

MID-MARKET

The New Frontier for IT Services



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THE RISE OF IT SERVICES IN THE MID-MARKET

The European mid-market represents 28% of the total IT services spend in the region. Our estimates for Germany, UK and France show a market worth €65.4 billion of annual IT services spend for companies with €500m-€5 billion of annual revenues (IT spending by all companies in Europe in 2021 reached €229.7 billion — excluding the public sector).

Mid-market IT budgets (+8.8% CAGR 21-26) are expected to outgrow the overall market spend (+7.6% CAGR 21-26) post-pandemic due to clients catching up on key investments to accelerate their transformation to cloud, rising cybersecurity requirements and a need to modernize applications. European mid-market IT budgets will grow by 52% to €99.6 billion by 2026, whereas the market as a whole will grow by 44%.

Out of the three European upper mid-markets analyzed by Oliver Wyman, the UK was the biggest spender on IT services, paying almost €18.5 billion on IT services. Germany spent nearly €10.9 billion, followed by France where expenditure was €7.5 billion.

So far, about 50% of mid-market clients have opted to primarily operate their IT themselves largely due to concerns about protection of sensitive data and cost advantages. However, many are now facing difficulties managing the full breadth of their transformation journey using their in-house resources alone. The current environment of IT expert resource scarcity also means that many of these mid-sized clients are finding talent acquisition challenging too.

Subsequently, these clients are increasingly turning to external providers for help.

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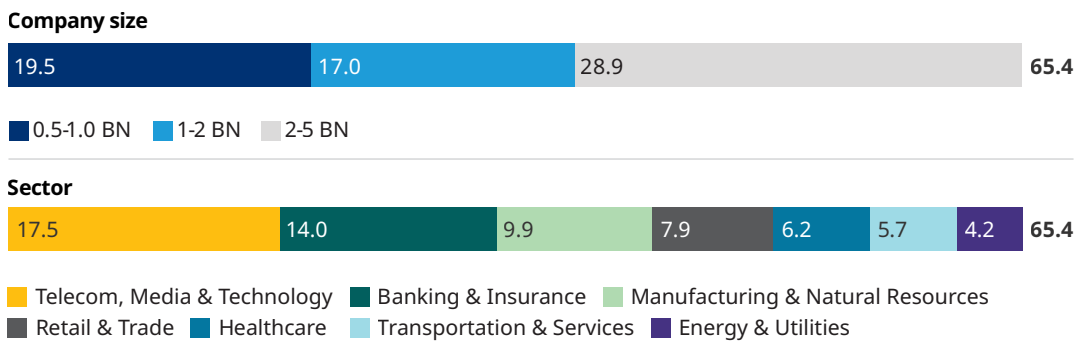
“In the aftermath of the pandemic, many companies have decided to catch up with key investments to accelerate the transformation to the cloud, address growing cybersecurity requirements and, ultimately, modernize their application landscape. Until now, about half of mid-market customers have opted to manage IT primarily in-house, due to concerns about protecting sensitive data and the cost advantage. However, many of them now face difficulties in managing the full extent of the transformation journey with in-house resources.

As a result, they are increasingly turning to external providers for help, especially mid-market clients, who are finding it more challenging to attract talent in an environment of a general shortage of IT resource experts”, explains Hendrik Willenbruch.

Price points in the mid-market segments are only slightly lower than in the enterprise space and delivery risks can be significantly reduced. This combination may translate into more attractive margins to providers overall.

Exhibit 1: Spending on IT services in Europe for the upper mid-market by company size and sector, 2021

