



# CATEGORY LED SOLUTIONS

Dealing with Inflation in Application Services

## Executive Summary

In today's digital economy, organizations seek ways to protect their business models, reduce costs, deliver high-quality customer service, and maintain agility. One popular solution for achieving these goals is outsourcing elements of the IT budget, such as Professional Services around Application Development and Maintenance, Testing and Test Automation, Project Management, and other Software Development Lifecycle related activities, collectively known as Application Services.

However, outsourcing non-core activities to a third party can be challenging, particularly with rising inflationary pressures. This paper explores how a Category Management led approach and strategy can help organizations navigate the inflationary environment in the Application Services industry.

The global market for Application Services has recovered from the impact of the pandemic, reaching a value of approximately USD\$ 488 billion in 2021. The market remains competitive, with top firms vying for large outsourcing contracts and leveraging lower wage costs in offshore locations like India. However, existing outsourcing arrangements present customer challenges due to contractual obligations and market dynamics, such as labor attrition and talent availability, leading to wage inflation.

Organizations can adopt a category management approach to mitigate cost pressures and enhance the quality of outsourcing services. This approach involves leveraging artificial intelligence and machine learning for spend and contract data analysis, supplier consolidation and replacement strategies, demand management techniques, introducing competitive processes, and collaborating with suppliers to manage costs. By implementing these strategies, organizations can control costs, minimize the impact of inflation, and achieve greater value from their Application Services outsourcing.



# Introduction

In today's digital economy, organizations must balance protecting their business model with the need to reduce costs, deliver high-quality customer service, and stay agile. For many technology-dependent industries, outsourcing elements of their IT budget has become a popular solution to achieve these goals. This can include Application Development and Maintenance, IT Outsourcing, Professional Services, or IT Services, collectively referred to as Application Services.



## Pressures in a globalizing and digitalizing economy



**Digital transformation:** Competition is driving the need for constant development of new and improved software solutions to aid speed to market.



**Integration:** A mix of legacy and latest technology creates a challenge of stitching these systems together.



**Speed of response:** responding to competitive challenges needs to be done in an agile fashion and requires collaboration.



**Security and compliance:** Cyberattacks mean that systems need leading levels of security engineering, and suppliers need to comply with the latest standards and regulations.



**Availability of internal talent:** Often the skills needed are specific to a particular technology or service don't match internal skills and are too expensive.



**Scale:** As the organization grows, it must respond quickly to maintain competitive advantage.

# Introduction

Outsourcing non-core activities to a third party can bring significant benefits but achieving them can be challenging. With inflationary pressures rising across various categories, organizations must carefully evaluate their options.

This paper explores how a Category Management led approach can help organizations navigate the challenging inflationary environment in the Application Service industry. By setting realistic expectations and adopting cost-saving practices, organizations can keep their costs under control and minimize the impact of inflation.

## Rationale outsourcing to Application Service Providers:



**Expertise:** Knowledge and expertise regarding integration, development testing and maintenance.



**Make v's Buy:** Outsourcing within a competitive market can be more cost-effective than an in-house operation.



**Scale:** Outsourcing providers offer better options to scale requirements as a business grows and can react to changing needs.



**Technology:** To be competitive, application service providers must stay current with the latest technology and trends. Customers can benefit from the latest technology without investing directly in new infrastructure.



**Core business:** Opportunity cost means that outsourcing application frees resources to focus on core business requirements.



**Savings:** In addition to savings from labor arbitrage, service providers can offer economies of scale, efficiencies, and investment in technologies that provide greater productivity and savings than a typical in-house model in most cases.

