Outsourcing Pricing and Attrition

April 21, 2022

Discussion points for today

Factors impacting attrition and outsourcing pricing

Managing outsourcing pricing

The way forward

Q&A

- Talent shortage
- Outsourcing price increase

Talent crunch in Europe

Key business challenges expected in 2022 – Europe enterprises

Percentage of respondents selecting highly challenging

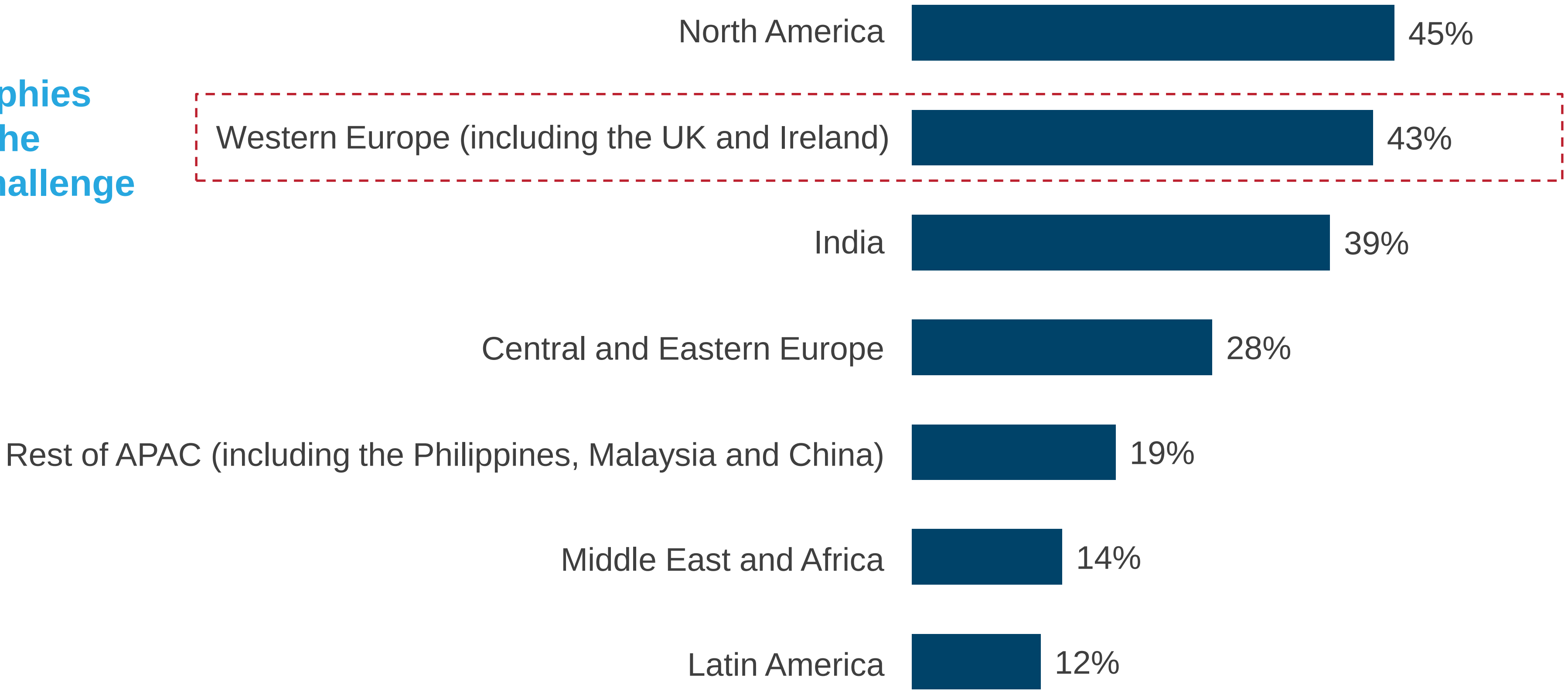
2022 rank	1	2	3	4	5
	Talent/skills shortage	Price/cost pressure	Adapting to new business models	Regulations in key markets	Slowdown in customer decision making
2021 rank	7	2	1	5	3
2020 rank	5	1	2	3	4

Source: Everest Group 2022 Key Issues Study.

The talent shortage is global but demonstrating differently by region

Top geographies with talent shortage challenges
Percentage of respondents selecting most challenging

Geographies facing the most challenge



Source: Everest Group 2022 Key Issues Study.

