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Beyond the back office: How managed services partnerships drive outperformance

New research shows how leading companies go beyond "old-school" notions of managed services to close talent gaps, keep pace with technology, and innovate for strategic advantage.

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Top-performing organizations are turning to a more strategic set of managed services partnerships (MSPs) to access talent and technology, with the goal of not only reducing costs but becoming faster and more innovative. As the need to transform accelerates, organizations adopting this approach are developing a competitive edge that will be hard to beat.

These are among the implications explored in a new PwC survey of more than 2,000 business leaders, through which we identified the top 20% of high-performing organizations by their "performance premium"—a metric combining the effect of profit margin and revenue growth, in industry-adjusted terms.

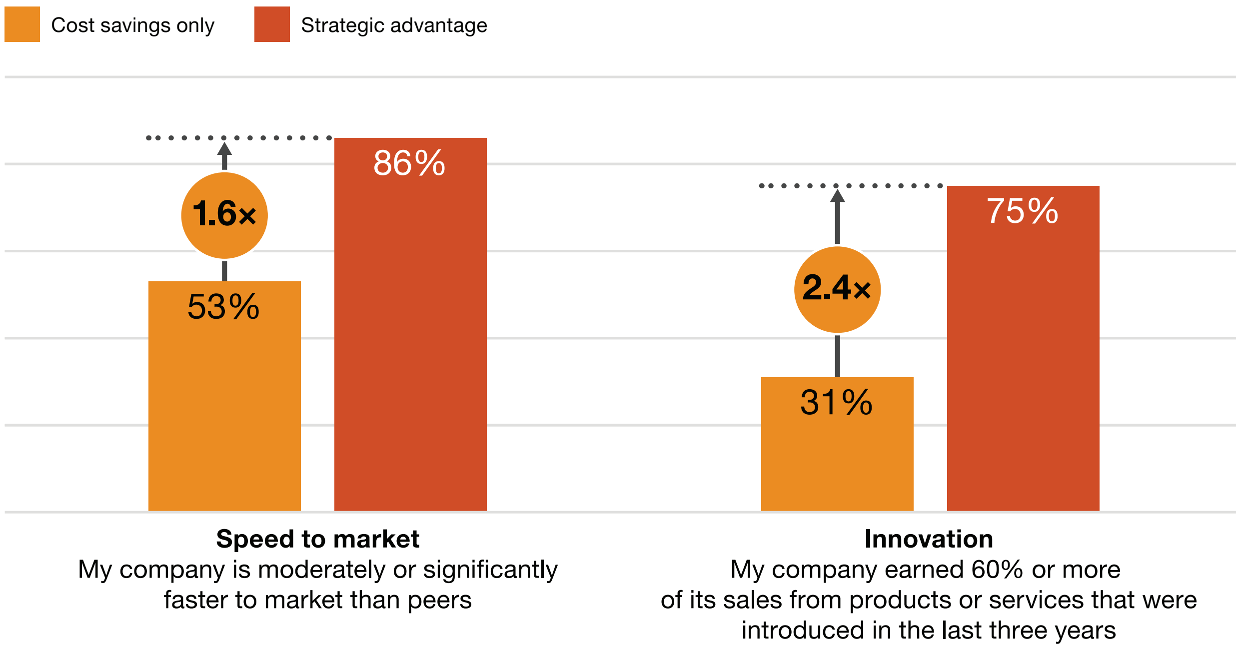
How do top companies approach managed services? In a word: strategically. The highest performers in our research are 4.2 times more likely to use MSPs for strategic advantage, beating companies that use them only for cost savings by 43 percentage points of performance premium. Further, companies that use MSPs for strategic advantage are 1.6 times and 2.4 times more likely to be faster to market and more innovative, respectively, than those focused solely on cost savings (see chart, next page).

Managed services might be the most common term used to describe these partnerships, but for many executives it suggests cost reduction in a narrow slice of the business, typically the back office. As we'll explain in this article, top-performing companies are using service partners far more broadly and strategically than traditional definitions might imply.

