CXM's Coming of Age: "Skin in the Game" Taking Center Stage

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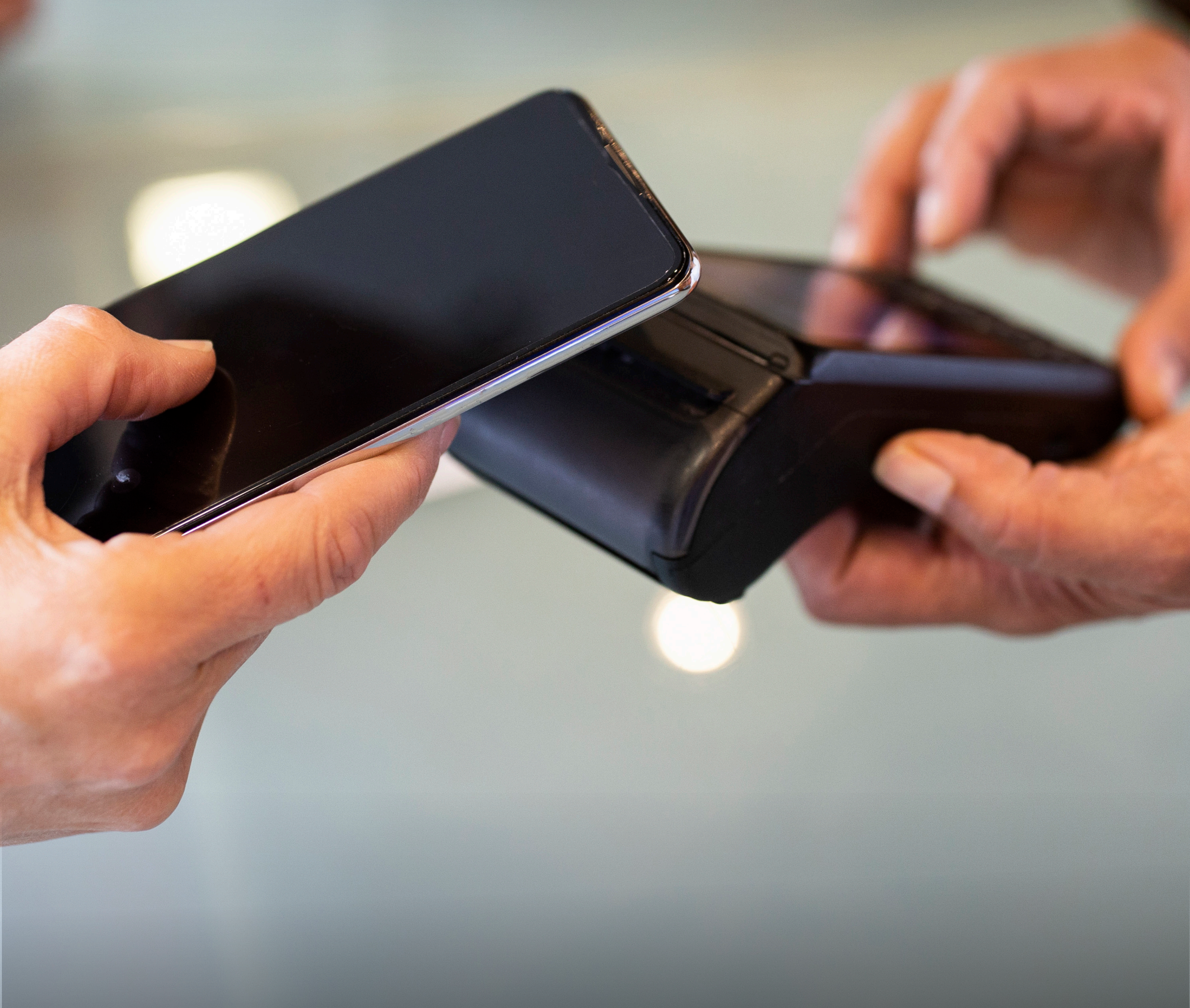

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The Era of Unreasonable Commercial Constructs is Here

