Client Meeting — 1996

Outsourcing Client Meeting 1996

Outsourcing Client Meeting

Held on 13th March, 1996

The Monkey Island Hotel, Bray, Maidenhead

INPUT®

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- Software and Services Market Forecasts
- Software and Services Vendors
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  - Forecasts
  - Awards (FAIT)
  - Agency Procurement Requests (APR)

CUSTOM PROJECTS

For Vendors—analyse:

- Market strategies and tactics
- Product/service opportunities
- Customer satisfaction levels
- Competitive positioning
- Acquisition targets

For Buyers—evaluate:

- Specific vendor capabilities
- Outsourcing options
- Systems plans
- Peer position

OTHER SERVICES

Acquisitions/partnerships searches

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IS Outsourcing Programme—Europe

Outsourcing Client Meeting

List of Attendees

Amdhal (U.K.) Ltd	Neal Gibson	Engagement Manager
Coopers & Lybrand	Peter Hindle	Principal Associate
Cray Communications	Davids Thackeray	Business Service Manager
Digital Equipment	Geoff Poplar	Sales Manager
Digital Equipment	Jerry Dixon	MCS Marketing Manager
FI Group Plc	Peter Dooley	Marketing Manager
FI Group Plc	Elizabeth Edmonds	Marketing Manager
Hoskyns	Nigel Whitmore	Information Officer
ICL	Paul Clayton	Business Analyst
IT Southern Ltd.	Charles Gray	Head of Sales & Marketing
Olivetti	Federico Corradi	Outsourcing Manager
Philips C & P International	Anil Joshi	Business Intelligence Manager
Sema group Plc	Frank Arnold	Production Services Manager
Sema Group Plc	Hilary Calow	Marketing Manager
Siemens Business Systems	Kathleen Street	Bid Manager
Storage Technology Ltd.	Martin Brown	Manager
Sun Life Assurance Society	Nigel Freeth	Computer Services Manager
Syntax Managed Services	Boni Chin	Marketing Manager

Outsourcing Information Programme

Presentation Format:-

Introduction by Peter Lines, V.P. of INPUT Europe

John Willmot, Outsourcing Programme Manager, Europe
Do Outsourcing Vendors Deliver the Goods?

Ben Pring, Business Integration Programme Manager Europe
"Delivering Value" The New Agenda for IT Services Companies

OUTSOURCING CLIENT SATISFACTION: DO VENDORS DELIVER?

Survey Objectives

In traditional customer satisfaction studies, it can be difficult to ascertain the true meaning of a score of e.g. 3.5. Is this a good performance in a difficult area or does it lag significantly behind the industry norm

This study aimed to assist individual vendors in identifying actions for improvement, by comparing their performance against both their clients' requirements and **their competitors' capability**.

The study will be conducted annually. For a modest additional fee, INPUT will provide detailed benchmarking information specific to the individual vendor.

This presentation is a general discussion of the key challenges faced by the IT outsourcing industry.

Survey Methodology

All research findings are the result of primary research with the clients of leading outsourcing vendors. 118 of the 131 interviews took place in the UK. This year it is hoped to extend the study more widely outside the U.K.

In order to quantify levels of user satisfaction, a one to five rating scale system was selected, five representing "highly satisfied". In general, INPUT considers a score of 3.9 or higher to indicate an acceptable level of satisfaction. This survey monitors performance relative to client expectations. Some vendors may consider that clients' expectations are *unreasonable*, given the context in which the contracts were signed.

Pattern of Service Usage

The contracts covered were on average 3 years old and the pattern of IT outsourcing is fairly conventional, with an emphasis on legacy support rather than new systems development. The 40% of users stating that they outsourced desktop services includes a proportion delegating desktop support services. Only a minority of these can be considered to be full desktop services outsourcing.

Areas of Discussion

To what extent have vendors delivered the goods in each of these areas?

Principal Benefits and Their Achievement

Users were asked what they perceived to be the main benefits of outsourcing *before* they outsourced. The profile of replies was once again quite conservative and the majority of clients were seeking support services rather than anything more revolutionary. The primary reasons cited were to: (1) achieve cost savings and (2) to outsource non- core activities. The results indicated that these objectives had been largely met, especially for mainframe services.

Other main benefits of outsourcing cited were to (3) gain access to new skills, (4) improve service levels and finally (5) gain competitive advantage. The achievement of competitive advantage, (5) received a relatively low rating of 3.2. This suggests that vendors are responding successfully to clients' IT *operational* needs, but less well to their broader *business* needs.

Where Vendors Succeed

In terms of overall satisfaction, 73% were highly satisfied, 24% moderately satisfied and 3% dissatisfied.

The Mainframe is Easy! (But Desktop Services are most unsatisfactory...)

When a similar INPUT study was undertaken two years ago, the pattern of satisfaction by service type was similar. However, at that time, there was a greater incidence of minor teething problems and communication issues often caused by high staff turnover (leading to lack of service continuity). These problems appear to have been corrected.

However, desktop service provision is still at an early stage of development and is seen to be a problem area by a number of clients.

Client Concerns with Application Management

Application management received a medium satisfaction score from users. The rapid introduction of new systems that provide business benefit remains a major challenge throughout the IT industry and not just for outsourcing vendors.

In addition, the perception in the AM field that "outsourcing equals cost reduction" reflects how users expect the outsourcing industry to operate in general - if these expectations are not met, the tendency is for users to want to return these functions in-house.

In the future, AM vendors will increasingly use automation and offshore outsourcing to reduce the cost of service delivery.

Client Concerns with Desktop services

Some outsourcing vendors, e.g. EDS, have been slow to develop a specialist desktop services capability. In consequence, a common view was that desktop support was being supplied by non-specialist, mainframe-oriented personnel. This has led to a sense of poor value for money. In this sense, INPUT *believes a clear business opportunity exists in this sector for specialist vendors*

Strengths of Vendor Service Cultures

Users were generally well satisfied with the effort of outsourcing personnel, especially for the service they were contracted to provide. Clients typically like the professionalism and helpfulness of vendor personnel. In this respect, outsourcing has been successful in achieving a culture change in service provision.

Client Concerns with Service Culture

Users expressed concern that outsourcing providers were content to provide a perfunctory IT role yet did not see a need for proactive innovation. Greater emphasis is expected in integrating the IT function with the business as a whole and ensuring the investments culminate in value adding.

A commonly expressed sentiment by users was that their organisations operate in a dynamic environment, and thus providers of outsourcing must also be able to change to suit.

The challenge to vendors is therefore to:
(1) be more flexible
(2) focus on satisfying customer expectations, not merely the outsourcing contract

Client Concerns with Contract Terms

- no further commentary -

Major Challenges

Users want vendors to shift from a rigid outsourcing service delivery mode to one offering more consultancy and business value-adding. Leading edge outsourcing suppliers are already making this transition and the challenge to those companies restricting their service delivery to the execution of outsourcing contracts is to meet this heightened competition.

Who Leads Technological Innovation?

Clients appear ill-equipped, even bewildered with some of the technical innovations taking place in IT. They perceive outsourcing providers as being well positioned to pass on leading edge knowledge and yet vendors are not adequately meeting this need, being frequently regarded as too mainframe-centric.

This is one area where vendors ought to be able to delight their clients. Possibly, the major challenge lies in making these skills more accessible to clients. While the vendor typically possesses the skills, they may well be located outside the immediate service group responsible for the client

Who Delivers the Business Benefit?

Sense of responsibility, ability to contribute and achievement (in the development of the business) were perceived by users as important outsourcing issues, resulting in aggregated scores of 3.9, 3.8 and 3.9 respectively. Yet in terms of users' satisfaction in these areas, scores dropped to unsatisfactory levels.

The paradox for vendors is that on one hand, vendors are often not actively encouraged to take part in clients' business planning, and yet when they do not, they are perceived as not being sufficiently proactive. One delegate (from a vendor organisation) noted that attempts to advise on business issues are often interpreted by users as a crude sales pitch. The challenge is therefore to gain trust with users and expose a greater readiness to pursue long-term business relationships.

Cost Reduction must be Continually Demonstrated

Survey results indicate a high level of satisfaction with initial cost reductions generated as the result of implemented outsourcing contracts. However, this satisfaction level generally declines regarding ongoing cost reduction. Users often have an apparently naive view that if, for example, PC prices are decreasing by upwards of 20%, then they can expect the same results with their outsourcing activities.

Perceived Areas for Improvement

- no further commentary -

Outsourcing
Client Satisfaction

Do Vendors Deliver?