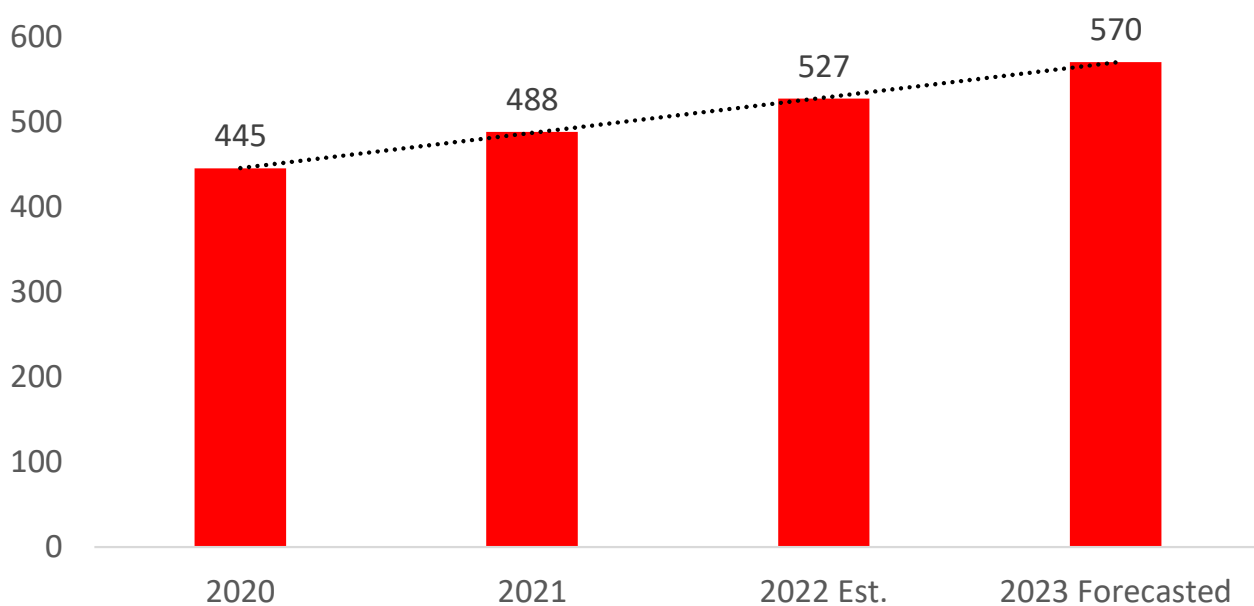
# A market point of view

## The health of the market

The global market for Application Services certainly felt the value loss due to the pandemic; it has been steadily recovering from the 2020 impact and has regained the value it had lost by the first half of 2021.

The market value in 2021 was approximately USD\$ 488bn showing the marginal recovery from the initial impact of covid and perhaps reflecting the contribution the category made to enable customers to be Hybrid enabled. Growth indications remain high, with an estimated CAGR of 8% through to 2023 [Beroe]

Market Value in USD Billions - As Reported by Beroe





## The health of the market

The Application Services market remains competitive, with the top firms regularly competing for large Application Services (outsourcing) contracts. Suppliers commonly leverage lower wage costs in offshore locations, typically in India, driving lower service costs than self-delivery. The Indian labor market, like other BRICK economies, has a large, well-educated workforce with underlying lower wage rates making it an attractive location for investment from outsourcing and offshoring companies.

For customers reviewing the potential to start outsourcing their Application Services requirements for the first time, or the opportunity to consider a new and alternative supplier to existing requirements, then the extent of competitive rivalry provides for a positive business case where labor arbitrage alone will be a significant source of savings.



The situation for customers with an existing portfolio of outsourcing arrangements is different. Whilst many of the same benefits prevail, once committed to an outsourcing agreement, the costs of changing a supplier mid-term can be contractually challenging and costly. In addition to wider economic inflation, Application Service providers must deal with certain market dynamics, such as Labor attrition and availability of talent which on their own drive wage inflation.

A professional category management led approach can identify and implement appropriate mitigating strategies and bring value to the customer.

