Customer Relationship Management Outsourcing Industry Report

KAULKIN GINSBERG

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Customer Relationship Management  
*Industry Overview*

*By Mark Russell and Matt Sherman*

This complimentary report provides an overview of the customer relationship management (CRM) industry and how it has evolved over the past 50 years. We have summarized the current primary service offerings, industry trends, regulatory activity and emerging market trends. Given our role as a merger and acquisition (M&A) advisory firm for the CRM industry, we have also incorporated an overview of the recent M&A activity, and the future drivers of deal activity in this industry.

The CRM industry is in the process of revolutionizing itself as new service offerings involving social media and other more modern communication platforms are unfolding, as well as those that enable flexibility for both workers (work-at-home) and clients (remote help desk technology support, Hispanic focused services, etc.) generate greater revenue opportunities.

It may take some more years for these new opportunities to generate significant growth, but it is becoming clear that like any other mature industry, CRM providers will either adapt themselves to current forms of communication or find themselves becoming extinct like their earlier predecessors.

We appreciate your interest in this report and would be more than happy to confidentially discuss your business interests and perspectives.

Mark Russell

Director, Kaulkin Ginsberg
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Evolution of the Call Center

The concept of a call center was originated in the early 1960s when large companies invested money in departments strictly dedicated to serving customer inquiries. The first call centers were adopted by information dependent industries, such as airlines and banking. The introduction of the Boeing 707, the first successful commercial airline, led to a major increase in demand by the general public. This created a necessity for call centers, which allowed for electronic streamlining of the reservation process. These early systems were the first wave of technology that brought about the present-day customer contact center.

More industries began to adopt call centers over the next 30 years as long-distance deregulation and technology improvements lowered costs and increased efficiency for inbound and outbound customer service. In 1967, 1-800 numbers were introduced by AT&T. 1-800 numbers eased customer interaction by allowing companies to have their own direct customer inquiry numbers and these calls would not have to be made by a collect call. At this time, many companies in a wide array of industries were opening up independent call centers that could be directly reached by a 1-800 number. The deregulation of long distance calls began in 1969 when the FCC allowed MCI to compete with AT&T and begin building large interstate radio towers. This increase in competition led to lower long distance costs which provided more flexibility and reach for call centers.

During the next few decades, the adoption of technology in the call center progressed with the addition of special features, including automated call distribution, interactive voice response, predictive dialers and, most recently, qualitative analysis, quality assurance and compliance, and customer interactive management solutions. This enabled call centers to service high call volumes, reduce cost, and improve customer experience with more powerful and less expensive technology.

As the growing demand for call centers surged in the 1990’s, more and more third party companies were created to help existing companies with their customer management needs. Call centers were expanding to new industries such as professional services. Lawyers, accountants, and engineers now had call centers where they could be contacted nationally and internationally. The prevalence of call centers and solicitation calls caused the Telephone Consumer Protections Act to be passed in 1991, which governed when and how companies could contact customers.

Also during the 1990’s, technology was growing in developed nations, which began the creation of overseas call centers in English speaking countries such as India, Philippines, and Panama. Lower labor costs were an incentive for U.S. companies to begin outsourcing call centers, and this trend only grew into the global call center industry that is present today.
Overview of the U.S. Call Center Industry

The U.S. telephone call center industry includes about 4,200 companies with combined annual revenue of about $20 billion. Major companies include Teleperformance, Convergys, Sitel, TeleTech, and West. The industry is concentrated: the 20 largest companies generate over 50 percent of revenue. Nationwide, over 4 million people have call center jobs with an average salary of $40,000.

Call Centers are sometimes called “Customer Management Centers” and make up a significant portion of the U.S. Business Process Outsourcing (BPO) Industry as a whole. Customer management has moved on from low-end process such as customer care to more sophisticated, high-end and knowledge-based processes such as customer analytics data mining and marketing.

There are four primary kinds of call centers that exist in the U.S. The first is the multi-client center, in which a provider owns or leases a call center to serve multiple clients. The second is a managed center, where an individual client owns the call center and hires the provider to manage and run it. The third is a dedicated center, where the provider owns the call center but dedicates it only to one client. The last, and most recent, is the remote/virtual center, where providers use a distributed workforce in which agents either work from remote sites or even from home. These agents are referred to as work at home agents (WAHA), this is a growing trend in the industry.