March 13, 1996

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Survey Objectives

- To monitor vendor performance against client requirements

- To identify actions for improvement

- To assist individual vendors in benchmarking their performance relative to the sector

INPUT

Survey Methodology

- 131 interviews with outsourcing clients

- Assess importance and satisfaction by:
  - Service type
  - Service culture
  - Commercial terms
  - Benefit contribution

INPUT

Pattern of Service Usage

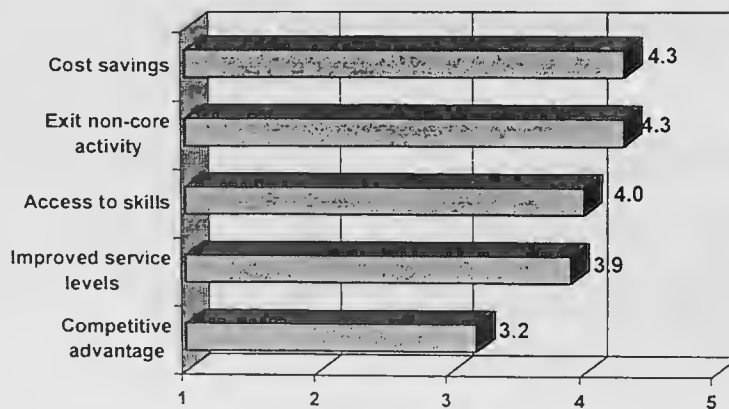| Function	Proportion Outsourcing (%)
Platform operations	80
Application maintenance	55
Desktop services	40
Application development	35

INPUT

Areas for Discussion

- Achievement of benefits
- Service delivery by function
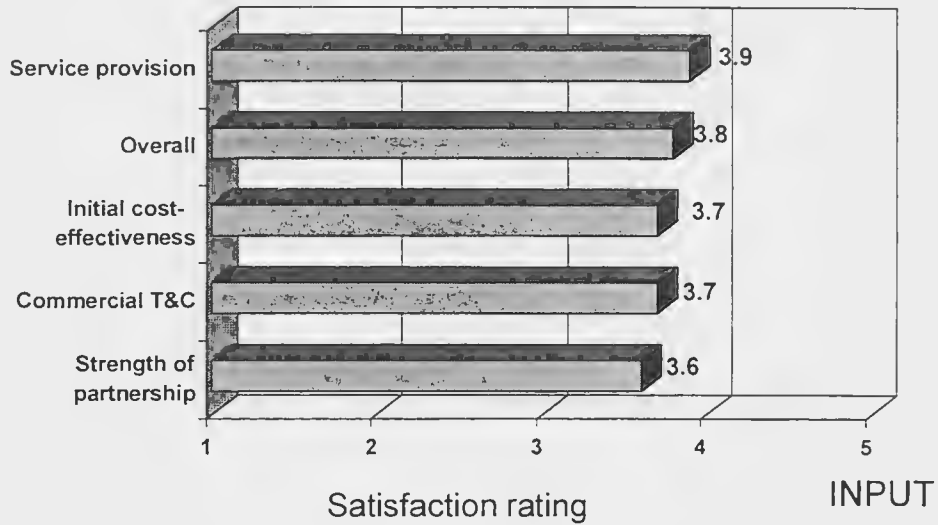- Service culture
- Contracts & pricing
- Challenges

INPUT

Principal Benefits and Their Achievement

Cost savings					4.3
Exit non-core activity					4.3
Access to skills				4.0	
Improved service levels				3.9	
Competitive advantage			3.2		
	1	2	3	4	5

INPUT

Where Vendors Succeed

Category	Satisfaction rating
Service provision	3.9
Overall	3.8
Initial cost-effectiveness	3.7
Commercial T&C	3.7
Strength of partnership	3.6

Satisfaction rating

INPUT

The Mainframe is Easy!

Service	Satisfaction level
Platform operations	High
Application management	Medium
Network management	Medium
Desktop services	Low

INPUT

Client Concerns with Application Management

- Ability to control costs/
meet budget targets

- Achievement of projected
business benefits

- Rapid introduction of
new systems

INPUT

Client Concerns with Desktop Services

- Lack of specialist skills

- Help-desk services

- Value for money

INPUT

Strengths of Vendor Service Cultures

- Responsiveness to day-to-day issues

- Openness of communication

- Calibre of personnel

INPUT

Client Concerns with Service Culture

- Understanding of business requirements

- Sense of responsibility for client goals

- Responsiveness to changing business needs

INPUT

Client Concerns with Contract Terms

- Economies of scale not passed on

- Lack of flexibility

- Lack of cost reduction with decreasing service usage
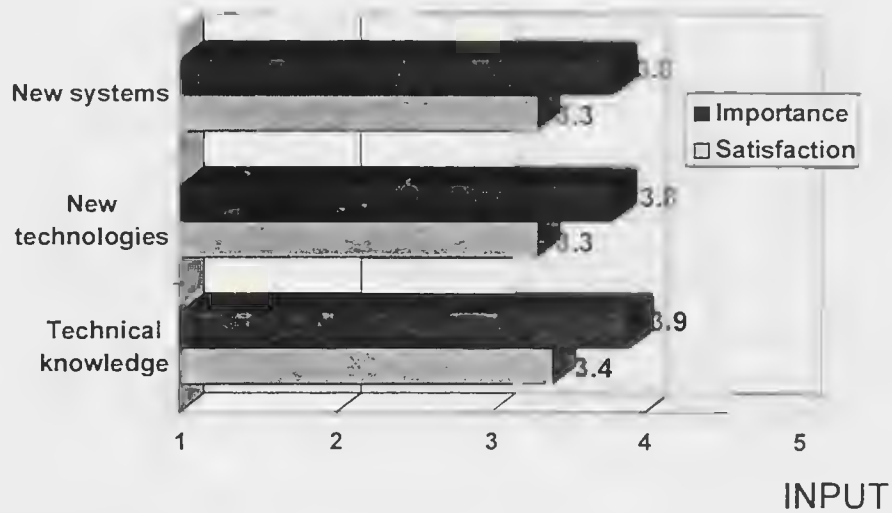
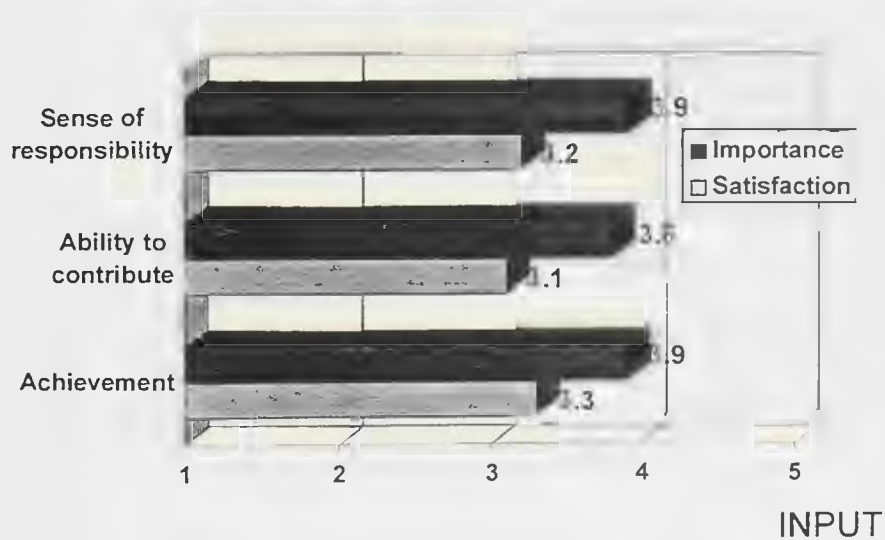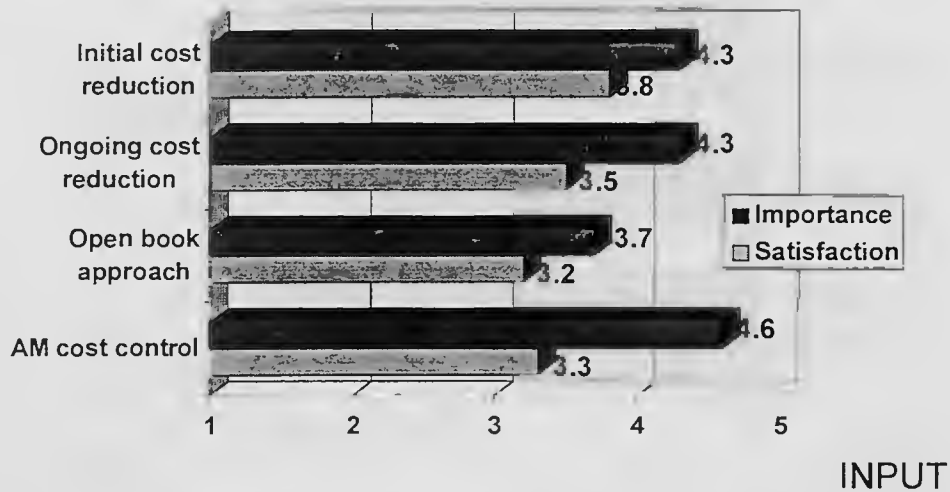- Lack of incentives for improvement

INPUT

Major Challenges

INPUT

Who Leads Technological Innovation?

