



EXECUTIVE INSIGHTS

Specialist Digital Service Providers: Mission-Critical to Enterprises or a Passing Trend?

Specialist digital service providers (“DSPs”) play a pivotal role in helping enterprises with their cloud-based digital transformations. The most successful DSPs offer deep local domain expertise and are quick and nimble at scaling up or down on a project. They are now active, serious competitors to the traditional IT consulting players in this area, such as global systems integrators and large digital consultancies.

Their future as digital transformation enablers in this area looks secure, but will they continue to play the crucial role of helping enterprises advance their digital transformation journey as the cloud computing space matures over the coming years? What challenges are they likely to face over the next three to five years, and how can they retain their market positions as key specialists in this area?

This is the first of three articles examining DSPs. In this article we examine factors behind this growth, including why DSPs have received such strong support from enterprise customers and vendors alike. We also discuss how these factors will continue to affect their progress as market leaders over the remainder of this decade and what is likely to put the most successful DSPs ahead of their competitors.

Spending on digital transformation continues to increase, even as the global economy enters a downturn. Cloud and data have become critical enablers of an enterprise’s digital transformation, which in turn now forms an integral part of its competitive abilities.

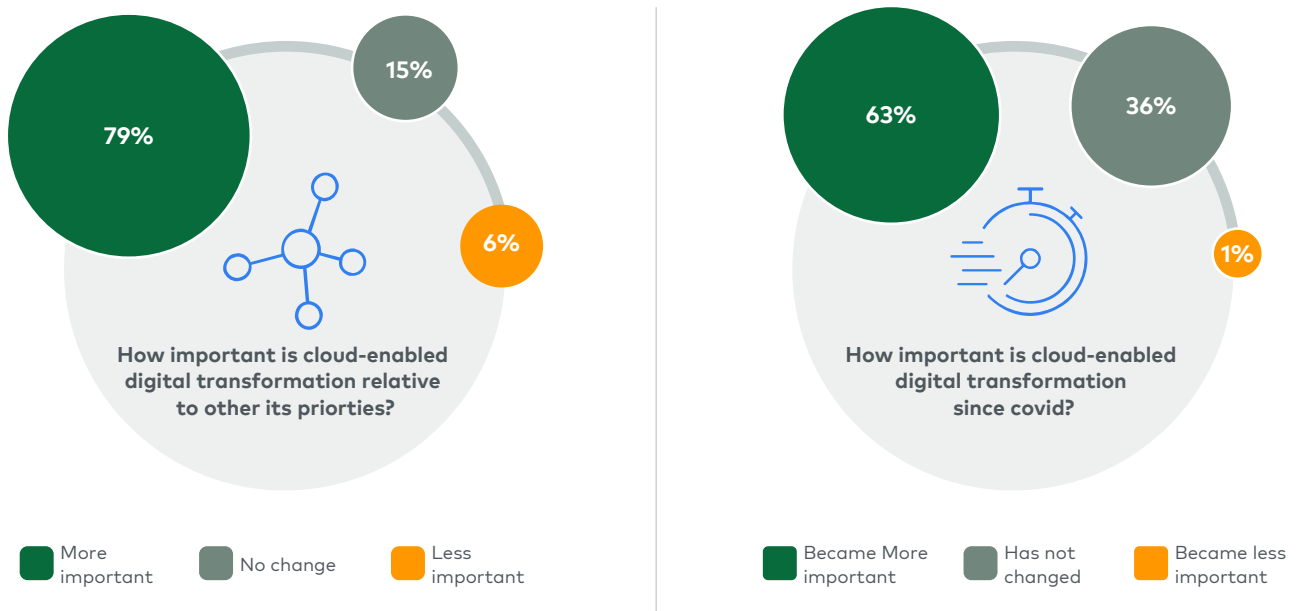
This surge in cloud-enabled digital transformation has driven the growth of specialist DSPs servicing enterprise customers embarking on cloud-based transformation projects. These DSPs are thriving as they meet a growing demand from enterprise customers for local, boutique providers with deep expertise in cloud computing and its allied services.