Speed and innovation: Two benefits of using managed services more strategically

Speed-to-market and innovation outcomes associated with basic (for cost savings only) and advanced (for strategic advantage) use of managed services partnerships (MSPs)

Share of respondents whose companies use MSPs for:



Note: Totals may not equal sums shown due to rounding.

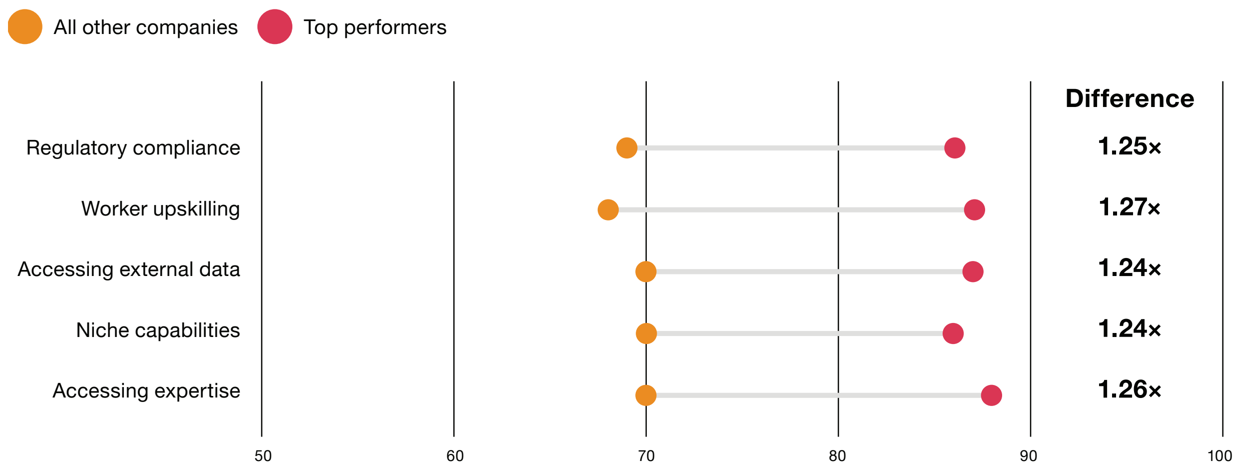
Source: PwC Global Advisory survey

Whatever you call them, though, these service partnerships offer access to expertise, knowledge, and technology assets that help accelerate enterprise transformation and performance around capabilities that companies view as critical—and sometimes even differentiating. On their own, companies may struggle to build these capabilities at the required pace, and to keep them relevant over time. And even if they could do both, the effort might dilute their focus on the distinctive activities that matter most to their competitive advantage.

Given the 43 points of performance premium at play, there is considerable value at stake. To join the top performers, the lesson is clear: look beyond the four walls of your own organization for the keys to speed- and innovation-driven outperformance.

Top performers go beyond cost reduction

Percentage of companies that engage managed services partners for:



Note: Totals may not equal sums shown due to rounding.