Importance / Satisfaction

- New systems — 3.8 / 3.3
- New technologies — 3.6 / 3.3
- Technical knowledge — 3.9 / 3.4

INPUT

Who Delivers The Business Benefit?

Importance / Satisfaction

- Sense of responsibility — 3.9 / 3.2
- Ability to contribute — 3.6 / 3.1
- Achievement — 3.9 / 3.3

INPUT

Cost Reduction Must be Continually Demonstrated

Initial cost reduction — Importance 4.3, Satisfaction 3.8

Ongoing cost reduction — Importance 4.3, Satisfaction 3.5

Open book approach — Importance 3.7, Satisfaction 3.2

AM cost control — Importance 4.6, Satisfaction 3.3

Legend: ■ Importance ☐ Satisfaction

INPUT

Perceived Areas for Improvement

- Become more proactive

- Become less bureaucratic

- Become more client-focused

- Invest in new technology

- Improve business knowledge

INPUT

CLIENT PERSPECTIVES ON THE OUTSOURCING RELATIONSHIP

Conflicting Demands

Our objective is to move from what are conflicting and, at times, unrealistic user expectations to a situation where progress can be made. Essentially clients want all of these attributes. Clients that start with a cost reduction perspective later expect a level of advice and innovation leading to business value. Similarly, organisations that initially seek business value also expect market pricing for the underlying IT services.

Evolution of the Outsourcing Relationship

Central to the debate are two issues:

1. From the user perspective, is outsourcing trending toward further cost reduction, or is the main emphasis now on value creation ?
2. Are renewal intentions determined primarily by meeting contract objectives, or more than this?

Future Benefits Sought

These are the replies to an open-ended question.

Changing Client Expectations

These trends result from a comparison of expectations for clients whose contracts started in 1995 compared to those whose contracts started in 1994 or earlier.

INPUT identified marked differences in the way users perceived their 1995 contracts compared to those predating this figure. The *stated* emphasis was away from strict cost reduction towards a more results-oriented focus. However, we believe that there is a danger in interpreting these sentiments too literally - users are still looking for value for money.

Future Assessment Criteria

When users were questioned about the criteria most important in assessing outsourcing vendors in future, IT and business benefit capabilities both scored more highly than price. Whilst this question did not disseminate views across different platform types, INPUT believes that the result would have been similar.

Current Role of Vendors

Note that in the way questions were set, the term "partner" was not defined further. In practice, users perceive vendors as key IT partners but not key business advisors. Given that a core activity of outsourcing organisations is technology transfer, the aggregated score of 3.7 for "a technology advisor" appears surprisingly low.

Image: Vendor A

The next two slides illustrate the difference in perception between two leading outsourcing vendors, often regarded as being similar in approach. Vendor A has achieved the status of being strongly regarded as a key partner (scoring 4.8) and is making considerable progress in being viewed as a business advisor and agent of change. Vendor B has achieved considerable success but tends to score highly as a technology advisor and has a low score as a business advisor.

This demonstrates that advanced technology skills are still very important to clients. However, Vendor A has achieved a strong marketing position being seen to contribute much more than IT skills and services to its clients.

Image: Vendor B

- no further commentary -

The Gap Between Satisfaction and Contract Renewal

73% of users expressed high levels of satisfaction with their current outsourcing provider, and yet of those, only 51% indicated a high likelihood of renewing their incumbent's service contract.

3% of users expressed low levels of satisfaction with their current outsourcing provider, and yet, 14% indicated that it was unlikely that they would renew their incumbent's service contract.

From this data, INPUT deduces that meeting the terms of the service contract is insufficient to guarantee vendor loyalty. The factors shown in the following slide show the highest correlation with contract renewal intentions, indicating what is required to delight the client.

What drives Client Renewal Intentions?

- no further commentary -

Attitudes to Incentives, Penalties and Innovation

A clear mis-match exists between what users and vendors perceive as basic outsourcing provision. Using the marketing concept, the moral for vendors may be the need to exceed your client's expectations, not merely meet them.

Frequency of Pricing Reviews

"Pricing review" is defined as a situation when the price of a contract is either negotiated or renegotiated between vendor and client - at any time.

The survey results showed the surprising inflexibility of vendors to increase the frequency of pricing reviews to more than once a year, given the fluid nature of technological change in the IT industry and the rate of change of the business environment.

While this lack of flexibility is perceived by vendors as a defence mechanism, users perceive it as a major barrier to engendering a more positive working relationship. INPUT views a quarterly review system to represent a more flexible arrangement.

Outcome of Negotiation

In practice, this inflexibility does not *protect* vendor pricing. During the course of contracts, 60% of clients negotiated lower terms with their vendors. In practice, most of the further 27% "successful" negotiations also constitute price reductions.

The message is clear: price reductions during contracts occur as a matter of course. This being the case, vendors are advised to turn weakness to advantage by volunteering to proffer unprompted price reductions. In this way, positive PR and client kudos can be achieved.

Conclusions

Increased price competition indicates that vendors must continue to demonstrate value for money. The principal challenges for vendors are to : (1) move from offering services in a reactive to a proactive manner, (2) be more flexible in adapting to changing client circumstances, including price reviews and (3) broaden the base of IT provision to encompass more business-oriented value adding.

At present, service provision is of a reasonably high standard but is too reactive in nature.

Client Perspectives
on the
Outsourcing Relationship

March 13, 1996

INPUT

Conflicting Demands

Certainty of budgeting ◄──► Innovation

Commodity pricing ◄──► Business value

INPUT

Evolution of the Outsourcing Relationship

- Changing client expectations

- Current perceptions of vendor role

- What drives renewal intentions?

- Pricing - the test of partnership?

INPUT

Future Benefits Sought

- Greater/continuing cost reduction

- Greater involvement of vendor
  with business success

- More flexible approach

- Exploitation of new technology

INPUT

Changing Client Expectations

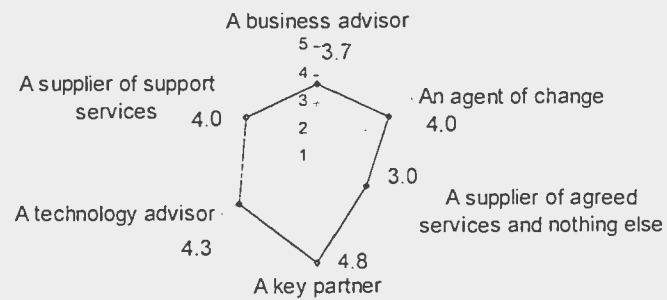| Increasing Importance	Decreasing Importance
Achievement of projected business benefits	Length of contract
Links to business success	To become more cost-effective in using IT

INPUT

Future Assessment Criteria

Criteria	Level of importance
IT capabilities	4.6
Business benefit capability	4.0
Price	3.7

Level of importance (1–5)

