



# **PricePoint**

## **Points to Consider in the Pricing of Outsourcing Services**

January-March (Q1), 2012 Update: Preview Deck

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- Tracking services | Service providers, locations, risk
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# Background and scope of the research

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## **Background of the research**

- Evolving demand-side, supply-side, and macro-economic dynamics complicate pricing in ITO and BPO deals
- As a result both buyers and service providers face several challenges while pursuing their pricing objectives
- Everest Group's PricePoint analyzes key cost and price drivers for ITO and BPO services on an ongoing basis to aid pricing related decision making
- PricePoint provides comprehensive coverage of pricing trends in India and US, which together form a majority of the global sourcing market
- Further, as part of its "Featured research", PricePoint provides additional coverage of pricing trends as governed by key developments

## **The scope of analyses in the Q1 2012 update includes:**

- Assessment of pricing drivers for outsourced IT and business process services including
  - Buy-side dynamics
  - Supply-side dynamics
  - Key macro-economic factors
- Overall impact of the drivers on pricing in Q1 2012
- Pricing outlook for Q2 2012
- Featured research
  - Overview of South African IT outsourcing landscape
  - Trend in BPO services pricing (2006-2012)
  - Outsourcing spend optimization

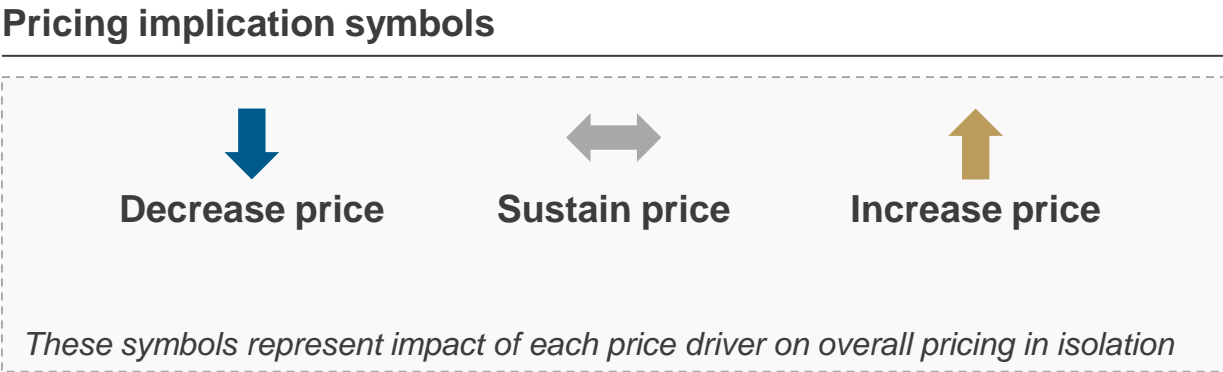
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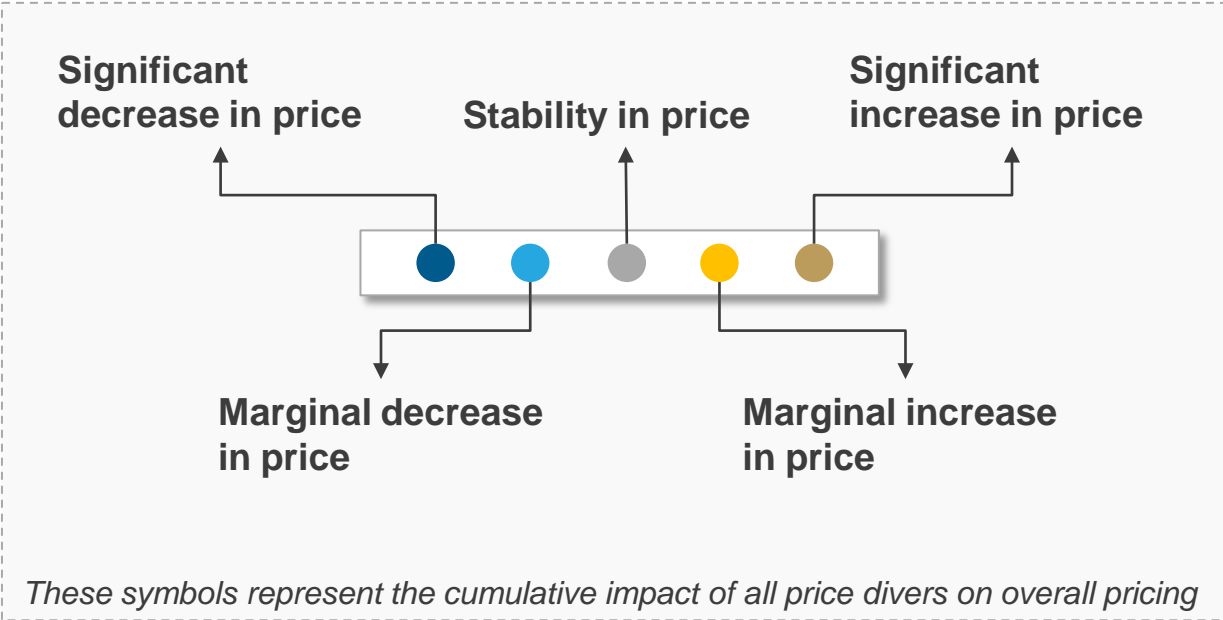
# Guide to interpreting pricing dashboard for outsourced IT and business process services

