

Despite decades of outsourcing experience,

pricing models remain largely input-based, a model that leaves little to no incentive for sourcing teams to change or for service providers to propose new options. However, [Everest Group research](#) shows that, as the march toward the as-a-service economy continues, the input-based model is increasingly less effective in some areas. An output-based services consumption model is better suited to the enterprise's overall IT program as it increasingly becomes cloud-based.

Before we get into the details of output-based pricing model options, we establish a few baseline definitions in Figure 1.

Figure 1 *Fundamental pricing model definitions*

Output-based pricing



Fees are linked to the output of a certain service or process
Examples: price per application support ticket, per story point, or per application

Outcome-based pricing



Fees are linked to an actual business outcome
Example: fees for applications managed services are linked to improvement in customer satisfaction

Input-based pricing



Fees are linked to the time or effort needed to deliver services
Example: rate per hour for a developer resource

Output-based models

There are two kinds of output-based models in application services, each predicated on different resource units.

Application-based model

In this model, the “application” is assumed as a unit, and the provider invoices the buyer based on the number of applications it manages. An application is assigned a score and is categorized under one of a number of pre-defined categories. The scoring is based on parameters such as:

- Ticket volume
- Application type (ERP, non-ERP, COTS, etc.)
- Technical characteristics

Each category typically has a price associated with it.

Figure 2 Pricing matrix and tiers

Influencing factor	Weight	Application score (increasing value) →			
		0-300	300-750	750-1500	1500+
Incident volume	xx%		xx	xx	xx
SR volume	xx%	xx	xx	xx	xx
Enhancements/month(hours)	xx%	xx	xx	xx	xx
Problems	xx%	xx	xx	xx	xx
Application age	xx%	xx			
Business criticality	xx%	Very low			
Support coverage	xx%	xx			
Technology	xx%	xx			
Regulatory impact	xx%	xx			
Change frequency	xx%	Annual / twice annually			

Application Type	Application score	Price
Diamond	>=16	XX
Platinum	>=11 and <16	XX
Gold	>=8 and <11	XX
Silver	>=4 and <8	XX
Bronze	>=2.5 and <4	XX
Copper	>=1 and <=2.5	XX

The application-based pricing model categorization is typically driven by multiple considerations:

- **Business criticality:** Highly critical applications may require higher support coverage or more senior resources due to their urgency
- **Geographical considerations:** Degrees of variation in outsourcing maturity may result in different shoring strategies, impacting application pricing
- **In-cloud or on-premise:** Cloud applications’ monitoring and customization needs are lower than on-premise solutions
- **Change requirement:** A consumer-facing app, such as an e-commerce website, might require more frequent changes than, for example, a back-end app
- **Transaction volumes:** Higher transaction volumes carry higher costs
- **Technology type:** Technology can impact pricing, as each set of applications might have different levels of configuration, customization, support, and testing

This information is distilled into a complex scoring matrix, after which the service provider slots the application into a tier with associated pricing, as illustrated in Figure 2.

Transaction-based model

The provider invoices the enterprise based on the number of transactions they handle, such as:

- Number of tickets resolved
- Number of users supported
- Per incident / service request / problem resolved
- Per P1/P2/P3/P4 ticket
- Per SAP / Non-SAP / SaaS ticket

Figure 3 offers details by stage.