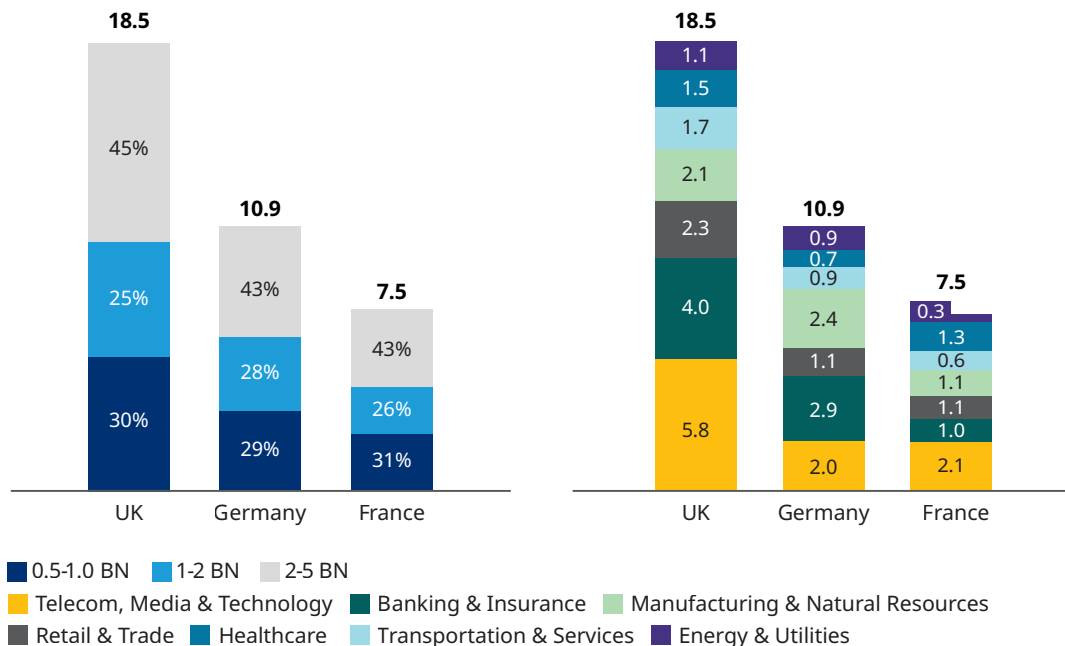
In million Euros, excludes public sector



Source: Oliver Wyman analysis

Exhibit 2: IT services spending in UK, Germany and France for the upper mid-market by company size and sector, 2021

In million Euros, excludes public sector



Source: Oliver Wyman analysis

FOCUS ON GERMANY

In Germany, mid-market companies spent €10.9 billion on IT services last year, with financial services and manufacturing sectors leading the way with a spend of more than €5.3 billion.

Germany's manufacturing, banking and insurance sectors led the spending, which is an exception to the other markets analyzed in the Oliver Wyman study, where businesses in the telecommunications and technology sectors invested the most in IT.

The survey also reveals mid-sized companies in Germany have a higher preference for on-site resources.

MEET THE PROTAGONISTS

We divide IT services players into five broad categories, according to their size and core positioning in the broader ICT value chain:

- 1. Large global — incl. Indian Pure Players (IPPs)**
- 2. Mid-sized players & system houses**
- 3. Telcos & hardware providers**
- 4. Cloud providers**
- 5. Software & cybersecurity specialists**

Let's zoom in on the first two categories:

1. Large global and traditional system integrators have global shoring models and broad transformation capabilities. They tend to focus their efforts primarily on the enterprise-level clients — with good reason. Enterprises provide large volumes and multi-year revenues, which may justify complex bid processes and risks related to initial transformation efforts or upfront delivery commitments. Enterprises see value in their providers' ability to handle complex transformation problems with their end-to-end solutions portfolios and proven tooling. In many settings the delivery mix leverages as much as 80% from near- or offshore locations, yielding attractive price points.

Within this segment, competition is intensifying as IPPs gain foothold in the European market, as evidenced by recent outsourcing deals between TCS and Deutsche Bank or Wipro and Metro, both transferring four-digit IT employee numbers to either of the providers.

Given their growing onshore delivery footprint and commitments to generate year-on-year savings in existing contracts, IPPs are looking to diversify their client base and compete head-to-head with traditional system integrators, who see a unique value proposition in the smaller customer segments.

2. Alongside these giants, mid-sized, locally focused players and system houses have traditionally succeeded in gaining the trust of the lower end mid-market customers. Their strengths reside in high customer intimacy and strong local operations which allow for physical proximity (for collaboration) and often local data storage. Their value proposition is to be an allrounder acting as a one-stop-shop for their loyal customers and widening their services portfolio. The natural growth vector for these players is to grow into larger customer segments, where they face the challenge of growing solution complexity, global client footprints and increasing cost pressure.

