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Information Technology Outsourcing (ITO) Market Update: July 2009 – Preview Deck

**Topic: Moving from Input-based to Output-based
Pricing – Why, When, and How?**

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Background of the research

- Pricing is an integral aspect of any outsourcing relationship. It is frequently complex in nature, with the result that a large outsourcing relationship is usually a hybrid of multiple pricing models
- Buyers explore transitions in pricing models to satisfy the need to reduce total cost, improve control on quality of service, increase flexibility, or improve risk management
- This research provides a buyer's perspective of the challenges and risks associated with switching from input-based to output-based pricing and a practical approach to implement this transition

The scope of analysis includes

- Key supplier and buyer motivations for transitioning to a new pricing model
- Buyers' risks and challenges in shifting from input-based to output-based pricing model
- A phased roadmap for transition from input-based to output-based pricing model with a discussion of key activities at each stage

Overview and abbreviated summary of key messages

(page 1 of 2)

Buyers explore transitions in pricing models in order to satisfy the need to reduce total cost, improve control on quality of service, increase flexibility or improve risk management. This research focuses on understanding the motivations, challenges and roadmap for implementing a transition from input-based to output-based pricing.

The study provides a buyer's perspective of the challenges and risks associated with switching from input-based to output-based pricing and a practical approach to implement this transition. Companies will benefit by understanding the key motivations for adopting a pricing model and therefore the reasons for seeking a transition to another pricing model.

Some of the findings in this report, among others, are:

Introduction to pricing models

- A holistic ITO pricing model evolves from the interaction of multiple structural elements including approach, method, adjustments base, and structure
- Competing buyer and supplier interests influence ITO pricing; a well-designed pricing model should help align buyer and supplier interests

Motivation for switching pricing models

- Buyer and supplier motivations to shift to a new pricing model have four themes: reduce total cost, improve control on quality of service, increase flexibility, and improve risk management
- Client examples in this section present some commonly observed transitions in pricing models and their ability to provide the expected benefits

Overview and abbreviated summary of key messages

(page 2 of 2)

Challenges and Implications of price transition

- This section takes a deeper look at understanding implications of the shift from input-based to output-based pricing
- Certain challenges must be overcome in order to implement output-based pricing models successfully. These could involve set-up complexity, volume uncertainty, impact on different IT functions, and organizational change requirements
- Additionally, buyers must contend with key risks inherent in the move to output-based pricing, e.g., shifting to output-based pricing could lead to cost escalation if volume trends are unknown

Practical approach to enable transition

- No BU should be adversely impacted in the shift to output-based pricing
- The migration roadmap has to include a comprehensive **change management** process, central to which is the education of the buyer organization
- The buyer and supplier should jointly ensure that critical **enabling mechanisms** like KPIs/SLAs, monitoring approaches, etc. are in place as the pricing transition is implemented
- Finally, both old and new pricing models should be run in parallel for a period of time. This helps ensure that all stakeholders understand the impact of the change going forward

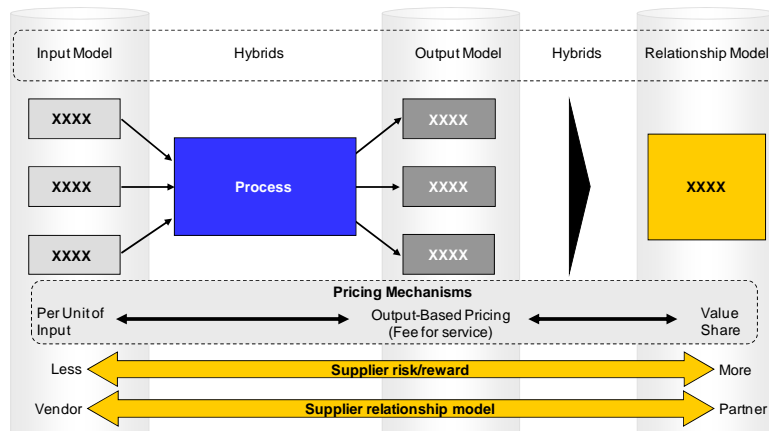
This study presents a deep dive into key aspects of ITO pricing transitions; below are four charts to illustrate the depth of the report



