



Identifying and Evaluating Winning IT Services

With services playing an increasingly vital role in the IT ecosystem, companies can use this framework, based on actual benefits and costs, to identify winning IT services attributes.

Executive Summary

Over the last few decades, companies have come to understand that products alone are not sufficient to make them successful. Every brilliant product needs to have an equally brilliant wrapper of service to make it and the business successful. Many of the top product companies – such as Microsoft and SAP in software, or Mercedes-Benz and Audi in automotive – boast of superior services blended with their products. It is quite apparent that without a brilliantly designed service around a product, it is very difficult to be successful in business. So as enterprises design new services using a variety of models, a million dollar question arises – how to identify and evaluate these services. This white paper proposes an approach focused on IT services to make things simpler.

Given how IT services are designed today, spanning multiple models and technologies, it has become highly difficult for enterprises to identify those offerings that can help them advance their businesses. Various models are presented, from staff augmentation to complex transformation engagements where the success of the program

is related to the business outcome and, in some cases, revenue as well. There are cloud-based models such as software as a service (SaaS), platform as a service (PaaS) and infrastructure as a service (IaaS) which essentially could be complete black boxes where the customer only receives the services according to the business SLA and is not aware of any other details.

Amid the explosion of service forms and flavors, it is essential for customers to develop a framework to identify and evaluate the right services for their needs. Moreover, since service offerings differ by vendor, it is nearly impossible for user companies to follow the standard routes of the L1 and T1 model, where contracts are awarded to the best technical solution or the lowest bidder (or both). This model was effective 20 years ago for standard defined services such as hiring security guards or for finding a plumber. However, with services growing in complexity and ambiguity, this model fails utterly.

This white paper examines how to create a framework that can help identify winning service models. Like viral marketing, it is extremely difficult to guarantee the success of any one model,



but we believe that if service identification and evaluation is designed around a fundamental framework, the odds of success are much higher. We think that by following this framework, companies buying IT services can consistently identify and evaluate winning services. We also have found that the same framework and model, with some minor alterations, could be adopted for purchasing other services as well.

Welcome to the World of Services

To appreciate why it is difficult to evaluate services, let us first examine services in detail. In the world of product homogeneity, services play a key role in differentiation. Since services are generated and consumed at the same time, customers are continuously involved in providing performance requirements and feedback. Where products with equivalent or similar functionality are available in the mass market, customer buying decisions heavily depend on services associated with those products. Most product companies try to create services around their products to make them more attractive to existing and new customers. Services have now become a strong route for leading companies to grow their revenues.

Why It Is Hard to Evaluate Service Alternatives

Before making a purchase decision, end customers compare and evaluate the alternatives. Unfortunately, in the world of services this is often difficult to do. Three attribute types emerge as differentiators:

- **Search attributes:** The tangible characteristics or features that could be easily seen or tried. Examples include the color or fabric of a shirt, or the processor speed of a PC. For any product or service that has “high” search attributes, it is usually easy to evaluate (e.g., an 8 megapixel camera is better than a 4 megapixel unit).
- **Experience attributes:** These are the attributes that can only be experienced after the end customer’s purchase. A software vendor’s customer service, restaurant service, live entertainment performances, vacations and watching movies are some of the typical examples where the service/product needs to be experienced before it can be evaluated. Services usually have high experience attributes and hence are usually more difficult to evaluate.

- **Credence attributes:** To make things even more difficult, these are characteristics or attributes that customers find difficult to evaluate even after immediate consumption. High-end services, such as a medical procedure, business process reengineering engagement and education services are very difficult to evaluate immediately after consumption. It usually takes months – and sometimes years – to accurately evaluate and judge the service. And due to the time lapse, the alternatives could have changed drastically.

All these attributes add complexity to the nature of services; hence, dealing with services is more complex than dealing with products. Typically, services can be characterized by five “I”s:¹

- **Intangibility:** Services are intangible and insubstantial. That makes it very difficult for customers to appreciate the value of services.
- **Inventory:** Services cannot be stored for future use; they are often simultaneously generated and consumed. Since customers are “always right” from the inception to the consumption of services, services can be modified to meet customer-specific, dynamic requirements. They cannot be mass produced and forgotten.
- **Inseparability:** Services have a great dependency on the service provider throughout their lifecycles, from inception to delivery to consumption.
- **Inconsistency:** Each and every service is unique, and addresses the needs of a specific target audience. It cannot be exactly replicated at any later time for any customer.
- **Involvement:** Customer participation is crucial in service delivery; as such, services can be modified based on their changing requirements.

