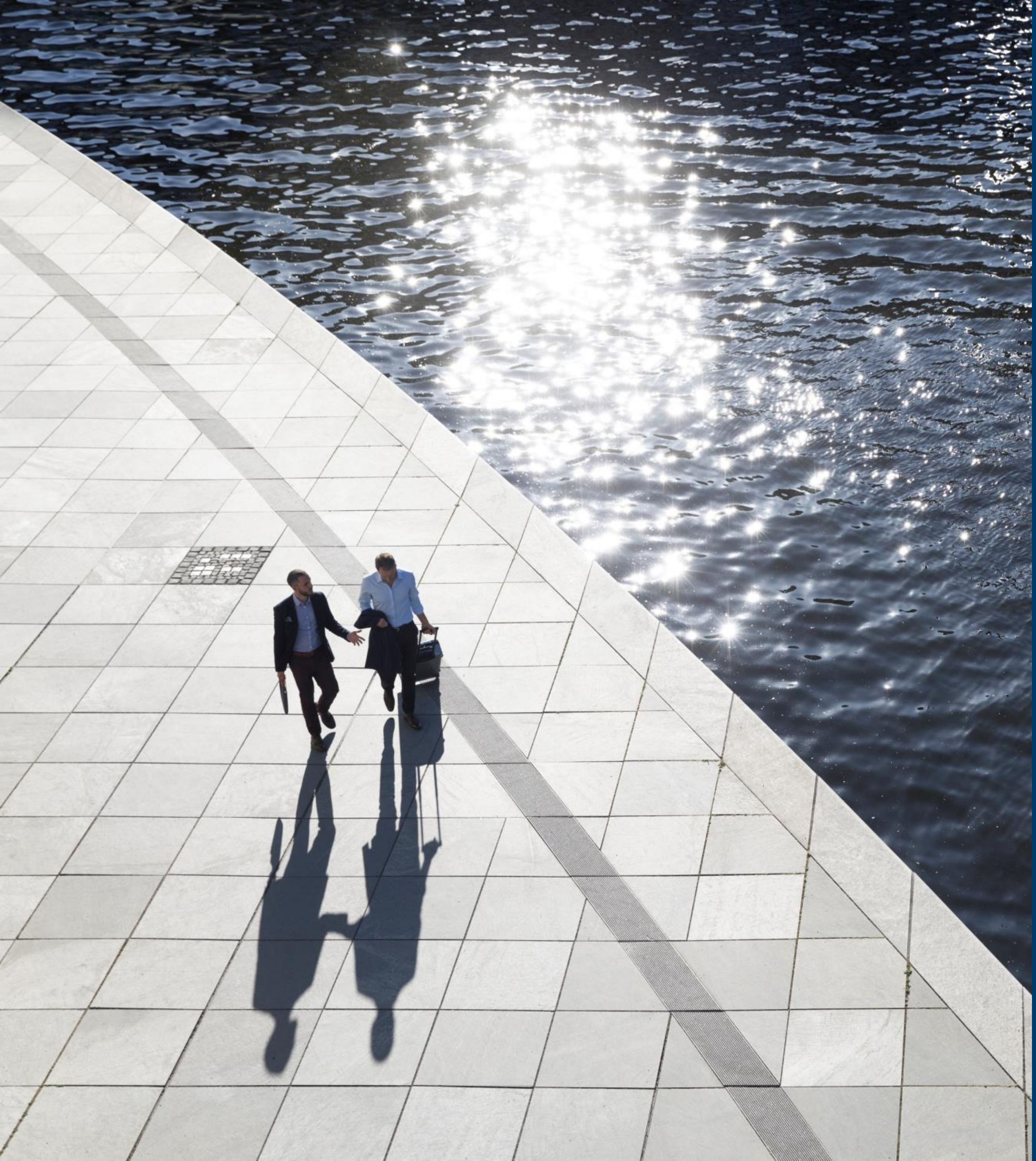
Practice Director

New India Department of Telecom (DoT) Guidelines for Remote Delivery Are a Game Changer | Blog

NOVEMBER 19, 2020 | SHARE

One of the key factors that has helped maintain service delivery levels in India – even during the peak of the COVID-19 lockdown – has been the government's temporary relaxation of various legal, regulatory, and compliance frameworks to allow remote delivery via a Work From Home (WFH) model. In an effort to continue to increase the ease of doing business, especially with a remote workforce model, India's Department of Telecom (DoT) has issued new guidelines for the IT-business process (BP) industry.

These guidelines should significantly reduce obstacles for companies adopting a WFH delivery model. In the post-COVID-19 era, scaled WFH adoption will be inevitable for IT-BP organizations as we highlighted in our previous blog. In our conversations with industry stakeholders, organizations have called out uncertainties around long-term legal and regulatory support to WFH as a key challenge to sustainable and scaled adoption. The new guidelines can be the steppingstone to assuaging some key business concerns, making these organizations truly bullish on WFH adoption.



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