Besides those two archetypes, there are three more groups of players which have focused on very specific services:

3. Telcos & Hardware providers mostly partner with managed services providers (MSP) as not only their equipment supplier, but also to provide connectivity services and infrastructure to large companies with their own IT services departments.

4. Cloud providers represent specialized service providers with a dedicated focus on cloud services. While they rarely compete on large IT transformations, they increasingly support both small and mid-sized companies in medium sized cloud projects.

5. Software providers such as SAP or Oracle usually leverage MSPs as integration partners — however (similar to Hyperscalers) they start to build their own relationship with the customers as increasing levels of automation and XaaS models decrease the integration volumes usually done by MSPs. While Cybersecurity is usually a service found in the portfolio of most of mid-size and large IT service providers, rising risk of Cybersecurity threats — and therefore increased market demand — has led to the rise of **Cybersecurity players** with a dedicated focus on cybersecurity services.

LET'S EXAMINE THE MARKET

Our research on the mid-market segments across three key European markets reveals the following:

Mid-sized companies are traditionally served by either **large traditional system integrators** or **mid-sized, local players and system houses, representing between 50% to 70% of their top two IT Services providers.**

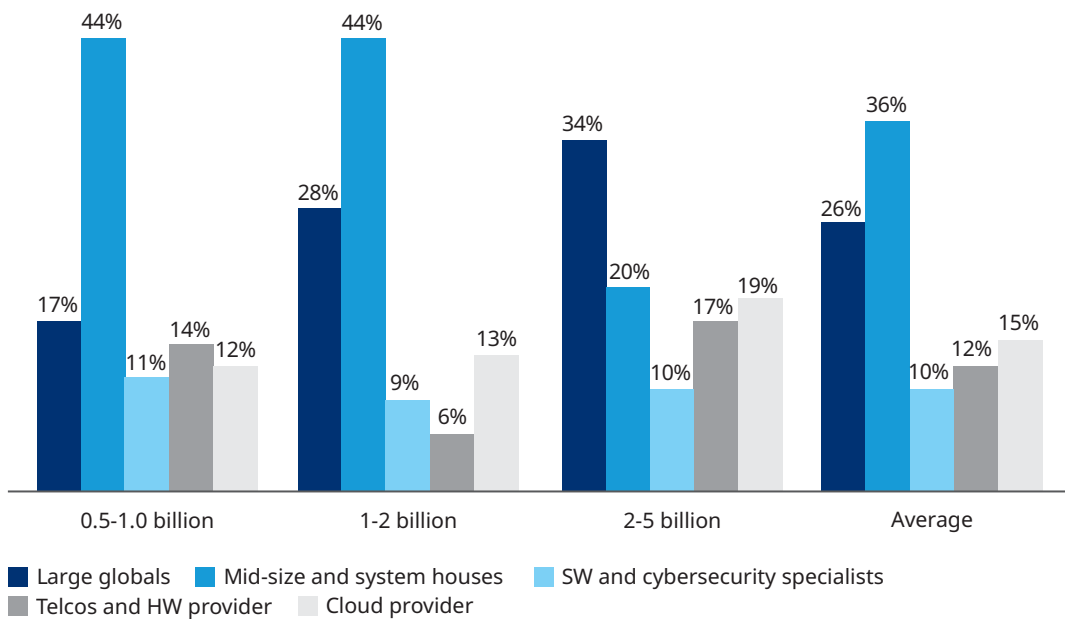
Regional mid-sized providers and system houses confirm a strong foothold, especially for smaller companies between €0.5-2 billion annual revenues where they represent 44% of the #1 or #2 providers. They score with their physical proximity, strength, and cost competitiveness.

The picture changes for the larger client segment, which tends to favor large global IT services providers.

Telco & Hardware, Software & Cybersecurity specialists and pure Cloud providers usually complement the top two providers, showing how important a core position in both "IT" and "Services" has been so far to gain pole position.

Exhibit 3: Type of IT provider selected as #1 or #2

By company size in Euros of revenue, in UK, Germany and France



Source: Oliver Wyman analysis

Overall, mid-market companies do not differ widely from their Large Enterprise or Multi-National peers in terms of purchasing behavior.

