

IT SERVICES: WHO WILL WIN WHEN DEMAND BOUNCES BACK?



Felix Iblher
Andreas Oberlaender
Hendrik Willenbruch
Hugues Havrin

WHAT'S NEXT FOR IT SERVICES?

The pandemic continues to affect business across industries. IT service providers are facing a demand shock, with CTO's and CIO's priorities shifting to damage control and external spend being cut. The recovery will be faster than for previous big crises but we will see increased market bi-modality. The rebound will be fastest for players with a diversified client industry coverage and portfolio strengths in digital and cloud offerings. We show what both IT services provider and CIOs should be considering now to set course for the future.

AN INDUSTRY AFFECTED BY AN UNPRECEDENTED DEMAND SHOCK

In the IT services industry, the spread of COVID-19 and related containment measures have stifled global demand. Gartner predicts a reduction of up to €120 billion (10%) in 2020 global revenues, with leading players revising target guidance across service segments.

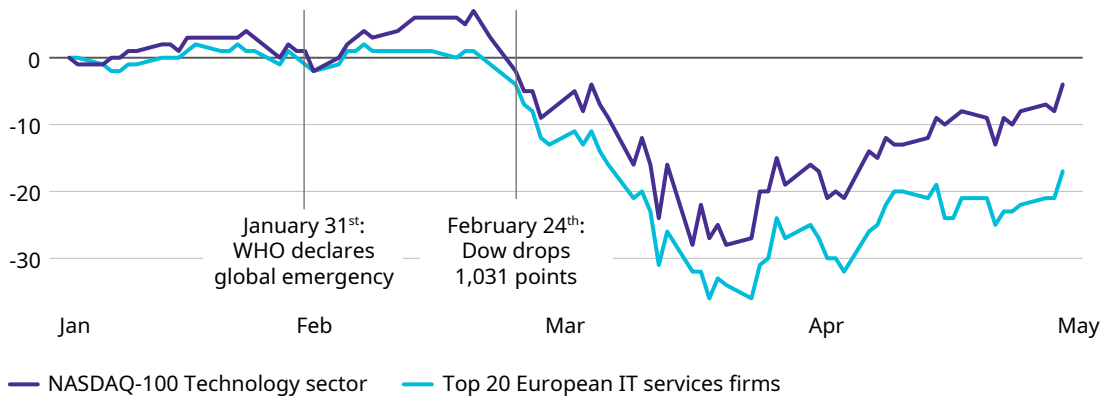
Client decision makers have focused on enabling operational continuity by implementing remote working tools and enforcing cyber security rules for the new work-from-home paradigm. Revenue gaps have resulted in increased cost pressure and a freeze on external spend, delaying or interrupting non-critical IT transformation efforts across industries.

Consequentially, IT services spend has taken a major hit. Within this downturn, our analysis shows client scope to be a major factor. IT services providers serving industries less affected by the pandemic (e.g., telecommunication, pharma) are more resilient, while exposure to discretionary spend in more critically affected segments (e.g., travel and leisure, automotive) creates a larger challenge.

Markets have reacted promptly to the change in demand, eliminating one third of market capitalization for Europe's top 20 IT services providers in the first quarter of 2020, implying a higher risk exposure than broader technology indices. And while traders have been more optimistic lately, IT services have a long way to go to catch up with pre-pandemic levels.