### Key suppliers:

Accenture

IBM

Tata Consultancy Services (TCS)

Capgemini

Infosys

DXC Technology

Atos

Wipro

Tech Mahindra

HCL Technologies

Cognizant

## Labor Attrition

Labor attrition, also known as employee turnover, is a common challenge in the Application Services industry. The characteristics that can lead to labor attrition include:



**High Pressure and Stress:** The nature of the role plus other contributing factors creates stress.



**Low Job Satisfaction:** Repetitive work, limited growth opportunities, and a lack of work-life balance.



**Salary and Benefits:** Can be competitive, but don't always keep pace with the rising cost of living.



**Lack of Training and Development:** Lack of adequate training or opportunities for professional development.



**Cultural Differences:** Working with customers worldwide creates cultural and communication challenges.

Suppliers have been experiencing high attrition rates for several quarters now [Beroe 2022], but fortunately, the industry has started to take measures to address and curb the problem. Some actions include a significant increase in fresh graduate recruits, but with limited (experience), continued investment in recruitment efforts, new retention strategies, re-hiring of alums, increasing compensation, and training and reskilling the existing workforce to tackle gaps created by sudden resignations

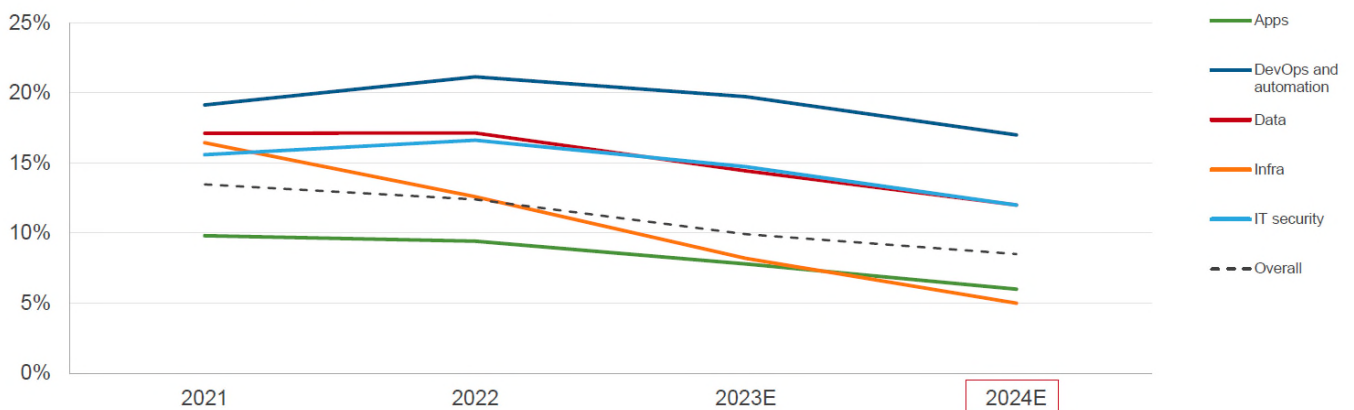
# Talent Availability

The talent availability gap is another Application Services industry dynamic contributing to wage inflation driven by higher salaries which are needed to attract candidates into roles.

Depending on the role, gaps during covid ranged between 10 to 20% depending on requirements [Everest's Group Talent Excellence, 2022 report]. However, while the report references an increase in this talent delta in 2022, fortunately, we see some improvements on this front, with the range anticipated to be 5-16% through 2023 and into 2024.

Firms are now actively shifting internal talent to fill capability gaps, building, and focusing on culture, recruiting, and opening up non-traditional recruitment channels. All tactics have a cross over effect in dealing with talent retention and attrition.