In an era marked by unprecedented and rapid change, the global business landscape finds itself navigating through a myriad of challenges. The newfound post-pandemic resilience and adaptability are facing their biggest test yet as demand softens, and the economic outlook grows increasingly muted. The once prevalent chorus championing growth has gradually waned, making way for a resounding emphasis on consolidation and efficiency across borders. Today, businesses of all sizes are taking drastic measures to remain in the green, while simultaneously grappling with the disruptive force of AI, which has become an undeniable reality vis-à-vis what used to be considered as far and distant before. As businesses confront this ever-evolving landscape, with the chilling winds of a funding winter blowing alongside, addressing difficult questions around path to profitability, it will be more than fair to say that change is the only constant permanence. And it is here to stay!

This pace of change has undoubtedly had profound implications for companies worldwide. However, amidst these transformative times, the one reign that continues to prevail is that of the customer. Yes, customer continues to be king/queen! Engagement, retention, and monetization of customers still are the utmost priorities. Central to this unfettered focus are the CX service providers who find themselves under immense pressure as they navigate this period of customer overemphasis on behalf of their clients.

On one hand, is the pressure to meet ever-changing, ever-increasing demands from end clients and on the other is the unreasonable expectations on the economics. Intense deal negotiations and re-negotiations of existing contracts have become far too commonplace. The era of unreasonable buyer expectations is indeed here.

What this has led to is a delicate balancing act for service providers, striving to deliver exceptional customer experiences while navigating budget constraints and increased efficiency demands.

- Whether it is aggressive commercial expectations in RFP for new deals for e.g., large HC buyer expecting bottom quartile pricing for licensed sales further exacerbating the already compressed onshore margins OR

- Renegotiation of existing long-standing contracts, for e.g., the demand to undo the price revisions for a 5 year renewal and revert to previous pricing at least in the upfront years pushing the service provider to bear the brunt in the present with only an optionality to recoup the investment later.

These not so sporadic episodes have necessitated innovative solutions thereby paving way for value-based commercial constructs as the preferred path to win-win. This paradigm shift moves beyond traditional commercial contracts based solely on resources employed, and instead not only emphasizes but also incentivizes "skin in the game" on part of service providers. While this transition is not new and has been long in the reckoning, what is new is the value-based-first mindset.

In this perspective, BCG and ResultsCX delve into the key drivers that have ushered in the pivot to "skin in the game" basis the collective industry experience. We examine the full array of commercial constructs available to service providers as well as break some popular beliefs and myths about these models. Lastly, we discuss how service providers can navigate the complexities around these models and embrace the change.

Key Drivers Ushering in the Change

We explore the key drivers at the helm of this transition in mindset both from a service buyer's point of view as well as that of service providers. From a CX service buyer's standpoint, the key drivers of change are as follows (See Exhibit 1)

1. **Pay for performance, and not operations.** The party is over! The good old times of delivering what you are told and completing transactions have unfortunately wrapped up. This long-developing trend is now drastically catching fancy. Running the business is no longer the ask rather running the business successfully is the expectation. Payouts are linked to tangible success outcomes, mutually agreed upon at the time of contracting itself. Running operations is reduced to mere table stakes, payouts are no longer certain, and are getting increasingly probabilistic.

2. **Co-own and co-fund transformation agenda.** The want to experiment and get ahead on the innovation agenda is at an all-time high while the risk and investment appetite is at an all-time low. As a result, there is a need to transition from transactional relationships to strategic partnerships that generate unique, impactful, and jointly created solutions. In such purpose-driven partnerships, both buyers and providers rely on each other's capabilities to achieve their goals. For instance, in some arrangements, providers may foot the bill for upfront investments and pilots with the ability to plough back from the value delivered as a result from the investment. Similarly, buyer and provider may co-opt to build an innovation fund and share the benefits jointly.