The talent shortage has spread beyond IT and high-end digital skills

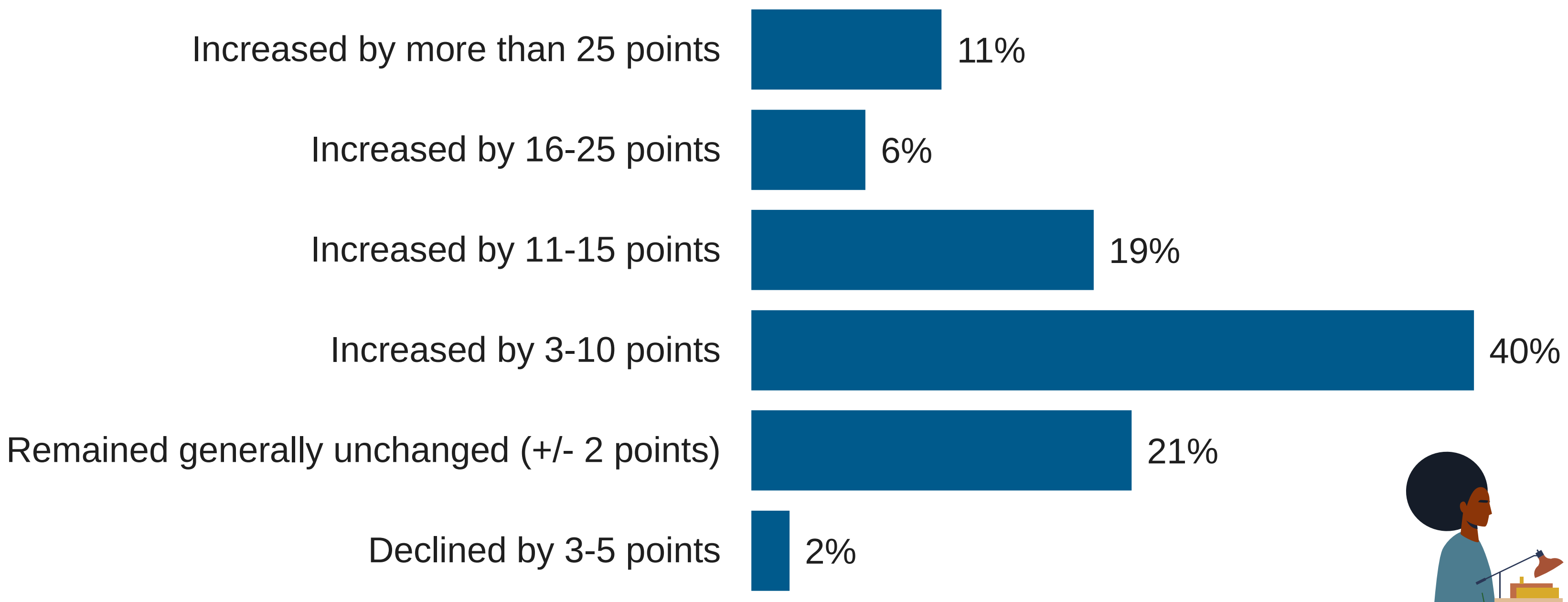
Top segments with talent shortage challenges
Percentage of respondents selecting as challenging

The problem seems to be pervasive

Associates: <2 years of experience **Senior associates: 2-6 years of experience
Source: Everest Group 2022 Key Issues Study.

As a result, attrition across industries is at a record high

Attrition rate 2021*; percentage



EXIT

Average attrition change

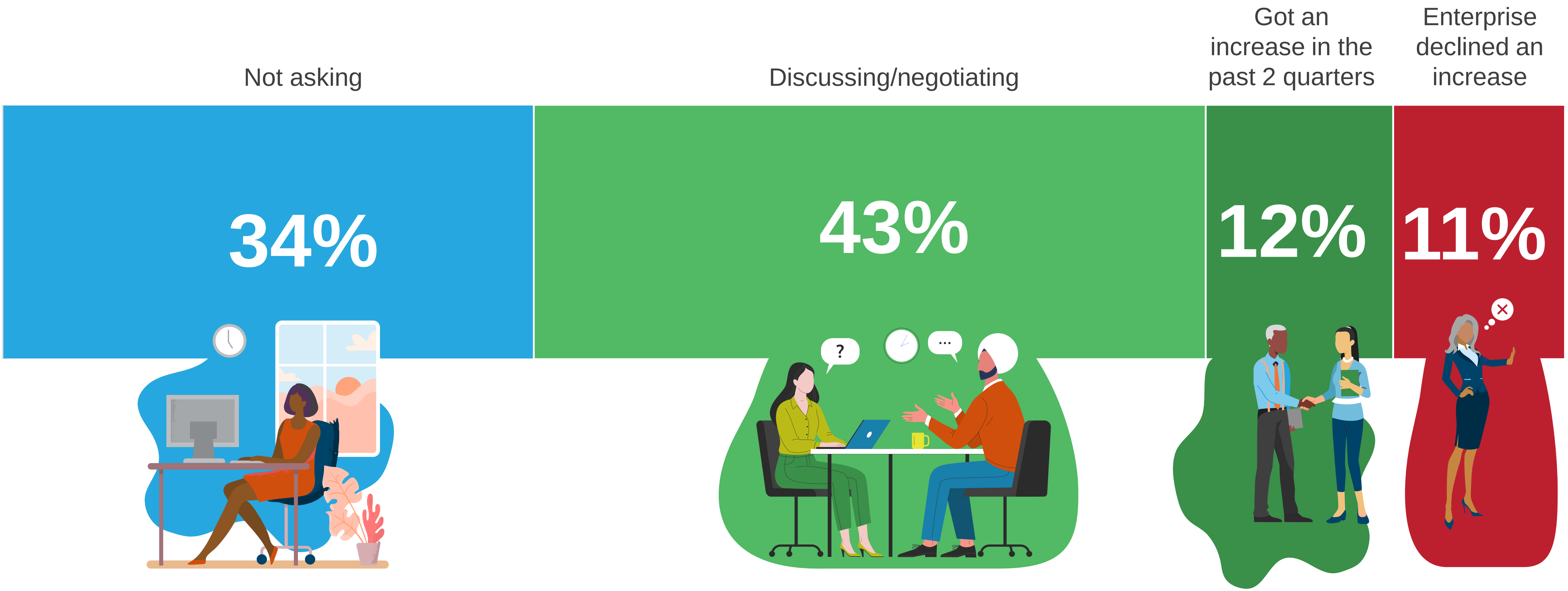
+10.5 points

* How have attrition levels in your organization changed (in percentage points) in the last three months? (For example, if attrition was 15% prior to the last three months and has risen to 25% in recent months, it has **increased by 10 percentage points**.)