The forecast: Sustained growth well into this decade

Over the past five years, an enterprise’s digital transformation has been underpinned by several key cloud-enabled technologies: cloud computing, data and analytics, innovative cloud-native applications, mobility solutions, and, more recently, artificial intelligence (AI), especially machine learning. Australian spending on cloud-enabled technology-related services (including internal and external labour) totalled approximately \$8 billion-\$10 billion in 2022,¹ excluding hardware and software licensing costs. This spend received a huge boost from workflows driven by the Covid-19 pandemic and is expected to grow at a compound annual growth rate of c.18%-20% until 2027.

L.E.K.’s recent research in this space identified that the vast majority – nearly 80% – of IT decision-makers in Australian enterprises regard spending on cloud-enabled digital transformation as their highest priority, with over 60% of respondents considering this an even more important priority after the advent of the Covid-19 pandemic.

Figure 1
Cloud-enabled digital transformation*



*L.E.K. Research and IP.

This shift in priorities covers industries of all sizes and types. Technology, healthcare and financial services are leading the charge in growing their cloud platforms and services. Even as the global and Australian economies face potentially recessionary concerns heading into the mid-2020s, these enterprise leaders have indicated that they will continue to invest in cloud and related services.

The research also reveals that Australia's key business sectors are 'rock solid' in terms of their ongoing commitment to digital transformation, recognising the critical role that DSPs play in the digital transformation of their operations and competitiveness.

Almost half the survey respondents indicated that they plan to increase their enterprise's spending on DSPs, and even those respondents who expected to spend less on cloud services in a recession indicated that they will still increase spend on DSPs. Areas of focus for this spend typically include shifting and modernising services into the cloud, the development of new cloud-based business applications, and the development and/or improvement of cloud security measures.

Much of this cloud-based digital transformation work has been (and will continue to be) performed by specialist DSPs, providers that typically focus on one or several of cloud, data/AI, cloud-native app development or mobility professional services. These specialist DSPs are proving worthy competitors of global systems integrators like Accenture, Wipro or Infosys, and also of the Big Four accounting firms, which have their own international digital consulting arms.

Typically specialist DSP's provide customers with services in one or more of four key focus areas: migrating and optimising their applications in the cloud; developing new applications that are 'born in the cloud'; providing associated data and analytics services, cloud security services, and enhancements; and managing services pertaining to these focus areas.

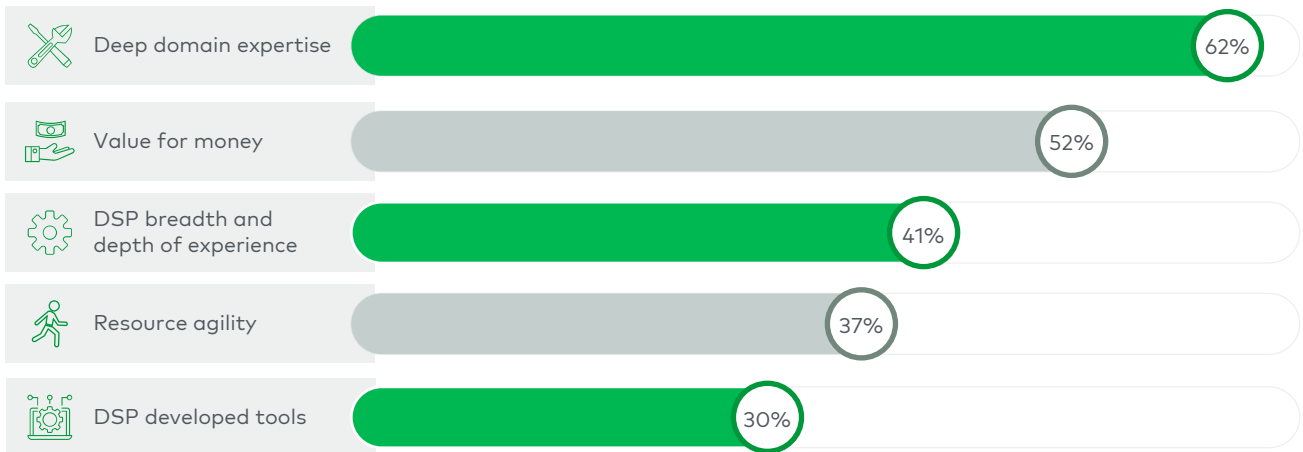
Enterprise leaders increasingly rely on DSPs for their very focused expertise as well as a local presence that ensures accessibility to key people, speed of project delivery and the assurance of high-quality outcomes tailored to the enterprise's requirements in the regional or local market.

