



# Leverage for advantage

The evolution of customer management outsourcing

Mike Purvis, UK Managing Director, Transcom

## Introduction

Recent events have forced all financial services organisations to reassess their cost bases in search of savings. This is no less the case in customer management than in any other area.

However, if those organisations wish to restore consumer confidence in the industry – its desire and ability to serve them well and protect their interests – they would do well to proceed with caution. Cost cutting measures that result in a degradation of service quality will prove a false economy.

The pressure is on, then, to respond to the understandable business need for cost reduction, while resisting all measures that compromise service.

In recent years organisations across the financial services industry have looked to outsourcing as a means of reducing cost, by leveraging the advantages of scale that dedicated customer management specialists are able to deliver. They have negotiated highly competitive deals and may well anticipate that, with outsourcing capacity now in ready supply across the UK, there are opportunities to sharpen their pencils to an ever more defined point.

Certainly those opportunities exist but, since they are based entirely on the erosion of the outsourced service providers' margin, they are relatively small and achieving them is fraught with danger. A provider that's facing relentless margin pressure will find the temptation to cut service quality corners almost overwhelming. For you, as a buyer, this is likely to translate into an unacceptable level of risk for a minimal cost advantage.

Many financial services organisations have been early adopters of customer management outsourcing and have already achieved its economy of scale advantages. Would they, then, be wasting their time looking to outsourcing as a source of the next round of substantive cost savings that the current economic climate demands?

Thankfully, no.

As this paper will demonstrate, new trends in outsourced contracting mean enlightened outsourcers are able, not just to chip away at their clients' day-to-day operating costs, but to remove their fixed asset burdens, provide a much needed cash injection and improve operational efficiency.

**Enlightened outsourcing deals can remove fixed asset burdens and provide financial services organisations with a much needed cash injection.**

This paper describes an emerging trend towards leveraged outsourcing deals, in which the outsourced service provider (OSP) takes over not just customer management activities currently undertaken inhouse, but the staff responsible for them, the premises in which they're housed and the infrastructure on which they depend. The first benefit of this comes in terms of the fair market value paid for the fixed assets. The second in the alleviation of long term asset management cost, and the third, from the outsourcer's commitment not just to 'take over' but 'transform' the adopted operation, delivering ongoing operating cost reduction on an agreed glide path.

This paper describes how such deals work and the benefits they deliver in practice. And offers pragmatic advice to organisations that have the appetite – and the courage – to seek more from outsourcing.



**Mike Purvis,**  
UK Managing Director, Transcom

## The emergence of the leveraged deal

The emergence of the leveraged outsourcing deal is the natural conclusion of an evolutionary process that, over the past five years, has transformed the way organisations and OSPs contract and transact. In the traditional outsourcing deals of yesteryear organisations simply transferred an agreed set of responsibilities and working processes to an OSP, who then undertook those tasks on their behalf, using their own infrastructure and people.

Such deals are, of course, still the norm, despite their inherent disadvantages. First, the client organisation is frequently left with expensive fixed assets – buildings, technology and equipment – that can be difficult and costly to offload. They also have to deal with a group of employees who, particularly if the outsourcer's location is far from their own, are unlikely to accept offers to transfer their employment.

For many organisations the cost of asset disposal and redundancy have eroded or negated the cost advantages gained through strategic outsourcing. Some, burdened with considerable assets that have proved difficult or expensive to divest, simply haven't been able to make the maths work. As a result, they've found themselves effectively locked out from the advantages of strategic outsourcing.

Over time, then, new outsourcing models have developed which have sought to ameliorate either the people or asset disadvantages:

**Insourcing:** This hybrid solution utilises the client's buildings and infrastructure, but uses staff supplied by the OSP. This can be ideal for organisations that are facing growth in their customer management requirement, but have little appetite to take on new head count. If they have buildings or facilities available that can be utilised cost effectively this option is likely to make good financial sense. However, while insourcing can make pragmatic use of a fixed asset, that asset – and its associated cost – remains. In the current climate, when organisations are likely to be focused on consolidation rather than growth, it offers no real benefit.

