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4 Practical Techniques for Midsize Enterprise CIOs to Make Outsourcing More Efficient

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Outsourcing serves many purposes for midsize enterprise CIOs, including enabling cost savings, repurposing internal staff and alleviating skills shortages. Regardless of the motivation for turning to outsourcing, CIOs must achieve optimized cost and performance associated with it.

Overview

Key Findings

- Midsize enterprises (MSEs) face risks including inability to drive proper provider behavior, paying above market prices, and missing out on improved performance opportunities that are brought by the latest tools and technologies. These risks drive suboptimal deal outcomes.
- MSE CIOs seeking to outsource their infrastructure must choose among a variety of emerging, sophisticated tool based solutions that are increasingly standardized, albeit fragmented.
- MSE CIOs are seeking to outsource more infrastructure operational activities.

Recommendations

CIOs in MSEs looking to optimize outsourcing engagements should:

- Utilize the pricing model that drives the correct provider behavior to improve solution performance and optimize cost.
- Employ discounting based upon deal length and number of units to lower and optimize cost.
- Ensure flexible delivery location modifications to optimize cost and performance.
- Utilize forward pricing reduction guarantees when signing three-year or greater deals to ensure optimized costs.

Strategic Planning Assumption

Through 2025, MSEs buying solutions that utilize intelligent automation (IA) technology when outsourcing have an opportunity to achieve a 55% increase in cost optimization than those who don't.

Introduction

MSEs can benefit from infrastructure outsourcing, including cost savings, operational efficiencies, and positive outcomes driving top- and bottom-line positive results, by offloading noncore activities. Staffing challenges are forcing some companies' hands, making them outsource activities that they might have kept in-house. This is most acutely felt in infrastructure where many roles traditionally carried out by humans are delivered using AI, automation and other digital tools.

Infrastructure outsourcing incorporates hardware, software, tools, technologies, labor and other components. With labor being one of the largest cost components of each infrastructure service category overall, when outsourcing, the average labor usage is down one-third since 2018. [1] This is because vendors have invested in automation, AI and other digital tools to reduce labor usage, and then spread those investments over their client base making it economically viable for both the vendor and their clients.

As automation and AI technologies continue to replace labor in vendor solutions, the pricing of standard marketplace solutions continues to drop. The average annual reduction across infrastructure services has dropped between 2% and 6% annually since 2009. For example, the annual compounded reduction in managed workplace services (MWS), which includes service desk, desktop and related devices, voice, and mobility support, has averaged 4.2% [1] year over year (see Tool: Price Ranges for Outsourced Digital Workplace Services). This is because providers have replaced labor costs with automated tools and technologies.

In order to achieve optimal outcomes while reducing risk, MSEs seeking to outsource infrastructure services and optimize costs must utilize the following key deal techniques:

- Select the best pricing model (see Table 1) for each solution type. [2,3]
- Include volume discounting that correlates to deal length and number of units or users (e.g., number of users, devices, servers, virtual instances or images, and GBs of storage). [4]

- Ensure utilization of common delivery tools and technologies that optimize outcomes while reducing costs. [2,3]
- Use forward pricing techniques [5,6] based on MSEs' ability to make long-term deal commitments.

Analysis

To take advantage of continuing marketplace solution improvements and price reductions, MSEs should use the following practical techniques:

Practical Technique 1 — Select the Pricing Models That Drive Correct Provider Behavior, Yet Remain Equitable While Optimizing Cost

With limited financial resources, the need for budget control and efficient operations in MSE — including the required performance from their outsourced provider — is a must. While today's outsourcing market is complex, some straightforward decisions, made incorrectly, can be costly. An example is choosing the pricing model for an outsourced service desk solution.

Vendors propose pricing models that are the least risky and work best for them — as an example in the service desk space most of the time that is per call or per agent. However, per user per month (PUPM) is the optimal service desk pricing model. It is a fair and balanced approach for both parties that supports MESs with budget control and improves end-user productivity by reducing calls to the service desk. This helps increase productivity, which is something that MSEs sorely need in today's competitive business world.