Exhibit 1 - Key Drivers Ushering in the Change

Perspective	Key Drivers	
From Customer's Perspective	Pay for performance, not operations	• Enterprises are linking payouts to tangible success outcomes, mutually agreed upon at the time of contracting itself • Running operations is reduced to mere table stakes, payouts are no longer certain, and are getting increasingly probabilistic
	Co-own and co-fund transformation agenda	• The desire to experiment and get ahead on the innovation agenda is at an all-time high while the risk and investment appetite is at an all-time low • Enterprises are urging their service partners to co-own and co-fund the transformation investments with the option to plough back from the value delivered
	Do whatever it takes to drive change, and at pace	• It is getting increasingly difficult to explain and contract on well-defined contours and scope of work. Businesses seek partners whose incentives are aligned with driving change. • Providers are needed whose own interests are at stake and are motivated to go beyond their operational duties to drive change at pace
From CX Provider's Perspective	Differentiate in a crowded space	• Enables providers to make a powerful statement about their commitment to success and belief in self-capabilities • Cements position of providers as a long-term strategic partner, and allows to differentiate themselves through "outcome-delivery"
	Drive better buyer access	• CXOs have been found to be more amenable to value-based models as compared to the traditional buying centers • They are also more likely to scale business with the service provider post successful service delivery
	Elevate the relationship, from provider to partner	• Creates a sense of security, that transcends the relationship from a buyer-provider dynamic to more of a partnership • Allows providers to instill trust in buyers that they are willing to do what is necessary to deliver successful business outcomes

Source: BCG analysis.

3. **Do whatever it takes to drive change, and at pace.** Working within the confines of a tightly defined scope is a thing of the past. It is getting increasingly difficult to explain and contract on well-defined contours and scope of work. Businesses seek partners whose incentives are aligned with driving change. They need providers whose own interests are at stake in the transformation process and are motivated to go beyond their operational duties. To top it off, patience is a virtue nearing extinction. The objective is to do what is needed to get things done and get it done as of yesterday. Whether it is driving cross-functional alignment, change management, data readiness or navigating several legacy systems, the mandate now is to do whatever it takes to drive the desired outcomes.

On the flipside, service providers are themselves taking the initiative to embed value-based models proactively into their deals, as it helps them to:

1. **Differentiate in a crowded space.** By demonstrating skin in the game, it makes a powerful statement about the provider's commitment to success and belief in its own capabilities to deliver the committed outcomes for its buyer. It cements its position as a long-term strategic partner, contributing towards buyer's positive transformation. Doing so allows the provider to differentiate itself through "outcome-delivery," and not merely "service-delivery".

2. **Drive better buyer access.** Unlocking CXO connect is critical for service providers. Basis BCG's buyer survey, CXOs have been found to be more amenable to value-based models as compared to the traditional buying centers and are more likely to scale business with the service provider post successful service delivery. Securing a foot in the door with the CXOs and not being stuck at level of business / functional owners has long been a pipe dream for providers. Value-based models have finally enabled providers to have a seat at the highest tables.

3. **Elevate the relationship, from provider to partner.** Value-based models instill trust in buyers and helps develop a sense of comfort knowing the fact that the providers have their back, come what may. That they will do what is necessary without arm-twisting on scope, commercials, timelines. This sense of security transcends the relationship from a buyer-provider dynamic to more of a partnership. Through this expanded scope of relationship, with greater control and access to data, providers are able to deliver on outcomes. And in the services world, the holy grail is still none other than being recognized as a trusted partner.

Entering a World of New Commercial Constructs

As the shift towards value-based models gains momentum, it becomes crucial to understand the various commercial constructs shaping the CX service provider industry (See Exhibit 2). From traditional models to consumption-based and now value-based models, each offers unique pricing and engagement approaches. By delving into these constructs, we can gain insight into the evolving CX landscape and the diverse pathways to success.

1. **Traditional models.** These include Time and Materials (T&M) and Full-Time Equivalent (FTE) models, which have long been established in the industry. T&M models involve billing based on the time spent on specific tasks or projects, while FTE models charge for dedicated resources on a full-time basis.

2. **Consumption-based models.** These include transaction-based and licensing-based models. Transaction-based models involve charging per interaction or service delivered, allowing businesses to pay based on their actual usage. Licensing models, on the other hand, offer access to specific services or software for a fixed fee or subscription. These models provide scalability and cost predictability, as organizations pay for what they consume.