What are enterprise customers looking for, and why do they use specialist DSPs?

L.E.K.'s research reveals that enterprise businesses and their key decision-makers — especially digital leaders — regard specialist DSPs as offering key advantages over larger global providers, with specialist DSPs becoming the provider of choice for many of the major digital transformation projects undertaken by these businesses.

Specialist DSPs achieve this competitive edge through offering specialised expertise (and experts) that enables a high-quality set of services and solutions delivered in agile and flexible ways. They offer improved cost competitiveness when compared to the larger global digital consultants. And they also ensure their enterprise customers have responsive local support for particular projects, using teams of diverse experts who can work alongside an enterprise's in-house technology team to achieve its digital transformation goals without the need for additional staffing overheads.

Figure 2
Top five DSP's differentiating factors*



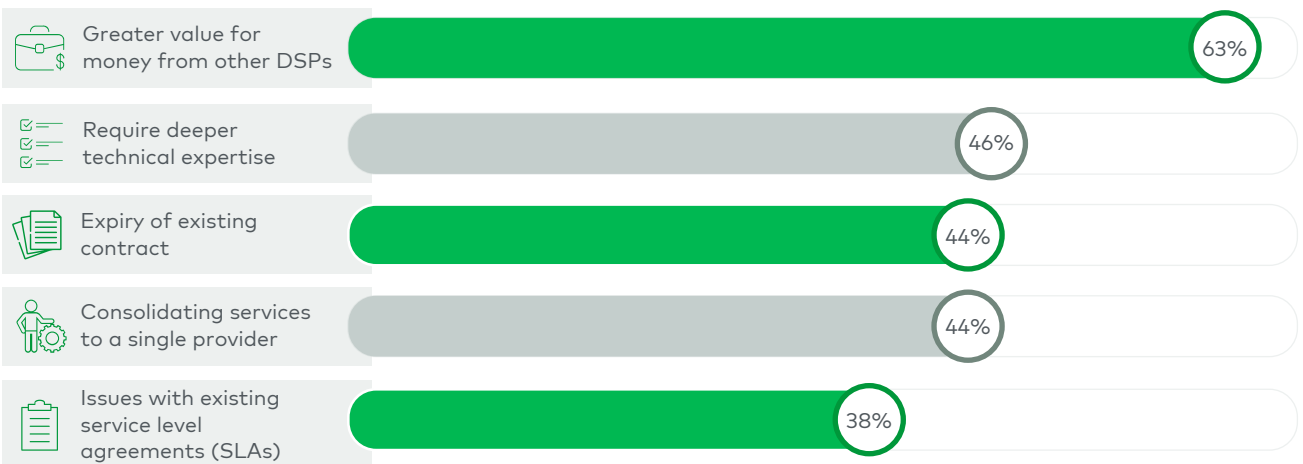
*L.E.K. Research and IP.

This is a particularly compelling advantage: enterprise customers have the expertise they need when they need it for specific transformation projects without having to try to recruit these experts as employees or having to carry them as internal resource overheads.

Often these customers face challenges in attracting experts in this very specialised area, and as a result, they turn to specialist DSPs for access to this high-quality talent. The best DSPs attract these skilled workers by offering them competitive compensation packages, a positive company culture and interesting, diverse work with lots of challenges along the way.