Global IT talent demand-supply gap (%), by IT function



We do not expect the gap to drop below 10% before 2024

Source: Everest Group Talent Excellence, 2022

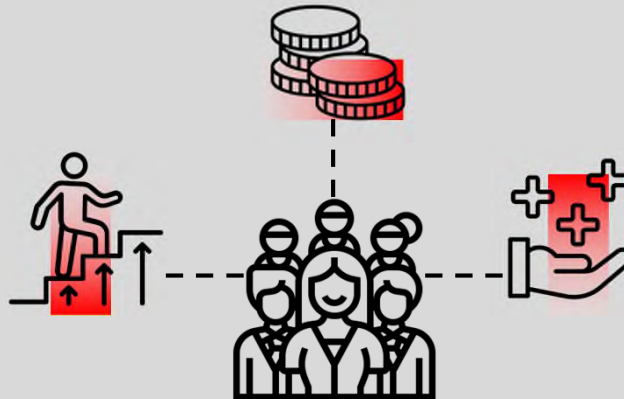
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## Geographic Influences

The key Application Services locations are based in India and primarily in Pune, Hyderabad, Bangalore Delhi, Chennai, Kolkata and Mumbai (Tier 1). They are natural talent hubs, with the majority of major Application Services providers located within close proximity of each other.

The hubs create their own attrition dynamics - expansion and development at one service provider location can quickly lead to attrition as a young and mobile workforce will quickly switch their allegiances looking for promotion, better pay and benefits at competitor locations.



The entrepreneurial nature of Indian enterprise has led to new hubs in other major cities (Tier 2: such as Kochi, Trivandrum, Kolkata, Jaipur), with major providers such as Accenture, Infosys, and TCS taking advantage of the new opportunities in recent years. Tier 2 cities offer higher retention rates due to less competition within the local geographic and economic environment when compared to Tier 1 cities.

## Why take a category management approach for outsourcing Application Services

As cost pressures mount, procurement objectives have become a top priority for many leaders. With talent shortages, high attrition rates, and inflationary pressures driving up wages, the question is: how can a cross-functional team use a category management approach to extract more value from their Application Services outsourcing? By adopting a strategic approach, organizations can mitigate cost pressures and enhance the quality of their outsourcing services.



## Spend and Contract Data analysis

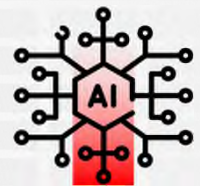
Artificial intelligence and machine learning are crucial to unlocking the full potential of spend analytics and contract lifecycle management. Reliable data and spend analytics tools provide valuable insights that drive better decisions for category strategy and supplier negotiations.



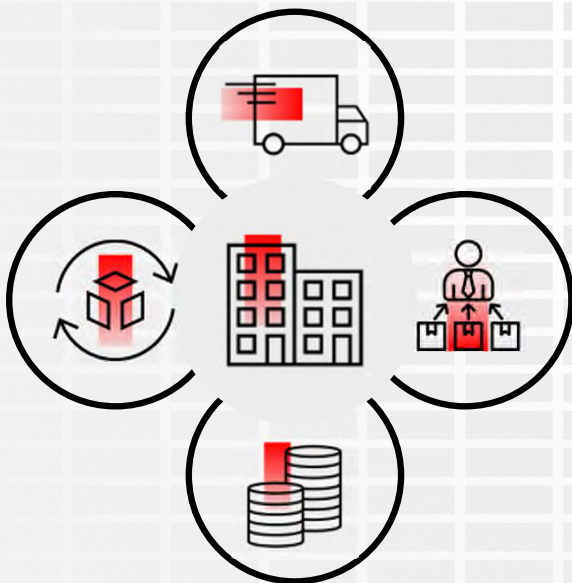
Unfortunately, many organizations rely on limited data analysis tools like spreadsheets to make critical decisions. This limitation is partly due to the difficulty of managing large amounts of incomplete data from corporate ERP systems and the skills shortage in the procurement function.



But with AI and machine learning, organizations can efficiently categorize spending commitments, and aggregate spend across supplier portfolios, leading to a more effective category-led approach.



## Supplier Consolidation and Replacement



Supplier consolidation is when a company reduces the number of suppliers it works with and instead focuses on building stronger relationships with a smaller group of key suppliers. This can lead to better pricing and terms, as well as a more efficient procurement process with lower administrative costs.

However, consolidating suppliers may also limit competition and innovation, and can make a company more vulnerable to supply chain disruptions.