Exhibit 2 - Entering a World of New Commercial Constructs

	Traditional Models	vs.	Consumption-based Models	vs.	Value-based Models
Description	• Models based on time spent on specific tasks or quantum resources deployed to run operations		• Models based on per interaction / activity delivered thereby allowing pay by usage		• Variable models with incentives to drive continuous improvements and innovations • Providers paid for delivering success parameters, not just driving operations
Types	• T&M-based • FTE-based • Fixed Price		• Transaction-based • Licensing-based		• Variable-based • Fee-at-risk
Relationship	• Transactional, input focused relationship • Inputs based models focusing on effort and materials deployed to perform agreed upon activities • Buyer and service provider agree on scope of operations		• Transactional but output focused relationship • Providers perform activities and payouts get linked to the quantum of usage / activities		• Collaborative relationship • Both parties invested in each other's success sharing risks and benefits • Limited certain fees, payouts linked to performance
Performance Measurement	• Performance defined in SLAs and measured through operational KPIs		• Performance is measured based on consumption patterns, usage levels, customer satisfaction with the service, and adherence to SLAs		• Performance defined and measured through mutually agreed outcomes • Outcomes reflect overall success of the program and the partnership

Source: BCG analysis.

3. **Value-based models.** These include fee-at-risk and variable-based models. Fee-at-risk is a type of commercial arrangement where a portion of a provider's compensation is tied to the successful achievement of predetermined outcomes, which if not achieved, results in fee reduction. In fee-at-risk models, there will be a ceiling price on which the penalties will be applied. The other type is the variable-based model, which operate on a similar principle but link compensation to the level of value delivered - be it in the form of cost savings, revenue increment, or productivity increase. In variable-based models, there is a floor price over and above which the incentives will accrue basis performance.

Beyond the Buzzwords: A MythBusters Guide to value-based Models

In Exhibit 3, we demystify some popular myths about value-based models, which are as follows:

1. **Margin accretive in nature.** Contrary to popular belief, value-based model have been found to drive uptick in margin realization when deployed effectively. Based on studies, up to 10-15% upside has been achieved over traditional models on like-to-like scope of services.

2. **Key growth enabler, not just a margin play.** In addition, growth expectations for value-based models remain aggressive across verticals and services, with buyers expecting them to grow twice as fast as traditional models in the next five years. Value-based model adoption is expected to increase to 30%+ by 2026.

3. **Limited pureplay, mostly hybrids.** Value-based models mostly come in shades of grey. Very few deals have been found to deploy pureplay value-based models. 9 out of 10 of value-based deals are hybrid in nature i.e., deploy multiple types of commercial including traditional and transaction based.

4. **Higher win rates.** A systematic approach to pitching value-based models during renewals results in higher win rates. Analysis of renewal deals revealed a win rate of 73% for incumbents, with a higher win rate (81%) when incumbents led with value-based models.

Exhibit 3 - Beyond the Buzzwords: MythBusters Guide to Value-Based Models

1 Margin accretive in nature

Up to 10-15% gross margin upside has been achieved over traditional models, for similar services, when deployed systematically

2 Key growth enabler, not just a margin play

Buyers expect double the growth in value-based models compared to traditional ones, with a projected adoption rate of over 30% by 2026

3 Limited pureplay, mostly hybrids

Mostly exist in shades of grey, with 9/10 deals being hybrid in nature i.e. deploy multiple types of commercial models in same deal

4 Higher win rates

A systematic approach to pitching during renewals leads to higher win rates, reaching up to 81% for incumbents leading with value-based models vs 73% for incumbents without value-based models

5 CXOs are bullish on adoption

Top leadership in buyer enterprises show great optimism in adoption of value-based models, with COOs exhibiting the most confidence

6 Paves way for longstanding partnerships

3/4 buyers show higher satisfaction with value-based deals over traditional ones upon successful delivery. Also helps build access to new buying centers

Source: BCG analysis, BCG BPO Buyer Survey.

5. **CXOs are bullish on adoption.** Top leadership in buyer enterprises show optimism regarding growth and adoption of value-based models. COOs have been found to exhibit the highest level of confidence among CXOs. Additionally, 3 out of 4 CXOs are willing to scale up business with service providers based on successful value-based model delivery.