Exhibit 4: Criteria in IT supplier purchasing decision making

(1= Least important; 10 = Most important)

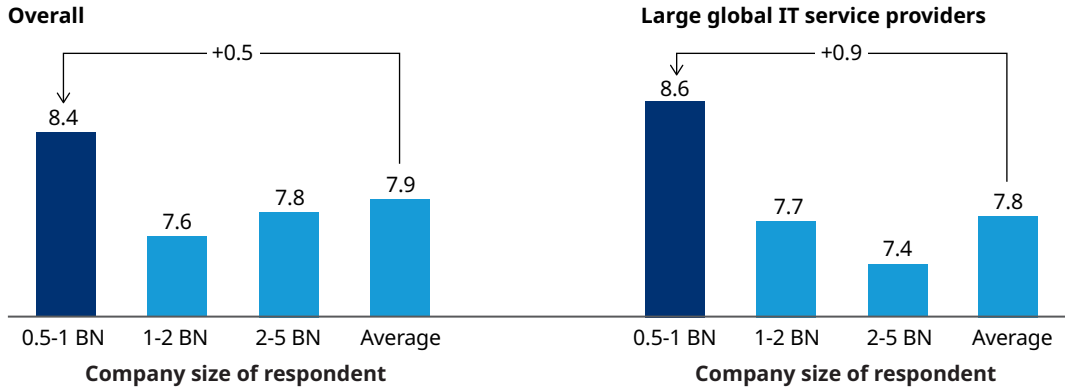
	Germany	UK, Germany, France
1 Has very strong knowledge of my industry and provides tailored solutions	8.9	8.8
2 Offers extraordinary service quality	8.9	8.8
3 Operates at a very attractive price point	8.0	7.9
4 Covers a broad set of capabilities and solutions	6.8	7.0
5 Provides resources on-site speaking the local language	6.4	5.9
6 Has a strong multi-national footprint	6.0	6.1
7 Is a leading provider of specialist services (for example cybersecurity, SAP, cloud migrations)	5.4	5.7
8 The delivery manager has direct control over delivery resources	5.2	5.3
9 Provides standard “off the shelf” offerings	2.7	2.8
10 Submits bids for new services very fast	2.4	2.8

Source: Oliver Wyman analysis

Industry knowledge/ Tailored solutions and **Quality of service** are ultimately what mid-market IT decision makers value the most. **Price does matter but only as an important secondary factor**, proving that clients appreciate the intrinsic value of these services above and beyond their direct cost. This pattern is consistent within the mid-market sub-segments, although **smaller companies generating between €0.5-1 billion of annual revenues appear to be more price-sensitive, especially when choosing large global IT service providers.**

Exhibit 5: Importance of purchasing criterium “Operates at a very attractive price point” compared to other criteria

(1 = Least importance; 10 = Highest importance)



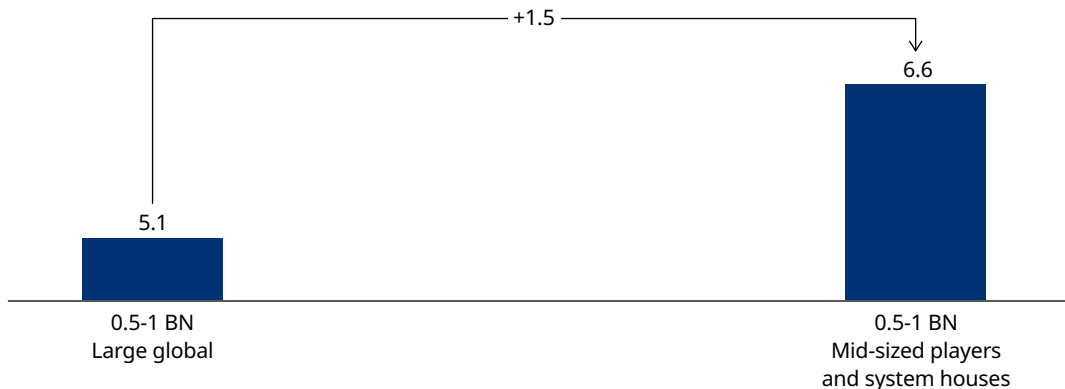
Source: Oliver Wyman analysis

Surprisingly, availability of local resources, which is usually thought of as a priority for mid-sized clients is **not among the key purchasing criteria**. This tends to demonstrate that clients will not be too fussy about the condition of the delivery and support, as long as the quality follows. However, amongst smaller companies (€0.5-1 billion of annual revenues), there is definitely a trend that the companies which declare they use mostly mid-sized providers, seem to have a higher preference towards on-site resources — indicating that regional teams speaking the local language acts as a differentiator for mid-sized IT service providers.