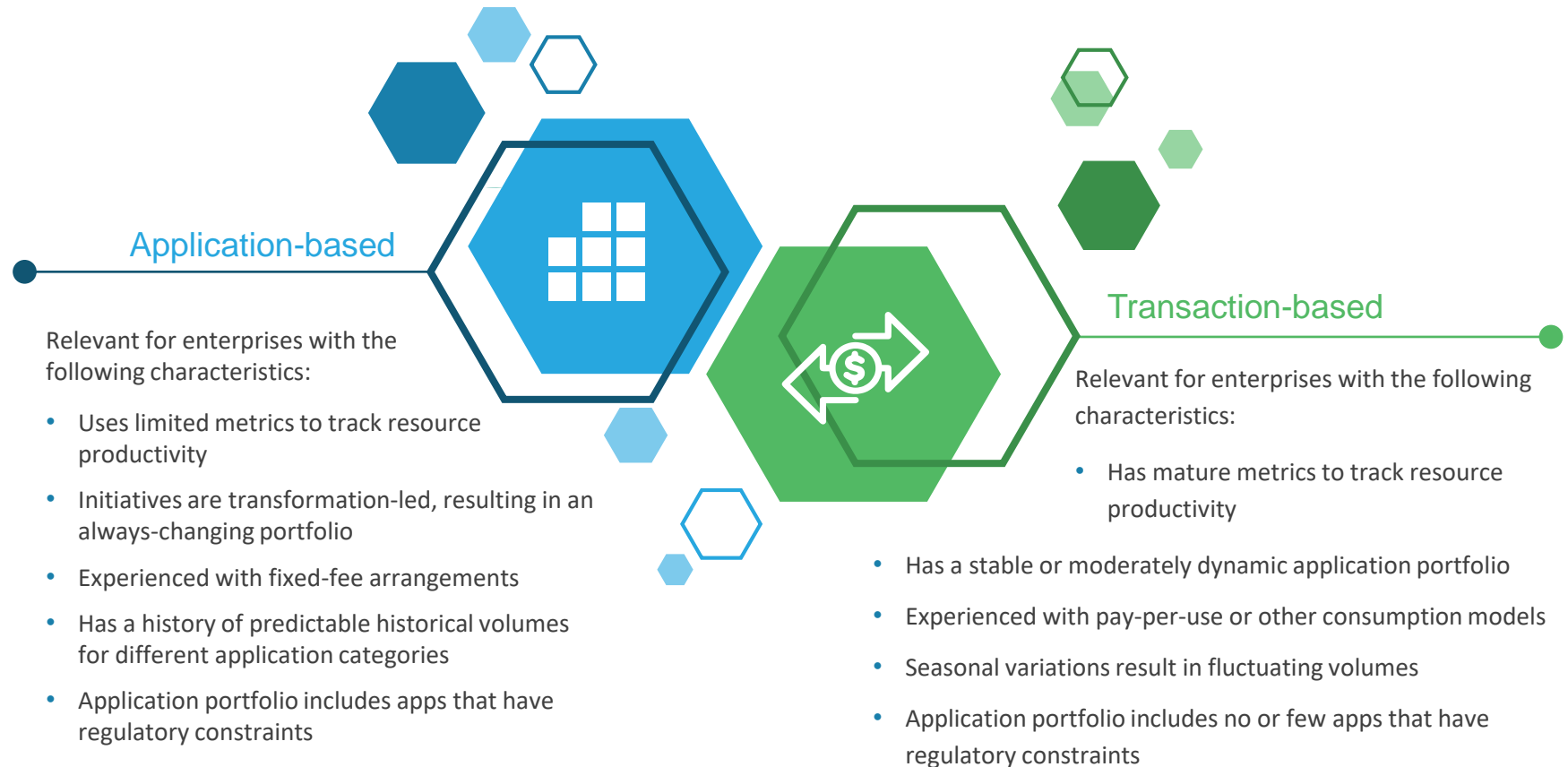
This model encourages lean practices, in which the need for dedicated resources is minimal, and service providers charge customers based on consumption, ensuring maximum utilization of those resources.

Figure 3 *Transaction-based pricing examples*



When to use which model

Each of these models has value; which to use depends on the specific scenario.