Before implementing a supplier consolidation strategy, careful consideration should be given to potential risks and benefits. It's important to get top-down support across the organization and incentivize suppliers to reduce rates.

Consolidation doesn't have to be limited to reducing spending with top suppliers; it can also help bring tail vendor spend into one or more of the panel suppliers, providing new opportunities for competition.



## Demand Management – Adapting supplier requirements to current demand context

Demand management is a technique used in Category Management to ensure that goods and services are sourced and matched to meet the requirements of the business.

For Application Service requirements, organizations can leverage existing internal resources, such as existing documentation, to create standard procedures and reduce the need for technical support and therefore reduce demand.



Agile methodologies also present an opportunity to ask for different rates for hybrid roles. Good contract management also ensures that suppliers meet their obligations, and track performance.

It's important to avoid "stacking" of senior resources on teams provided as part of Application Services by suppliers, which can lead to top-heavy contracts and cost profiles may change over time from the original agreement. These issues can lead to cost increases and inflationary pressure but can also be identified during the category review.

### Introduce a Competitive Process

With the demand requirements of the organization established and with a clear understanding of the spend analytics and contract lifecycle, the category strategy can set a timeline and plan for introducing a competitive tender in the form of an RFx, an e-Auction, or targeted negotiations with all current suppliers.

Challengers help move the status quo quickly and show a market view of rates not inflated by the existing rate environment. Strategic procurement teams can work with stakeholders to identify a supplier's bid list based on their knowledge of the market and supplier insights to participate in a competitive bid process. This process should also include suppliers to act as credible challengers.



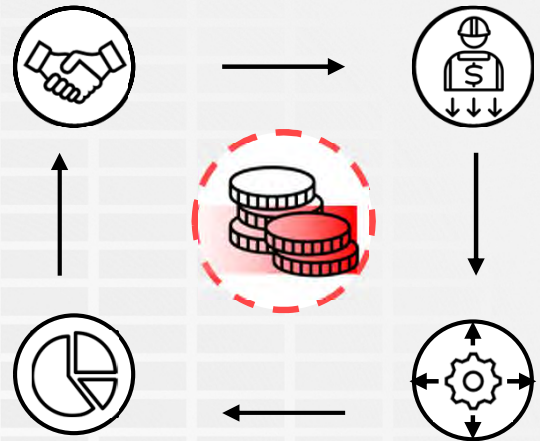
Clear timelines for suppliers to compete within maintain stakeholder confidence in the process and drive decisions, including decisions on offers, rate negotiations, and finalizing offerings with a contract.





## Collaboration to manage costs

To manage costs effectively, it's important to understand the components that make up rates - labor costs, overheads, and margin. This knowledge helps in negotiations and understanding supplier positions.



Suppliers can also be supported in managing costs outside of service delivery, such as overheads, by requesting cost details and removing unnecessary requirements.

Cost of Living Adjustments (COLA) should only apply to labor costs and negotiating FX adjustments may also be appropriate to limit risk. Some areas of spend, like Cloud and Cybersecurity, may demand higher rates owing to skills shortages, so the Procurement Function needs to consider proposing alternative negotiation strategies as part of the Category Strategy.

## Managing Attrition

While attrition has historically been on the rise, we are finally seeing a slowdown of attrition rates. Managing attrition is also part of the negotiation strategy and rate negotiations in a few different ways. First, a rate reduction because of high attrition levels. (Rate of change in personnel affects productivity).

Second, the customer has a real opportunity to impact the lives of these resources by understanding what type of working conditions can be improved to help make happier workers. In one instance, an organization was able to loosen its security requirements to allow for teams to communicate with teams outside of the initial contract scope, which resulted in a dedicated group feeling more involved in the organization.