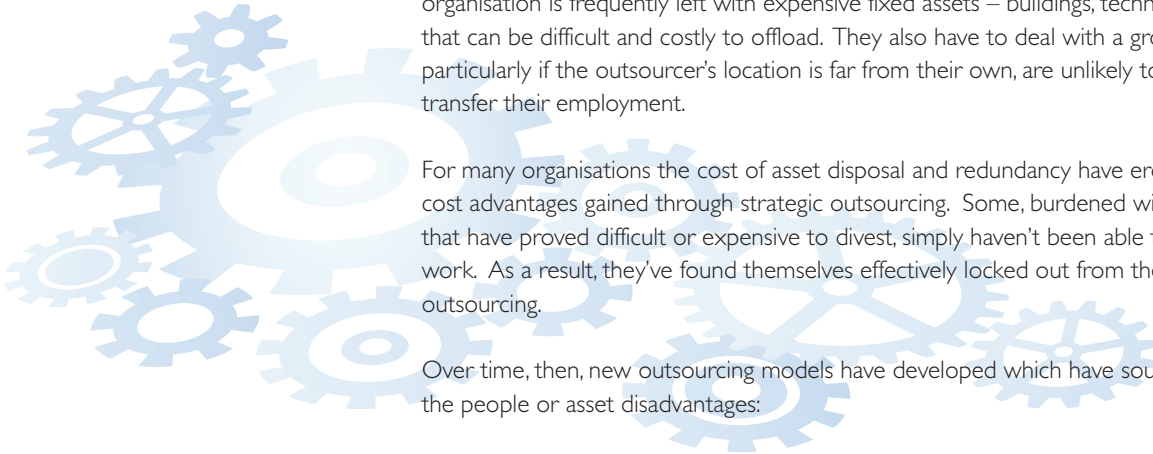
**Managed service (hotelling or hosting):** This solution uses the client's own people, but houses them in premises provided by an OSP. It is frequently used for short term projects, or to provide low cost flexibility to meet business peaks. It rarely offers a long term solution and does nothing to alleviate a fixed asset burden.

Though these models have been useful to some degree and for specific purposes, neither create an opportunity for a serious step change in the client's cost model.

The next logical step, then in the evolution of outsourcing contracts is the emergence of the leveraged deal, in which the OSP relieves the client of its fixed assets and people. The benefits to the client are obvious. But there are considerable advantages, too, for the OSP. They are able to acquire the fixed assets on which their business growth plans depend at little risk, since it is acquired in tandem with a supporting revenue stream. As they build the productivity and effectiveness of the operation they've taken over (which as experts and specialists they are well positioned to do) they can maximise the utilisation of the asset with the addition of new work that has been contracted under more traditional terms from other clients.

In turn, this drive for optimal asset utilisation on the OSP's behalf works in the client's favour, too. Leveraged deals are generally combined with a transformational programme that will radically alter and improve operational performance.

One of our own leveraged deals, with a leading broadband provider, allowed us to take over an operation based in three of the company's UK contact centres and, after an eight month bedding in period, transfer the work to our contact centres in the Philippines and Lithuania, where operating costs are, respectively, around 60% and 40% lower.