6. **Paves way for longstanding partnerships.** 3 out of 4 buyers express higher satisfaction with value-based deals when compared to traditional deals. Positive experiences with value-based models not only help maintaining business in existing buying centers but also translate into expanding to new buying centers.

While buyers have stated several apprehensions as well while negotiating value-based deals.

- 2/3rd initially raised concerns about sub-optimal maturity of internal systems, unclear attribution of outcomes to vendor performance or lack of cost transparency i.e. vendors may squeeze large margins.
- Others include flexibility provided for change requests, lack of comprehensive benchmarks, complexity in requirements from buyers, lack of cost predictability, etc.

These initial concerns during outsourcing have been put to rest as 64% of buyers have stated a positive impact on their relationship with vendors after value-based delivery.

Navigating Complexities and Embracing Change

As the CX industry goes through this shift, CX providers need to take the onus on to themselves to be the front drivers for expediting this change. Customers will no longer just want to simply "improve" the processes, but to transform them and drive better outcomes. With that in mind, there are a few key factors that need thinking about (See Exhibit 4), that will act as catalysts and enable both the buyers and service providers to widely adopt a skin in the game approach over the coming years:

Exhibit 4 - Navigating Complexities and Embracing Change

Embed value-based first approach

Crucial to incorporate risk management as a part of portfolio play to drive pervasive embedment. Not all deals will achieve 100% success however, the overall performance of the portfolio is what's important. Providers need a common playbook, vocabulary, and language to drive this mindset. Scaling of value-based models will require 4 key capabilities:

- Diagnostic Capability Building
- Cross-functional Integration
- Codification - Commercial and Solutioning
- Value-Based Sales Support

Establish clear outcomes

Measuring granular impacts is important but challenging. Neglecting factors like NPS and cycle time while overemphasizing on either cost or revenue is a common mistake. Misalignment on expected outcomes can lead to conflicts. Crucial to establish clear and measurable metrics that are:

- Smart
- Time-bound
- Attainable
- Relevant

Meticulously Evaluate the outcomes

Defining success metrics upfront facilitates tracking progress and making adjustments. Factors like dollar impact, addressing arbitrages, and isolating impact of extraneous variables need to be considered when measuring outcomes to prevent conflicts and ensure effective collaboration

- Dollar Impact
- Timing Arbitrage
- Value Arbitrage
- Isolating Extraneous Variable Impact

Endure the initial turbulence

Implementing value-based models requires preparation and a different mindset. Initially, there may be lower returns when transitioning from traditional models. However, robust implementation can drive revenue acceleration and higher profit margins. 4 key areas require focus:

- Robust Stakeholder Management
- Effective Risk Management
- Continued Process Optimization
- Building Operational Flexibility

Source: BCG analysis.

1. ‘EMBED’ value-based-first approach

To drive value-based embedment pervasively across deals, it is crucial to incorporate risk management as a part of portfolio play. While not all deals may achieve 100% success, the overall performance of the portfolio is what matters. By acknowledging and managing risks, providers can ensure readiness and proactiveness in delivering value consistently. There is a need to establish a common playbook, vocabulary, and language so as to sing from the same songbook, every time. To drive this at scale, providers will need the following:

- **Diagnostic Capability Building.** Providers should prioritize the development of diagnostic capabilities at the organizational level. This includes productizing diagnostic support to analyze buyer data, establish baselines, and identify opportunities based on benchmarks. Partner support is crucial in this process, enabling the organization to effectively crunch data and provide valuable insights.

- **Cross-Functional Integration.** Successful implementation of value-based models requires cross-functional integration across various areas such as analytics, consulting, legal, and commercial functions. These teams need to collaborate and align their efforts throughout the sales process for value-based projects. By leveraging their expertise collectively, organizations can deliver comprehensive solutions to buyers.

- **Codification of Commercial and Solutioning Process.** Providers should focus on codifying their commercial and solutioning processes. This involves developing pricing and value measurement frameworks, as well as establishing master agreements with multiple options and customizability. Sales teams should be trained on different options, and dedicated resources from the commercial teams can help streamline the process with buyers.