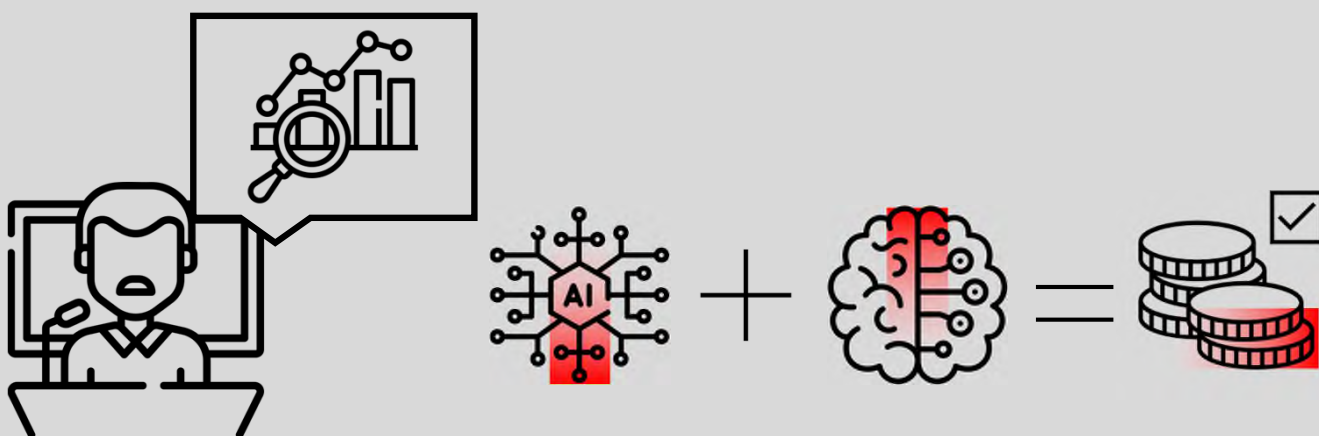


Finally, attrition tends to be higher in Tier 1 cities where most Application Service providers locate their offices. However, suppliers and customers find retaining talent in Tier 2 cities easier. We suggest businesses start looking at Tier 2 cities or cities that are not on any list just yet and potentially be the first to open a location there.

## Case Study

Chain IQ successfully implemented a category led approach for a major financial services company to reduce inflationary cost pressures on their global Application Services requirements. By utilizing innovative spend analytics and category strategy, Chain IQ was able to provide market and insights, identify historical buying patterns, and prioritize savings opportunities for the company.

The team performed a thorough market analysis, reporting on market trends, insights, and cost drivers. The analysis provided a clear understanding of the market dynamics and helped identify opportunities for cost savings by leveraging Chain IQ's Artificial Intelligence (AI) and Machine Learning (ML) capabilities.



Chain IQ set up a cross-functional team, including top management and finance stakeholders, to review the existing Application Services Supplier landscape and contracts. The team developed a business case with stakeholders to identify the best strategic choices, projects, and suppliers to deliver business value and achieve savings mitigating the inflationary pressure. The team identified multiple opportunities to reduce costs and improve the terms of business and rationalize the number of suppliers by nearly 70%.

## Case Study (continued)

Leading the group, Chain IQ made specific recommendations for the existing and future supply base and formulated a negotiation strategy with all stakeholders involved. The company also identified new areas of future demand and decided to take them to the market in a series of planned e-sourcing events and e-auctions. The team's digitally enabled sourcing platform reduced the historically lengthy negotiation process by 60-80%.



Reducing the number of suppliers whilst also having a comprehensive understanding of the markets and suppliers allowed the team to comprehensively renegotiate existing terms, including rate cards around the globe for existing contracts. The category strategy also allowed for a full review of market capability, including some innovative opportunities for the suppliers to differentiate themselves by offering key value add concessions during the bid process and negotiations.