Understanding the IT Services Lifecycle

Based on our finding that traditional IT services companies progress along the above five incremental levels of value creation over time, and after examining the offerings of various companies throughout the last 20 years pre-cloud, we have come to the conclusion that IT services are identified, procured and implemented uniformly over time (see Figure 1 on the following page).

The IT Service Continuum

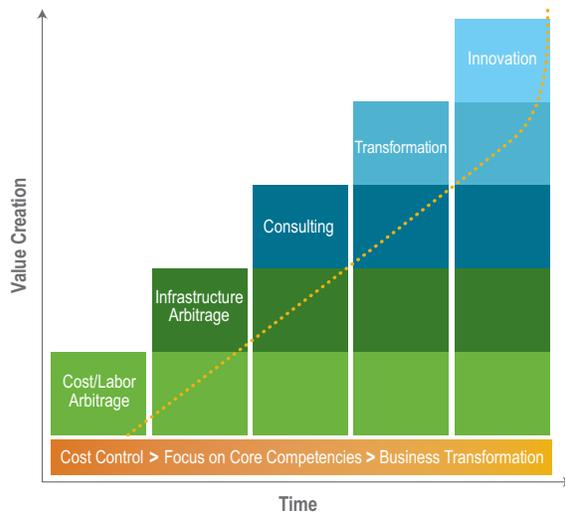


Figure 1

We call this the IT services continuum, comprising the following levels:

- Cost/labor arbitrage.
- Infrastructure arbitrage.
- Consulting.
- Transformation.
- Innovation.

We believe that as IT services companies mature, they start to move gradually from the left side of the curve to the right side of the curve, offering more complex services along the way.

The Challenge in Identifying and Evaluating IT Services

According to our study, as time progresses and IT services mature, organizations move slowly but surely to the right and follow a path toward higher value creation. It is similar for end-user companies as well. Companies that are new to global IT services usually start with the first or second level of services. With more experience, these companies move on to procuring higher levels.

This progressive journey typically begins with cost or labor arbitrage. Depending on the location of delivery and the location of resources, the company sees IT service delivery by a third party as a less expensive option. Using just two factors makes it easier for organizations to identify and evaluate a partner of choice – though the quality and cost of delivery still need to come in at an acceptable level. However, with similar

prices offered by multiple service providers and similar quality of resources, it became difficult for the customers to differentiate. And it became difficult for IT services companies to sell their offerings primarily on the basis of cost. Hence, many players moved into the next level by using infrastructure arbitrage.

To achieve the benefits of infrastructure arbitrage, service providers relied on locational diversity and scalability. As a result, additional evaluation points were added for issues such as capacity, lead time, number of delivery centers, etc. The concepts of near-shore, far-shore and follow-the-sun were then introduced as ways for providers to differentiate themselves. Over time, however, these factors also became commonplace and were imitated by all competitors. This again posed a problem for both user companies and providers to evaluate and differentiate the competitive space.

To remain relevant, providers developed 2.0 versions that focused primarily on consulting engagements. Over time, IT services companies understood that while the consulting piece of large engagements generated only 20% of revenues, they had the potential to control the remaining 80% of downstream revenue. Most IT service companies then built consulting skills to differentiate themselves. The industry then reached a tipping point where standard RFP parameters of T1 and L1 began failing. The reason: Consulting cannot be evaluated easily. The results of most pure consulting engagements can be measured only over the long term, typically with a minimum time frame of 18 to 24 months. So how could enterprises evaluate the services that only lasted for three months while the results were expected in the future?

The final two levels of transformational services and innovation are still evolving so it is hard to draw any meaningful conclusions.

IT services companies are now engaging in enterprise transformation using IT and non-IT services, with success measured by the business outcome. As explained above, these kinds of services are very high in credence attributes. Business process reengineering projects, for example, can typically take two to three years after the service is procured for benefits to be fully realized. Hence, it is next to impossible to identify and evaluate the right partner through a traditional RFP process.