Source: PwC Global Advisory survey

Beyond the back office

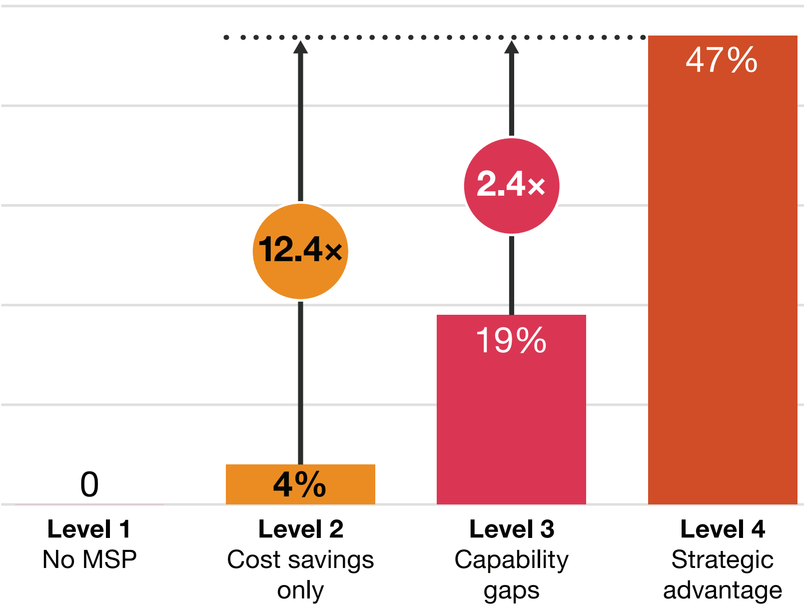
As the managed services market shifts, both buyers and providers are moving beyond the old-school, cost-focused outsourcing arrangements that used to characterize it. While cost reduction is still an important consideration, today's leading companies go further. They work with their managed services partners to close capability gaps and support strategic advantage in areas ranging from compliance and upskilling workers to gaining access to external data and innovating customer experiences, among others (see chart above).

Our research suggests a close correlation between financial outperformance and this broader approach to managed services partnering—a relationship that we've depicted along a maturity curve. The further companies journey along the curve, the more their performance premium increases (see chart, next page).

Consider level two of our maturity model, which includes companies exhibiting the least mature use of managed services partnerships (level one companies don't use them at all). The exclusive focus that level two companies apply to cost savings in their MSPs nets them a 4% performance premium.

With increased maturity comes greater reward

Performance premium associated with different levels of managed services partnership (MSP) maturity



About the MSP maturity curve

1. **No MSP:** companies that do not use MSPs.
2. **Cost savings only:** companies that use managed services to reduce operating costs, but not for any other reason.
3. **Capability gaps:** companies that use managed services to close at least one key capability gap; they may also be using it for cost savings.
4. **Strategic advantage:** companies that achieve maturity level three and use managed services for strategic advantage, which means using them to respond to opportunities and threats, and for at least one other strategic reason, such as to improve customer experience or keep pace with changes in technology.

Note: Performance premium is the combined effect of profit margin and revenue growth in industry-adjusted terms. Totals may not equal sums shown due to rounding.

Source: PwC Global Advisory survey

Meanwhile, at the next level of maturity (level three) companies turn to MSPs to close capability gaps and “uplevel” their operating models—and, in return, gain a 15-percentage-point advantage in performance premium over level two companies.

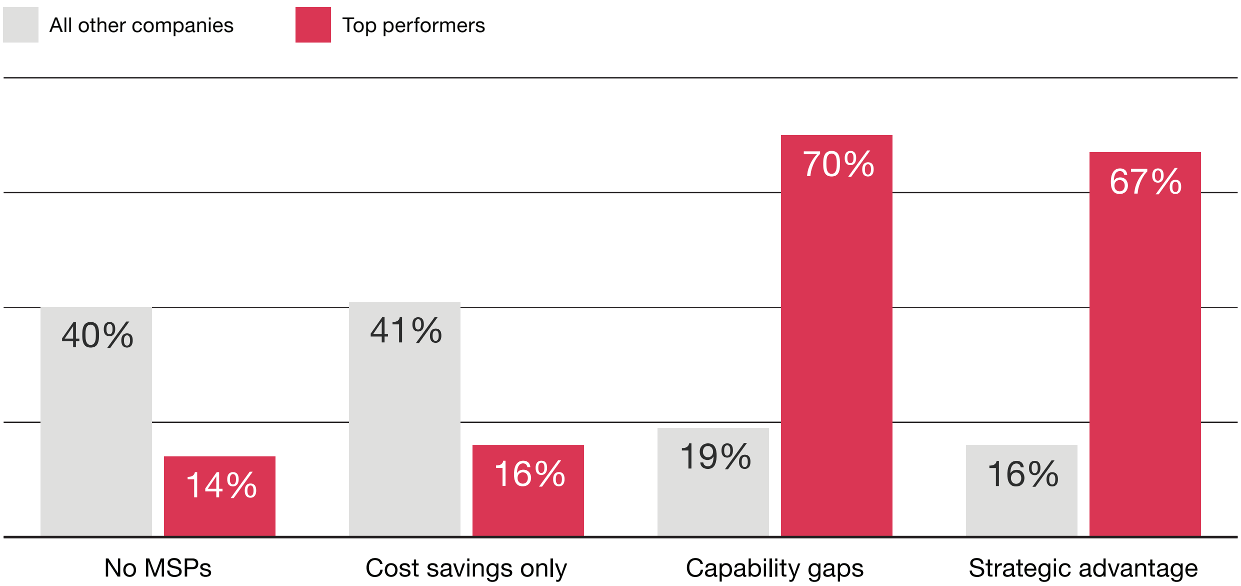
Finally, level four companies focus on MSPs for strategic advantage—such as innovating the experiences of current customers. These companies enjoy a whopping 43-percentage-point advantage in performance premium over their level two counterparts.