Table 1 presents results from recent MSE client interactions [7] and demonstrates the results when using the correct pricing model. The MSE case point examples amplify the need for MSEs to use the correct pricing model.

Table 1: Why the Pricing Model Makes a Difference (e.g., Service Desk)

(Enlarged table in Appendix)

Number of Users	Contract Length	Behavior Drivers	Solution Attributes	Complexity Factor (1 = Low, 2 = Low Medium, 3 = Medium, 4 = Medium High, 5 = High)
500	3 years	Yes, 10%-20%	Yes, 24/7, Three Languages	4
Pricing Model Category	**Cost/Price**	**Call Per User Per Month (PUPM)**	**Risk (Client or Provider, or Both)**	**Total Annual Cost/Price**
Per Call	$16.50	1.23 - 1.52	Client	$133,650
Per Agent	$67,500	1.27 - 1.48	Client	$118,125
PUPM	$10.25	0.50 - 0.75	Both	$61,500
Pricing Model Category	**Calls**	**FCR**	**C-Sat**	**Comments**
Per Call	1.23 - 1.52	45%	3.82	Lower SLA, Higher Cost/Price
Per Agent	1.27 - 1.48	50%	3.89	Lower SLA, Higher Cost/Price
PUPM	0.50 - 0.75	>85%	4.82	Best Performance, Lowest Cost

Source: Gartner (March 2023)

Features that make this practical technique compelling to MSEs include:

- **Budget Control** — Knowing what costs are and when costs will increase or decrease as employee counts increase or decrease is critical to budget conscious MSE enterprises.
- **Behavior Drivers** — Behavior drivers for the service providers not only drive their performance but provide evidence for them to continually implement better tools that improve their processes. This would include the use of automated tools such as chatbots, automated password resets, and most frequently asked questions and answer databases. A key result of using behavior drivers is to reduce call volume, improve client satisfaction and drive client users to use the service desk.
- **High User Productivity** — Fewer user calls means more time for end users to do their jobs. This results in higher end-user productivity and higher customer satisfaction, all at reduced provider pricing.

Practical Technique 2 — Include Volume Discounting in Infrastructure Outsourcing Deals for Both Deal Length and Number of Units or Users

Unit or use price decreases are based on volumes and enhanced by deal length. Three to five years is a typical length for infrastructure deals. Higher spend results in lower unit or use prices with each additional contracted year of revenue, predictably resulting in an additional 3% to 5% annual price reduction.

Table 2 identifies the most successful practical techniques by category in the infrastructure outsourcing marketplace. Similarly, Table 3 identifies the risk impact of both the client and provider for each of the eight most common pricing models.

Those with the least risk for both the client and provider produced the best results for both parties. Using this data for outsourcing helps ensure optimum results including improving solution financials, driving the correct provider behavior and improving client organization productivity.

Table 2: Techniques and Attributes by Solution Category

(Enlarged table in Appendix)

Solution Category	Data Center	Outsourcing Digital Workplace Services (ODWS)	Networking	Security	Cloud-Based Solutions	Applications
Functional Service Areas	▪ Mainframe ▪ Midrange ▪ Client/Server ▪ Storage ▪ Hosting ▪ Colocation	▪ Desktop/Laptop ▪ Other Devices ▪ Service Desk ▪ Mobility ▪ Voice Premises	▪ Routers ▪ Hubs ▪ Switches ▪ Communication	▪ Enablement ▪ Protection ▪ Governance	▪ IaaS ▪ PaaS ▪ STaaS ▪ SaaS ▪ CIPS	▪ Development ▪ Enhancement ▪ Maintenance ▪ Support
Best Practice Pricing Model	Firm fixed price (FFP), per MIPS, server, instance, GB of storage	FFP, per user, per device	FFP, per device, per location	FFP, per system, blended	Varies, instance, GB of storage or others	No FFP — unless specific requirements identified — variable per hour, day, etc.
Geographic Attributes	All geographies available, AI tools somewhat in use for all above categories	All geographies available, AI tools always in use for above categories	Hardware, geography-specific, AI tools mostly in use for all above categories	All geographies available, AI tools always in use for above categories	Hardware, geography-specific, AI tools always in use for all above categories	All geographies available, AI tools in use for "Support" category
Forward Pricing Attributes	Commonly used for all categories above except colocation	Commonly used for all categories above	Commonly used for all categories above	Infrequently used for this solution unless bundled in other solution categories like ODWS, networking, cloud or data center used for all categories above except colocation	Commonly used for all categories above	Rarely used for this solution category