For example, in Germany the preference for on-site resources with local language skills is 20% higher than in the UK.

Exhibit 6: Importance of purchasing criterium “Provides resources on-site speaking the local language” compared to other criteria for companies with €0.5-1 billion revenues by choice of #1 provider type

(1 = Least importance; 10 = Highest importance)



Source: Oliver Wyman analysis

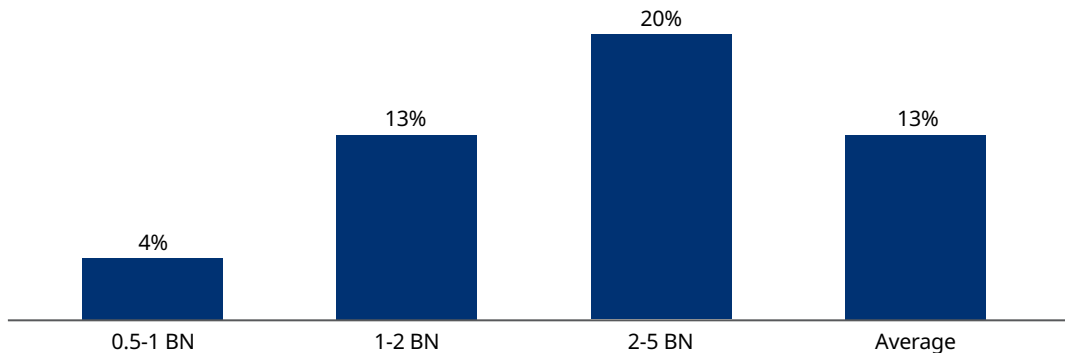
One of the most size-sensitive differences is the level of stickiness achieved by IT Services players in this space. **The lower range of the market with companies ranging €0-5-1 billion of annual revenues are typically very sticky with their IT Services providers: only 4% of them have changed their top two IT Services providers in the past two years.**

Of the reasons underlined by mid-sized companies, the main one suggested is usually the trusted relationship which they have nurtured with their IT Services providers over the years. Often this relationship has started over the procurement of hardware before extending into more complex one-stop-shop services.

As expected, **larger companies** (€2-5 billion annual revenues) **are more prone to make the jump**; they display a lesser loyalty to their IT Services providers with **20% of them declaring having changed one of their top two providers**. This translates into opportunities for newcomers to enter the higher segment of market and challenges incumbents to continuously deliver consistent quality.

Exhibit 7: Have you changed any of your top 2 IT managed service providers in the past 2 years?

Percentage of "Yes" responses of total; analyzed by company size



Source: Oliver Wyman analysis

IMPLICATIONS FOR IT SERVICES PROVIDERS

There are some huge opportunities for IT Services providers due to the European mid-market gaining weight vs. the overall market and the trend for customers looking for external support to help execute their digital transformation plans. We see two key implications for providers willing to grow in this space:

Partnering

The complexity of mid-market customer requirements is not far from large enterprise but comes at a significantly lower service cost expectation. At the same time, the lower in sub-segments we look, the higher the customer stickiness. Therefore, providers stand in between maintaining customer intimacy and managing for complex service delivery and will thus need to partner with each other to be successful, whether it's for local delivery resources, niche solutions or hyper-scaling computing power.

Portfolio choices

As workloads increasingly move to the cloud, providers need to carefully assess their future service portfolio to support their customers, as well as taking critical steps to plan and execute the transformation. Margins associated with non-differentiating infrastructure 'run' services will vanish especially for large global providers, requiring dynamic, expertise-related service models, which tend to come at significantly lower contract sizes.

Oliver Wyman is a global leader in management consulting that combines deep industry knowledge with specialized expertise in strategy, operations, risk management, and organization transformation.

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