To be sure, being a level four company is no guarantee of being a top performer. But as the chart below shows, it raises the odds hugely: two-thirds of the top-performing companies in our research are using managed services partners at maturity level three (capability gaps) or level four (strategic advantage).

What does level four look like in practice? Consider how Axos Bank turned

Top performers are more plentiful at higher levels of maturity

Share of companies who qualify for given managed services partnership (MSP) maturity level



Source: PwC Global Advisory survey

to a service partner, named Q2 Software, to provide the digital account switching software-as-a-service (SaaS) solution needed to speed up and simplify new account onboarding. This in turn helped Axos achieve higher average customer account balances, while enhancing customer relationships. In this instance, it wasn't simply a matter of software implementation, but instead an ongoing process enablement that Q2 provided to Axos in one of the bank's core business processes. For more about how technology and consulting combine to create a new approach to managed services, see "A new era for managed services" (next page).

In another example of managed services maturity, Eli Lilly became the most valuable standalone pharmaceutical company in the US through a wide-ranging transformation that made speed to market its "number one incentive"—underpinned, in part, by partnerships with contract research organizations and other cloud managed services. Similarly, Moderna achieved strong growth, avoided

(continues on page 8)

A new era for managed services

Defining managed services partnerships more broadly than traditional "managed services" begins to blur the lines between managed services, management consulting, technology solutions, and other types of service provision. That's no coincidence. By availing themselves of a wide range of complementary and overlapping services, winning companies are themselves blurring the lines between service categories that used to be more strictly defined. Academics observe that business models for managed services are broadening to "involve networks of collaborations, value chain dynamics, and customer co-creation…[often through] digitally enabled service ecosystems" in a synergistic combination.

Consider a retail bank looking to reduce customer churn. This bank might have previously spent considerable time with consultants analyzing and modeling attrition and coming up with new approaches to solve the issue. Today, that same bank might ask its service partners to target at-risk customers through an AI- or machine learning–based SaaS offering that's more effective, faster, and less costly.

That is to say that services, which used to be provided primarily through labor, are now being "productized" into a combination of both labor and technology—usually at a lower price. This often results in improved quality, since the labor isn't necessarily replaced by the technology but is now engaged in more value-added activities, while repetitive tasks are automated through an embedded product.

The upshot? Companies using managed services in a mature way free up time for people to work on activities that deliver higher value, increasing their odds of arriving at the outcomes that matter—and improving their ability to sustain them.

capital investment, and closed capability gaps by using managed services for manufacturing and distribution. (No doubt they were also fortunate to be in the right place at the right time with their revolutionary mRNA platform.)

Seen from a broader perspective, the leading companies in our research point the way toward a reconception of company boundaries that makes the most of business ecosystem participation on the one hand and managed services partnerships on the other. These companies become more permeable as they provide only a part of an ecosystem's overall value proposition to customers and let their partners provide the rest.