INPUT

Current Role of Vendors

A business advisor
5
2.5
4
3
A supplier of support services
4.1

An agent of change
3.1

2
1

A supplier of agreed services and nothing else
3.3

A technology advisor
3.7

A key partner
3.7
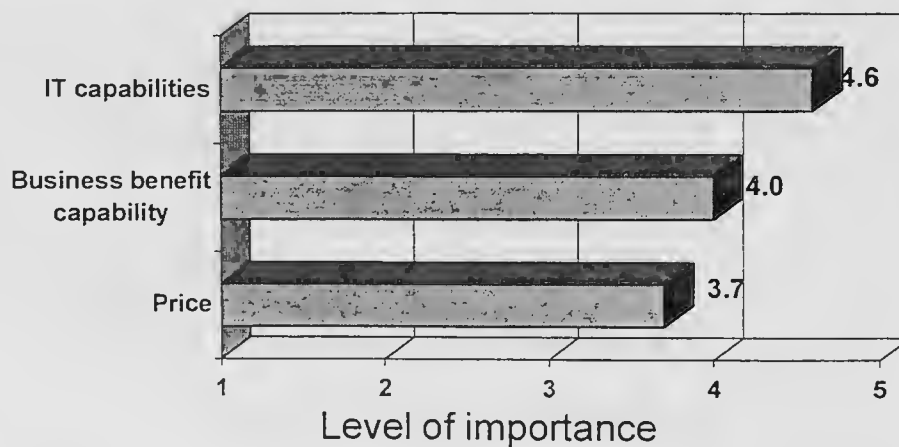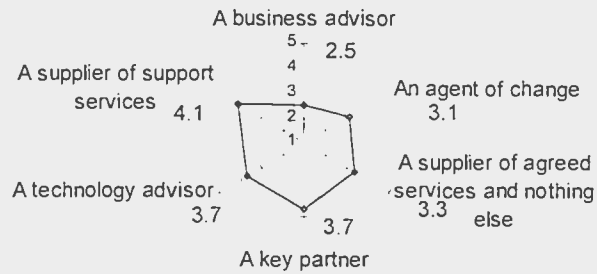
Sample of 130 respondents. Standard error=0.1

Image: Vendor A
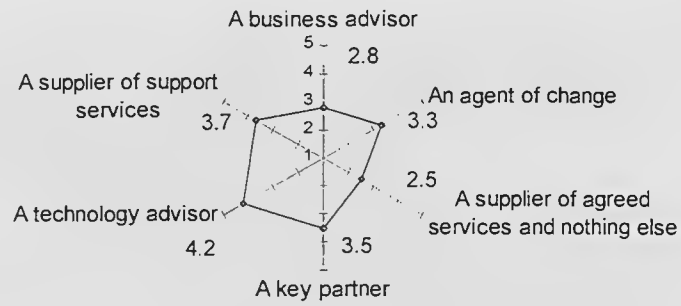
A business advisor
5
3.7
4
3
A supplier of support services
4.0

An agent of change
4.0

2
1

3.0

A supplier of agreed services and nothing else

A technology advisor
4.3

A key partner
4.8

Image: Vendor B

A business advisor
2.8
A supplier of support services 3.7
An agent of change 3.3
A supplier of agreed services and nothing else 2.5
A technology advisor 4.2
A key partner 3.5

The Gap Between Satisfaction and Contract Renewal

High
Moderate
Low

0   20   40   60   80
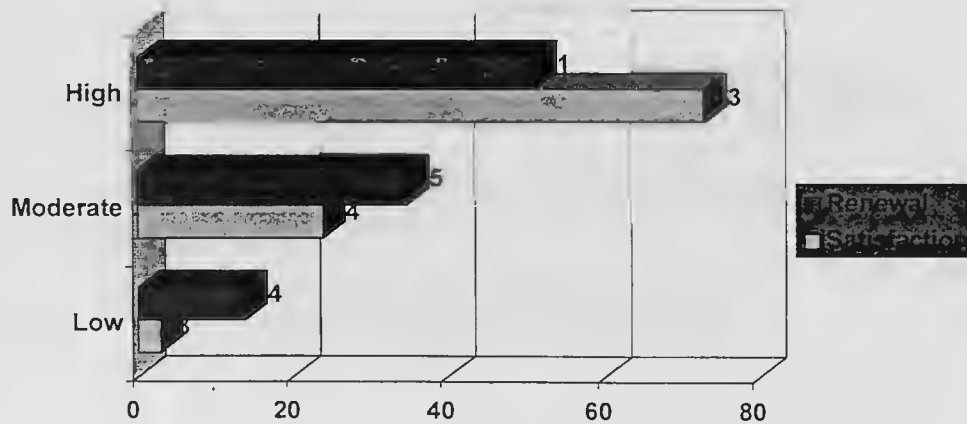
Renewal
Satisfaction

What Drives Client Renewal Intentions?

- Business contribution
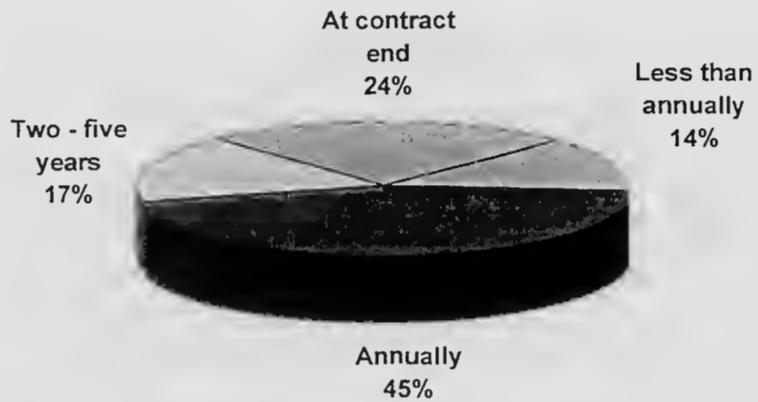
- Performing as agent of change

- Flexibility of approach

INPUT

Attitudes to Incentives, Penalties & Innovation

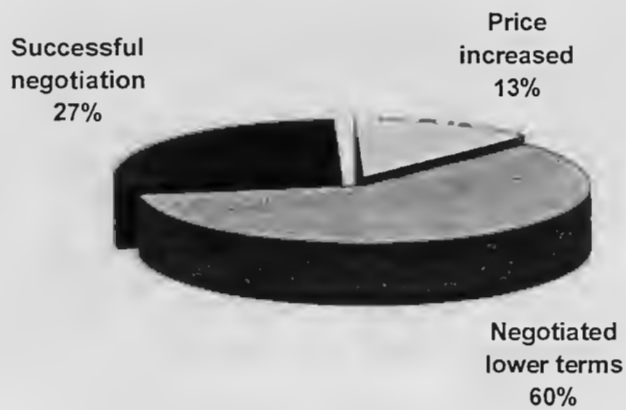|	Clients	Vendors
Penalties	Necessary to ensure SLAs met	Show unwillingness to work together
Incentives	Contract renewal	Appropriate if targets exceeded
Innovation	A basic service element	High risk - requires high margins

INPUT

Frequency of Pricing Reviews

At contract end
24%

Less than annually
14%

Two - five years
17%

Annually
45%

INPUT

Outcome of Negotiation

Successful negotiation
27%

Price increased
13%

Negotiated lower terms
60%

INPUT

Conclusions

- Vendors provide good reactive, operational services

- Vendors must in future:
    - Make greater business contribution
    - Be more flexible
    - Demonstrate value for money

INPUT

INPUT

"Delivering Value" The New Agenda for IT Services Companies

Ben Pring - Business Integration
Programme Manager, Europe

Maidenhead - 13 March 1996

Frankfurt · London · New York · Paris · San Francisco · Tokyo · Washington

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Objectives

To examine value-based service delivery and its implications for vendors of IT Services, focusing on:

- Understanding the Marketplace Context
- Examining the Strength of Supply Side Push
- Identifying Demand Side "Early Adopters"
- Discussing Market Prospects and Scenarios

INPUT

The Marketplace Context

- "Convergence"; the Age of Changing Value Chains

- The Business' Agenda is *Value*

- Being First is No Guarantee of Downstream Revenues

INPUT

Received Wisdom or the Truth ?

- 70% of users state that their systems are not returning their company's investment
- 30-40% of IS projects realise no net benefits (however measured)
- "Return on IT investment over the past 20 years has been so low that companies would have done better ... to have invested that same capital in almost any other part of their business"

INPUT

The Business Integration Paradox

- *"The bloom of the IT rose has faded"*
  - various, after Vernon Ellis

- IT has never been more important

Value Based Pricing

- Delivering IT to non-IT Metrics

Shift From "Task Based" to "Value Based" Services

• "Task-Based" - delivering on time and budget

• "Value-Based" - measurable increases in shareholder value, earnings per share, market share growth etc.