- **Value-based Sales Support.** Providers should invest in building ringfenced sales support teams to drive proactive pitching to buyers. By presenting value-based constructs and solutions proactively, organizations increase their chances of success in renewals. This approach also ensures preparedness if a renewal goes to a request for proposal (RFP), resulting in higher win rates.

2. ‘ESTABLISH’ clear outcomes

It is often more practical to measure more granular impacts, even though the buyer would like to measure them at the highest levels. Choosing the right metrics that can be easily measured, solidly attributed, agreed upon, and provide the most value can be challenging. Over-emphasizing cost as a source of value, while ignoring the impact on NPS, cycle time, among other factors, is a common mistake. Similarly, revenue alone is not the best metric to use in a value-based contract, as there are too many things that go into it.

For example, if a buyer engages a service provider to increase sales by 20%, the provider may focus on increasing the quantity of leads generated, while the buyer may have expected an increase in conversion rates. This misalignment can lead to a conflict between the two parties, resulting in a failed engagement.

To ensure the success of value-based models, it is crucial to establish clear and measurable metrics at the outset of the project itself. These metrics must be STAR-

- **Specific.** To ensure all stakeholders have clarity on objectives and scope of workstreams.

- **Time-bound.** To monitor and manage the engagement, while encouraging timely action and progress.

- **Attainable.** To inspire confidence in stakeholders, while promoting sense of ownership and commitment.

- **Relevant.** To align with the overall objectives and strategies of the buyer and ensure meaningfully impacting outcome.

and should be agreed upon with all the parties involved.

3. Meticulously ‘EVALUATE’ the outcomes

Post defining the success metrics upfront, it becomes easier to track progress towards the desired outcome and make any necessary adjustments along the way. However, while doing so, following factors need consideration since measuring these outcomes is as important as defining them is, to avoid any inter-party conflict:

The Dollar Impact

In traditional T&M models, the financial impact is more straightforward to measure. However, in a value-based construct, the value is tied to achieving the desired outcome, which may have other non-financial benefits that are challenging to quantify in dollar terms. To overcome this challenge, clear metrics need to be defined for measuring the financial impact of achieving the outcomes. For instance, this can be done by using the baseline comparison approach.

Addressing arbitrages

- **Value Arbitrage.** Buyers and service providers define value differently, with buyers having multiple sources of value and providers having only one source. Value-based models need to account for both parties' value perceptions and incentivize buyers to share rewards with providers.

- **Timing Arbitrage.** Benefits and costs realized by buyers do not occur at the same time and need to be accounted for in value-based models. There may be a lag between cost and benefit realization, and this needs to be understood and addressed in the commercial model.