Source: Gartner (March 2023)

Volume unit or use price decreases based on long-term deals — three to five years are typical in most infrastructure deals. Each additional contracted year of revenue typically results in a 3% to 5% price reduction.

Table 3: Pricing Model Attributes, Risk Factors

Service Category	Flexibility	Transparency	Predictability	Client Risk	Provider Risk
Time and Material	⬆	⬅	⬇	⬇	⬆
Cost +	⬅	⬆	⬇	⬇	⬆
Open Book	⬅	⬆	⬇	⬅	⬆
Unit-Based, Use-Based	⬆	⬆	⬆	⬆	⬆
Incentive-Based	⬇	⬅	⬇	⬆	⬇
Shared Risk-Reward	⬅	⬆	⬅	⬇	⬇
Gainsharing	⬇	⬅	⬅	⬅	⬇
Fixed Price	⬇	⬅	⬆	⬅	⬇

⬇ = Most risk, least favorable ⬅
= Okay ⬆
= Most favorable, least risk

Source: Gartner (March 2023)

Practical Technique 3 — Ensure Delivery Location Modifications Are Flexible and Lead to Price Adjustments

Examples of delivery location modifications include:

- Remote monitoring and management solutions using automated technology-based capabilities can provide price reductions when compared to a current onshore delivered solution.
- Level 2 (L2) or Level 3 (L3) service desk solutions delivered offshore or "nearshore," and, in some cases, in rural delivery locations with the client authority to determine delivery location.

Delivery location modification [8] items provide optimized costs with equal or better performance. Using AI and other automation, for example, desktop support, reduces field headcount required through call avoidance and/or ensuring that technicians go to the site properly prepared to fix the problem. On average between 8% and 14% cost optimization improvements resulted, with automation tools boosting these percentages.

Practical Technique 4 — Use Forward Pricing With Three- to Five-Year Deals

Forward pricing with outsourcing managed services includes annual price decreases based on current marketplace pricing analysis. Prices have dropped year over year, compounded from 2009 through 2017 — decreasing, on average, between 2% to 5%. Beginning from 2018 through the end of 2022, Gartner tracked the impact of AI and automation on managed infrastructure services. Outsourcing contract evidence reveals that prices dropped at a higher rate than from 2009 through 2017. However, in order to take advantage of price improvements, MSEs must sign three- to five-year deals and specifically contract for price reductions.

Infrastructure managed service providers continually seek operational efficiency improvements in their solutions to gain competitive advantages. The following key points identify reasons and inflection points that drive provider behavior to continually improve processes to compete in the outsourcing infrastructure managed service marketplace.

Virtualization — In the mid-2000s, virtualization technology began driving advantages to those managed service providers who were first to use virtualization as part of their data center outsourcing solutions. Virtualization improvements drove marketplace pricing reduction for many years along with competition from the hyperscalers.

Competition — A subset of providers, the three top hyperscalers (Amazon Web Services, Microsoft Azure and Google), entered the managed service world driving all providers to use virtualization and reduce pricing.

Ask for Forward Pricing — Cost reductions, and thus reduced prices, squeezed providers who were late to execute on virtualization implementation and the same is true with automation and AI. However, managed service providers did not automatically offer these new solutions to all clients, only to those who asked or those who had the requirement built into their contract structure. MSEs' job is to ensure the forward pricing is included, thereby forcing improvements to be built into the solution.

Table 4 depicts the ability to achieve forward pricing by solution category.

