EFFORT, PERFORMANCE, PURPOSE:
THE 3 EVOLUTIONS OF IT AND BUSINESS SERVICE RELATIONSHIPS

Saurabh Gupta
President, Research and Advisory Services
HFS

Don Ryan
Chief Strategy Officer
HFS

#HFSSuperSummit

Setting the context

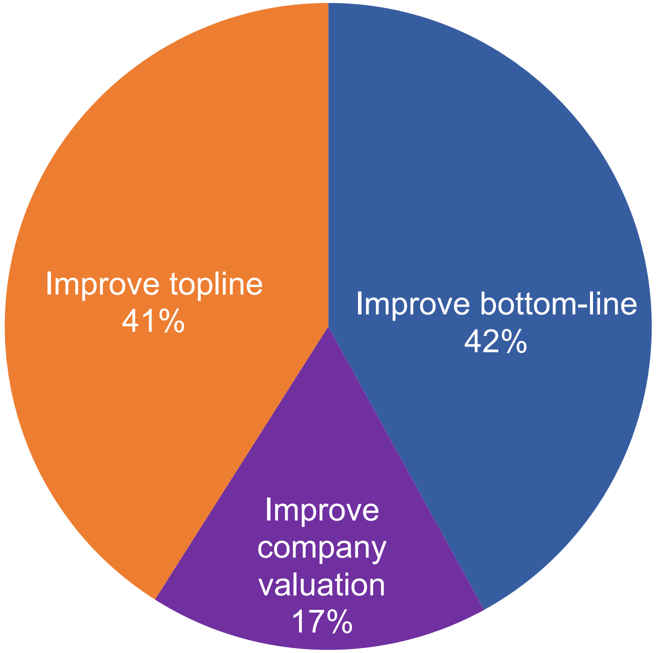
We've been covering IT and business services for over 20 years, and it's still sold and bought the same way: enterprises pay for effort, and providers sell effort. There is no pricing nirvana in IT and business services. But relationship structures should evolve as the relationship matures from effort to performance to purpose.

In this session, we will discuss:

- The diminishing returns in an effort-based services model
- Practical suggestions for creating performance-driven relationship structures.
- Finding a common purpose to convert a services relationship into a growth engine for both parties in order to create good partnerships