Last but not least is the level of innovation services, where the end-user company and provider cocreate intellectual properties. This is usually in the form of disruptive processes and technologies, such as ERP systems designed for specific industry sectors or cloud solutions for particular sets of customers.

Our Solution

To help enterprises identify and evaluate the right service partners along the right parameters, we have developed a simple but logical framework (see Figure 2). Every service type/level is evaluated across levels of complexity varying from “easy to evaluate” to “difficult to evaluate,” and will not be evaluated on the same scale or with the same parameters. The position that a service would occupy in the continuum is based on the attributes, or features, compared – search, experience and credence.

For instance, a cell phone purchase decision is product-oriented and is characterized by a set of well-defined attributes in terms of performance, size, weight and several other easily searchable attributes. As we move from immediate product-consumption-based services to actual services consumption such as high-touch consulting services, many intangible elements come into play to form a cohesive customer experience that is realized over a long period of time. To explain this concept in an easy way, we have created what we call a “service measurement continuum.”

While different strategies work for services at different levels of the service continuum, one common concept holds true across all types of services we have discussed. The single binding thread that holds all of these things together –

and forms the fulcrum of our framework – is value. As long as services/products are designed properly to satisfy the value element, and have a proper mechanism for exhibiting or conveying that value to customers, enterprises will perceive value in them. In short, as long as the value delivered by a service and service provider exceeds or equals the perceived cost, end-user companies should be interested in considering it. The following equation² captures our thinking:

Net Value = Perceived Benefits – Perceived Cost (Equation 1)

This equation simplifies the evaluation parameters considerably. End customers need only check to see if the net value is >0, which means if the perceived benefit is greater than the perceived cost. So, in simple terms, the customer needs to check if he/she is deriving more value or benefit than what he/she is paying for the service. If so, then the partner that provides the maximum value is the right partner for providing the winning services. Now to use this model to evaluate partners, end customers need to see the monetary value of the perceived benefits and costs of each provider.

Perceiving Benefits and Costs

It is important to capture the details of each of the items mentioned in the previous equation.

Perceived Benefit

Perceived benefit could be defined as below:

- **Perceived Benefit = Monetary Benefit + Non-monetary Benefit (Equation 1a)**

Service Measurement Continuum



Figure 2

In other simple words, the benefit perceived by the customer is always a sum of tangible and non-tangible results.

- **Monetary Benefit:** While it is usually easy to define or calculate the tangible results, it is usually difficult to obtain the quantifiable number for the non-monetary value. We believe using standard RFP parameters as well as established metrics it is possible to evaluate the first part of the equation easily.

The most used model of evaluation covers the ROI calculations that highlight the overall business benefits achieved. Evaluating the TCO calculations over a period of time also is an important tool for end-user companies to capture a detailed understanding of the overall cost.

- **Non-monetary Benefit:** However, it is not easy for all customers to calculate non-monetary value. Hence, it becomes difficult to arrive at the total value of the perceived benefit.

While this varies per company, based on our extensive experience we are providing organizations with a list of a few elements that could be considered when calculating the overall perceived benefit resulting from services provided by the service provider.

- Increased end-user satisfaction resulting from the service provided is usually measured by customer satisfaction surveys: Satisfied, or happy, users are usually more productive in an organization.
- Increases in end-user productivity resulting from the service (e.g., anywhere access, bring your own device, etc.).
- Increase in business efficiency and effectiveness (e.g., use of cloud computing and doing more for less).

- Reduction of risks associated with business (e.g., reducing downtime or unplanned shut-down of business).
- Increase in overall brand value, as measured by a rise in the net promoter score.
- Creation of unique points of difference (PODs) or unique selling points.

While the list above is not complete or comprehensive, it could help organizations understand the different areas that should be considered while calculating non-monetary benefits.

Perceived Cost

After assessing perceived benefits, the only thing that remains is to identify a model to evaluate the perceived cost of service delivery. We suggest the following equation:³

Perceived Cost = Price + Related and Unrelated Non-monetary Costs (Equation 1b)

Both parts of the equation are equally important. However, they need to be handled in different ways.