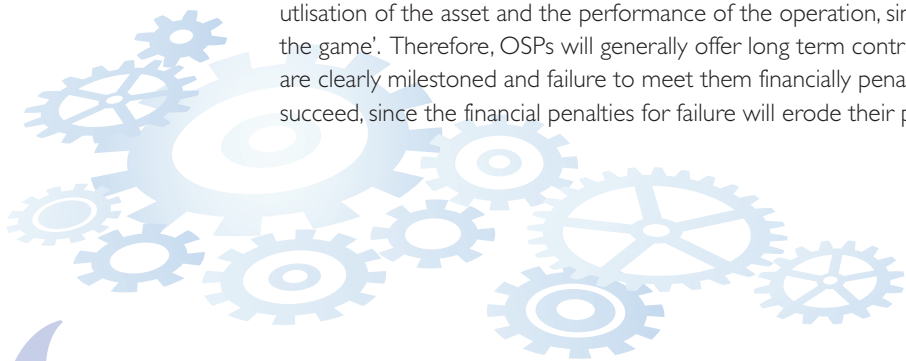


The offshore relocation of the work was eased for us because we were able to take over a stable operation and operate it in a 'steady state' for a period of time while we planned the transition. It worked for the client because we were responsible for maintaining stable performance throughout the transition, recycling the assets and managing the closure of the existing UK operation, (along with the redundancies that were inevitably involved). And there was some good news for the employees, too. Redundancies were kept to a minimum because many of the staff were able to transfer onto other client contracts.

## **Under the terms of a leveraged deal with UK broad band provider Transcom:**

- *TUPE'd 774 staff to its own employment*
- *Ran the customer service operation in 'steady state' for eight months while planning a long term offshore move*
- *Successfully transferred the operation to its own centres in the Philippines and Lithuania, where operating costs are approximately 60% and 40% lower respectively*
- *Is working with the client to deliver an additional 15% annualised cost reduction by increasing first time resolution and streamlining processes*

Within a leveraged deal, then, both the OSP and client have a vested interest in improving the utilisation of the asset and the performance of the operation, since both have considerable 'skin in the game'. Therefore, OSPs will generally offer long term contracts in which cost reduction targets are clearly milestone and failure to meet them financially penalised. They are highly motivated to succeed, since the financial penalties for failure will erode their profit margin on the original deal.



***Leveraged deals offer very real business benefits to clients as well as growth opportunities to the outsourced service providers that offer them. They can also be successful in winning the support of employees, unions and other representative groups, because they offer reasonable chances for ongoing employment with an organisation that has – by entering into the deal in the first place – made a clear statement of its intention to grow.***

Peter Ryan, Lead Analyst – BPO and Contact Centre Outsourcing, Datamonitor

## Leveraged deals in operation

Entering into a leveraged deal requires a degree of maturity, sophistication and openness from both parties. Because they represent a considerable financial and strategic commitment from each that cannot easily be walked away from, they will typically be relatively long term deals of at least five years duration.

The good news from the client's point of view is that they deliver both immediate and long term financial gain:

### **Immediate gain:**

- Cash injection from sale of assets
- Transfer of the asset base to the OSP eliminating investment required to keep those assets fit for purpose
- Immediate head count reduction giving improved 'revenue per head' performance.

### **Long term gain:**

- Ongoing operational cost certainty, since service provision is based on a per-minute, per-seat or per-transaction arrangement
- A sustained and contractually committed cost reduction programme that reduces operational cost over a three to five year period.
- Reduced redundancy costs since the OSP will seek to find alternative work for staff no longer required because of transformational improvements.

### **A typical leveraged deal:**

- ***Outsourcer acquires property assets – either buying buildings/ or taking over leases – paying market value to do so, plus other fixed assets such as technology, fixtures and fittings***
- ***Outsourcer runs operation in 'steady state' for a period of time (usually six to twelve months) to ensure stability, continuity of service and efficient transfer of responsibility***
- ***Outsourcer begins transformational programme to deliver a glide path of cost reduction and performance improvement, agreed upfront with the client***

Such deals are unlikely ever to become commonplace, since they depend upon a provider and an outsourcer finding sufficient mutual motivation in terms of shared objectives and complementary business strategies. However, they are becoming increasingly popular outside of the UK, where Transcom has completed four such deals in the last two years. They are gaining ground, too in the UK and, we predict, their popularity will be boosted by the current economic climate.

And, of course, while not all of the benefits are financial, they are certainly valuable. It is particularly useful to know that leveraged deals minimise head count reduction and transfer the public and employee relations risk associated with redundancy programmes to the outsourcer.

For any organisation interested in negotiating a leveraged deal, here are seven steps that will guide your progress:

## Step one: Understand your costs

Undertake a full evaluation of the customer management processes you're looking to outsource and understand their fully loaded costs. Only with this foundation of knowledge will you be able to be sure that the cost model you enter into with your outsourcer will deliver value over the long term.