CRM companies specialize in selling services to corporations, government, and professionals that don’t want to handle customer relationship management functions internally. Major clients are in customer-intensive industries like telecommunication, financial services, publishing (magazine subscriptions); fund raising, cable TV advertising, airline/travel companies and computer technology. Although these are the major industries, new industries such as healthcare, government agencies and professional services are beginning to outsource to call centers more and more. Primary industries that CRM companies service are depicted in the chart below.

Source: Frost and Sullivan

Primary Industries

![Primary Industries Chart]

Financial Services: 16%
Communications: 12%
Travel/Hospitality: 7%
Healthcare: 11%
Retail: 21%
Government/Education: 7%
Outsourcing: 6%
IT: 3%
Insurance: 1%
Other Professional Services: 3%
Utility: 2%
Others: 6%

In the U.S., call centers are often located in centrally located states such as Texas, Ohio, Illinois or Nebraska, to allow the easiest coverage of U.S. time zones. States with large labor pools, such as California, New York, and Florida, are attractive to telemarketing companies.

The industry has been heavily affected by the lower cost of operating call centers in overseas English-speaking locations, such as India or the Philippines. These locations are attractive because a large majority of the population speak English, and companies are able to pay those workers lower wages than U.S. workers. Although lately, wages are not as low as they used to be. Wages for call center workers in the Philippines, for example, have dropped from 80 percent lower to only about 20-40% percent lower (based on job function). Although the cost differential gap had gotten smaller, it still makes foreign locations attractive despite higher costs for communications and the risk of currency exchange fluctuations. Foreign call centers that serve U.S. customers have been established both by foreign competitors, like 24/7 of India and by U.S. firms.

While the industry is mature, a majority of large enterprises, as well as medium and small businesses, maintain their customer care operations in-house. The estimate of the amount of companies that maintain in house customer care ranges from 75-85%. According to Frost and Sullivan, as providers in this market continue to deploy successful implementations, offer advanced services and publish customer success stories, companies are less concerned about losing control over customer interactions.

Alongside being a mature industry, the CRM outsourcing market faces other growth issues as well. Foreign competition, revenue tied to spending during the current economic downturn and ongoing legislation are all reasons that the projected market growth is relatively low over the next five years. The output of U.S. telephone call centers is forecast to grow at an annual compounded rate of 3.5% between 2012 and 2017, with potential revenues of $27.46 billion (Frost and Sullivan).

The next phase of CRM, through the year 2020, is predicted to be integrated channels, social media outreach, mobile phone applications, video-chatting and online avatars.
CRM companies focus on these services: telemarketing sales, inbound customer service and technical support. Smaller companies tend to focus on providing only one of these services for their clients.

Telemarketing sales are focused on acquiring customers by making outbound phone calls to sell products or services to new customers. Inbound customer service requires agents to answer billing and shipping questions and may require outbound calls to follow-up or up-sell. Order management are the technicians that handle accounts and orders, from placing an order to cancelling it. Technical support, which can require heavy training depending on complexity of product or services, consists primarily of taking inbound phone calls from existing customers needing help with the product or service. Below is a breakdown of each of these functions.

<table>
<thead>
<tr>
<th>Customer Acquisition</th>
<th>Customer Support</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Telemarketing</strong></td>
<td><strong>Customer Service</strong></td>
</tr>
<tr>
<td>• Outbound sales</td>
<td>• General inquiries</td>
</tr>
<tr>
<td>• Inbound sales</td>
<td>• Billing management</td>
</tr>
<tr>
<td>• Cross-sell</td>
<td></td>
</tr>
<tr>
<td>• Up-sell</td>
<td></td>
</tr>
<tr>
<td><strong>Order Management</strong></td>
<td><strong>Technical Support</strong></td>
</tr>
<tr>
<td>• Account activation</td>
<td>• Equipment installation</td>
</tr>
<tr>
<td>• Book/order taking</td>
<td>• Troubleshooting</td>
</tr>
<tr>
<td>• Subscription services</td>
<td>• Remote resolution</td>
</tr>
<tr>
<td>• Cancellations</td>
<td>• Software usage/activation</td>
</tr>
</tbody>
</table>

Answering services are becoming more common as professionals start using call centers. These services include automated voicemail systems and live operators and are often used to provide information to callers outside of regular business hours.
Industry Trends

The telephone call center industry has evolved from a sales industry to a customer care industry. The need for customer care services was initially driven by sales of technical products and services, such as computers, software, cell phones and phone service plans. The high cost of providing in-house customer support encouraged telemarketers, which already had call centers, to develop a cheaper outsourcing solution.