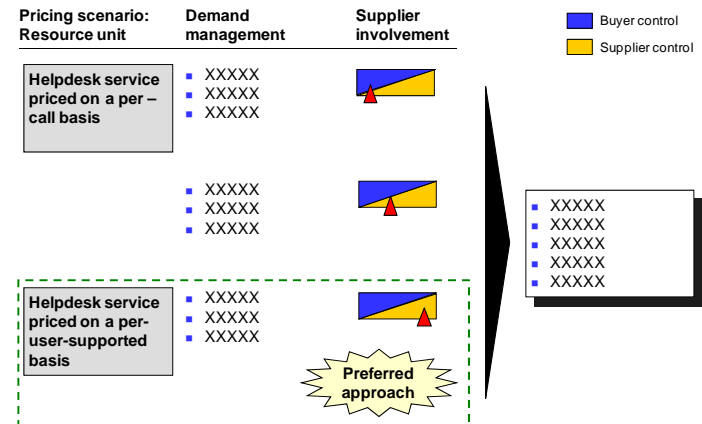
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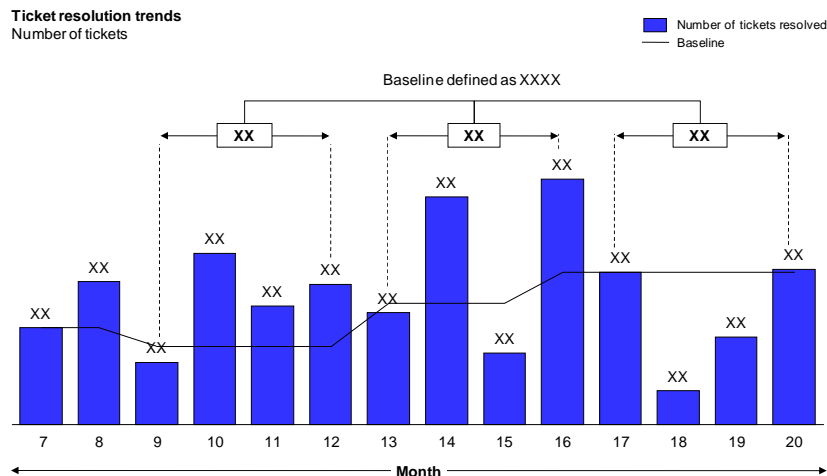
Economic model continuum



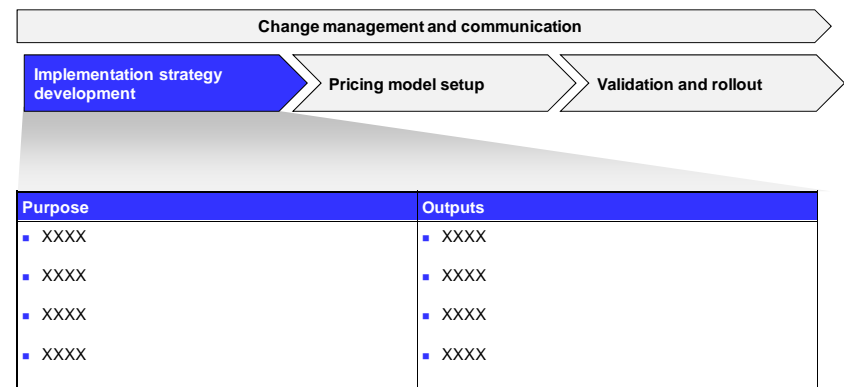
Demand management



Output-based pricing model impact



Practical approach to enable transition



Appendix: Additional ITO research recommendations



The following documents are recommended for additional insight on the topic covered in this Research Report. The recommended documents either provide additional details on the topic or complementary content which may be of interest

1. **Every Solution Has a Price – Primer on Pricing in IT Outsourcing** (ERI-2009-4-R-0330); 2009. This report describes how common issues in IT outsourcing can be resolved by making appropriate changes in the pricing mechanism of the contract. It demonstrates the application of these pricing strategies through four in-depth client examples and illustrations of issues faced by buyers in their outsourcing relationship
2. **Infrastructure Outsourcing Output-based Price Benchmarking** (ERI-2008-4-R-0271); 2008. This report facilitates output-based price benchmarking analysis for IT infrastructure outsourcing deals, providing comparative pricing data by resource unit for each tower and an adequate understanding of the pricing drivers in a typical deal environment
3. **The Pandora's Box of IT Services Pricing (Whitepaper)** (ERI-2009-4-W-0321); 2009. This whitepaper focuses on the comparison of similar rates for IT services between offshore and MNC players, and a comparison of margins on offshore rates across skills in ADM and IO

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