RESTRUCTURING YOUR SERVICE PROVIDER CONTRACT TO DRIVE GREATER VALUE

Opportunities for Immediate Cost Takeout

CAPTO

Market Factors Make Now the Time to Restructure

Optimized service provider relationships will be a crucial driver for success in 2023 and beyond. Restructuring existing partnerships to meet current cost challenges and provide medium- to long-term capabilities and flexibility will lead to a competitive advantage going forward. Enterprises that truly partner with their service providers will find success in navigating these uncertain times and establish the foundation necessary to exploit opportunities for future growth.

Service providers are primed for this discussion. They are facing a variety of challenges that create opportunities as they retool their businesses for the future. While facing margin pressure and competitive challenges, providers are looking to strengthen their market presence by upskilling their talent and investing in future technologies.

In a highly optimized provider engagement, near-immediate annual **savings in the range of 10% to 12%** can be realized. For partner relationships lower on the maturity spectrum, **savings could reach 35%**.

SmartSpend™ Model

- **Enables 10%-15% cost takeout within 60-90 days**
- **Effective across the sourcing maturity curve from staff augmentation to outcome based managed services**
- **Lock down a committed spend with a partner of choice**
- **Existing contracts stay intact; negotiations required are mostly commercial discussions**
- **Flexibility throughout the term to change the composition of scope enabling responsiveness to the business**

Result: Win-Win Partnership

- **Buyer enjoys near-immediate cost savings**
- **Provider locks in longer-term revenue**

The client's challenge is to achieve meaningful immediate cost takeout while strengthening the ability to exit the downturn with new capabilities and flexibility. Capto's proprietary SYNAPTIC methodology will help clients optimize their service provider relationships. Our decades of experience and in-depth knowledge of provider priorities and strategies enable us to deliver unique and successful outcomes for our clients. Capto will guide you through the process of restructuring your relationships to maximize cost takeout and create flexible spending models agile enough to adjust to changing demand.

Understanding Your IT and BPO Supply Chain

A deep understanding of the strategies and challenges facing your service providers is required to optimize economic and operational performance. Margins across the service provider industry eroded as labor costs outpaced pricing and resource demand mushroomed through the pandemic. Service providers were stuck in long-term contracts with fixed fees and static rate cards while the labor market was becoming increasingly competitive, leading to skyrocketing compensation. Since the beginning of the pandemic, the traditional labor pipeline has been insufficient to meet demand. To compensate, service providers increased lateral hires and relied heavily on contract labor to compensate for the lack of "freshers" (first job; just out of college), therefore driving labor costs to historical highs.

Another challenge facing service providers is that 60% to 70% of their revenue comes from legacy services such as infrastructure and operations, application maintenance and support, finance and accounting, contact center outsourcing, and simple staffing services. These legacy services are rapidly commoditizing and are largely undifferentiated, leaving little room for price increases.

Although providers are challenged by legacy engagements with locked-in rate cards and managed services pricing, it is also true that approximately 60% of overall service provider revenue is subject to annual renewal and engaged on a staff augmentation basis.

Understand your partner's position to create a more productive relationship:

1. **The fallout of the talent war**
2. **The commoditization of core services**
3. **Increased competition for high-value services**

Finally, smaller, more specialized firms are competing for high-margin, premium services in new technology areas.

The fallout of the talent war, the commoditization of core services,and increased competition for high-value services make it difficult for providers to maintain the historic gross margins (35% or greater) that their business model requires to achieve bottom-line results.

Large service providers are responding to these challenges by investing in their teams to better serve their clients. Industry merger and acquisition activity reached its peak from 2020 to 2022. Acquisitions provide greater speed to market than organic development of new capabilities. Large service providers also continue to invest in disruptive technologies led by AI innovations, cloud and SaaS adoption, and continued acceleration of robotic process automation (RPA) to compete with small, specialized firms.

C-suites and boards of major service providers are looking to strengthen their positions by investing in their long-term client relationships to create a predictable and profitable revenue base while also increasing value for their clients. Restructuring these relationships with a transparent and collaborative approach represents a true win-win.

Restructuring Opportunities

Embarking on restructuring a service provider relationship presents three core opportunities. First, immediate cost takeout is possible by leveraging current market dynamics and utilizing new solutions and contracting models. Second, restructuring can improve transparency and collaboration to increase productivity. Third, restructuring can lead to strategic engagement by creating flexible spending models able to adapt to changes in demand and market trends as the economy recovers.

The benefits of restructuring existing service provider agreements are threefold:

1. **Immediate cost takeout**
2. **Partnered productivity**
3. **Strategic alignment to business**

Cost Takeout

Cost takeout is delivered via a one-two punch. First, service provider contracts can be quickly adapted for immediate cost takeout. Considering the service provider challenges above, modifying legacy contracts to incorporate Capto's SmartSpend™ model in exchange for immediate pricing concessions, if structured correctly, provides upside to the provider as well as the client.

Properly structuring the renewal commercial terms allows service providers to address many challenges while offering immediate savings to their clients. Service providers can complete these modifications in weeks, delivering near-immediate cost takeout for clients.

Imagine the following example of looking up a property value on a realtor group website. The data being pulled for the property value is provided by a business process outsourcing (BPO) service on a transaction basis (data packets). The realtor group recently restructured its BPO engagement with the provider by leveraging SmartSpend that yielded an almost 14% savings.