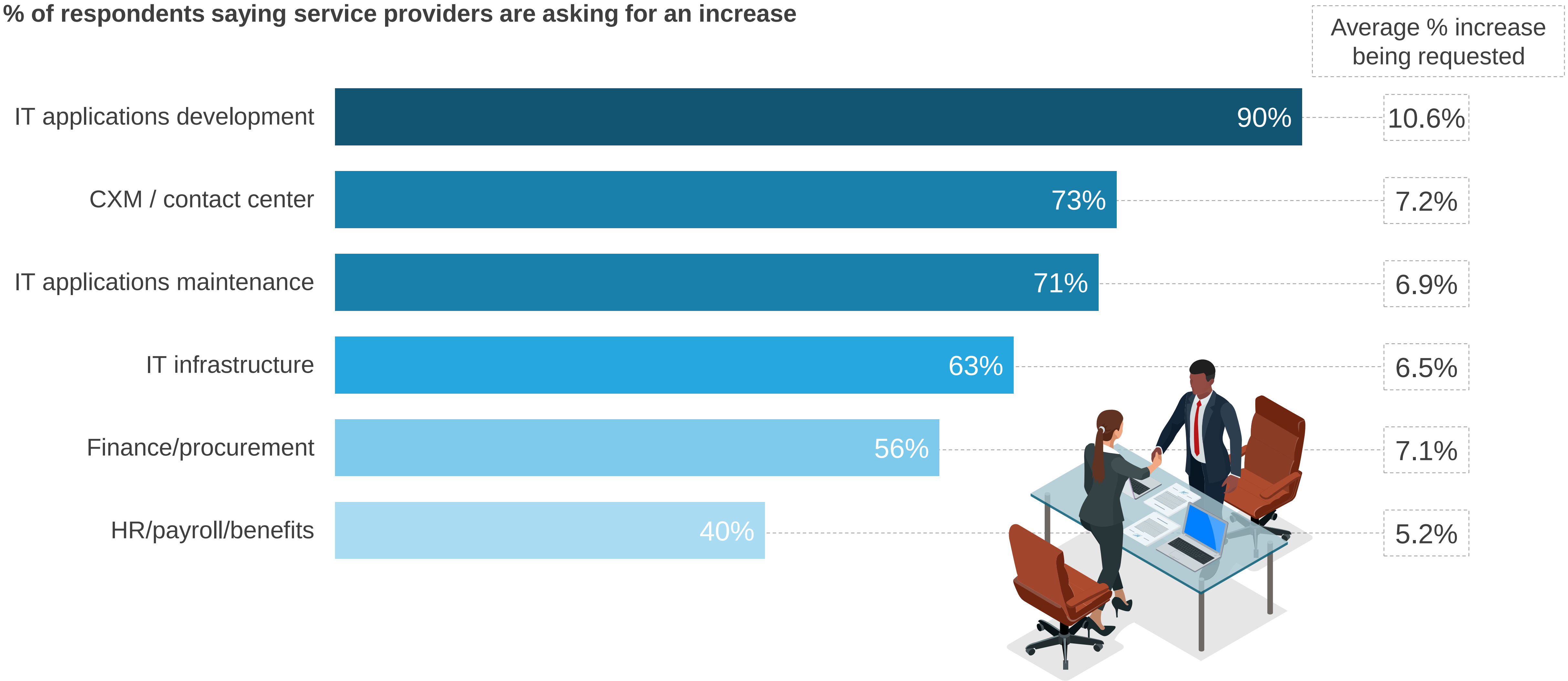
Source: Everest Group quick poll

A large proportion of enterprises have already been approached by service providers and a majority of them are conducting educated negotiations

% of respondents saying service providers are asking for an increase



Service provider-requested rate increases, by function



We expect pricing for IT services in Europe to rise further over the next 12 months…

Generic IT application skills	Generic IT infrastructure skills	Specialized IT skills
Examples: Java, .NET, PHP, manual testing	Examples: compute, storage, workplace, helpdesk	Examples: open stack, docker, cloud native app dev, cyber security, Kubernetes
Trailing 12 months		
3-5%	1-3%	4-6%
Next 12 months outlook		
3-5%	2-5%	5-8%

- Overall, we anticipate a high wage inflation market in the near term
- We expect a price correction in the previously signed hyper competitive deals, especially for onshore locations
- Specialized skills are a seller's market, with many buyers acceding to price increase demands to ensure a steady supply of resources

...and a similar pricing trend for BPO services in Europe, with some variations across segments

Transactional F&A processes	Complex/judgement-intensive F&A processes	Customer and sales support
Examples: accounts payable, accounts receivable, fixed assets	Examples: FP&A, internal audit, treasury	Examples: technical support, customer support, loyalty and retention
Trailing 12 months		
2-4%	3-5%	3-6%
Next 12 months outlook		
2-5%	4-6%	4-7%

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5 steps to managing high outsourcing spend

#1: Benchmark contracted pricing against *current market rates* as managing rate increase requests requires a precision-based approach

How competitive is your deal already?