In a survey by Frost and Sullivan, clients select CRM outsourcer based on these criteria (in order of importance):

1. Security certifications, disaster recovery and data privacy
2. Functional expertise (sales, support, service, etc.)
3. Expertise in client-specific industry vertical
4. Multi-Lingual capabilities

The majority of call centers in the United States have fewer than 500 agents and due their small size, can sometimes not keep up with the rapidly changing business/customer care expectations (social media, mobile applications, etc.) This is a factor driving consolidation within the industry. This chart shows how many agents various call center
Nearshore and Offshore Outsourcing

Popular call center destinations used to be India and Philippines, however offshore destinations are becoming much broader (Eastern Europe, China, Latin America). U.S. companies are beginning to use Latin America more for call centers due to proximity to clients, cheap labor pool, multilingual skills of population and improving technology in this region. One issue with outsourcing is the quality of service overseas and companies recently have brought their offshore call centers back to the U.S.

<table>
<thead>
<tr>
<th>Strengths</th>
<th>Weaknesses</th>
</tr>
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<tbody>
<tr>
<td>• Lower agent costs</td>
<td>• Long travel distance to foreign call centers</td>
</tr>
<tr>
<td>• “Follow the sun” service provisioning growing technology in emerging markets provide for high quality sound and no time delays</td>
<td>• Customer-Agent cultural differences inhibit quality of customer service</td>
</tr>
<tr>
<td>• Lower employee turnover</td>
<td>• Higher training costs</td>
</tr>
<tr>
<td></td>
<td>• More difficult management support and performance review</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Opportunities</th>
<th>Threats</th>
</tr>
</thead>
<tbody>
<tr>
<td>• New emerging markets with large labor pools and low costs</td>
<td>• Political instability</td>
</tr>
<tr>
<td>• Latin American nearshore locations support the U.S. Hispanic market (English and Spanish speaking)</td>
<td>• Natural Disasters</td>
</tr>
<tr>
<td></td>
<td>• Currency fluctuations</td>
</tr>
<tr>
<td></td>
<td>• Lobbying for new regulations that take away tax breaks for nearshore and offshore call centers</td>
</tr>
</tbody>
</table>

Offshore Help Desk Technology

Call centers are implementing IT help desk services that offer real-time help from live computer engineers. Remote-in technology allows help desk engineers to access your computer via an Internet connection. They are able to take over your computer and assist as if they were sitting there with you. The advantages of these outsourced IT services for companies is reduced costs, more efficient customer service and remote access available to customer’s anywhere a technical problem occurs.
Work at Home Agents (WAHA)

Rapid evolution of technology allows telemarketers to hire WAHAs who work from home, rather than from a call center. This capability allows companies to hire a more skilled workforce, especially for technical support, and reduces the need for large capital investment in call centers facilities. Agents who work from home use Internet-based systems to schedule work, receive assignments and access relevant customer and product information. These internet-based systems benefit companies on multiple fronts:

One major advantage for call centers to employ WAHAs, among many others, is that employee turnover is only 10% versus 30-50% for brick and mortar call center agents. Other advantages include: increased productivity, having a unified procedure, facility expenses are lower, etc.

A survey by Frost and Sullivan in 2010 asked companies how much they expect to their WAHAs to increase in the next two years. The results were the following:

- **Total Sample**: 37%
- **Financial Services**: 24%
- **Communications**: 41%
- **Retail**: 25%
- **Healthcare**: 52%
- **Others***: 54%
Although a main concern for all clients when outsourcing customer care is data privacy and security, the financial service industry is most sensitive to this issue. They only expect to increase WAHAs by 24% (lowest among industries) as work at home security provisions are still a work in progress. Some companies have taken this initiative to create their own security solutions for CRM WAHAs. West’s “West at Home” solution offers a patent-pending ‘Locked-Down Desktop Security Environment’ where they can remotely lock down a home agent’s existing computer during a work session, preventing them from performing non-approved operations such as cut, paste, copy or print. West also utilizes a secure Citrix® gateway to ensure that sensitive customer data never resides on an agent’s computer.

Here are some examples of Work-at-Home initiatives by leading companies in the industry:

- Teletech (Nasdaq: TTEC) “@Home Initiative” which is a dynamic program that allows agents to work from home.
- Convergys (NYSE: CVG) “10,000 Jobs” program which aims to hire 10,000 war veterans to work from home.
- West “West at Home” program that boasts an 80% college educated workforce, compared to 34% of an average call center.

### Hispanic Work at Home Agents

With the Hispanic population reaching 52 million in the United States, almost 17% of the entire population, companies are becoming more focused on delivering quality customer service to this market.