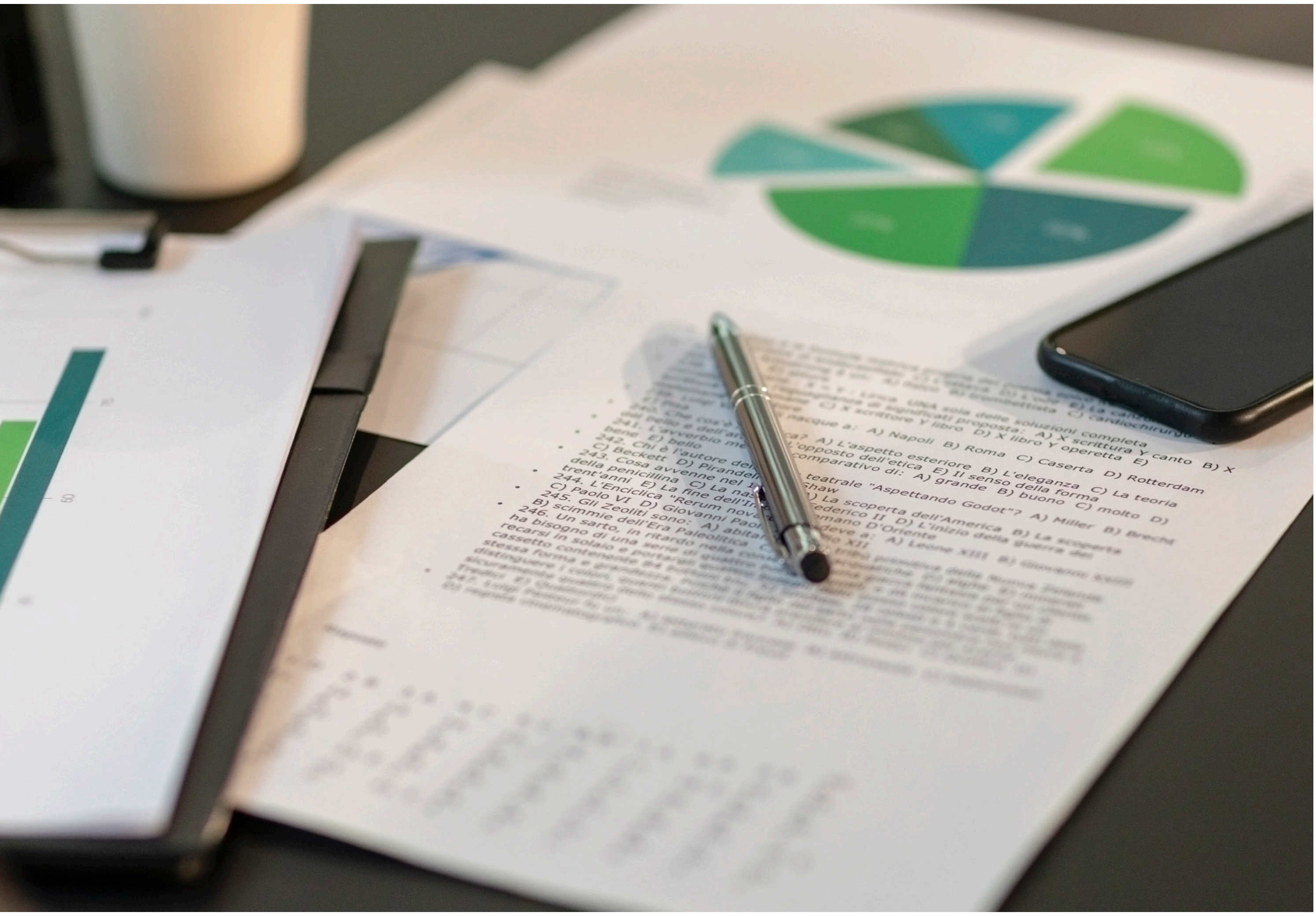
- **Ownership Arbitrage.** It occurs when different owners within the buyer's organization account for the benefits and costs of a value-based model in different budget codes. This creates complexity in terms of ownership and incentives. To overcome this, commercial models must align all owners towards the same objective, incentivize collaboration, and establish clear goals and metrics.

Isolating impact of extraneous variables

Providers face a perennial challenge in isolating the impact of their service delivery, as various external factors can influence the results. It is difficult to attribute the impact solely to the provider's efforts because various factors, including macro demand-supply factors, competitors' performance, and the buyer's own previous performance, can also influence the results. Isolating the impact generated on the selected KPI can be a daunting task for providers, as they need to ensure that the impact is solely attributable to their services.

4. 'ENDURE' the initial turbulence

Implementing value-based commercial models may not yield immediate returns, and providers should prepare for an initial adjustment period, especially when transitioning from traditional pricing models. This is due to the need for a different mindset and implementation approach. It takes time to prepare, implement, and execute value-based models effectively across an organization, resulting in a period of lower-than-expected returns. However, if implemented robustly, value-based invariably will drive revenue acceleration at accretive margins.



Conclusion

The shift towards value-based models is not only inevitable but also essential for service providers who want to stay competitive in the ever-evolving business landscape. This trend is being driven by the increasing demand for better outcomes and value delivery by enterprises. With VALUE-BASED, service providers are now more invested in the outcomes, which helps to build trust with buyers and encourages them to think more deeply about the goals they want to achieve. The transition from "transaction-based" relationships to "skin in the game" relationships is well under way, and providers who are not prepared for it, risk being left behind. As more enterprises become aware of these commercial constructs, it is expected that they start demanding them too, and the usage of value-based models expand beyond the current pioneers. However, implementing these models requires providers to develop new capabilities such as stakeholder management, risk management, and data analytics. They must also have the financial and operational flexibility to invest in new technologies and talent to deliver the desired outcomes. In conclusion, the transition to value-based models is a strategic move that benefits both providers and buyers, but it requires preparation, flexibility, and a willingness to adapt to new ways of doing business.