Exhibit 1. IT service providers market capitalization, NASDAQ price index

Percent vs. January 2nd, 2020



Source: S&P Capital IQ, Oliver Wyman analysis

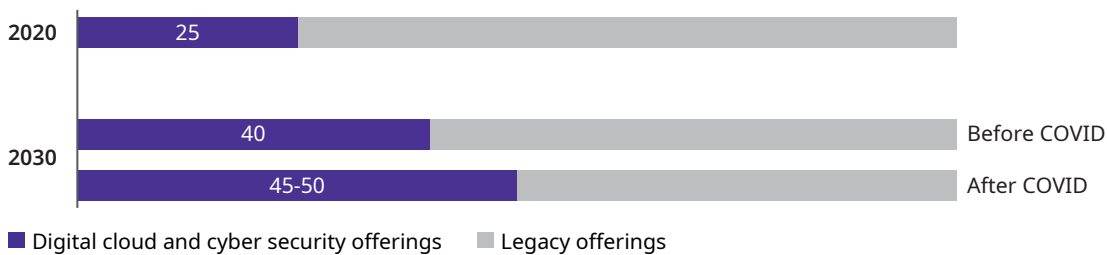
Despite this, the industry has proved to be resilient in the past. After the Dot-com bubble burst in the early 2000s growth was back to normal after around two years, and the financial crisis of 2008 left a textbook V-shaped dent in demand that recovered after just 12 months.

AN EXPECTED V-SHAPE DEMAND CURVE WITH INCREASED MARKET BI-MODALITY

Based on our models, the COVID-19 fallout will turbocharge the evolution of IT services. In fact, chances are turnaround will happen even faster this time. IT services have seen a remarkable shift in demand in the last few years, with an ever-increasing share of digital, cloud, and cyber security offerings over legacy infrastructure and application services

Exhibit 2. IT services market evolution

Percent of total market



Source: Oliver Wyman analysis

Digital capabilities will be in high demand coming out of the pandemic. Retailers' online channels are experiencing unprecedented demand, the proliferation of remote working highlights the need for cyber security tools, and cloud services are enabling new ways of off-site collaboration. IT service providers can be at the heart of this transformation.

Exhibit 3. Transition from legacy to digital driven by revenue uptake of seven offerings

Market	IT service	Impact on revenues ¹		Comments
		Short term	Mid-term	
Legacy offerings	Core systems integration (e.g., ERP, etc.)			Buyers likely to postpone decisions on "slow payback" projects
	Application development and legacy migration			Business likely to only prioritize legacy migration projects if excellent business case
	IT operations and application management			IT operations & application likely to suffer contract revision in the mid-term
	IT infrastructure Management			IT infrastructure outsourcing deals most likely to decrease in favor of IaaS
	Contact Center/ Service desk			Expected contract revisions and cost reduction through AI (e.g., chatbot)
Digital & Cloud offerings	Workplace services			Increase in spending to support collaboration (e.g., Zoom, Slack, MS teams, etc.)
	Digital transformation and Customer experience			Boost of digital channels and UX project to maintain newly acquired customers
	Automation & Robotics			Automation projects with quick ROI likely to be triggered in the mid-term
	Data driven intelligence and AI			The AI/ML momentum could be hit in the short-term due to budget constraints
	Digital manufacturing (e.g., IoT)			Digital manufacturing projects likely to be paused in the short-term
	Multi-cloud/Cloud IaaS			Cloud vendors are generally seen as benefitting beyond the immediate crisis
	Cyber security			Work-from-home programs increased cybersecurity risks and wthus demand