Some enterprise clients may already be paying their providers much higher than market ranges. In such cases, it is important to not blindly agree to rate increase requests.

The converse could also be true; a super-competitively negotiated set of rates should be examined for equitable increases.

What are the most impacted scope areas?

Wage inflation is not the same across every skill set or geography.

Enterprises should assess the most critical skill sets for their businesses and determine which are seeing the most significant talent shortages. This process will help to prioritize focus areas for rate discussions.

What is the justifiable magnitude of increase?

Use **contemporary price benchmarks** to ascertain the correct increase for each location and function.

Avoid paying specialty skill premiums for mature skills and avoid across-the-board rate increases.

#2: Calibrate the automation charter against market best practices

- The nature and extent of automation being leveraged in the industry has been increasing consistently over the last five to six years
- Automation elements that were a novelty three years ago are table stakes now
- It is imperative for enterprises to constantly push providers to increase the use of automation in their solutions

IT APPLICATIONS EXAMPLE

Tools and accelerators	2014-15	2016-17	2018-19	2020-21
E2E automation orchestrator	✓	✓	✓	✓
Point or wrapper solutions	✓	✓	✓	✓
Reporting dashboards	✓	✓	✓	✓
Intelligent knowledge management		✓	✓	✓
Autonomic problem resolution		✓	✓	✓
Automated test generation and execution			✓	✓
Conversational chatbots			✓	✓
Integrated DevOps toolchain				✓
Self-heal or self-service solutions				✓

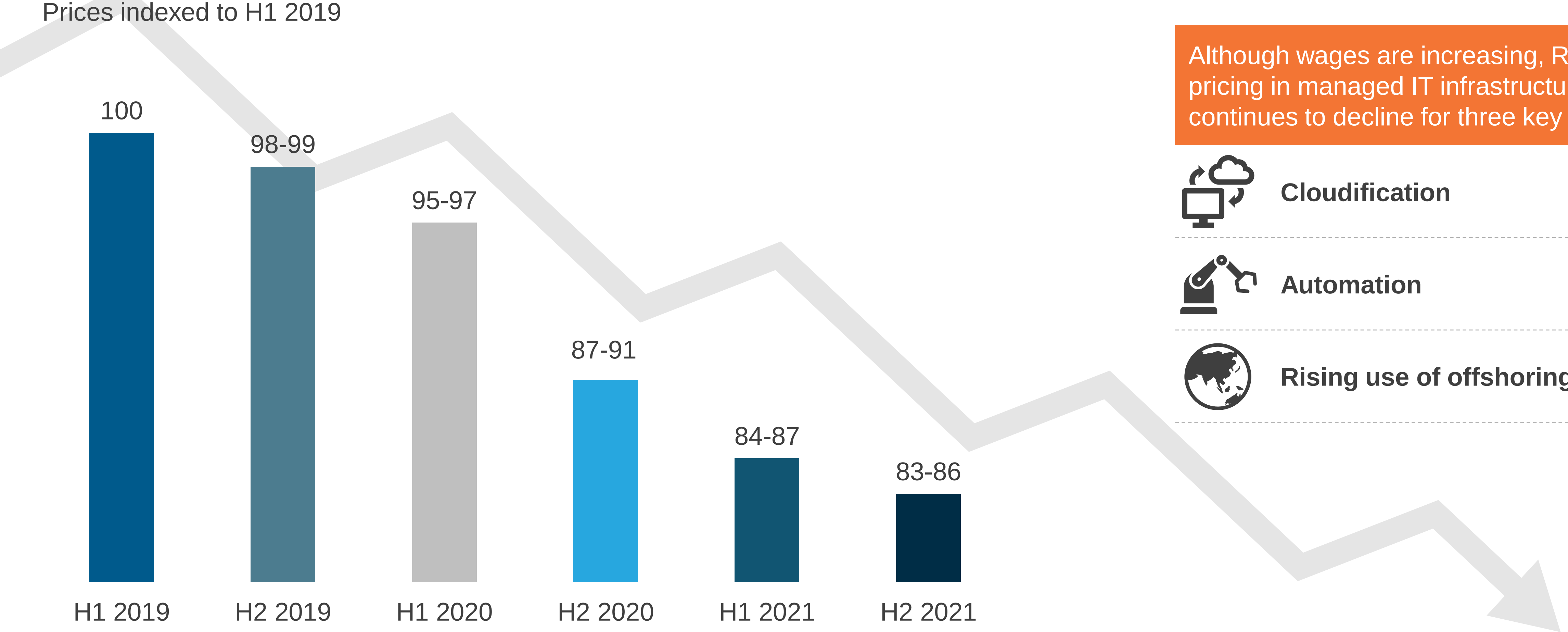
#3: Review your engagement model and/or the pricing mechanism; input- and FTE-based models are simple but most susceptible to rate increases