Specialist DSPs also field teams of experts who are certified in the processes and tools required for a compliant solution that best meets the specific needs of their enterprise customers, ensuring a high-quality result that delivers certified best practices.

Figure 3
Top five drivers for switching DSPs*



*L.E.K. Research and IP.

Another point of interest from the research: enterprise customers tend to be very loyal customers and only consider switching from a specialist DSP to another provider if they believe the other can offer greater value or a higher level of technical expertise.

Partners as well as competitors?

Of course, enterprises will still engage the larger global systems integrators and digital consultancies for much of this work. The latter are seen as key providers for high-value, 'bet the farm' projects, but their limitations when set against the more nimble and flexible specialist DSPs will see them increasingly focused on acquiring these competitors or setting in place subcontracting arrangements with selected specialist DSPs.

The latter option can be a win-win — for both the specialist DSPs and their larger competitors. The DSPs receive regular, high-value projects from the larger providers and also present opportunities for these bigger players to acquire some or all of their specialised operations. The number and value of these acquisitions have grown considerably over the past five years, and this trend is set to continue across the rest of this decade. Careful due diligence is required here, to ensure the buyer is confident that a potential specialist DSP acquisition has the right mix of skilled staff, appropriate product and solution sets, and a business direction in place that ensures it will remain ahead of its other competitors in its chosen niche.

Public cloud vendors, such as AWS, Microsoft Azure and Google Cloud, also champion and support specialist DSPs, in part so that specialist DSPs can position the vendors' cloud platforms with customers, leading to improved vendor revenues as a result of faster customer adoption of these platforms. To make this an easy play for themselves and those specialist DSPs they most want to get close to, public cloud vendors often provide specialist DSPs with attractive partnering programmes, including financial incentives for implementation and marketing, and recommend their favoured DSP partners to their enterprise customers.

An ever-evolving market for specialist DSPs

All these growth factors have seen the top specialist DSPs establish profitable niche services and markets in the past five years, along with a solid foundation of enterprise clients. This trend is likely to continue over the next five to seven years, as more enterprise businesses continue their digital transformations and embrace the cloud. In Australia today, approximately 30% of traditional workloads have been migrated to the public cloud. By 2027, this is expected to increase by another 15% to 45%, further fuelling the market demand for specialist DSP services.²

And, as cloud technology continues to develop and mature to match this growth, enterprise customers will continue to seek providers that can deliver the specialised services, proven expertise, innovation and thought leadership that they require for their unique needs. As a result, the specialist DSP market is likely to become even more competitive.

To remain at the forefront of their markets and ahead of their competitors, specialist DSPs will need to rapidly develop specialisation in other key areas adjacent to cloud services. Data and analytics, AI, and robotics are just some examples of these: the forward-thinking specialist DSPs will extend their competencies into these and other areas as they become increasingly relevant to customers' businesses and as the cloud services market becomes increasingly mature. At the same time, a competitive DSP will need to maintain its specialised focus as a niche provider in one or two of these areas or else risk stretching too wide to become yet another generalist in a crowded market.

All this will most likely lead to increased consolidation and acquisition activity, with the larger IT businesses – consulting houses, global systems integrators and others – acquiring the best specialist DSPs while new players with even more specialised DSP services enter the market. Careful due diligence and expert advice from third-party advisors will be crucial for any acquisition play, to ensure buyers are clear on their target's strengths: culture and retention of expert staff, high-quality track record and solutions, and a clear path towards a competitive position in the new areas opening up alongside cloud-based services.

Challenges on the horizon

Heading into the next five years, specialist DSPs will face several challenges, including increased competition, evolving customer needs, technology advancements and changing market conditions, particularly as the broader market for cloud services becomes less specialised and more mature in its outlook and operations. The success factors outlined above will be critical to their continued progress. Finding and retaining highly skilled professionals will continue to be an ever-present challenge in a tight international labour market. This factor, along with increased competition and more market players, will put pressure on profitability and performance. To remain relevant and successful in the changing landscape of the near future, specialist DSPs will need to continuously evaluate their offerings and make strategic investments in their own capabilities. They will also need to consider the options of partnering with, merging with or acquiring others, or even seeking to be acquired by larger market players.