INPUT


Trends in IT Development and Integration Project Delivery

1991 - 1994   1994 - 1998

Lowest Based   ➡️   "Best Economics"
Unit Price

Cost   ➡️   Value

Service   ➡️   Business Results
Provision
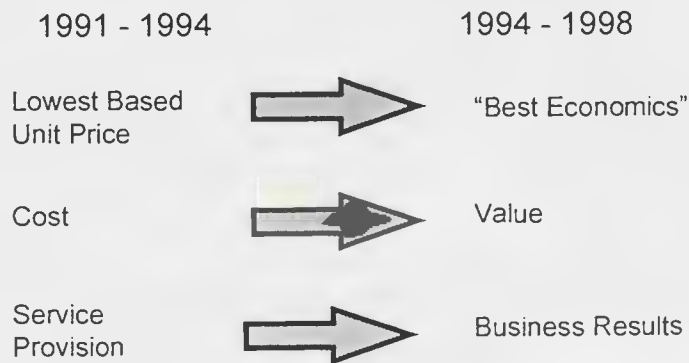
INPUT

Evolution of Service Offerings

Past	Present	Future
Box Minding for a Fee	Co- Sourcing	"The White Space"
IT Service Levels for a Fee	BPM	

INPUT

Quest for Predictable Business Results

Business Impact

Business Results

Delivery

Resources

Advice

Accountability
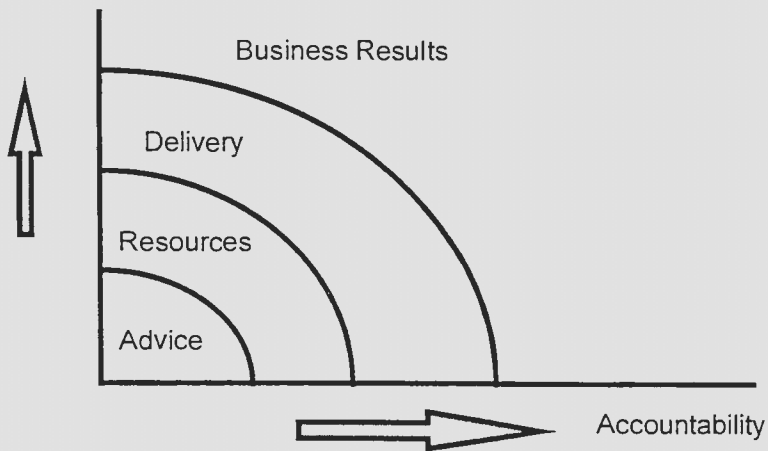
INPUT

Gap Between Benefits-Managed and Cost-Managed Utilisation of IT

Performance

Benefits
Managed

Cost
Managed

Time

Source: Nolan Norton
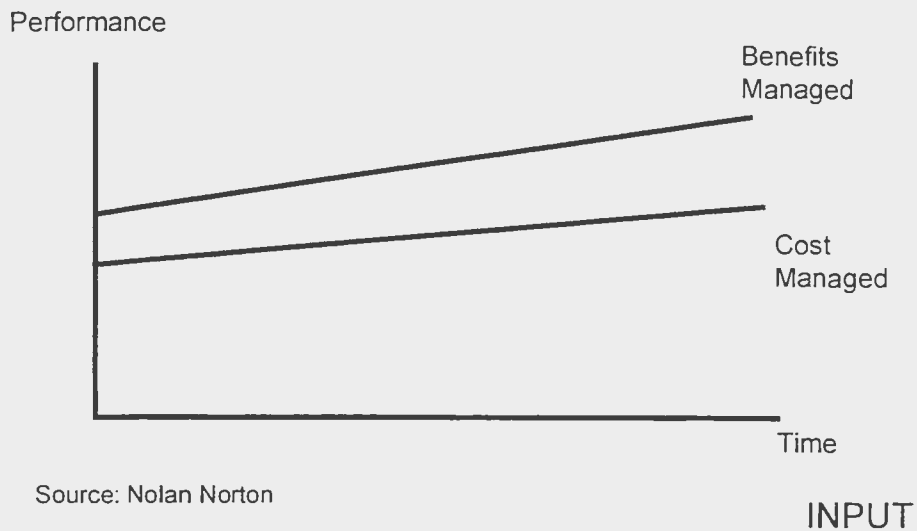
INPUT

Fundamental Changes in the Supplier/Buyer Relationship

Value

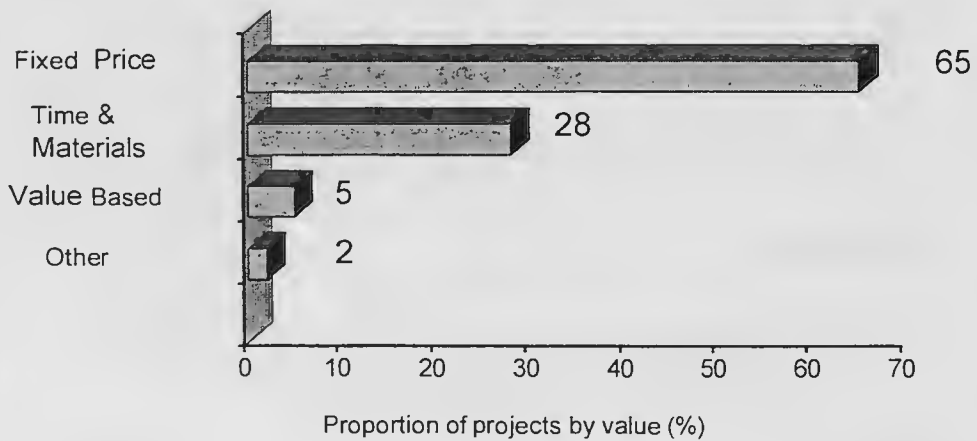*From Successful Execution to Measurable Results*

Partnering

*From "Doing to" to "Doing with"*

INPUT

Client/Supplier Relationship

Knowledge
Transfer/
Task

Learning
Process

Learning
Process

Learning
Process

Time/Price
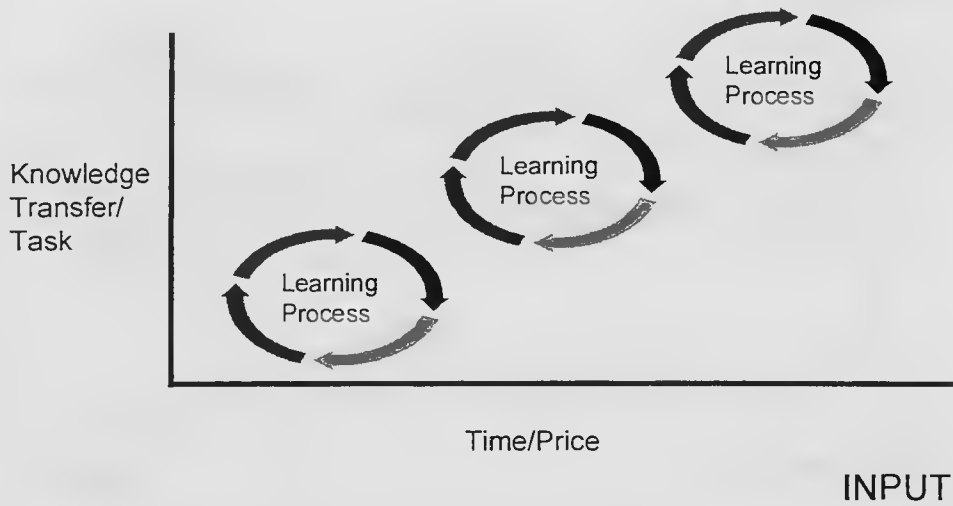
INPUT

Project Pricing Mechanisms
Vendor View

Fixed Price — 65

Time &
Materials — 28

Value Based — 5

Other — 2

0   10   20   30   40   50   60   70

Proportion of projects by value (%)