Benefits of output- and outcome-based models for enterprises

Big picture, these pricing models aid enterprises in transparency, alignment with cloudification objectives, and flexible cost rationalization. Specifically these models help to:

- **Solve transparency issues:** Output-based pricing provides better insights into assumptions around volumes, continuous improvement, and application performance
- **Encourage transformation:** Visibility into applications that require high maintenance fees aids in decision-making around replacing, retiring, or rebuilding those apps
- **Reduce costs:** These models enable enterprises to foresee annual spending, helping to identify applications for which continuous improvement benefits have not been passed on by providers
- **Increase flexibility:** Ease of price change – without complex governance discussions – in the event an application is retired
- **Prepare for value-based pricing:** Helps enterprises prepare for value-based pricing, as a best-priced application should be those for which additional tickets per change are lowest

Implementation challenges

In spite of the benefits, these pricing models are complex to implement. Most enterprises tend to focus on the attractiveness of the pricing models and overlook the impact of the factors involved in the transition. The key areas in which we see organizations stumble include:

- Failing to consider the impact of volume variations
- Problems arising from unclear volume tracking mechanisms
- A significant price increase due to poor baselining
- A higher-than-usual risk premium
- Lack of clarity around complex pricing mechanisms
- Potential confusion over inclusions and exclusions

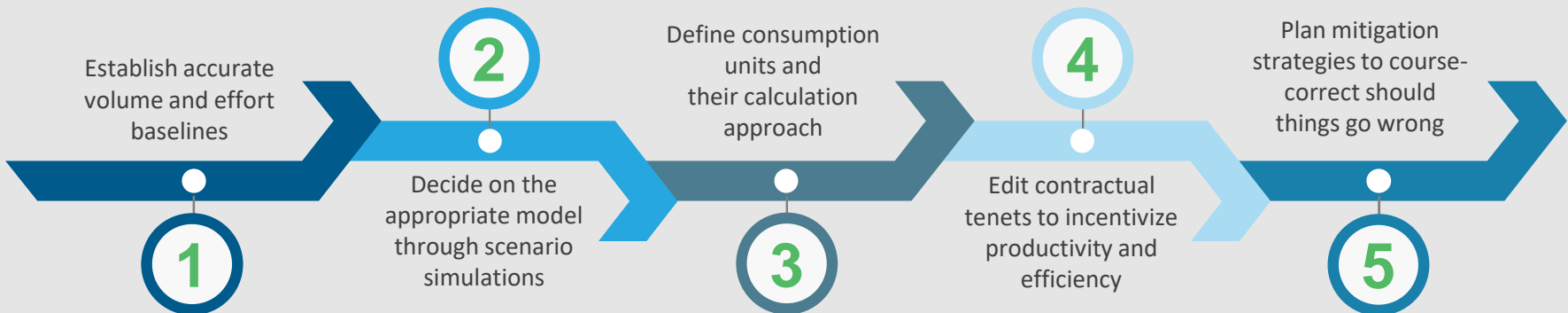


To address these challenges, enterprises should consider the following actions:

- Use accurate estimation models: Carefully implement an accurate measure of resource productivity – one that considers influencing factors
- Streamline processes: Ensure that processes are well-defined and waste leakage is minimal
- Use robust historical data: Baseline volumes, service levels, and underlying assumptions are critical to ensuring appropriate pricing

- Ensure service governance and control: Enterprise stakeholders must drive contractually bound continuous improvement from providers
- Manage demand: Ensure a minimal supply-demand gap to prevent any lost business opportunity
- Manage risk: Enterprise buyers should align with provider assumptions to prevent contingency cost bloat

Figure 4 *High-level action steps to consider when planning a move to these models*



For more information on this topic, [view the on-demand webinar](#).

Additional Resources

- [Webinar Deck: The Latest Trends in IT Services – Four Prescriptions to Make Digital Real](#)
- [Output-Based Pricing Models in Application Outsourcing](#)
- [PricePoint™: Q1 2019](#)
- [Webinar Deck: Outsourcing Pricing: Do You Know What You Don't Know? \(Key Trends Impacting Your Agreements\)](#)
- [Narrowing Choices in Traditional Application Services Deals](#)

How we can support you

Sole-source proposal review

- Solution validation
- Price and performance metrics assessment
- Continuous improvement mechanism validation

Moving to an output-based model

- Baselining support
- Target per-application price benchmark estimation
- Target per-ticket price benchmark estimation
- Contract T&Cs adjustment
- Price bloat risk management

Benchmark existing output-based pricing

- Contextualized price benchmarking
- Ready to use standard activity based pricing
- SLA and KPI benchmarking
- Service credit regime alignment



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