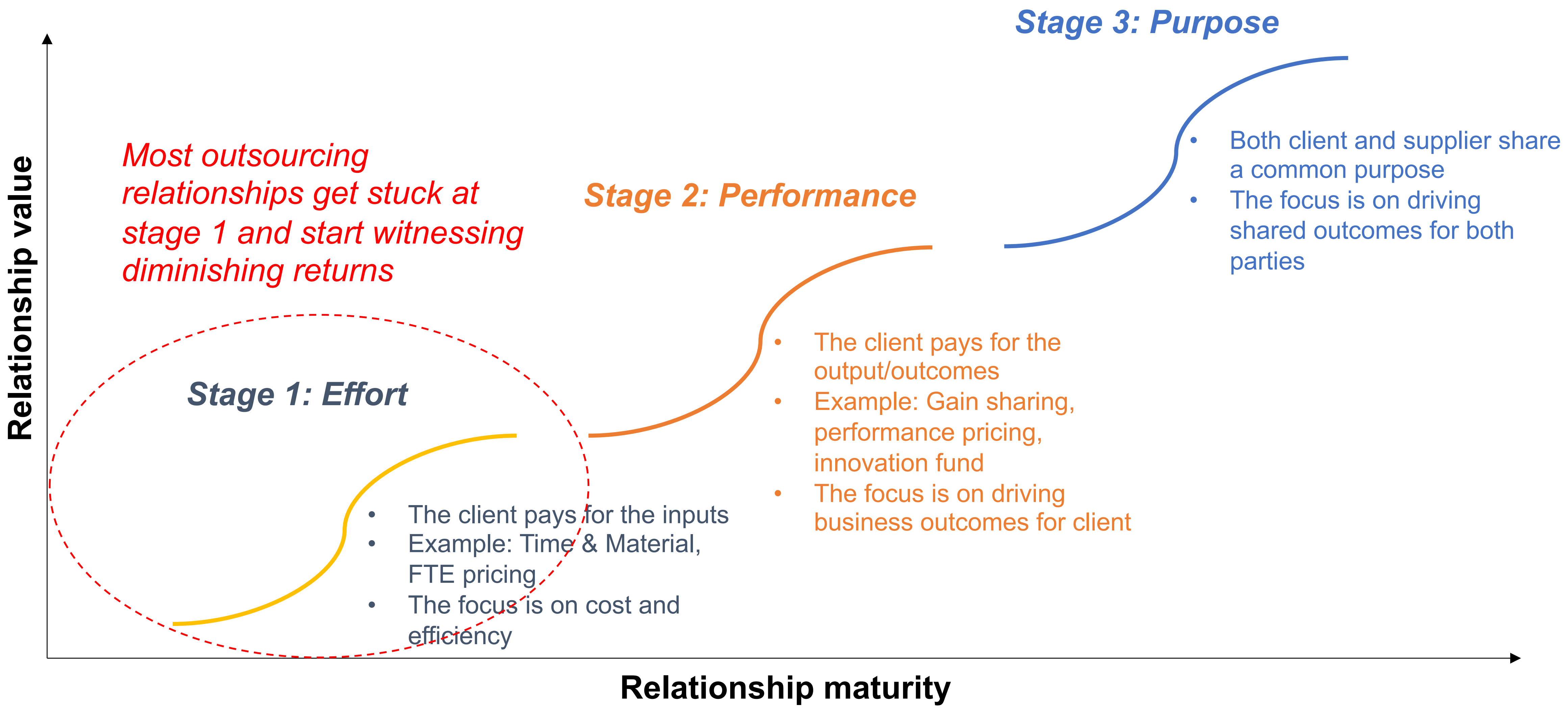
Discussion Topic #1

Is the economics of the current services model based on "effort" failing when 60% of emphasis is on growth and valuation?



What is the single most important strategic goal for your organization for the next 12-18 months?

Stages of maturity and value in services relationships



An effort-focused relationship can be a very good start to a relationship but has diminishing returns in the long run

Why a big pharma transitioned from transaction-based pricing to FTE-based pricing?

- The company had been created as a result of a divestiture and its process visibility was low after the separation from the parent company.
- It witnessed significant volume variation between actual and contracted volumes that an output-based pricing structure could not manage.
- The adjustments to BPO solution became hard to benchmark and time-consuming to implement.
- And the overall pricing for the BPO relationship became risky.

Be careful with “gain-sharing” as it can drive opposite behaviour than envisaged initially

How gain-sharing can become a pain in the backside for a global firm that outsourced procurement?

- A large organization outsourced a large part of its non-core procurement spend to a service provider leveraging a gain-sharing structure.
- However, within a year, the relationship started to sour primarily because the gain-sharing-based pricing model was driving the opposite behavior of both parties.
- The buyer organization was reluctant to cooperate as there was no internal incentive for them to contribute – no additional budgets were allocated.
- The service provider was also reluctant to make up-front investments as its entire fee was at risk.
- In one particular category, the service provider negotiated significant savings, but the buyer organization wanted to avoid high gain-share pay-out
- It was difficult to isolate supplier contribution and quantify the impact on the outcome organization.

Introducing “Pay-for-Performance”

“Pay-for-Performance” pricing is simple, transparent, and mutually beneficial as the service provider is incentivized to create value, it is relatively straightforward to track and measure, and the buyer payouts cannot be so huge that they can cause budgetary issues.

This is how it works:

- Identify the desired outcome for a potential relationship by milestone
- Supplier proposes fixed service fees to implement milestone
- X% of Supplier fixed fees “at risk” for non-performance
- Supplier earns a “performance bonus” (up to Y% of fixed fees) if it exceeds project Savings Target

A gain share model backed with an “innovation fund” is also a better idea than pure gain sharing.

- The supplier (and buyer) commits to a pool of money to drive innovation.
- A joint innovation council identifies potential projects and uses the innovation fund.
- The supplier recovers its investment using a gain-share approach with a potential upside if the project is a huge success and a downside if it fails.