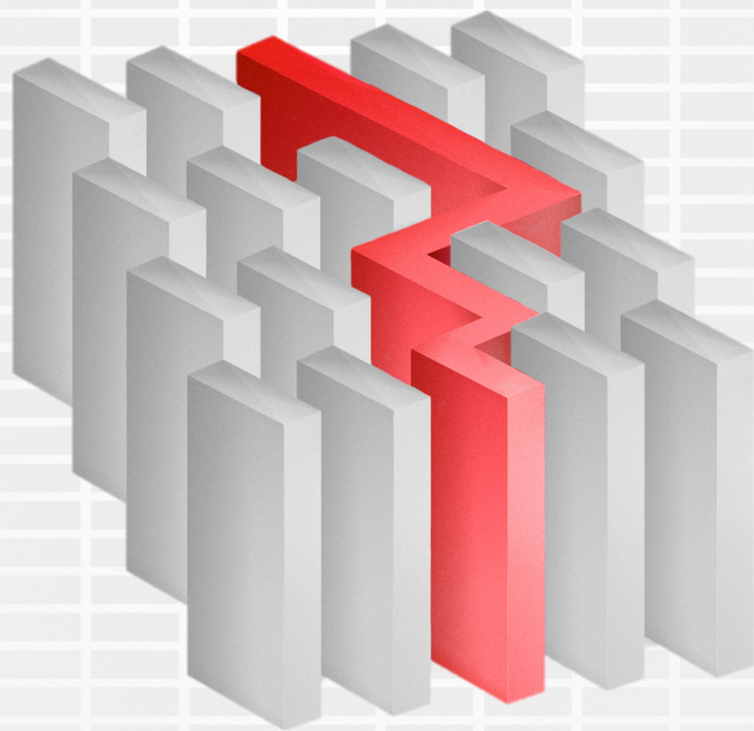
Chain IQ's category-led approach to tackling inflationary cost pressures in Application Services begins with establishing extraordinary stakeholder collaboration, great teamwork to understand the issues and demands beyond the contract, frequent communication, outstanding analytics and insights, in-depth knowledge of market insights, and a clear commitment to strategy and to act on decisions early in the process.





## Conclusion

In conclusion, there is ample opportunity to reduce costs even in an inflationary environment. With the right expectation setting and cohesive communication plan, a category management-led approach will use techniques to help the organization achieve its objectives and reduce the inflationary impact on costs and rates. The key is to highlight potential levers, pick which ones work best for your organization, and prepare a strategy that incorporates competition, challengers, direct rate negotiations, and challenging the root of attrition, low employee morale, and what the organization needs versus current role utilization.



## Article by

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Ammar Hussain has led large and complex outsourcing initiatives at a variety of clients over the course of 10+ years. He is the Global Category Manager at Chain IQ responsible for the Outsourcing and Offshoring category covering Application Services and Business Process Outsourcing services in a multi-client environment.



Ammar works directly with clients helping them develop and implement objective focused category strategies and monitors implementation of such strategies by empowering Chain IQ outsourcing professionals of 70+ through leadership and training around the globe. Ammar is based in New York City and has a deep understanding the outsourcing space with a focus on Financial Services and Capital Markets.