	Input-based	Output-based	Outcome-based
Key characteristics	• Customers pay for the time and resources leveraged as an **input** into the solution • Easy to implement • Limited innovation and value articulation possibility	• Customers pay for the operational **output** • Provides assurance around paying for deliverables, not time • Incentivizes the provider to innovate/automate to improve margin	• Customers pay based on the **business outcome** • High risk, hard to implement, but immense business impact if done right
Typical examples	• Managed capacity • Time & material (staff augmentation / advisory roles) • Time & material (projects such as implementation or run support)	• Fixed price (for a particular set of volumes or defined deliverable) • Resource unit-based pricing – per server, per call, per user, application-based pricing • Menu-based or package-based pricing (service catalog) • Unit-based pricing (ticket, per story point, etc.) • Fixed + variable hybrid	• (Fixed + variable) fee linked to percent of savings achieved, or other impact metrics being met – For example, fee linked to accuracy in predicting wear and tear of a part (ER&D services) • Purely variable fee linked to percent of savings achieved, or other impact metrics being met
Operational visibility	**High**	**Low to Medium**	**Low**

#3: Moving to managed services or output-based pricing can help enterprises manage the price impact in the medium term

IT INFRASTRUCTURE EXAMPLE

Compute services pricing trend
Prices indexed to H1 2019



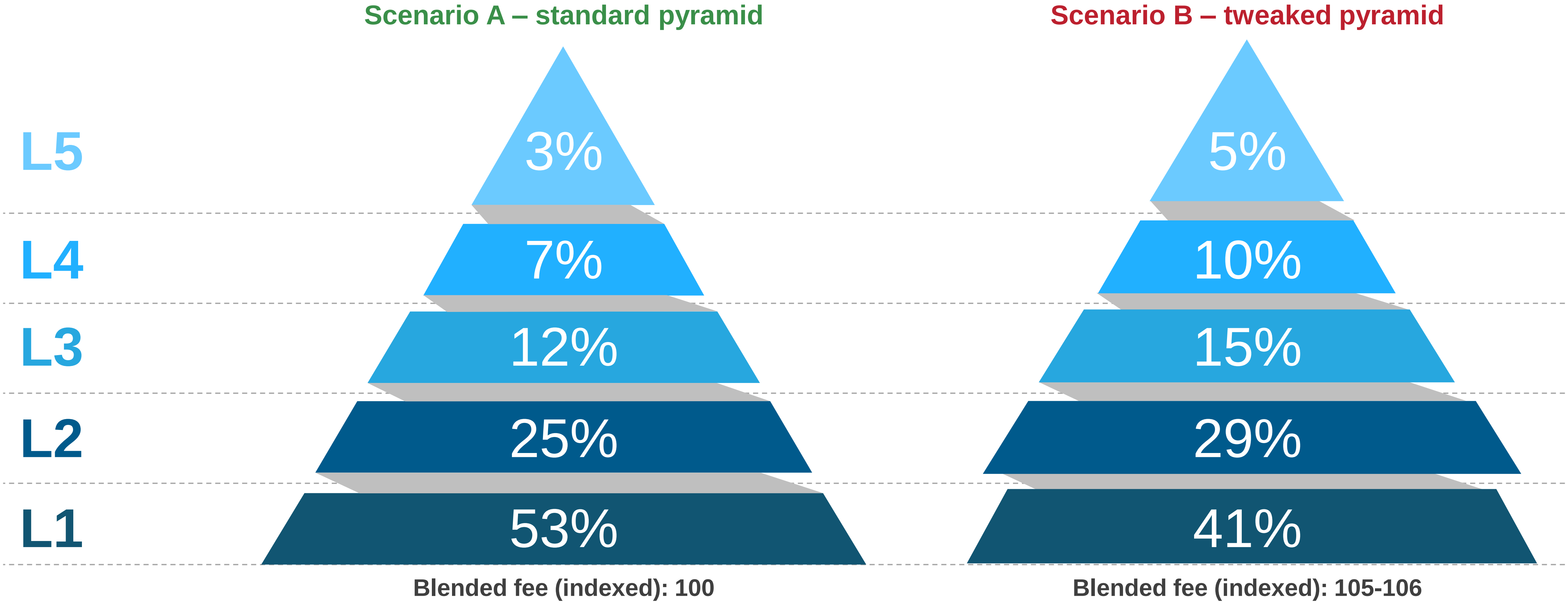
Although wages are increasing, RU-based pricing in managed IT infrastructure services continues to decline for three key reasons

- **Cloudification**
- **Automation**
- **Rising use of offshoring**

#4: Benchmark your staffing pyramids

ILLUSTRATIVE EXAMPLE – AD OFFSHORE PYRAMID

Role inflation is not uncommon these days as a mechanism to increase prices. Even a seemingly innocuous change in staffing pyramids can lead to a 5-6% increase in overall fee.



#5: Look beyond services – reviewing software products and platforms pricing can yield significant benefits for the overall budget

Spend on software products and licenses is 0.5-2% of annual revenue for an enterprise, and enterprises should watch out for these common pitfalls.