Area

Impact of price driver



Overall price trend/outlook



# Pricing dynamics in outsourced IT services

## Pricing dashboard – summary of pricing drivers in Q1:2012

### Overall trend in Q1:2012:



- Demand for “cost take-out initiatives” and increase in operating costs for service providers led to XX in IT services pricing in Q1:2012

### Outlook for Q2:2012:



- Sustained demand and cost pressures will continue to exert upward pressure on pricing. However, recent price revisions in H2:2011 will prevent further price changes in the next quarter

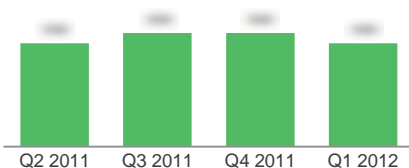
Dimension	Price Driver	Impact Q4:2011	Impact Q1:2012	Conclusion
Demand-side factors	Deal size			<ul style="list-style-type: none"> <li>• In the previous quarter (Q4:2011), we had assessed softening of demand due to decline in deal volume and number of new deals</li> <li>• In Q1, slight decline in deal size and share of ERP/SI projects in ITO deal-mix might indicate buyer caution around discretionary spending. However, demand for IO and ADM remained strong per stable deal volumes and fresh signings (Refer to slides 8-9 for details)</li> </ul>
	Deal volume			
	Value mix			
	New deal - renewal mix			
Supply-side factors	Resource utilization			<ul style="list-style-type: none"> <li>• In the previous quarter, operating margin had improved, despite increase in operating cost, due to favourable forex movement</li> <li>• In Q1, higher overheads and lateral hires, and lower resource utilization led to increase in operating costs for providers</li> <li>• While greater offshore leverage somewhat eased margin pressures, both revenue and operating margin declined implying that no major price increases were implemented (Refer to slides 10-12 for details)</li> </ul>
	Hiring mix			
	Overhead cost			
	Onshore-offshore mix			
	Financial performance			
Macro-economic factors	Inflation			<ul style="list-style-type: none"> <li>• The operating cost inflation was relatively lower in both India and the U.S. compared to Q4:2011</li> <li>• US\$ depreciated marginally XX against INR in Q1:2012 while it had appreciated significantly XX in the previous quarter (Refer to slides 13-14 for details)</li> </ul>
	Forex rates			

# Pricing dynamics in outsourced IT services

## Snapshot

### Demand-side factor (sample extract)

Cumulative size of ITO deals announced  
US\$ billion



- Cumulative ACV declined in Q1:2012 due to weaker than expected discretionary spending ramp-ups, especially for XX
- On a CY basis, 2011 saw a significant reduction in deal sizes compared to CY2010 due to xx

