

How Business Services Companies Unlock Value

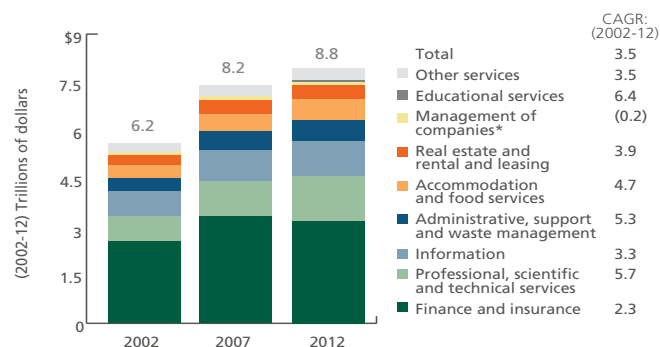
As an industry sector, “Business Services” is defined in many ways and inevitably encompasses a vast array of subsectors, business models and industry dynamics. To many, business services is equivalent to outsourcing, and to a large extent, this is correct. However, while outsourcing tends to be associated primarily with reducing costs, business services providers seek to go much further and integrate with their customers’ business model to provide better, faster, more reliable and increasingly more technology-enabled support models. So while emphasis on service quality and value remains important, the most successful business services companies are finding ways to innovate and differentiate their offerings in order to gain share and build strategic “moats” around their customer relationships.

Business Services Growth Outlook

U.S. demand for business services has grown by 3-4% per year over the past decade, marginally outpacing broader macroeconomic growth as companies have sought to focus on what they do best and bring in third parties to do the rest (see Figure 1). Within this space, the strongest areas of growth have been educational, and professional and technical services.

Looking ahead, the outlook for business services growth remains positive but ultimately hinges on numerous factors linked to both customers and providers. On the demand side, many companies continue to look for ways to shift non-core activities to more efficient third-party providers, as well as to leverage specialized capabilities in technology, (e.g., Big Data,

Figure 1
U.S. Business Services by Sector
Within the U.S., the business services market has grown at ~3.5% per annum over the past decade, with certain segments seeing higher growth



Note: *2012 U.S. Economic Census Data does not include an updated estimate for “Management of Companies and Enterprises,” assumed flat given historical trend

Source: Lloyds Bank, 2002, 2007 and 2012 U.S. Economic Census, Education Industry Association, Bureau of Economic Analysis, IBIS World

digital marketing, etc.) Indeed, over the past few decades, many companies have honed their internal capabilities to manage third parties effectively, giving them the confidence to push the outsourced services model further where appropriate.

On the supply side, business services operators have become more sophisticated in their ability to serve customers efficiently and reliably, while demonstrating the economic benefits they provide. Many business services providers have also sought to adapt their business models and value propositions to better respond to customer needs; for example, adding adjacent

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service capabilities that offer a wider set of services to customers, or developing a national delivery capability to serve large customers more widely). Indeed, in virtually all business services subsectors, supply-side innovation has been a critical component for the growth and sustainability of outsourced services demand.

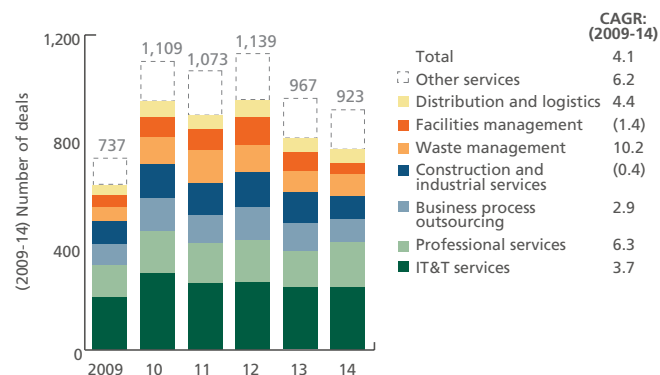
Evolving Industry Landscape

Many business services subsectors are somewhat fragmented given the inherently local nature of providing services, the wide array of customer needs, different price points, etc., as well as the challenges for operators to build scale. Nonetheless, there is a gradual but clear trend toward consolidation in most business services sub-sectors, which is driven in part by:

- Economic and competitive benefits of geographic scale and service scope
- Opportunities to play a larger service provision role for customers
- Active participation of financial/strategic investors pursuing roll-up investment strategies

Since 2010, there have been more than 1,000 business services M&A transactions each year in the U.S. alone (see Figure 2).

Figure 2
Business Services M&A Activity in the U.S.
Since 2009, the waste management, professional services, and distribution and logistics subsectors have shown notable rises in M&A activity



Note: *Other includes remaining L.E.K. subsectors: personnel supply, marketing & advertising, security & safety, education & training, and food services

Source: S&P CapIQ

While this has slowed somewhat in recent years, the sustained pace of deal-making is driving consolidation across most subsectors, with subsectors such as waste management, professional services and distribution and logistics seeing the strongest recent growth in deal activity.