Incorrect usage estimation

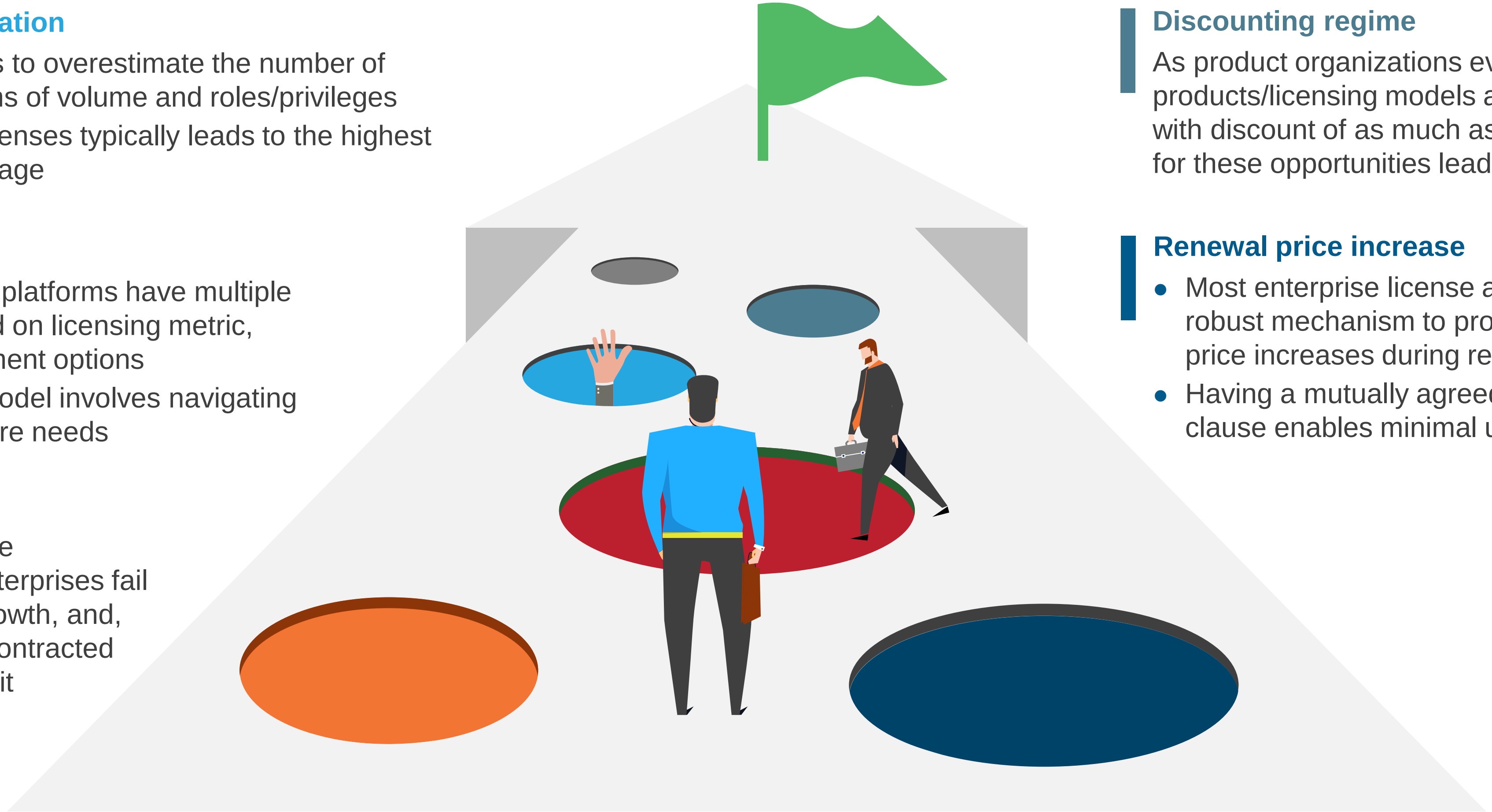
- A common mistake is to overestimate the number of licenses, both in terms of volume and roles/privileges
- Underutilization of licenses typically leads to the highest amount of value leakage

Right pricing model

- Almost all enterprise platforms have multiple pricing models based on licensing metric, version, and deployment options
- Choosing the right model involves navigating both current and future needs

Audit challenges

When estimating license requirements, many enterprises fail to account for future growth, and, therefore, exceed the contracted volume and risk an audit



Discounting regime

As product organizations evolve, newer products/licensing models are released in the market with discount of as much as 90%; keeping an eye out for these opportunities leads to significant savings

Renewal price increase

- Most enterprise license agreements do not have a robust mechanism to protect against software price increases during renewal
- Having a mutually agreed renewal price protection clause enables minimal unforeseen cost overruns

Discussion points for today

- Current pricing and attrition trends
- Managing outsourcing pricing
- **The way forward**
  - Is it a good time to re-negotiate your contracts?
  - Key pitfalls and unknowns to be mindful
- Q&A

Is now a good time to re-negotiate your contracts?