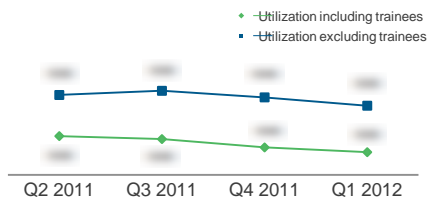
Total ITO deals announced  
Number



- Despite decline of XX in cumulative ACV, deal volume remained stable primarily due to the following:
  - XX
  - XX
  - XX

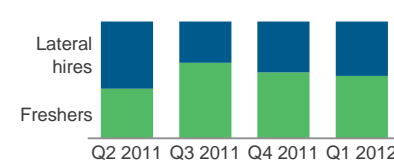
### Supply-side factors (sample extract)

Resource utilization



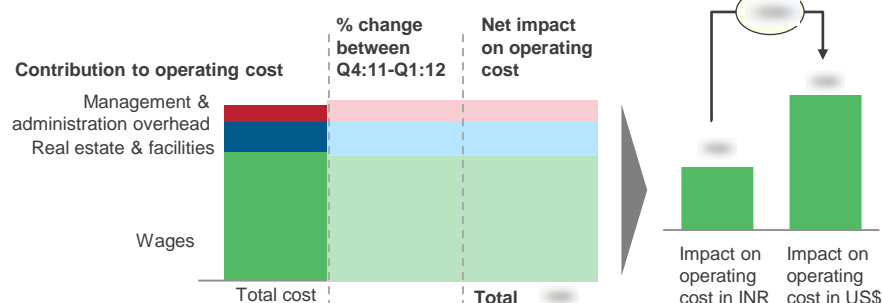
- Providers continued to struggle with lower IT resource utilization in Q1:2012 primarily due to XX
- Q1 is historically weak for Indian IT firms, worsened by XX
- XX

Hiring-mix



- Lateral hiring increased marginally in Q1:2012 largely driven by project-specific requirements, and put some pressure on provider margin
- In the long term, we expect XX
- XX

### Macro-economic factors (sample extract)



- Wages increased marginally by XX in Q1:2012. In the near term, wage inflation is expected to XX
- Increased demand for office space in most cities resulted in a slight increase in real estate rentals
- Overall, operating costs of service providers increased by XX in local currency (i.e., INR)
- However, INR appreciated marginally by XX against US\$ in Q1:2012
- Accounting for these currency fluctuations, net US\$ operating cost increased by XX in Q1:2012

### Trends and future outlook (sample extract)

Trend in blended FTE price at offshore (India) for ADM  
US\$/hr/FTE



Trend in blended FTE price at onsite (U.S.) for ADM  
US\$/hr/FTE



- On the buy-side, demand for SI&C slowed down whereas cost take-out initiatives sustained momentum
- On the supply-side, providers' revenue & margin were negatively impacted
- Pricing cues, shared by most service providers, suggest XX
- Overall, pricing was XX