Table 4: Forward Pricing Capability Table

Forward Pricing Attributes	Commonly used for all categories above except colocation	Commonly used for all categories above	Commonly used for all categories above	Infrequently used for this solution unless bundled in other solution categories like ODWS, networking, cloud or data center used for all categories above except colocation	Commonly used for all categories above	Rarely used for this solution category

Source: Gartner (March 2023)

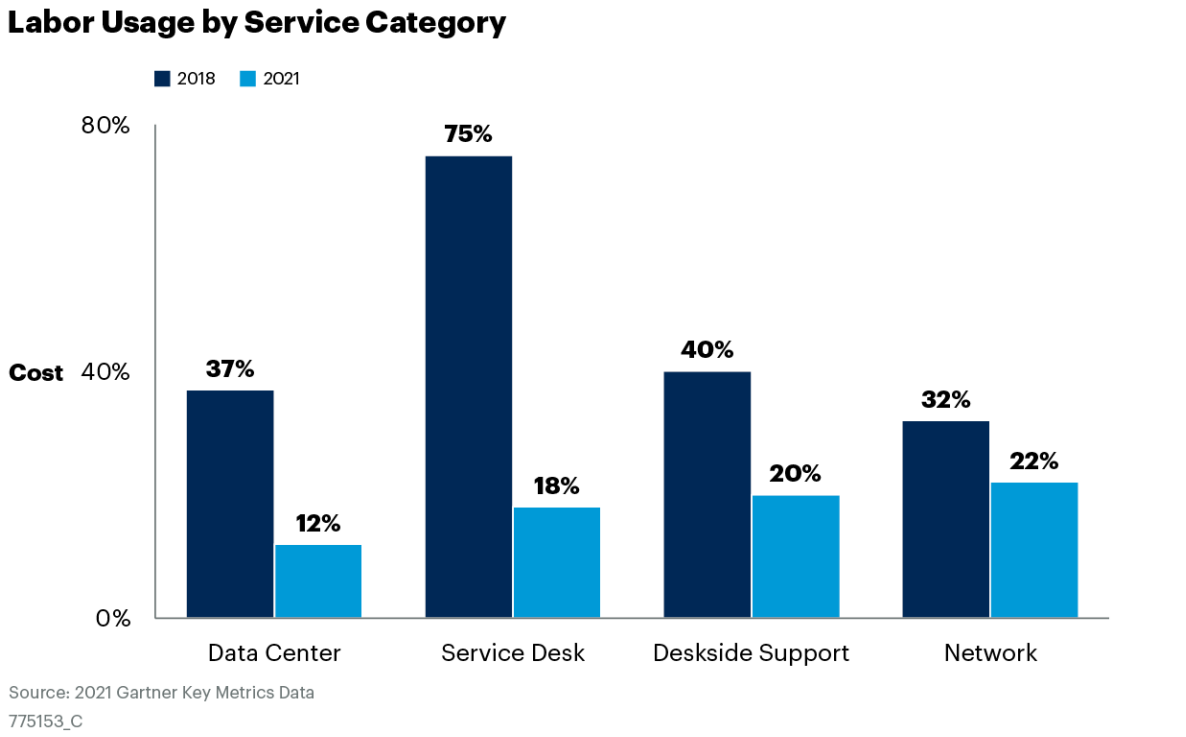
In 2018, automation and AI became the latest technology used to improve solutions and drive lower marketplace pricing. While automation and AI have years to go before they saturate the marketplace, new technologies will replace the automation/AI solution as the next “banner technology” to reduce managed infrastructure service cost/price. Based upon twenty years of historical data, including AI/Automation, new technologies will continually improve outsourcing delivery models going forward just like virtualization and automation have done the past ten years. Therefore, the most effective way to ensure your organization takes advantage of cost/price saving opportunities is to contract for forward pricing. Thereby, ensuring that during the three-year, or greater, deal length MSEs will receive the lowest relevant price for their engagement. This can be achieved by reviewing Gartner pricing research such as Tool: Price Ranges for Outsourced Digital Workplace Services and Tech CEOs Must Price Competitively to Reflect AI With Forward Pricing of Infrastructure Deals. To ensure continued price reductions, MSEs must utilize forward pricing (see Toolkit: Outsourcing Contract Measurement Charter Attachment) t o run their course. Hence, clients must ensure that they take advantage of these cost improvement opportunities by the use of forward pricing.