Additionally, business services customers are often willing to pay a premium for reliability, automation, bespoke value-added services and one-stop shop capabilities — whether geographic or across a wider service spectrum. As industry consolidation continues, it will be increasingly critical for operators of all stripes to double down on their commitment to creating value for their customers in order to remain relevant. Doing so will require a rigorous focus on the factors driving value creation and outperformance for business services companies.

Unlocking Value from Business Services

In our experience working with a broad range of business services providers, we have observed five common denominators that enable business services providers to outperform their peers and drive value for their customers. These core capabilities, when managed well, serve as powerful catalysts for growth and profitability of business services companies.

1. Focused Growth Strategy

The abilities to actively define their vision and growth strategy, prioritize the most critical strategic initiatives, and successfully execute the strategy are common traits among the most successful business services operators. For many high-performing companies, these initiatives tend to revolve around:

- Creating differentiated service offerings to win/build customer stickiness
- Expanding into adjacent markets, geographies and/or niche service spaces
- Acquiring new capabilities/coverage when organic growth isn't fast enough

For example, a temporary labor operator focused in a specific technical end market could seek to expand into other end markets with bespoke technical requirements, or broaden its existing service scope to gain greater share of wallet with its existing customers. Whatever strategies are followed, being able to successfully activate them while managing the existing business is what ultimately creates value.

2. Compelling Value Proposition

Business services operators must not only be better than their customers' in-house alternatives, but they must also have a compelling value proposition vis-à-vis competitors. The most successful business services companies are very clear about the value they bring customers and seek ways to reinforce this whenever possible, with messages that emphasize business impact resulting from some combination of:

- Meaningful reduction in unit/activity level costs
- Higher quality of commercial and operational productivity/efficiency
- Insights from data analytics to measure/validate the benefits of outsourcing

It's important to note that leading business services operators don't rely on static business models and value propositions. They innovate constantly, looking for unsolved customer problems where their capabilities can be applied, and proactively pivoting to where they see opportunities. For example, an environmental services provider offering a suite of site remediation technologies provides a more compelling value proposition to large customers with complex needs than does a highly specialized competitor with a single area of expertise.

3. Rigorous Commercial Focus

The best performing business service operators focus on the key commercial value drivers that are most critical to their business performance:

- **Persistent Customer Focus.** Winning new business and retaining existing contracts requires constant focus on customer needs, service quality and value delivery

- **Productive Commercial Teams.** The best performing businesses execute well on their go-to-market approach, measure progress and equip sales teams to be responsive to customers
- **Strong Commercial Discipline.** To ensure that scarce resources are not tied up in value-compromising commitments, these businesses are selective about which customers and contracts are pursued/bid on

4. Operational Flexibility

High utilization levels and effective cost management are essential to achieving and sustaining value creation in the business services sector. The most successful companies are structured in operationally flexible ways enabling them to remain cost-responsive to their broader business environment. When times are uncertain, resources and costs can be scaled back; when demand is strong, they are able to scale up appropriately. And the abilities to grow service capabilities, expand geographically, or move into new end markets are closely tied to greater operational leverage.

Business services operators tend to be lean at the top, and rely on strong commercial and operational teams to run the business. Given the need to retain their best/most scarce talent in order to maintain existing customer relationships and operational know-how, they must be thoughtful about optimizing operational flexibility and about the potential ramifications for retention and future recruiting. Outside of management, the most valuable resources are typically sales staff with strong customer relationships and those with technical/operational depth and experience. It is very important to avoid excessive turnover of these skills and capabilities.

5. Performance-Oriented Culture

Leading operators take their ability to provide services better, cheaper and/or faster than others to heart and build performance-oriented cultures within their companies. They emphasize data, performance measurement and continuous improvement — with both customer-facing and internal activities. Key performance indicators are a fundamental component, but the performance-based culture goes much further in stressing transparency and objectivity around

performance metrics; it rewards those who deliver more value. Pay-for-performance models with staff are another lever to ensure that costs remain in line with revenues. Business services companies with scale tend to be better able to attract and retain quality talent that their customers may be able to do on their own. For example, a large landscaping services provider is in a better position than its customers are to find and retain management talent specific to landscaping. And the larger provider can reward such talent more effectively given the value generated.

Conclusion

Despite the wide range of business services sub-sectors and niche markets in which service providers operate, the five core value drivers outlined above are equally relevant in optimizing performance and driving growth. Executing well across these five dimensions is a defining element that makes the best operators successful.

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