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# Your Captive Service Center Survived the First 100 Days of the Pandemic. Now What?

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**ISG WHITE PAPER** 

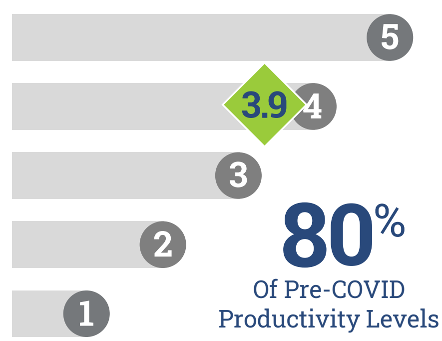
## INTRODUCTION

Early in the pandemic, ISG collected feedback from enterprise clients about their experiences with offshore services to see how everyone was faring. We were not optimistic, but the reports that came back were extraordinary. In late March, about ten days into the lockdown in India, ISG advisers rated the service provider response and service delivery from India at nearly 4 out of 5, with 5 being no change in services. They reported that productivity levels were 80 percent of pre-COVID-19 productivity levels. This remarkable performance was due to the instant response, resourceful problem solving – including in some cases "leasing" employee hardware and repurposing it with remote IT intervention – and deep commitment to service continuity for their clients.

**To respond to a crisis of this size, companies need deep logistical and operational expertise on delivering services globally.**

For captive centers that are owned and operated by individual companies, the pandemic response was not as smooth. Investment in these centers over the past couple of decades has been significant, but the pandemic laid bare a lack of scale that proved to have a real impact. To respond to a crisis of this size, companies need deep logistical and operational expertise on delivering services globally. For example, they need to be able to acquire and secure lots of technology quickly, move services between global delivery locations and rapidly scale up training initiatives. These skills are not the province of a typical captive owner.

Overall Provider Service Delivery Rating Post-COVID, April 2020*




Source: ISG Research, April 2020
*1= unable to deliver, 5 = no change in services

We saw this impact play out in captive call centers, where, in some cases, wait times increased significantly leading to frustrated customers. Enterprises in the Insurance, Healthcare, Hospitality and Travel industries experienced severe call volume spikes. Some call centers were forced to ask customers to return after 72 hours due to unavailability of agents, a practice that persists today even after call volumes have tapered off. Standard service levels like average handling time, first-call resolution rates, call abandonment rates and queues drastically degraded amidst lockdown. Many captive operations didn't have the experience, investment or knowledge to enable their call center agents to work productively from home, and they have seen non-volume related impacts on quality, accuracy, conversion and customer satisfaction.

How prevalent are captives in today's business economy?


There are approximately 4,000 captives being operated by about 2,500 companies around the world. In the last five years, less than 500 new captives have been set up. Approximately 40 percent of all captive centers employ fewer than 500 people.

Captives provide services that cover a wide variety of functional domains. Far from the proverbial Indian call center, these centers manage complex financial transactions, claims processing, finance and accounting, and many other operational functions.

Smaller captives have struggled more than larger ones and have struggled with backlogs in critical areas like mortgage processing for banks, CAD design services in manufacturing and so forth. Some have suffered from business continuity plans (BCP) that provided insufficient solutions when the entire workforce was ordered to stay at home.

Enterprises that own and operate these struggling captives may have an opportunity. Over the last ten years, service providers that wanted to enter a specific vertical but lacked expertise or experience in that industry have shown themselves to be capable buyers of enterprise-operated captive centers. Acquiring a captive with the requisite expertise was seen as a fast-track approach to market penetration.

The confluence of trends – struggling enterprise-owned captives and interested provider buyers – has led us to expect a significant increase in monetization of captives in the coming months. Enterprises that are working toward a post-pandemic future state and a resilient business built on a digital backbone very well may depend on it.

## Fast Forward to Today

The economic uncertainty caused by the pandemic is making many enterprises question the logic of owning a captive service delivery center for non-core business activities, such as IT, finance and accounting, procurement, human resources and engineering. The fact is, many captives have not stood up well to the crisis.



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This lack of scalability causes resource costs to be quasi-fixed in an economic period in which the enterprise is looking for increased variability in their cost structure.

They have struggled to scale operations up or down in the face of dramatic and swift changes in demand. Workforces that were not trained or well-versed in best practices for working remotely have seen a short- to intermediate-term reduction in productivity. Even captives that were able to configure remote operations but took weeks to do so still face a backlog.

At the same time, many captives have seen a devastating drop in demand for goods and services that have left some employees idle while others are experiencing a spike in demand for order cancellations, refunds and customer contact. Most captive operations are not as strong as service providers in scaling resources up or down in the short term. This lack of scalability causes resource costs to be quasi-fixed in an economic period in which the enterprise is looking for increased variability in their cost structure. Meanwhile, the captives' need for increased bandwidth, always-on connectivity and greater access to collaboration software has exploded.