An explosion in the real estate market caused an increase in data packets. With this increase, the realtor group was meeting their committed spending level with their BPO provider solely with the property value work. The explosion in the real estate market was also taxing the provider's call center support services. With the SmartSpend in place, the realtor group could shift the call center services to another provider better suited to handle the volumes without a lengthy contract renegotiation or penalties. The flexibility to create a strategic response to a change in demand is a win for both the realtor group and provider.

Maturing the engagement model with your service provider creates short- to medium-term opportunity. A pharmacy benefits management (PBM) client supported its application environment using a 100% staff augmentation staffing model that is renewed annually. By initially implementing SmartSpend, the client realized a 12% savings increase within 45 days. The client then progressed to implementing a change to their operating model.

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Over a period of 12 months, the client shifted to a managed service model to support their PBM application environment, resulting in a 35% increase in savings across the entire portfolio. Using this two-stage approach to restructuring their relationship, they quickly reduced spending by 12% and achieved incremental savings over the course of a year with improved service levels and other benefits of managed services.

Productivity

Productivity is the second half of the one-two savings punch. Achieving meaningful, long-term productivity cannot fall solely on the shoulders of the service provider. You and your team are in a strong position to envision your productivity use cases because you know your business best. It is imperative to be transparent and collaborate with your service provider to map these use cases within the solution strategy.

Productivity can be segmented into three categories: (1) human productivity, (2) robotic process automation (RPA), and (3) productivity driven by artificial intelligence/machine learning (AI/ML). Human productivity is naturally the first lever. Increased familiarity with a work environment leads to increased efficiency. Most enterprises moved onto RPA and invested heavily in tools as athe next progresison. RPA tool investments have not yieleded the anticipated return and represent a continued opportunity. Enterprises that have maximized their human productivity through RPA begin turning toward AI/ML for the next phase of productivity gains. This stage requires intense collaboration to create meaningful productivity gains.

Regardless of where you fall on the productivity maturity spectrum, a productivity strategy is required to drive sustained cost savings and serve as a growth driver for the business Productivity targets must be managed jointly. Both parties must be accountable for milestones and track and share the realized savings.

At Capto, we use the term Partnered Productivity™ to describe businesses collaborating with their partners to create significant productivity gains and savings. Perhaps the greatest outcome of Partnered Productivity is the true realization of operational excellence (e.g., process elimination) and financial performance. The one-two punch of restructuring contracts to realize immediate cost takeout and driving long-term productivity is the key to sustained cost savings.

Partnered Productivity™

- **Productivity beyond Robotic Process Automation**
- **An essential readiness step to deploy Artificial Intelligence/Machine Learning**
- **Extends productivity tool investments**
- **Intense collaboration to create meaningful productivity gains**
- **Renews savings momentum and serves as a growth driver for the business**
- **Productivity targets managed jointly**
- **Both parties accountable for milestones and tracking the realized savings**

Renewal Opportunity Matrix

The matrix below depicts entry points, solutions, and outcomes for clients considering restructuring their service provider relationships.

Starting Engagement Models for Contract Restructuring

Where do you plug in?	Cost Savings Opportunity %	Solution	Time to Value
Staff Augmentation	Up to 35%	Managed Services and/or SmartSpend	• 90-180 Days to Completion • MSA modified to facilitate new delivery model • Immediate early savings yielding to incremental savings over the term
Managed Services	10-15%	SmartSpend	• Go-live in 60-90 days • Minimal legal revisions • Existing work remains intact • Immediate savings
Multi-Vendor Environment	Up to 30%	Vendor consolidation – migration to /or continuation of Managed Services; SmartSpend an option	• 90-180 days effort • Dependency on disengagement requiremaents with affected partners • Jumpstart savings in 45 days
Multi-Engagement Environment	10-15%	SmartSpend	• Go-Live in 60-90 days • Minimal legal revisions • Existing work remains intact • Immediate savings

Depending on where clients land in the matrix, they can expect 10% to 35% savings on current and consolidated spending with their service providers. In almost every case, including mature environments, restructuring will result in savings of 10% to 12% in 6 to 12 weeks. Less mature environments have a much greater savings potential given the optimization levers available.

In addition to cost takeout, restructuring these relationships can improve provider performance and establish the foundation for innovation and agility as the economy recovers.

Enterprises facing uncertainty require flexible and adaptable provider engagement models, savings, and velocity. Capto can help clients achieve these results.

Why Capto?

Capto's proprietary SYNAPTIC methodology will help you optimize your service provider relationships. Our decades of experience and in-depth perspective on service provider realities, challenges, and strategies enable us to deliver unique and successful outcomes for our clients.

The first step in leveraging Capto's SYNAPTIC sourcing methodology is understanding your current IT, BPO, and service provider environment through a brief questionnaire. Capto's iterative process will evaluate cost takeout levers and give you an initial recommendation on renewal options, expected outcomes, and actionable next steps. This process takes two weeks or less. From there, we will engage with your team to develop a detailed road map and business case for renewing and restructuring your relationships.

Capto works closely with only a handful of clients at any given time, providing senior advisory services every step of the way. Look under the hood of any successful team or project, and you'll find strong leadership. Our success is led by an executive-level team spearheading each engagement. Our clients and their service providers describe our approach as direct and professional. We take pride in focusing on the information that matters. When retooling the partnership with your service provider, Capto leads to quick results and strong partnerships.

Capto will guide you through the process of restructuring your relationships, strengthening partnerships, and ensuring the quickest time to value, ensuring winning returns on both sides of the partnership.

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