INPUT

Sample of 10 Leading European Vendor Organisations

Pricing Mechanism Preferences
User View
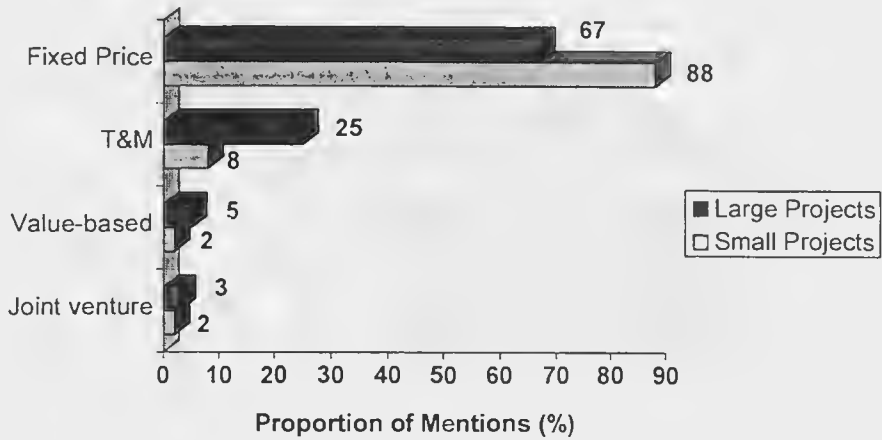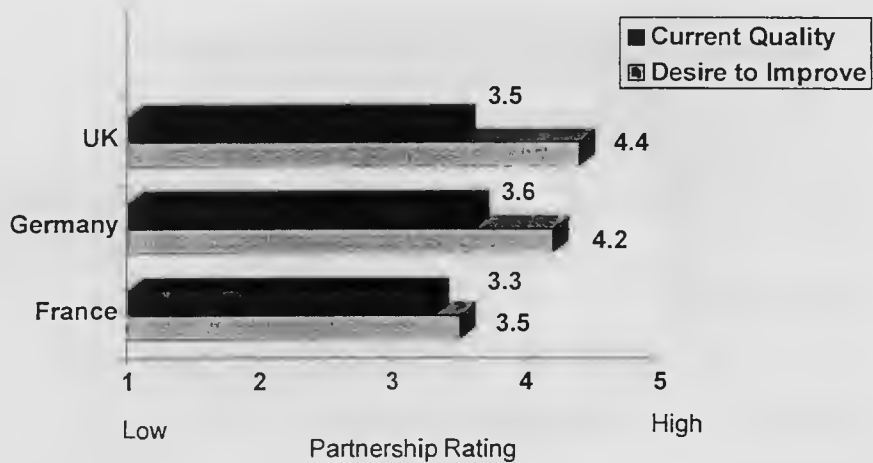
Sample of 90 Leading European User Organisations

INPUT

Attitudes to Vendor Incentives
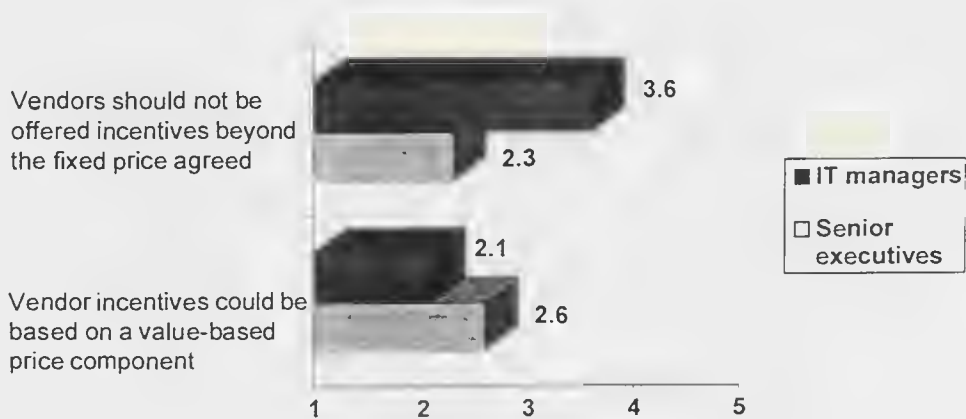
Sample of 90 Leading European User Organisations

INPUT

Partnership Quality
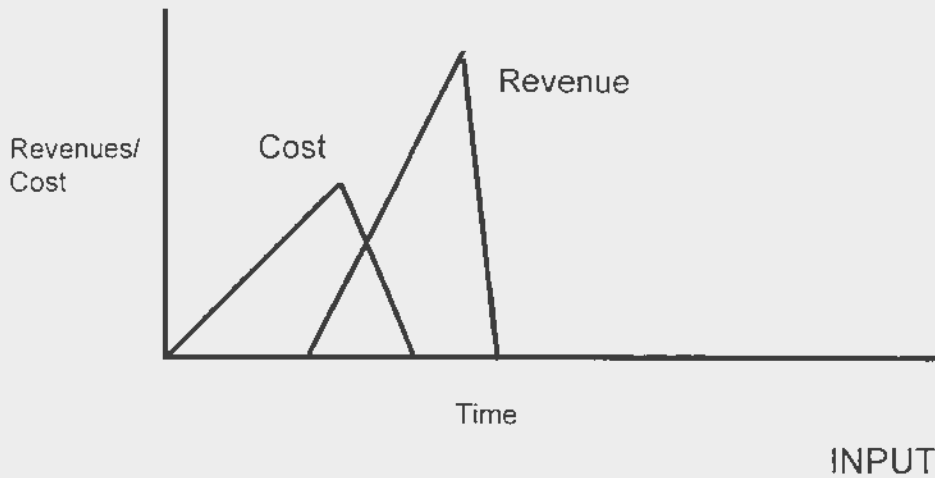

Sample of 90 Leading European User Organisations

INPUT

Contract Review

Traditional	Co-Sourcing	Business Process Management
Inland Revenue	Royal Bank of Scotland	National Westminster Bancorp
American Express	Moore Corp	Care 1st HealthPlan
Xerox	IBOS	BPX
Lucas	Rolls Royce	

INPUT

Traditional IT Prime Contractor Financial Model

INPUT

Value/PFI - BPM Finances

	1996	1997	2001
Revenues	0	0	5
Order Intake	10	3	2
Expenses	5	4	3

INPUT

Value/PFI - BPM Financial Model
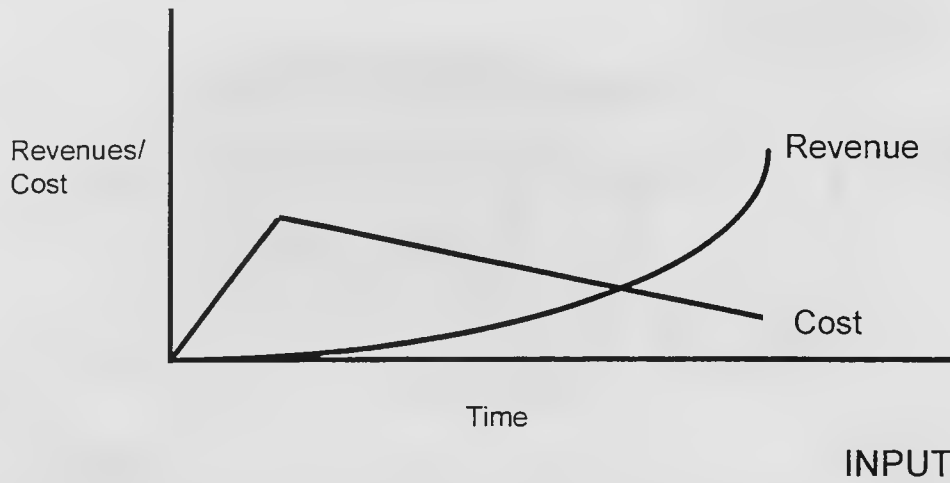
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PFI - Opportunity Model
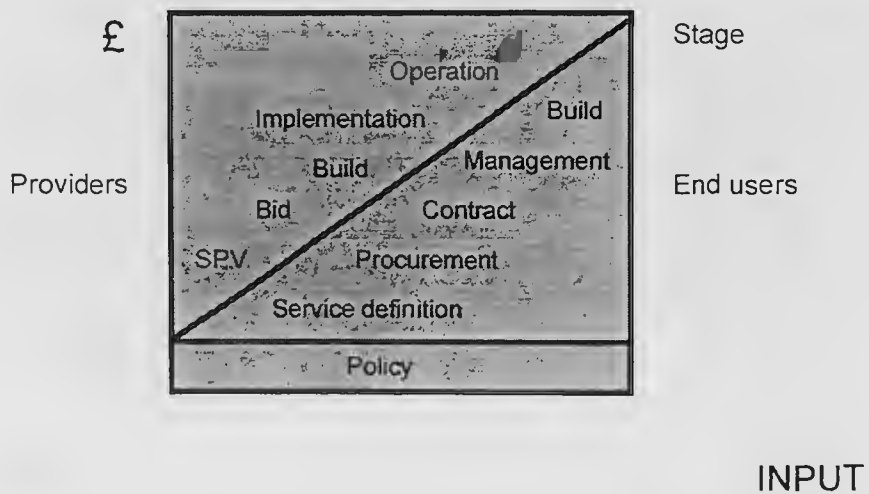
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% Of Revenues Derived From Value Based Pricing Contracts