Many enterprises, especially those from hard-hit industries like Retail, Travel, Hospitality, Airlines and Oil and Gas, are experiencing substantial "losses" at their captives; volumes dropped more quickly than the companies could restructure the costs. The pain of getting services back up and running – even just to emergency levels – has been difficult, and, in some cases, the captive no longer offers the advantages it was built to offer: high quality, low attrition and cost savings. In these cases, the strategy that drove companies to build captive operations instead of outsourcing the services is no longer viable. This realization, that legacy views of core or essential functions have changed in light of automation and customer capability, is driving enterprises to consider changing their strategy and monetizing (and outsourcing) their captive operations.

## What Are the Options for Your Captive Operation?

Enterprises have two potential solutions, and both have advantages. Inaction in this volatile environment is not recommended. The difficulty of initially recovering from the pandemic and the ongoing challenges from business conditions mean that one of two courses must be taken now.

**Improve your captive:** This involves an overhaul of the captive operations, staffing, network access, business continuity planning, security and physical plant operations. The objective is to improve resiliency and productivity, which means a focus and investment in digital technology and robotics that strengthen remote work capability and security and process redesign. These activities are possible to accomplish but they will take focus – and this means focus on transactional functions rather than on front-office, revenue-generating or customer-facing innovations. You will likely need help, either from a provider in a build-operate-transfer model or from consultants who can accelerate your improvement and hardening program to ensure it happens as cost efficiently as possible.

**Sell it:** If the back-office function performed in the captive center is not core to the business (and in some cases even when it is), you may find that a provider with experience managing and optimizing such functions may be interested in buying your captive – and selling you back the services in measured increments. This can be accomplished without a wholesale layoff of your employees in the captive. In a world of less certain demand, this could be ideal for your balance sheet. Many service providers today have a particularly strong appetite for acquiring captive operations as a way to enter or expand operations in a desired industry vertical or needed functional area, and enterprises with intellectual property or a strong resource pool can find that selling their captive operations not only brings in cash but also relieves the need to manage the remote operation and continually optimize and automate the processes.

## How to Decide Whether to Improve or Divest your Captive?

It is time to take a rational look at the captive as it pertains to your business. Every enterprise will weigh the factors for consideration differently, depending on the nature of the business and the market conditions they face. Your business may have additional or more complex factors to consider. Here is a list of 10 factors to consider to create the best outcome for your company.

1. **The value of the captive as a true internal service provider to the business:** The most successful captive operations are run like a stand-alone business. Some captives over time begin to behave like a cost center rather than a strategic internal service provider to the business. If the captive is not run like a true internal service provider, it may indicate an opportunity to improve operations by monetizing your captive.
2. **Ability to deploy cash more advantageously to advance the overall business:** Would immediate cash from the sale allow you to invest in digital upgrades in client-facing activities, create ongoing operations savings or relieve your scarce management talent from the management of the captive center? Consider how more strategic use of management and staff might shift the paradigm for operating the business as demand recovers. Your skilled and thought-leading resources must be deployed on strategic profitability and not managing a cost center captive.
3. **Ability to scale:** Because service providers recruit, hire, train and onboard thousands of associates every month, they have an "HR factory" in place to scale up quickly. Does your captive center have a similar capability?
4. **Attrition rates:** Attrition rates are typically higher for service providers than captive operations in most markets. A peculiar impact of the COVID-19 pandemic is that those traditional situations have reversed with attrition rates dropping for service providers. If your captive operation is experiencing higher than normal attrition, monetizing your captive may be an option.
5. **Processes or tools that are valued as intellectual property:** Just as service providers are interested in acquiring captives to enter a specific industry vertical, they are likely also interested in leveraging intellectual property for other clients and will value your captive higher if you have intellectual property to sell.
6. **Geographic location:** The location of the captive will impact its value. Service providers are interested in acquiring captives in North America and Western Europe during this pandemic. Providers are anticipating future needs to have domestic delivery centers, which can offer flexibility to enterprises that may want to stabilize operations in country and then move them offshore.
7. **Degree to which the captive operates out of a culture of continuous improvement:** Process improvement, implementation of emerging technology and continuous improvement are critical success factors for providers and captives alike. If your captive is lacking the "DNA" of continuous improvement, monetization can be the driving force behind instilling this mindset into your captive operations. Though it will be owned by a provider, the same people will be delivering the service to your enterprise, and a new management model may make the difference.

8. **Rate of success or failure with BCP in face of COVID-19:** Many enterprises struggled with resiliency at their captives in the face of COVID-19 and do not want to repeat the painful process if another global event impacts operations. For this reason, many captives are rethinking their fundamental strategy.

9. **Level of physical and technical security:** Depending on the physical location of your captive, you may or may not be able to physically separate the delivery center floor from other operations. Service providers have always needed to have state-of-the-art physical and cyber security. Monetizing your captive can deliver this security expertise as a standard component of the services.