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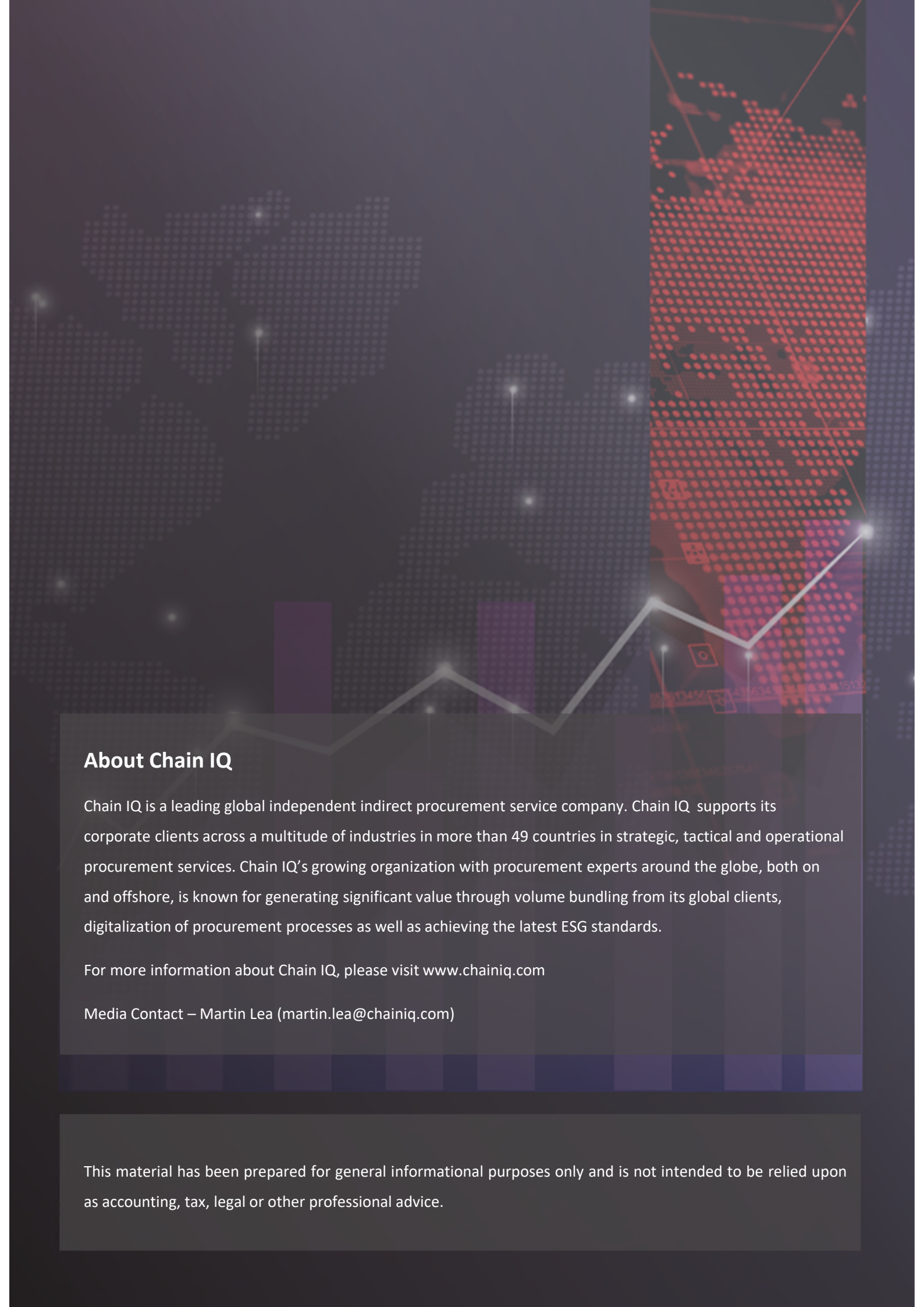
Ivo Claus has over 25 years of IT Outsourcing, Offshoring and Consulting experience from several international Global IT Corporations. He is the Global Sourcing Lead at Chain IQ for the Offshoring and Outsourcing Category supporting all clients to bring unique value procuring and negotiating Global large scale BPO and offshoring projects together with his global outsourcing procurement experts.



In previous roles he was the Global Client Director for a large IT Corporation responsible for a multi-million outsourcing spend of a large manufacturing client optimizing the IT application and infrastructure landscape leading a global team of IT and sales and negotiation specialists.

Ivo is based in Zürich and has an in depth understanding of the IT outsourcing space and IT supplier landscape with a focus on IT Outsourcing and Offshoring for the Financial and Manufacturing Industry.





## About Chain IQ

Chain IQ is a leading global independent indirect procurement service company. Chain IQ supports its corporate clients across a multitude of industries in more than 49 countries in strategic, tactical and operational procurement services. Chain IQ's growing organization with procurement experts around the globe, both on and offshore, is known for generating significant value through volume bundling from its global clients, digitalization of procurement processes as well as achieving the latest ESG standards.

For more information about Chain IQ, please visit [www.chainiq.com](http://www.chainiq.com)

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