The most successful DSPs will be alert to and ready to adapt to market changes and technology trends while maintaining their expertise, talent pool and internal culture ("it's a great place to work"), and strong customer relationships. They will continue to maintain

and grow their local presence while still being flexible and agile enough to compete against global players. And they will remain competitive on price and value for money while still delivering the high-quality services and results that have positioned them as the current providers of choice for their customers.

Getting all this right will require exceptional leadership and management, as well as the ability to pivot to succeed around the rapidly evolving cloud-enabled technology services sector. The smarter market players will continue to build relationships with their best and most loyal enterprise customers, with many entering acquisition and partnering arrangements to further enhance their business competitiveness. And to be successful, market participants will also need to seek — and will benefit from — advice from experienced external advisors that leads them down the right strategic path to a successful future in this ever-changing market.

For more information, please contact strategy@lek.com.

Endnotes

¹L.E.K. research and intellectual property

²L.E.K. research and intellectual property.

About the Authors



Aakash Gandhi

Aakash Gandhi is a Partner in L.E.K. Consulting's Sydney office. With more than 20 years of experience across technology and telecommunications, he advises clients on a range of issues, including technology and digital strategy, corporate growth strategy, new market development, product development and M&A. He has particular expertise in cloud computing, software/SaaS, data and analytics, digitization, communications and data centers. Aakash is also part of L.E.K.'s Major Capital Projects Advisory practice, advising major project stakeholders on digital and technology portfolio assets, including feasibility for major capital investment decisions and sustainable solutions in complex project turnarounds. Aakash holds a Bachelor degree in electronics and telecommunications engineering from MIT, University of Pune, India, an MS in network systems from Swinburne University of Technology and an Executive MBA from AGSM.



David Ferrarin

David Ferrarin is a Partner and Head of L.E.K. Consulting's Sydney office. He leads Australia's Media, Entertainment and Technology practice, while also consulting widely across many other sectors over his 20-year career. David has a reputation for delivering successful, complex, multistakeholder engagements in both the private and public sectors. He has advised clients on a variety of commercial issues including digital strategy and transformation, corporate and business unit growth strategy, merger and acquisitions, advanced analytics and data strategy, sports media rights, organizational strategy and transformation. David received a Bachelor of Commerce degree from the University of New South Wales and an honors degree in Marketing.



Stuart Westmore

Stuart Westmore is a Partner at L.E.K. and leads the Australian Mergers & Acquisitions and Retail and Consumer Products practices. Stuart works extensively in the area of mergers and acquisitions, on both the purchaser and vendor side of transactions, and has advised a diverse range of corporations, domestic Australian PE teams and Asia-Pacific and Global PE clients on acquisition due diligence. He has also led a range of other merger and acquisition projects undertaken in many diverse sectors. Prior to joining L.E.K., Stuart held management roles with Pacific Dunlop Group and the ANZ Banking Group. He earned a Bachelor of Arts with honors from the University of Melbourne and a Master of Business Administration degree from Melbourne Business School.

About L.E.K. Consulting

We're L.E.K. Consulting, a global strategy consultancy working with business leaders to seize competitive advantage and amplify growth. Our insights are catalysts that reshape the trajectory of our clients' businesses, uncovering opportunities and empowering them to master their moments of truth. Since 1983, our worldwide practice — spanning the Americas, Asia-Pacific, and Europe — has guided leaders across all industries, from global corporations to emerging entrepreneurial businesses and private equity investors. Looking for more? Visit www.lek.com.

L.E.K. Consulting is a registered trademark of L.E.K. Consulting LLC. All other products and brands mentioned in this document are properties of their respective owners. © 2023 L.E.K. Consulting LLC