Using these practical techniques will lead to optimal deals for MSEs while maintaining or improving service quality. The amalgamated case studies in the Evidence section showcase one of the four practical techniques and are provided to show examples before and after results, and how multiple Gartner clients arrived at the after results.

Evidence

[1] Figure 1 data comes from 300+ midsize client interactions using their vendor proposals and/or contracts that determined the statistics.

Figure 1: Labor Usage by Service Category



[2] During the past year, more than 600 client interactions were conducted, including clinics at Gartner events and workshops for MSE clients. As per the interactions, over 65% of the clients stated that they use the provider pricing model without asking about other pricing models, and less than 20% considered their deals to be successful.

[3] During the past 12 months, 342 MSE organization proposals and/or contracts were reviewed, with approximately 30% using the right pricing model and/or both the right pricing model and discounting for contract lengths of three or more years.

[4] Of the 30% of the 342 MSE organizations' proposals and/or contracts that were reviewed, 91% who had deals of three or more years had lower unit prices than those that had less than three years.

[5] Over the same 12 months, forward pricing was included in slightly less than 18% of the contracts that Gartner reviewed even with competitive pricing taking place at all deal sizes, scopes and complexities (see Tech CEOs Must Price Competitively to Reflect AI With Forward Pricing of Infrastructure Deals).

[6] Over the past 12 months, more than 83% of more than 100 clients that we spoke to during interactions achieved their primary goal of reducing costs and/or improving productivity, and improving revenues and profits, where appropriate. This was done by using the correct pricing models, behavior drivers, incentives, and, most importantly, midsize enterprises ability to quickly make decisions and consolidate infrastructure services to a single or fewer providers.

[7] Using Gartner's Managed Workplace Services Outsourcing Pricing Analysis during client interactions from January 2021 through August 2022, prices were reduced as follows:

- The largest (from three- to, in a few cases, five-year deal lengths) price reduction equaled 31%
- The smallest price reduction was 10%
- Average price decrease was slightly more than 18% over the three- and five-year deals

[8] During hundreds of MSE client interactions, less than 30% of those organizations outsourced solutions that include asking for a specific delivery location.

[9] IT Key Metrics Data:

- Service Desk

IT Key Metrics Data 2023: End-User Services Measures — IT Service Desk Analysis

- Digital Workplace Services.

IT Key Metrics Data 2023: End-User Services Measures — Digital Workplace Services Analysis

- Network

IT Key Metrics Data 2023: Infrastructure Measures — Network Analysis

- Data Center

IT Key Metrics Data 2023: Infrastructure Measures — Windows Server Analysis

IT Key Metrics Data 2023: Infrastructure Measures — Linux x86 Server Analysis

IT Key Metrics Data 2023: Infrastructure Measures — UNIX Server Analysis

IT Key Metrics Data 2023: Infrastructure Measures — Mainframe Analysis

IT Key Metrics Data 2023: Infrastructure Measures — Storage Analysis

IT Key Metrics Data 2023: Infrastructure Measures — Network Analysis

Document Revision History

4 Practical Techniques for Midsize Enterprise CIOs to Make Outsourcing More Efficient -21 August 2019

Recommended by the Authors

Some documents may not be available as part of your current Gartner subscription.

Toolkit: Price Ranges for Managed Workplace Services

Toolkit: Data Center Outsourcing and Hybrid Infrastructure Managed Services Price Ranges

Tech CEOs Must Price Competitively to Reflect AI With Forward Pricing of Infrastructure Deals

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Incentive-Based	⬇	⬅	⬇	⬆	⬇
Shared Risk-Reward	⬅	⬆	⬅	⬇	⬇
Gainsharing	⬇	⬅	⬅	⬅	⬇
Fixed Price	⬇	⬅	⬆	⬅	⬇

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