To support their strategic focus on ecosystems, top companies *also* open up their operating models, so to speak, by partnering with managed services providers to keep pace with technology changes and close capability gaps (by addressing process, talent, technology, and functional needs)—all of which supports the innovation and speed to market that collectively lead to outperformance.

Making the most of managed services partnerships

Companies looking to join the leaders in the top quintile of performers should begin by figuring out what our PwC colleagues have called their "unique value." Absent a similar level of strategic clarity, companies may find it difficult to define a coherent and useful approach to managed services partnerships.

Knowing their unique value encourages focus; indeed, the leading companies we studied were 33% more likely to say they focused only on the distinctive activities that matter most to their competitive advantage.

But focus, while crucial, won't be sufficient. Companies also need to avoid several failure modes relating to organizational culture, high transaction costs (also known as friction or sludge), and the effective use of technology.

Overcoming cultural resistance. Taking a more mature approach to managed services partnerships requires investment, not only in your level of spending (winning companies are 4.2 times more likely to out-invest their peers in managed services), but in your organizational culture. Companies that have a culture characterized by a not-invented-here (NIH) disposition, or by silo syndrome, or by general resistance to change for whatever reason, may struggle to expand their use of MSPs—and thus lack the willingness to trust external partners with crucial elements of their strategic advantage.

How might you recognize an NIH disposition, for example? One indication might be your track record in building new businesses. When was the last time your company started and then scaled a new business to greater than 10 to 20% of your existing revenues? New business building can often be sabotaged by the same “antibodies” and cultural resistance that undermine the more strategic use of MSPs.

If your organizational culture displays some of those tendencies, look for ways to revisit the status quo. You might consider zero-based budgeting, for example, as a forcing device to subject longer-standing fiefdoms or investment areas to more frequent scrutiny—perhaps encouraging them to thereby reconsider which activities they might consider giving to managed services partners. Or you could examine the incentives you provide to your executive team—for instance, by rewarding business units for taking a broader approach to MSPs in support of a clear strategic focus.

Reducing friction. You’ll also want to look at the level of friction in your organization, or what economists call transaction costs. These terms refer to the time and resources needed to do business inside your own organization and with external parties. Companies with high transaction costs can be slow to arrive at consensus, to sign off on decisions, to allocate (and reallocate) budget, or to act on strategic objectives—all of which are impediments to working effectively with managed services partners. According to our research, companies that use these partnerships for strategic advantage are 1.4 times more likely than less mature ones to have lowered their transaction costs.

How much friction is in your business? One way to find out is what author Cass Sunstein calls a “sludge audit,” which can help measure the extent to which paperwork, inconsistent and duplicative requirements and reporting mandates, and muddled governance slow your organization’s decision-making and dynamic resource allocation.

Getting the technology right. There’s an additional point that nearly goes without saying: if you don’t have your technology basics sorted out, chances are you won't get very far in your effort to get the most from managed services.

It's a bit circular to assert this, of course, since many companies turn to managed services partners precisely to help with the transformations that they need to keep pace with technology's rapid advancements. That said, it's essential to recognize where you are on the transformational journey.

If your company has costly and outdated IT applications, systems, and infrastructure, you may need to address these challenges before you can expect greater speed to market and innovation. If your company doesn't know an API from a KPI, you may struggle to share data within your organization and beyond. For example, you might miss out on the benefits of using application programming interfaces (APIs) to sit on top of—and help make sense of—outdated IT systems.

Once the basics are sorted out, you can look toward the leading edge—for example, with generative AI. While it's far more accessible to businesses than its conventional counterpart, generative AI still requires new skills and talent that non-technology companies may struggle to find. Ask yourself how many "prompt engineers" or "model mechanics" you employ, and then make a realistic assessment of your ability to attract them. Good managed services partners should offer an "AI factory" that can help you scale generative AI responsibly and quickly, even as it helps automate and enhance business operations ranging from customer service to software development and data analytics.

No company can go it alone. Winning companies team up with managed services partners to address scarce talent and fast-moving technology—the better to achieve the operating model changes needed to support business model reinvention.

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