Increase Decrease

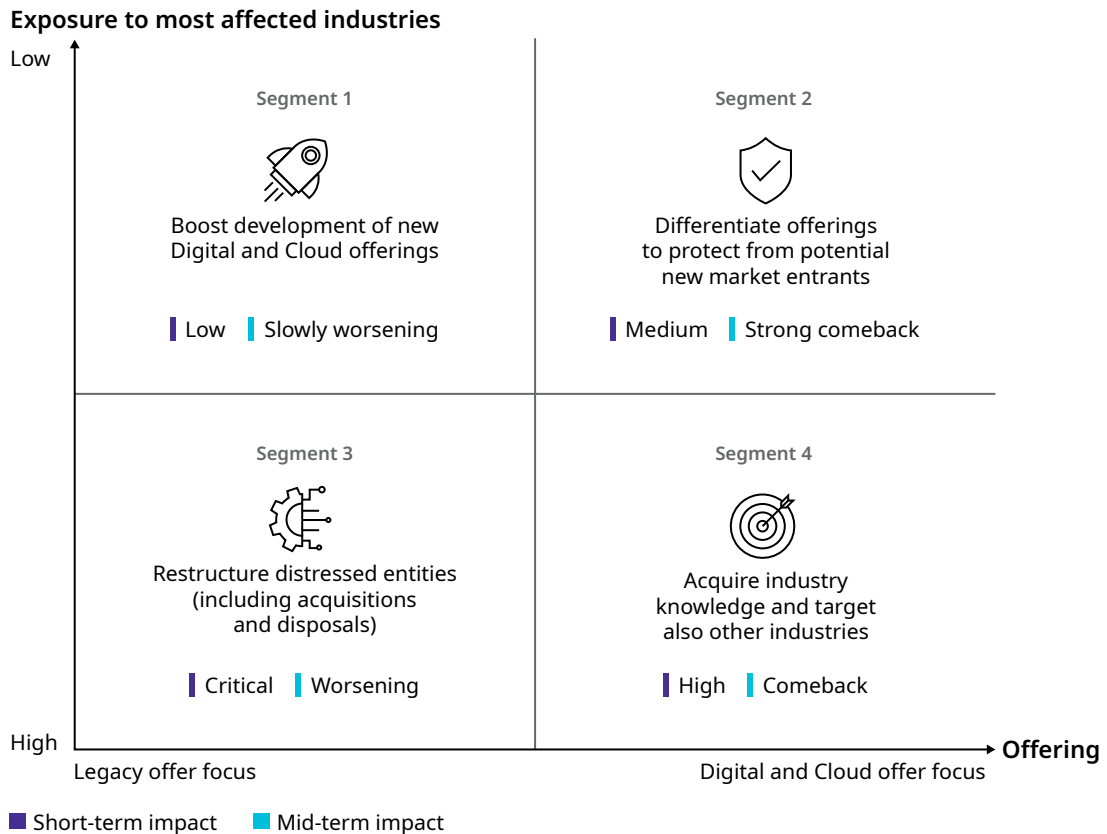
1. Expected impact vs market forecasts

Source: Gartner, OW analyses

SETTING COURSE FOR THE FUTURE

While the segment outlook is positive, individual players in the industry need to act now to sharpen their portfolio and set course for a brighter future.

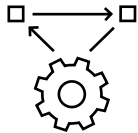
Exhibit 4. Strategies for winning in IT services post-COVID



Source: Oliver Wyman analyses

NOW IS THE TIME TO ACT

IT service providers may find that the external demand shock caused by COVID-19 will soon give way to an unprecedented push for digitalization of client interfaces and industry processes arising from the current crisis. And yet, unlocking this opportunity will require a targeted, nimble strategy. We suggest focusing on six activities going forward:



Shift commercial focus to meet the new demand structure, aiming at better covering industry IT buyers least affected by the crisis (e.g., healthcare, e-commerce)



Leverage potential temporary idle capacity to reskill employees, (e.g., strengthening digital and cloud capabilities)



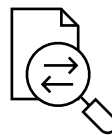
Extend support of distributed delivery models, exploiting the remote working momentum and developing scenarios for revised offshoring strategies/destinations



Strengthen partnerships with specialized software vendors of digital and cloud solutions, to target IT spend pockets likely to grow (e.g., remote working and cyber security)



Tighten the cost base, creating room for maneuver in offer pricing



Actively monitor M&A opportunities, assessing opportunities for acquisitions and disposals as means to reshape the organization and enter new markets

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For more information, please contact the marketing department by phone at one of the following locations:

Americas
+1 212 541 8100

EMEA
+44 20 7333 8333

Asia Pacific
+65 6510 9700

AUTHORS

Felix Iblher

Partner

felix.iblher@oliverwyman.com

Hendrik Willenbruch

Partner

hendrik.willenbruch@oliverwyman.com

Andreas Oberlaender

Principal

andreas.oberlaender@oliverwyman.com

Hugues Havrin

Partner

hugues.havrin@oliverwyman.com

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