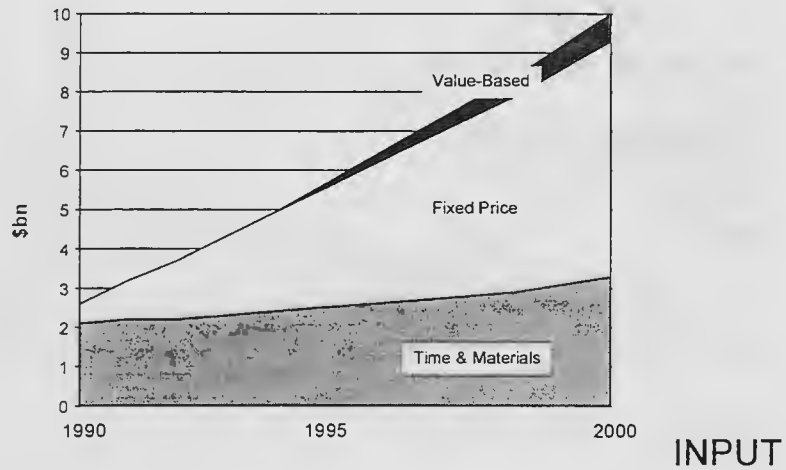| Vendor	%
Andersen Consulting	20
EDS	15
Cap Gemini Sogeti	10
Logica	15
NCR	5

INPUT

Leading European Systems Integration Vendors 1994

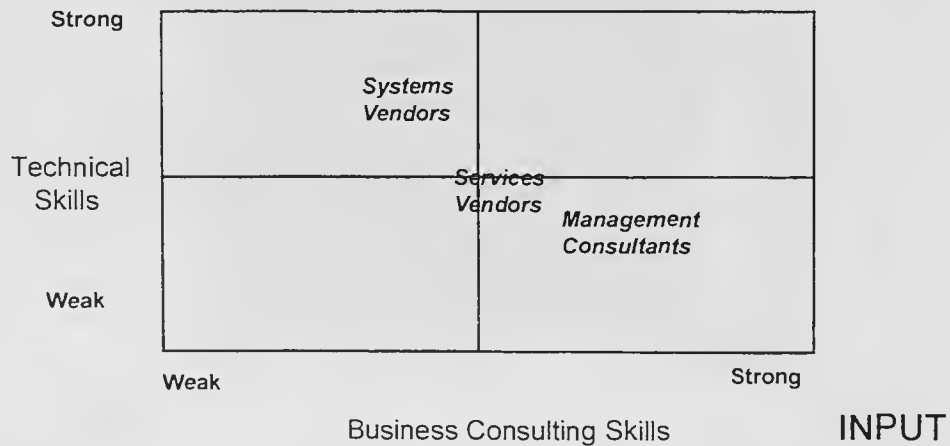| Rank	Company	Market Share (Percent)	1994 Estimated Revenue ($ Millions)
1	IBM	20	994
2	Andersen Consulting	10	474
3	Groupe Bull	7	370
4	CGS	7	342
5	EDS	5	250
6	DEC	5	235
7	ICL	5	225
8	Sema Group	4	192
9	SNI	3	152
10	Logica	3	126
	Total Listed	69	3360
	Total Market	100	4700

INPUT

Contractual Approaches to European SI Projects 1990 - 2000

INPUT

Vendor Positioning

Is there a magic model ?

INPUT

Developing Marketplace Model

New

Traditional

Management Services

MC's

End Users

IT Services
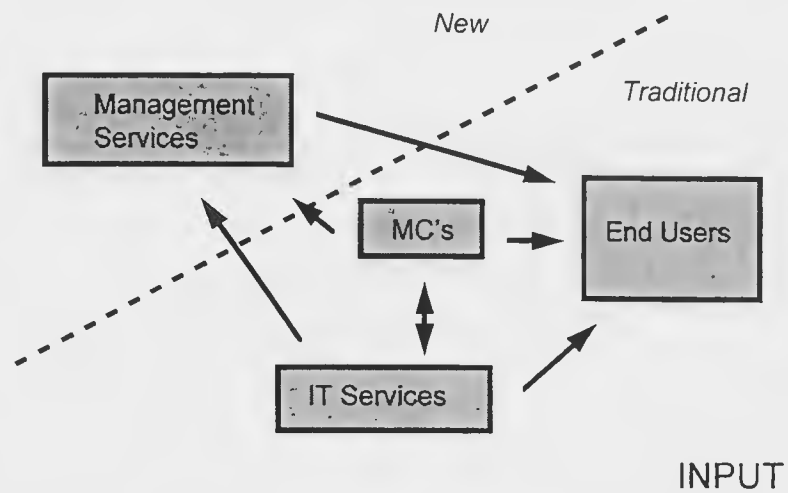
INPUT

The Name of the Game

- "Protecting and expanding the core business through account control" (According to Porter)

INPUT

Vendor X's Differentiators

People, Processes, Technology

- Leader in client/server technology
- Commitment to knowledge transfer
- Senior level consultants
- Problem solving approach
- Direct access to advanced technology

INPUT

Key Success Factors Towards Value

Incremental Growth from
Market Share Gain

- Ability to deliver world class service
- Technical Problem Solving
- Lowest cost supplier position from economies of scale
- Ability to finance large deals
- Ability to win against known competitors

Transformational Growth from
New Service Development

- Ability to bring multiple strands of world class service to a single issue
- Highest value added supplier
- Establish and support higher risk ventures
- Ability to create new revenue streams
- Thought Leadership

INPUT

Customer View of Cost and Value

- Cost

When it's signed

- Value

When it's delivered

INPUT

Final Thoughts & Summary

- (Some) Vendors are Pushing the Envelope

- Emergence of a New Lingua Franca

- Three Responses to Change: Initiate, Respond, Get Trampled

- Convergence and Fragmentation Are Not Mutually Exclusive

INPUT

"Delivering Value"; The New Challenge for Business Integration Vendors

The systems integration and professional services industry has entered a phase in which vendors are attempting to demonstrate IT's ability to deliver benefits on business terms, for example, increasing an organisation's earnings per share or its market ranking.

This message is fast becoming the new mantra for success in the increasingly competitive project delivery marketplace.

Vendors such as EDS and Andersen Consulting have been extremely vocal in pushing the message that they are now contracting to deliver IT projects to non-IT metrics rather than traditional IT ones based on functional requirements aligned to a fixed development term or price.

However, other vendors have expressed scepticism towards these developments seeing enormous complication in defining and isolating specific measurable metrics which can be used to judge the long term success or failure of a contract. The ability to separate the causal correlations between the development of an IT system and the subsequent fortunes of a company have also been questioned.

This bulletin examines the development of this issue since INPUT first commented on this in April 1994. In particular it focuses on:

- Questioning whether messages of "value" and "business benefits" are a response to user demand or whether they are marketing propositions being driven by competitive supply side issues ?

- How vendors are developing and positioning their new added value service offerings

- What effects these developments are having on the overall shape of the industry, and what impact they are having on the market's growth prospects.

"Value" — A Marketing or an Operational Issue ?

Value-based pricing has rapidly become a major issue for Business Integrators over the last 18 months. It is though, a contentious topic which is dividing opinion in the European project services community.

Value-based pricing can be defined as the linking of project price to the achievement of specific business goals within a client organisation. If the project succeeds in achieving these goals then the vendor is rewarded with a share of the savings or potentially more importantly of the increased revenues.

This approach has benefits for both the client and the vendor as value-based pricing focuses management attention on the achievement of the client's business goals.

Value-based pricing provides vendors with an incentive to address business problems rather than just minimising their own commercial exposure while delivering a technical solution.

The emergence of this concept is the result of a maturing of IT development and integration processes, in turn a consequence of the increasingly embedded role technology plays in business processes.

It is becoming increasingly inappropriate to examine, and more importantly change, business processes without examining, understanding and changing the technology underlying and facilitating these processes. IT is also becoming a much more significant cost as its uses change.

Vendors and users now concede that it is artificial to draw a distinction between strategy and implementation; that unless one knows what each part plays, one cannot understand the other; that one needs strategy knowledge to do successful implementation and implementation knowledge to do strategy.

As a result technology services organisations are being forced to understand business issues which historically have been above them on the theoretical strategy/operations "value chain".

Exhibit 1 illustrates a number of key developments as IT development and integration projects moving from lowest based unit prices towards "best economics"; from cost to value, or from service provision towards business outcomes.