NOT EXHAUSTIVE

It depends on the context, and there is no easy answer. Even if your current prices are super-competitive, it could have implications on the supplier's ability to provide the right talent. That, there are three situations where we believe contracts could be negotiated in the coming weeks or months.

Current rates are higher than market

- If for 75-80% of the scope, current rates are already higher than market median, this could be used to carve out the small part where adjustments need to be made
- Specific skills or role types can then be prioritized for negotiation, and areas of high current pricing can be used to negate against some of those thereby creating a strong negotiation posture

Change in pricing models

- Some enterprises are using this situation to negotiate changes in pricing models (from FTE-based to output-based managed services)
- As we discussed earlier, this decouples the link between FTEs deployed and revenue for suppliers; thereby incentivizing suppliers to improve efficiency

Change in non-price commercial tenets

- Rates are not the only component of deal TCV. Now is a good time to approach changes in offshore mix, staffing pyramids, and SLA metrics
- Another key element is increasing the committed efficiency delivery using automation and/or other means of transformation. This way FTE pricing can be increased without impacting TCO

Having a no COLA[1] policy does not necessarily mean a competitive deal – it could have serious implications for cost and quality

REPRESENTATIVE – FOR DISCUSSION

Commercial impact

- The service provider will have baked in the risk already, leading to a higher rate from the start
- You may see ad-hoc rate increase requests, the size for which may be higher than what is justifiable
- Low rate predictability, especially in the current situation when it is imperative for service providers to increase rates

Service quality impact

- High risk of poor service quality, as the service provider may cut corners to retain margin
- Lack of (or delayed) access to resources, as the service provider may staff them elsewhere
- Less service provider interest in pursuing and growing the relationship; providers are much more aggressive today in letting go of unprofitable clients!

1 Cost of Living Adjustment.

The talent crunch and rising wages are leading to a reversal of the former trend of no COLA contracts and ad-hoc COLA waivers

2010 to 2019

Parameter	Onshore (US)	Offshore (India)
Typical inflation	1.5% to 3%	4% to 8%
Forex	Not applicable	Depreciating INR
Net impact	Slightly inflationary	Slightly inflationary

Present

Significantly unfavorable to buyers · Moderately unfavorable to buyers · Favorable to buyers

Parameter	Onshore (US)	Offshore (India)
Typical inflation	> 5%	4% to 8%
Forex	Not applicable	? Fluctuating
Net impact	Highly inflationary	? Unpredictable / highly inflationary

Analysis of deals in 2018-20

Prevalence meter (proportion of deals) Low → High □□□□□□□

Function	With COLA	Without COLA
IT applications	■■■■■■□	■□□□□□□
IT infrastructure	■■■■□□□	■■■□□□□
BPO	■■■■■□□	■■□□□□□

- Prior to 2017-18, deals without COLA were even less common, but their prevalence rose during 2018-20
- In deals where COLA was present, waivers/holidays were common in 2020, but service providers started pushing back in Q2 2021

FX can be an ally, as high inflation is often accompanied by exchange rate depreciation

Currency	September 2021 – March 2022 change
INR	4.2% against USD
MXN	5.0% against USD
PHP	5.2% against USD

The approaches enterprises use can vary depending on the specific contractual language

Full or shared FX risk with the enterprise

- Assertively use FX rate depreciation to lower the impact of inflation-related rate adjustment
- Typically, a simple conversation as it is acting on what is already agreed in the contract

Full FX risk with the service provider

- Negotiation lever to partially negate the size of the rate increase
- Enterprises should take into account both historical trends and future projections when negotiating

Unknown #1 | Cyclical or event-driven demand reduction could cause yet another U-turn in the pricing environment

HYPOTHETICAL – NO EVIDENCE THIS WILL HAPPEN

Consistent price increase from 2020 levels	Sudden decrease to below-2020 levels	The overall impact could be a rate reduction of 8-15%from the peak at that point

Talent implications for the market

- Sudden over-supply of currently hard-to-find skills, which typically results in a buyer's market
- Hiring freezes across the board, which could lead to cooling off in wages
- Talent model (location/type of pool) restructuring

Pricing implications for enterprises

- Sudden fall in market rates
- Some enterprises could be stuck with high rates they may have recently negotiated
- Predatory pricing by service providers to retain book of business and/or drive growth

Unknown #2 | Geo-politics can exacerbate the already precarious talent demand-supply situation in the global services industry, leading to hyper-inflation in pricing

Current situation in the global services industry

- Multi-year demand for digital transformation
- Talent shortage
- Wage inflation

Increase in pricing

+

Recent geo-political triggers in the global economy

- COVID-led supply chain shocks impacting revenue growth
- Oil price shock
- Escalating commodity prices (steel, aluminum, etc.)