- **Price:** There are normally three ways in which prices are determined for any service:
 - Cost-plus model.
 - Competition-based model.
 - Value-based pricing.

Our model takes a unique approach, one that presents the entire pricing strategy as a continuum. The five services highlighted in Figure 1 can be plotted on this continuum (see Figure 3).

IT Service Pricing Continuum

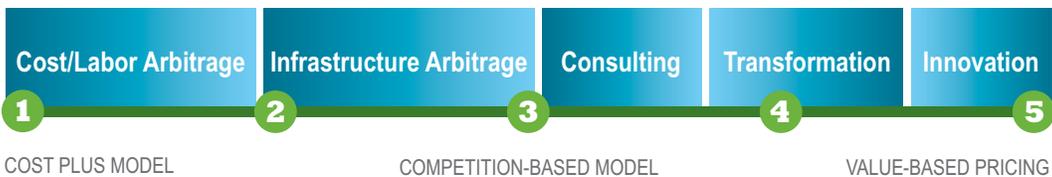


Figure 3

With low-end services that use the cost/labor arbitrage or infrastructure arbitrage model, end-user companies should ask for the lowest possible price and expect a cost-plus model. However, for services that are difficult to evaluate and are highly experiential, it is important to ask service providers for value-based pricing.

Our view is that a company buying the complete range of services should not accept the same pricing models for all services. In our experience, most companies look for a cost-plus pricing model as the standard. However, we suggest that they examine the price continuum and the position of the service offered, and then decide the most appropriate pricing strategy. For high-end or complex services, the lowest price may not always be suitable. Organizations should look at the overall value and benefit that can be derived from the services offered by the provider.

Related and Unrelated Nonmonetary Costs

For end-user companies, it is also important to make sure that nonmonetary costs are also calculated as part of the overall cost evaluation. Major nonmonetary costs include:

- **Related:**
 - Transaction cost for entering the contract.
 - Resource required to manage the contract.
 - Resource required to verify the service deliverables.
 - Space and asset allocations.
 - Increased risk and its monetary value.
 - Increased cost in communication and collaboration tools.
 - Transactions for terminating the contract.

Unrelated:

- Impact of the sourcing contract on the morale of the IT team.
- Lack of innovation and new ideas from the service provider as it is primarily focused on the contract deliverables.
- Change of end-user perception.
- Risks associated to work with resources not present in the location.
- Overall change of the IT strategy.
- Impact of the loss of control.

As mentioned above, end-user companies should spend enough time to find ways and means of evaluating nonmonetary costs because they have a significant impact on perceived costs. While it is relatively easy to evaluate the price, it is very difficult to ascertain the exact nonmonetary costs as there are multiple levers of influence and drivers.

Looking Ahead

Our model for identifying and evaluating services is based on two continuums and the equation of perceived net value. As mentioned throughout this white paper, it is important to differentiate the types of services and decide which parameters to evaluate. It is impossible to identify and evaluate all the different types of services using the same parameters.

Therefore, whenever an IT services company plans to offer a new service it is important to understand where it is situated in the service measurement continuum. The end-user company should learn if the service offered is high on search attributes, experience or credence. Once the position in the continuum is identified, end-user companies should have a proper framework and parameter for evaluating and comparing those services, as discussed above.

While cost and quality could be the only factors of evaluation for the primary levels of IT services (e.g., labor arbitrage/infrastructure arbitrage), they would be insufficient measures to evaluate the higher levels of service. For higher levels of IT services, companies must examine the value equation and make assessments based on the values provided and the perceived benefits. However, if the service is new – and thus lacking industry standards – then the end-user company needs to assess the values in the service that will resonate with their users.

Footnotes

- ¹ [http://en.wikipedia.org/wiki/Service_\(economics\)](http://en.wikipedia.org/wiki/Service_(economics)).
- ² Adapted from "Service Marketing," by Christopher Lovelock, Jochen Wirtz and Jayanta Chatterjee, p. 141.
- ³ Adapted from "Service Marketing," by Christopher Lovelock, Jochen Wirtz and Jayanta Chatterjee, p. 142.

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About Cognizant

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