Exhibit 1

Trends in IT Development and Integration Project Delivery

1991–1994		1994–1998
Lowest Based Unit Price	→	"Best Economics"
Cost	→	Value
Service Provision	→	Business Results

Source: INPUT
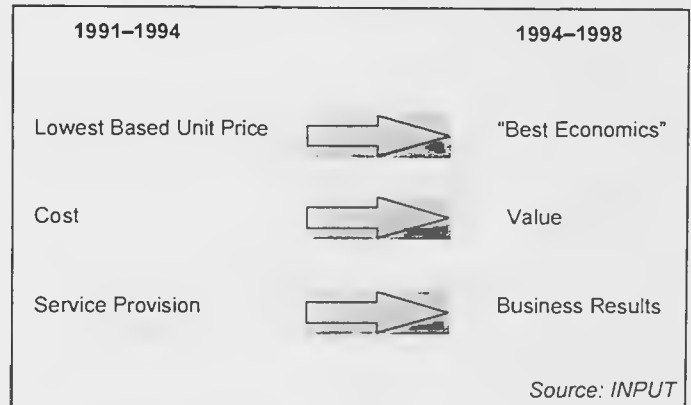
Supporting this dynamic is the fact that many major user organisations have, over the last five years of recession and slow post-recession growth, been through huge cost saving engagements with management consultancies and find now that there is not a lot more cost to be stripped out.

Consultancies and the new "management services" organisations, as vendors such as EDS and Andersen Consultancy could be characterised, are thus moving more towards revenue generation engagements and are

looking for shares of the value they claim process-rich-IT systems will deliver.

The scepticism these developments are producing (from vendors not driving these concepts) is understandable. There are clearly serious complications in defining and isolating specific measurable metrics which can be used to judge the long term success or failure of a contract.

The ability to separate the causal correlations between the development of an IT system and the subsequent fortunes of a company is a key issue.

Shareholder value is the most difficult one of the business metrics to relate to. Defining deals on this basis will undoubtedly be difficult to negotiate with senior client executives.

Sceptics have also raised the question as to whether the dynamic of value-based delivery of products and services is happening in other business areas and if not, why not.

Why is this going to occur in IT/business relationship; is there anything intrinsically special about IT ?

The concept of value based delivery is also occurring at the same time as partnering is becoming a key concern for IT users and vendors.

A willingness to enter into partnering relationships based on trust is not intrinsic to north European cultures, where organisations have historically only been comfortable dealing on a contract basis. Value and long term business relationships challenge these historical tenants.

Partnering needs to be based on shared risks and shared rewards and vendors will need to put money where their mouths are; quick win,

short term thinking will have no place in this types of relationship. When, at the beginning of a contract it is unclear what the configuration of the deal is going to be, and it is therefore difficult to hammer issues into a hard contract, both sides of the equation will be required to demonstrate good deals of trust, with the onus, if anything, being heavier on the vendor's side.

The jury could be said to be still out as to whether users are demanding these approaches; users are certainly wise to sales messages of partnership and value which come to them through an historical filter.

Some users have stated that value based contracts appear a bad basis for commercial relationships and potentially represent a lawyers' field day.

Vendors are selling to experienced people who have seen many different contract approach appear and disappear; vendors need be aware that often they are selling to bruised and sceptical people who may firstly believe that partnership and value are not the way to proceed, and secondly regard them purely as marketing hype.

The key to operating value-based contracts is in defining what are the projects business benefits and how will these be measured. Only then can contractual arrangements be struck towards payment; a 50% payment up front and a delay of 12 months before final payments are made may be fairly typical.

Vendors face the question of whether these delays, and potentially longer delays of 2-3 years before the results can be proved and payments be made, are acceptable and attractive.

Vendors Position New Value-Added Services

The vendors who have been most aggressive in driving these deals, Andersen Consulting and EDS, argue that IT delivery has now moved on and is now not just about delivering to SLAs, not even about reducing unit costs, but about bringing value to shareholders.

This, they argue, is the new paradigm and defining characteristic of the next generation of professional services firms and brings with it a new set of rules of engagement.

EDS are aiming to take clients from initial "insights" through to the implementation that results from these insights. This represents a major change for EDS and information services firms in general and requires change in everything from the refocusing and reskilling of account teams through to investments made at senior levels to facilitate higher level account management.

EDS suggest that their business is now about finding where the added value is in their potential client relationships. EDS would argue that users want to know that the vendor can deliver the IT solution, not just advise on it.

EDS argue that vendors cannot bring value to deals unless they understand client's business drivers. This is why the consulting part of their operation, A.T.Kearney, is a strategic imperative.

As a result of these strategic moves EDS is withdrawing from basic IT management bids; this is not where they perceive value to be.

IT was not involved in strategy and planning a few years ago. Now it is, as firm's strategies and plans are more closely tied to what can be achieved by information technology.

For example ATM was a technology issue that changed the way that banks were run. First Direct and DirectLine Insurance are examples of businesses that have been created around new uses of IT.

EDS are engaged in value-based deals with IBOS (the Inter Bank On-Line system) and the Royal Bank of Scotland. EDS state that they have not yet *not been paid* for a contract written on these terms but that the benefits will begin coming on stream in 1996.

The next logical stage in this process is to create a separate enterprise to run an outsourcing operation. Andersen Consulting's business with Northwest Airlines for ticketing and booking fits this category.

Now partly owned by Andersen Consulting this is a stand alone business where risk exposure is increased but potential revenues are too.

Another major value-based deal Andersen have been involved with is a contract with the US pharmaceuticals company Astra Merck where Andersen have been involved in reinventing pharmaceutical production and retailing process and are now sharing a proportion of a $5 billion per year drugs business with Astra.

Other similar deals include ones with the US firm Planters Lifesavers and Fiat - New Holland where Andersen manage many of the production business processes on a shared reward of sales basis.

Impact on the European Systems Integration Marketplace

The ability to engage potential customer's senior executives in discussion about the contribution technology can make to an organisation in terms of value rather than purely cost is giving certain vendors an edge

in the marketplace's consideration of service providers.

The development of the concept of "value-delivery" is part of the process of creating a differentiated, premium position and attempts to move a vendor up the value chain of positioning, pricing, and profitability away from pure IT based systems integration where margins are under intense pressure.

The development of this "value proposition" is in many ways analogous to the development over the last five years of Business Process Reengineering which, though as a theory has had many detractors, has had a significant impact on the systems development and integration industry.

As in the early period of the BPR movement there are, as yet, only fragmented details about the actual structure of these types of contract; vendors are, unsurprisingly, cautious about laying competitive details on the table. This tantalising situation of course plays into the hands of the doubters and sceptics.

Vendors should regard value-based contracts as another string to the bow not another bow; this is also undoubtedly a large versus small project issue. Is it only going to be large projects where business metrics come into play.

Exhibit 2 illustrate the growing role this approach will play in the European Business Integration market over the next five years.

Exhibit 2

Contractual Approaches to European Systems Integration Projects 1990-2000

Source: INPUT
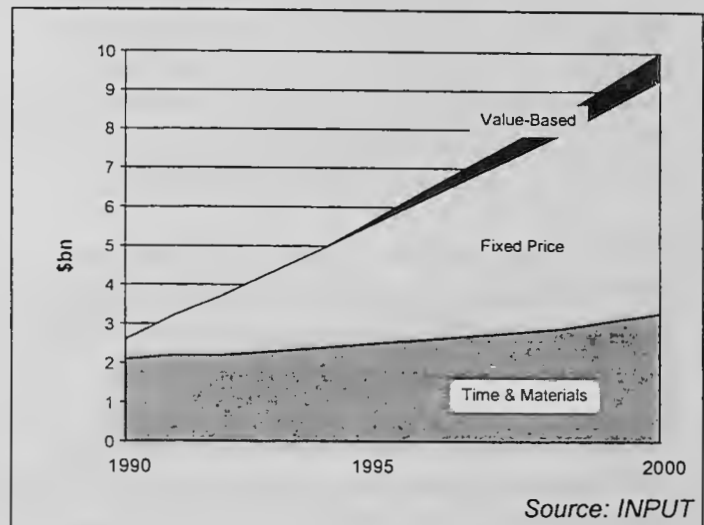
Some organisations will experience significant problems and become spectacularly unstuck. Scandal will no doubt drive out the charlatans and will emphasise the firms with a strong brand image.

The market will also see a number of vendors getting burnt because they didn't understand the real implications and then cutting down drastically, the deal making culture is not appropriate to these situations.

However, more and more contracts are being struck in this way (Delivering IT to non IT metrics) and though it should be recognised as a leading edge, and that the proportion it represents of overall contracts is still small, it is a major stage in the growing maturity of the marketplace.