Severe margin contraction for enterprises

=

Potential impact on the global services industry

- Resurgence of cost takeout sourcing initiatives
- Further increase in talent requirement
- Reduced talent supply due the situation in Ukraine
- More global wage inflation

Hyper-inflation in global services pricing

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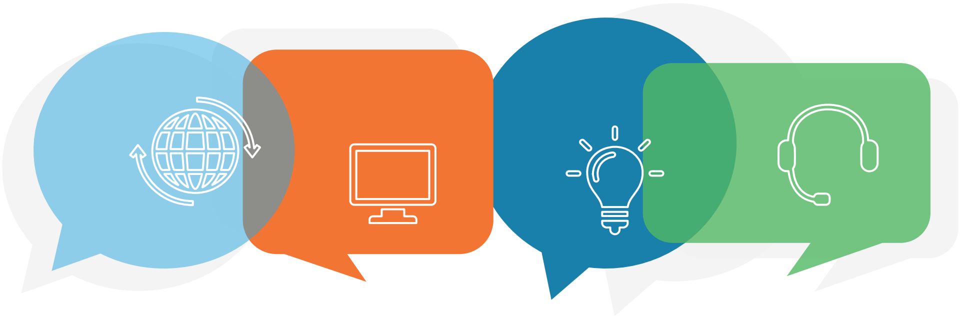
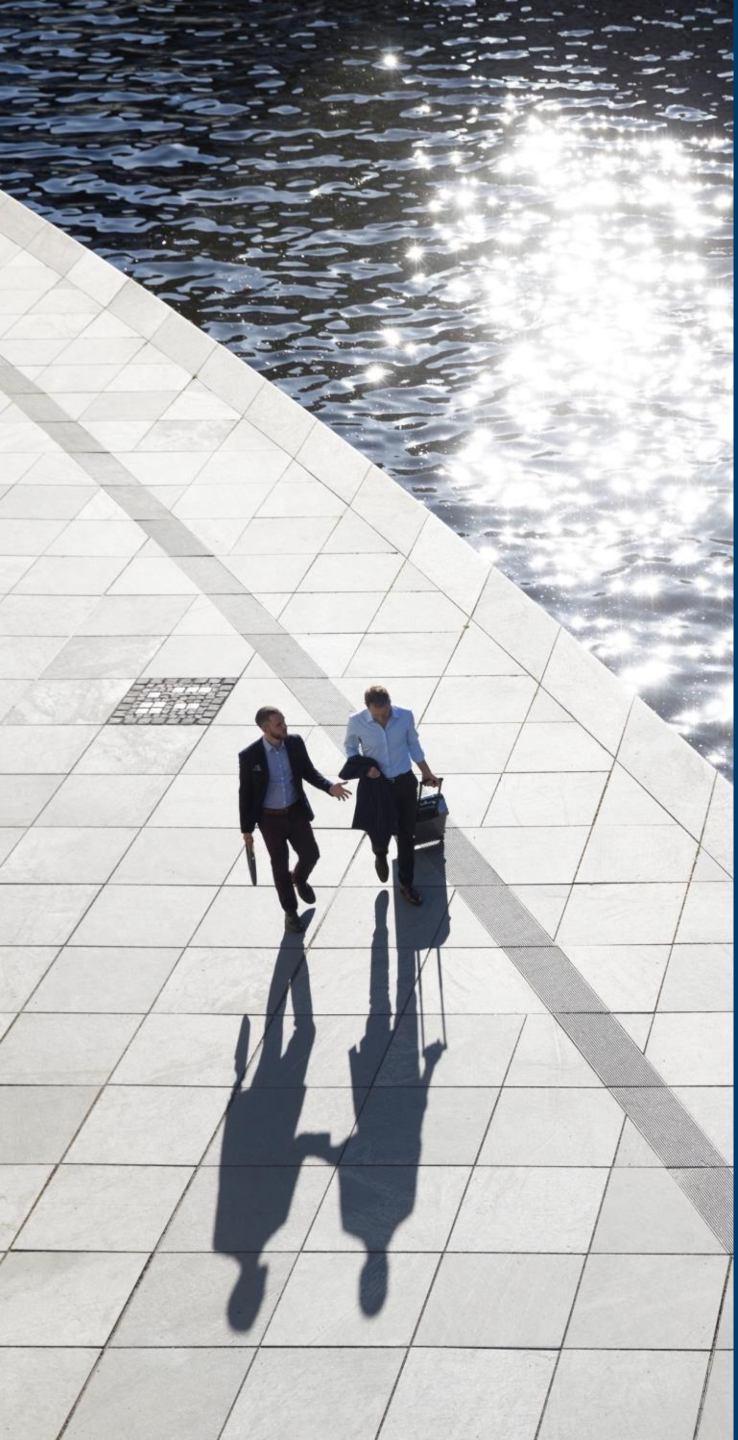


To ask a specific follow-up question, please contact Ricky Sundrani, ricky.sundrani@everestgrp.com

Ricky Sundrani
Vice President, Everest Group

- Ricky is based out of London and leads Everest Group's work on Cloud, Infrastructure and Security services price benchmarking services globally and leads price benchmarking work for Everest Group in Europe
- ~11 years of experience as an IT Services SME
- Has led over 100+ benchmarking projects for clients in North America, EU, APAC and Middle east during his tenure at Everest Group over the last ~8 years
- He works with clients across both the service provider and enterprise community across a variety of areas such as Cloud, Digital Workplace services, network services, Cyber Security services, Storage and Backup services, Service Desk, Middleware, Database etc.
- Prior to joining Everest Group, he worked as a Bid Manager at HCL Technologies within their IT Infrastructure Services vertical
- Started his career with Persistent Systems as a Software Engineering Consultant
- Holds an MBA from NMIMS, Mumbai



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