Finding a common purpose in a relationship can convert it into a growth engine for both parties

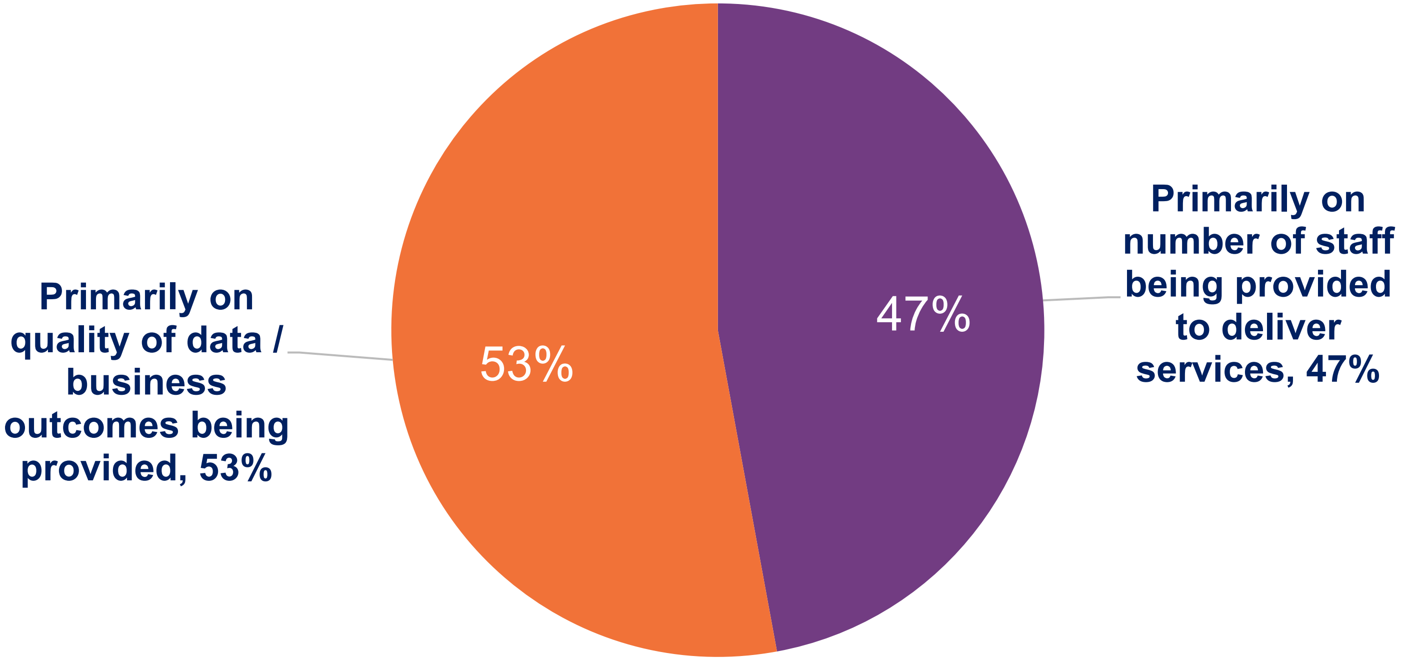
bp and Microsoft form strategic partnership to drive digital energy innovation and advance net zero goals

- Microsoft to further bp’s digital transformation with Azure
- bp to supply Microsoft with renewable energy to help meet the company’s 2025 renewable energy goals

Discussion Topics

- **Is the legacy services industry perpetuating mediocrity and playing a zero-sum game?**
- **Are service providers not innovative or are buyers risk-averse? How do we change the mindset?**

How would you prefer to pay for IT / Business services?
% respondents



Sample: 602 executives across Global 2000 enterprises
Source: HFS Research, 2022

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HFS Research introduced the world to terms such as "RPA" (Robotic Process Automation) in 2012 and more recently, the HFS OneOffice™. The HFS mission is to provide visionary insight into the major innovations impacting business operations such as Automation, Artificial Intelligence, Blockchain, Internet of Things, Digital Business Models and Smart Analytics.

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