You'll also be expected to cover some of the transfer costs. So you'll need to make sure that these make sense as an 'investment' to secure the cost savings to which your OSP will commit.

## Step two: Isolate the assets

Make sure that you are free to divest the assets alongside the processes you wish to outsource. If, for example, the building that currently houses your contact centre operation is also utilised by the business for other purposes, you may not be free to let it go. Similarly, make sure that your technology, fixtures and fittings can be easily transferred.

## Step three: Identify potential partners

Not every OSP has the appetite or resources for such deals. Here's a checklist of the characteristics a viable partner will possess:

- A proven ability to transform operational performance for its clients – check references and uncover the reality behind case studies by speaking directly to their clients.
- Financial stability, with a strong balance sheet, underlying profitability, top line growth and margins that are growing above the market average.
- Demonstrably good employment practices and a track record for successful TUPE processes. If you're handing over responsibility for your people, you want to be sure they're going to be taken care of. It's a good idea, too, to negotiate staff severance packages as part of the deal, since these are not typically covered in standard employment contracts.
- An appetite for risk – a leveraged deal that isn't supported by a 'transformational' programme that provides clear milestones for cost reduction delivery is questionable.
- Near and offshore capability is an advantage. Even if you're not looking for immediate offshoring options your longer term strategy may take you in this direction in search of economic advantage.

## Step four: Be open

Your outsourcer will need to conduct a very thorough due diligence process that will involve a close examination of your assets - and the financial arrangements associated with them. This will be in addition to the usual service and process audit you'd expect with a typical outsourcing procurement process. And, because they'll be committing to a transformational process, you can expect them to be meticulous. Be as 'open book' in your approach as possible, both about the finances and the company's long term customer management objectives.

## Step five: Safeguard the customer experience

Take time upfront to clearly define the customer experience you want to deliver. It should be reflective of your brand and service proposition and designed to meet or exceed the demands of your marketplace. Share that understanding with your OSP and make sure they have a convincing plan to deliver it. Encapsulate both the service objectives and the plan to achieve them within the contract. Make sure cost benefits can't be delivered at the expense of the customer experience by ensuring that quality scores and customer satisfaction targets are clearly stated and the contract stipulates that failure to reach them will result in the imposition of financial penalties.

## Step six: Evaluate

Evaluate the outsourcer's proposal exhaustively. You should expect it to contain:

- A detailed process for the transfer of physical and human assets
- A clear understanding and re-articulation of the business processes for which they'll be responsible
- A thorough plan to manage the programme in the 'steady state' period, with a clear strategy for knowledge transfer
- A detailed transformational plan in which cost reduction milestones are linked to performance improvements, customer satisfaction and the delivery of business objectives.

## Step seven: Keep control of what matters

You're letting go of assets, staff and processes. Make sure you keep control. The evaluation of quality, measurement of customer satisfaction and regular monitoring of regulatory compliance should remain in your hands. In fact, we usually advise clients to engage a third party to evaluate our customer satisfaction performance and we expect our remuneration to be linked to it.

Finally, to mitigate against extremes, make sure that the contract you sign maintains your right to step in and reassume management of the operation in the unlikely event that your outsourcing partner fails dramatically. This may include the right – at a given juncture – to 'buy back' the fixed assets.

## Seize the day

We started out this paper by stating that new outsourcing models present fresh opportunities, not just for incremental cost savings, but for the achievement of a major step change in operational performance and overall business profitability. The current economic climate may breed caution, but experience shows that bold organisations, rather than timorous ones, are generally rewarded with the most dramatic success. Providing, of course, that boldness is tempered by diligence, strong governance and rigorous control.

**The time to ask more of your outsourcing partners has come.**

Transcom is a leading provider of customer and credit management services to clients across the globe. Our operations span 75 sites in 29 countries and our clients include Grupo Santander, AIG, Sky, Xerox, 02, Vodafone, Orange, Tiscali, Tele2, Expedia, Hotels.com, StenaLine, Indesit, Redcats, Statoil, e.on, Accenture and TNT.

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