Steering Clear of the IT Danger Zones

In this Executive Insights Analysis on Technology, L.E.K. Consulting examines the key drivers behind the global growth in IT services, changing behaviors of IT services buyers – and how vendors and investors can steer clear of danger zones.
What’s driving global growth in IT services?

Companies increasingly seek to maximize operating flexibility by taking advantage of IT services that help migrate their industry-specific business processes to the cloud.

<table>
<thead>
<tr>
<th>Key market demand drivers over the next 3-5 years</th>
<th>Regions impacted</th>
<th>Segments impacted</th>
<th>W.W. market</th>
</tr>
</thead>
<tbody>
<tr>
<td>Migration toward the cloud</td>
<td>Customers need help developing customized cloud strategies; however, cloud reduces demand for on-premises ITO services, cannibalizing traditional offerings</td>
<td>Largest impact in U.S.; China earlier in adoption curve, and EU lagging</td>
<td>Applications Infrastructure Technology Outsourcing</td>
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<td>Moderated macroeconomic growth</td>
<td>Spending on IT services contracted during the most recent global slowdown, but has since improved with macro conditions</td>
<td>U.S. strong, with EU beginning to strengthen and APAC softness expected to continue</td>
<td>All segments</td>
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<tr>
<td>Increasing IT complexity / resource constraints</td>
<td>Increased IT heterogeneity heightens demand for specialized expertise; an industry talent shortage has made finding required IT skill sets more difficult</td>
<td>Worldwide trend</td>
<td>Infrastructure Technology Outsourcing</td>
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<tr>
<td>Industry-specific demand for technology offerings</td>
<td>Customers are demanding new ways to view and interact with data, driving industries (e.g., banking) to bolster offerings</td>
<td>Worldwide trend</td>
<td>Applications</td>
</tr>
<tr>
<td>Growing pricing pressures</td>
<td>IT services prices have increased in line with inflation; commoditization of ITO is putting some pressure on prices overall</td>
<td>Worldwide trend; strong APAC pricing pressures</td>
<td>All segments</td>
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</tbody>
</table>

What market trends underpin demand?

Source: L.E.K. survey, interviews and analysis
Most companies expect to increase their spend on outsourced IT

To realize better returns on their IT dollars, companies are increasing their outsourcing relationships with vendors. Over half of all senior executives surveyed expect to increase their level of IT outsourcing over the next three years, with a majority of those expecting to spend 10 percentage points or more on outsourcing compared with last year.

What market trends underpin demand?

Source: L.E.K. survey, interviews and analysis

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Outsourced IT has huge upside — $1 trillion in annual spend by 2018

At face value, almost all service lines are expected to experience some growth and appear attractive.

Upon closer examination, however, those services that more directly drive workflow productivity gains are expected to generate higher revenue and/or margin opportunity for vendors.

How are customers utilizing vendors? ▶

Source: L.E.K. survey, interviews and analysis

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Although companies are increasing IT services spending overall, they are also utilizing more vendors to meet the growing complexity of their business and operational needs.

As a consequence, vendors must accelerate new-customer wins or successfully increase their share-of-wallet to keep pace with overall industry growth.

**Fragmented IT spend: more on specialized service providers, less on legacy providers**

What vendors are winning or losing?

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Source: L.E.K. survey, interviews and analysis

**Expected change in customer spending per vendor**

- Average spend per customer: 100
- Increase in total spend: 5
- Decreased spending per vendor due to vendor fragmentation: (13)
- Average spend per vendor: 92

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Companies are shifting spending away from undifferentiated generalist service providers and toward specialist providers, demonstrating increasing confidence that specialists will deliver meaningful business impact.

Service providers that don’t tailor their offering to the customers’ nuanced business needs are expected to struggle, particularly as companies increasingly realize more value from specialists than from generalist IT services vendors.

How are vendors capitalizing on these trends?

Source: L.E.K. survey, interviews and analysis

Specialists preferred by 2-to-1 margin over generalist vendors
To address IT services needs, CSC has pivoted from its focus on traditional lower-margin/lower-growth infrastructure and horizontal applications toward more attractive spaces such as industry-specific solutions, cloud infrastructure, big data, security, etc.

This shift in perspective has resulted in higher profitability, as customers are willing to pay more for these services.

**What are the key issues for operators or investors?**

Source: CSC; L.E.K. survey, interviews and analysis
Our Executive Insights Spotlight on IT Services series provides a perspective on IT services spending trends and evolving customer purchase behaviors – particularly their growing appetite for specialized vendors.

Tomorrow’s winners will be those players that know the danger zones to avoid and can pinpoint where to exploit the greatest opportunities in a fast-changing market that rewards responsiveness and specialized capabilities.

### Key considerations for evaluating IT services investments

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<td>Build specific capabilities to deliberately accelerate differentiators in a well-defined set of functional or industry-specific solution areas</td>
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<td>Ensure ongoing investments in organization, systems and processes continuously improve the delivery effectiveness of cloud/next generation-oriented services</td>
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<td>Measure the effectiveness of SLAs primarily against contribution to customers’ most relevant business metrics</td>
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<td>Understand the triggers behind timely changes in customer satisfaction scores to quickly uncover areas requiring attention/additional investment</td>
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<td>Segment customers based on spending behaviors and appetite to pace change, accordingly engage customers with a tailored services adoption roadmap</td>
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<tr>
<td>Focus on driving scale and extracting as much operating inefficiency out of undifferentiated service lines such as infrastructure technology outsourcing</td>
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About the Authors

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