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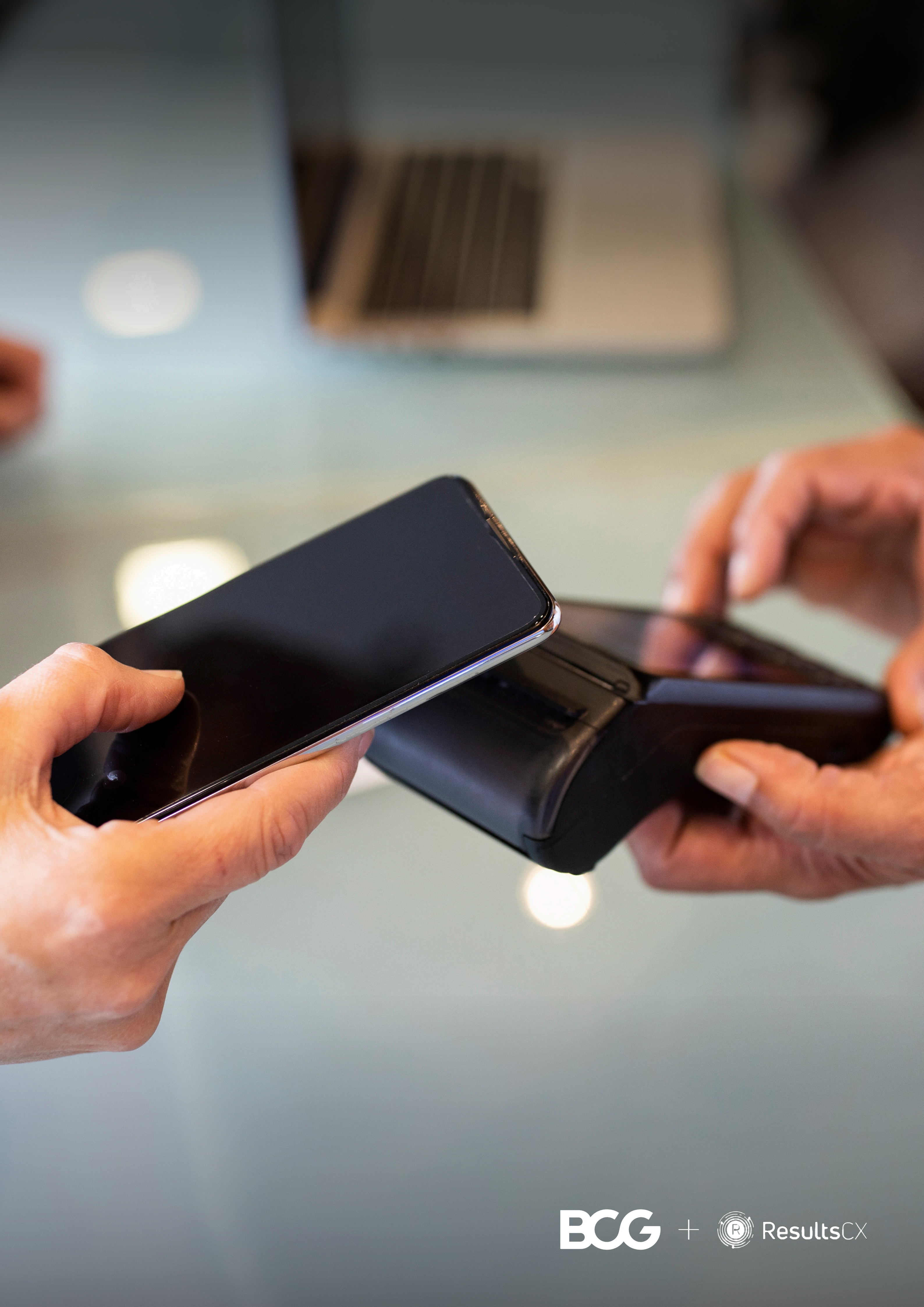
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