#### Future outlook:

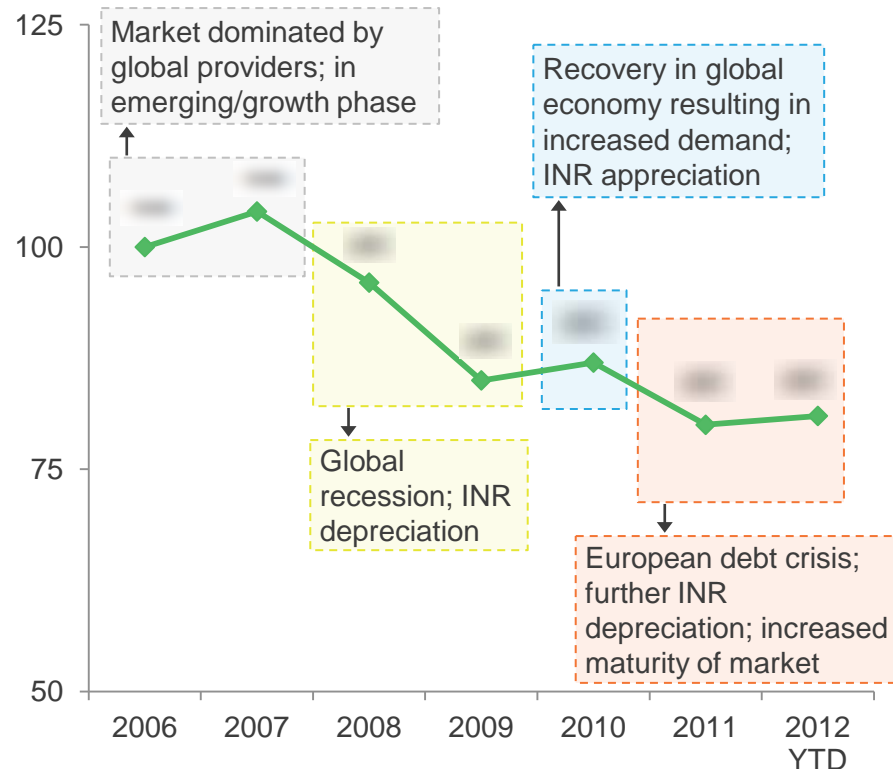
- IT budgets announced by most buyers for the year 2012 were similar to last year suggesting steady demand
- Discretionary buyer spending is expected to remain lower due to XX
- Providers' operating costs are expected to maintain inflationary trend
- Forward-looking pricing cues, shared by most providers, suggest XX
- Overall, pricing is expected to XX

# Featured research

## Trend in BPO services pricing (2006-2012)

### Trend in BPO pricing in India, 2006-2012

Base index (100) = 2006 price



### Key takeaways

- Overall BPO services pricing decreased by [redacted] between 2006-2012. Key factors that contributed to this trend are:
  - Global recession (2008-2009) and European debt crisis (2010-2012) leading to increased pricing pressure from buyers
  - Depreciation of XX in Indian currency against US\$ allowing providers to retain margin despite lower price
  - Increased competition due to entry of new players, forcing the dominant global providers to rationalize prices
  - Increasing maturity of outsourced functions allowing providers to deploy lower skilled talent at reduced cost
  - Increased leverage of tier 2/3 cities (such as Jaipur, Pune, and Hyderabad) thereby lowering provider's operating costs by additional [redacted]
- While the overall pricing declined in past 6 years, the year-on-year trend showed marginal increase in 2007 and 2010:
  - Till mid-2007, the global economic sentiment was largely positive, allowing providers to realize COLA/inflation-based price increases
  - In 2010, price saw minor uptick due to recovery in buyer spending led by pent-up demand built during recession
- In 2012, BPO pricing has remained mostly stable though marginal increase was recorded in few deals

Source: Everest Group (2012)



# Appendix | Additional research recommendations

The following documents are recommended for additional insight into the topic covered in this research. The recommended documents either provide additional details on the topic or provide complementary content that may be of interest:

1. **Price Benchmarking - Time to Take a Hike?** ([EGR-2011-9-V-0626](#)); 2011. It is common knowledge that pricing of IT outsourcing services dipped during 2009-2010 on account of substantial pressure from buyers hit by global recession. Not only did they sign new deals at lower price points, they even renegotiated the existing relationships at substantially discounted rates. This viewpoint highlights three common arguments that support a price increase. It also examines the rationale behind each argument and whether it should practically lead to a price hike or not
2. **Benchmarking for Good** ([EGR-2011-9-R-0599](#)); 2011. Though buyers of outsourcing services are increasingly adopting price benchmarking as a lever to optimize spend, we have observed that “quick-and-dirty” benchmarks often fail to provide the expected negotiating leverage. This viewpoint outlines some of the common challenges buyers need to be aware of in order to derive meaningful benchmarks
3. **Outsourced Portfolio Rationalization** ([EGR-2011-9-V-0585](#)); 2011. Large outsourcing arrangements are frequently plagued with complexities that can significantly undermine the outsourcing benefits. This viewpoint highlights a real-life client situation to describe how Everest Group’s proprietary “Outsourced Portfolio Rationalization” methodology helped unlock sourcing efficiencies

For more information on this and other researches published by Everest Group, please contact us:

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