10. **Risk Mitigation:** While risk generated by a pandemic is obviously front of mind in today's environment, there are numerous risks associated with captives and outsourced operations. While enterprises are usually adept at managing typical risks – like those posed by regulations, macro-economics and technology – there are many less visible risks – like those posed by attrition, performance, tax changes, transformation, governance, degree of internal stakeholder buy-in – that do not get as much attention from enterprise-operated captives as they do from service providers.

## Invest or Divest? A Quick Gauge

Take a simple test to help decide if investing or divesting your captive service center is the right choice for your business. Check one choice in A, B or C in every row – and total up the number of checks.

| Attribute | Your response | | | | | |
|---|---|---|---|---|---|---|
| | A | A✓ | B | B✓ | C | C✓ |
| Select the value the captive service center provides to your business | Substantial | | Moderate | | Little | |
| Do you plan to invest in the center to create stronger business resiliency? | No | | Maybe | | Yes | |
| If you could do it over again, would you invest in creating your captive service center as opposed to oursource the work? | Unlikely | | Maybe | | Likely | |
| Rate your ability to scale operations, either up or down | Easy | | Moderate | | Challenging | |
| Rate your sense of the employee attrition at the center | Low | | Moderate | | High | |
| Rate your sense of the use or presence of proprietary processes or intellectual property deployed in the center | Low | | Moderate | | High | |
| Rate your sense of the center's location today for resilience | Unfavorable | | Neutral | | Favorable | |
| Rate your sense of the center's level of achievement of continuous improvement | High | | Medium | | Low | |
| Rate your estimate of the of success or failure of business continuity at your center at the beginning of the COVID-19 pandemic | High | | Medium | | Low | |
| Rate your sense of the level of physical and technical security of your center | High | | Medium | | Low | |
| **Total number of checks in each column:** | | | | | | |

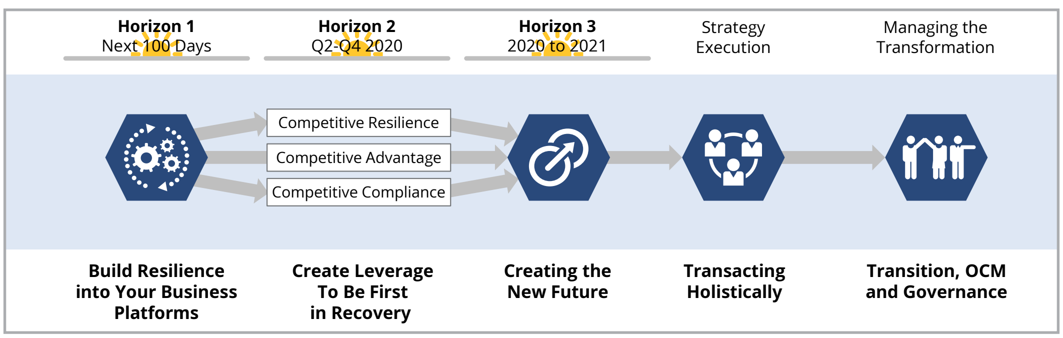
How to read the results:

- If the number of check marks in column A exceeds the number in column C, consider improving your center.
- If the number of check marks in column C exceeds the number in column A, consider divesting your center.
- If the number of check marks in column B exceeds both columns A and C, explore both options.

If you want to understand what your captive center might be worth, please contact Scott Furlong at scott.furlong@isg-one.com.

## The Time is Now

Pandemic recovery is happening across three horizons. Building resilience – and finding ways to position your enterprise as a leader in your industry – is critical now.




As your enterprise prepares for further digital transformation to drive resilience, consider upgrading or monetizing your captive operation as part of your increased competitiveness and digital transformation. The provider community has a deep interest in collaborating in these engagements. A focus on your captive center can deliver greater resilience and workforce flexibilty, which will be critical for your new future in the post-pandemic global business world.

ISG helps enterprises evaluate their captive centers and subsequently optimize or monetize it for the most value. We understand the role of captives, the potential for improvement or divestiture and the potential acquisition market. Contact us to quickly create an indicative valuation of your captive center and a list of service providers that have expressed interest in captives that share the same characteristics as yours. Join me for a webinar **Assess the Value of Your Captive and Improve Your Risk Profile** or **contact us** to discuss how to think through the possibilities and come out ahead.

# ABOUT THE AUTHOR

## Your Captive Service Center Survived the First 100 Days of the Pandemic. Now What?

### SCOTT FURLONG

Mr. Furlong is a Partner at ISG and has over 25 years of experience in assisting companies transform their general and administrative functions including finance and accounting, human resources, and procurement. He has expertise in formulating strategies and designing alternative service delivery models (Global Business Services, shared services and outsourcing), transforming processes, driving organizational change and implementing emerging technologies such as advanced analytics, mobile solutions, cognitive computing and cloud based solutions. Mr. Furlong leads ISG's Business Advisory Services practice and serves on the Americas Leadership team.

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