In 2010, the Hispanic market had a buying power of $1 trillion and that is estimated to grow to $1.5 trillion in 2015. These trends are requiring companies to hire Spanish-speaking customer contact agents for their CRM needs.

A recent study conducted on 6,000 Hispanics living in the U.S. showed that 76% would rather speak to a native, Spanish speaking marketer (Callzilla Company).

Marque Dos, a Spanish-Language dedicated call center on U.S. soil, launched a routing model named C.A.R.E that routes calls to specific WAHAs based on the client’s culture and accent.
Emerging Trends

Social Media

Social media is becoming a primary channel that customers communicate to each other about products and services. Major companies have created social media accounts, where they encourage customers to provide feedback or ask any questions. Call centers are beginning to integrate social media management platforms into their business models. These platforms (Facebook, Twitter, Google+, Tumblr, Yelp, and hundreds of others) assist clients responding to customer's questions, criticisms and complements. This platform provides a more personal approach to customer interaction, by letting customers post their own success stories, ask questions about the product or even try to troubleshoot problems they may be having in a more timely manner. Social media also adheres to a strict timeline, when a comment is posted by a customer, usually within 24 hours, in the social media world, it’s old news.

A recent report by techland.time.com, a website owned by Time Magazine, reported that a single Facebook post available to be seen by “friends of friends” has an average reach of 156,569 viewers. Clients that outsource customer care are looking for call center agents that can monitor and respond to these customer’s social media posts quickly. Teleperformance, a leader in the industry, has recently won Frost and Sullivan’s Competitive Strategy Leadership Award for “E-performance”, which is a social network platform that builds dialogues and relationships, engagements, interactions, and connections between people and brands. According to CRM Magazine, 18.6% of call centers currently incorporate social media interactions in their customer service operations, and 22.9% plan to do so in the near future.
Regulations

Legislation includes:

- **Telephone Consumer Protection Act of 1991** - Limits solicitors to calling only from 8am-9pm and cannot use an artificial voice or recording. Imposes a $1,500 fine per violation.
- **The 2 second rule** - An agent must be available within two seconds of a live answer, or a recorded message stating the name and phone number of the seller must be played.
- **Caller ID** - This TSR addition requires that all telemarketers provide their telephone number to consumers. This enables those with caller ID to effectively screen their calls. Outbound calling programs are no longer be able to block their Caller ID information. In addition, companies must also provide their name to callers when making outbound calls to consumers.
- **Do Not Call List** - Once on the list, consumers will automatically remain there for five years, unless they request that they be removed or their phone number changes.

There is a pending legislative act titled “The United States Call Center Worker and Consumer Protection Act”, which was introduced by two Democratic Senators. This bill aims at keeping call center jobs in the U.S. The bill would require the federal government to give contract award preference to companies that do not offshore call center work, create a list of those that do ship jobs to other countries, and prevent such companies from receiving federal loans and grants.

The recent federal healthcare reforms are prompting companies to hire more call center agents as the reform is expected to expand the marketplace. Also, the budget cuts and existing fragmented customer service with government agencies is causing the government to consolidate into a shared service contact center that can benefit from higher efficiency and economies of scale. SAP created a CRM rapid-deployment solution for the Government’s citizen contact center. The solution helps simplify and accelerate the implementation of a government multi-channel contact center, enabling governments to provide services and information to citizens in a consistent manner while providing the highest levels of customer service by making customer engagement accessible anywhere, any time and on any device. The solution also allows governments to more efficiently manage and monitor their organizations and operations.
The market for outsourcing customer care is very fragmented and fiercely competitive. There are about fifteen or so global outsourcing firms that continue to dominate the industry in North America. These vendors continue to grow organically as well as through mergers and acquisitions. The smaller call centers are very fragmented and consist of hundreds of small providers which each have less than one percent of the total market share. The following chart depicts the 15 largest outsourcing companies market share:

Information from Microbilt’s First Research on 1674 companies (6 large, 7 medium, and 1661 small) reveals:

<table>
<thead>
<tr>
<th>Ratios</th>
<th>All Companies</th>
<th>Large (50 M+)</th>
<th>Medium (5M-50M)</th>
<th>Small (Under 5M)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Ratio</td>
<td>1.56</td>
<td>1.55</td>
<td>1.48</td>
<td>1.61</td>
</tr>
<tr>
<td>Total Assets to Sales</td>
<td>35.5%</td>
<td>35.7%</td>
<td>42.1%</td>
<td>32.8%</td>
</tr>
<tr>
<td>EBITDA to Sales</td>
<td>2.4%</td>
<td>2.5%</td>
<td>28%</td>
<td>2.2%</td>
</tr>
<tr>
<td>Working Capital to Sales</td>
<td>7.2%</td>
<td>7.2%</td>
<td>7.4%</td>
<td>7%</td>
</tr>
<tr>
<td>Current Liabilities to Net Worth</td>
<td>78.4%</td>
<td>76.8%</td>
<td>84%</td>
<td>81.1%</td>
</tr>
<tr>
<td>Days Accounts Receivable</td>
<td>39</td>
<td>40</td>
<td>42</td>
<td>33</td>
</tr>
<tr>
<td>Capital Expenditures to Sales</td>
<td>0.5%</td>
<td>0.5%</td>
<td>0.6%</td>
<td>0.4%</td>
</tr>
</tbody>
</table>
Merger and Acquisition Update

The CRM industry’s low organic growth (<5% globally per year) coupled with the thin margins achieved by many of the publicly traded companies has limited the valuations buyers are willing to place on traditional CRM companies.

However, CRM companies that target specific growth areas expect to see higher growth rates. These companies are still receiving premium values if they are large, growing market leaders with sustainable top and bottom line performance. These specific areas include:

- Emerging International Markets (Brazil, China, India, South Africa, etc.)
- Healthcare Services
- Hispanic U.S. Market
- Work-At-Home-Agents (WAHA)
- Remote Help Desk Technology Support

<table>
<thead>
<tr>
<th>Size of Acquired Company ($ Revenue)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Multiples/Structure</td>
</tr>
<tr>
<td>Small* (&lt;5M)</td>
</tr>
<tr>
<td>Mid-Sized ($5-20M)</td>
</tr>
<tr>
<td>Large** (20M+)</td>
</tr>
<tr>
<td>Recent multiples</td>
</tr>
<tr>
<td>2-5 X SDE</td>
</tr>
<tr>
<td>3-6 X Adj. EBITDA</td>
</tr>
<tr>
<td>5-10 X Adj. EBITDA</td>
</tr>
<tr>
<td>Recent structure</td>
</tr>
<tr>
<td>25%-100% cash</td>
</tr>
<tr>
<td>50%-100% cash</td>
</tr>
<tr>
<td>80%-100% cash</td>
</tr>
</tbody>
</table>

*SDE = Seller’s Discretionary Earnings (Seller compensation + expenses combined with EBITDA)

**Adj. EBITDA = Adjusted EBITDA (Earnings Before Interest, Taxes, Depreciation + Amortization adjusted for non-recurring expenses that would not exist post-transaction)

The following chart depicts the level of merger and acquisition (M&A) activity that has occurred within the global CRM industry in 2011 and 2012 year-to-date by quarter.

Some notable M&A activity in the industry includes:

- Sykes (Nasdaq: SYKE) acquires Alpine Access for $150 million in summer of 2012
- ACS, A Xerox Company (NYSE: XRX) acquires XL World in summer of 2011
- NCO acquires APAC Customer Services, Inc. for $470 million in summer of 2011
Since 1991, Kaulkin Ginsberg has provided value-add strategic advisory services tailored specifically to outsourced business services (OBS) companies. Our client-centric approach covers almost every stage of a company’s lifecycle and enables us to maintain long standing and intimate relationships as trusted and reliable strategic advisors.

Service offerings include:

**M&A Services**
We have completed over 130 transactions representing north of $3 billion in aggregate deal value. We are deeply experienced in advising owners and acquirers of mid-market firms in buying and/or selling a business.

**Strategic Consulting**
Kaulkin Ginsberg is the leader in providing strategic consulting services to the ARM industry where our services are valued and utilized from the board room to the court room.

**Valuation Services**
For nearly a quarter century Kaulkin Ginsberg has been the leading authority on the valuation of privately owned companies within OBS.

**Litigation Support and Expert Witness Services**
Kaulkin Ginsberg litigation support professionals have a track record of success; our findings have never been invalidated in any court or formal proceeding.

**Market Intelligence & Analysis**
We believe that executives should be armed with the most relevant and timely information enabling them to make informed decisions. To that end, we provide a number of free resources to assist you.

**Executive Search Services**
We utilize our top-notch recruiting team to help identify and hire the talent you need; delivering focused executive search services that are well integrated with your business strategy.

Read more about Kaulkin Ginsberg at [www.kaulkin.com](http://www.kaulkin.com)

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