



Marcus Evans Conference
Call Centres: Addressing Changing Needs

Charge Outs / Transfer Pricing Strategies from the
Call Centre to Business Units in the Organisation

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1. Introduction

Results of a recent benchmarking survey indicate that, in South Africa, the top three business drivers for call centres are: improving customer service, creating direct relationships, and retaining profitable customers.¹

To respond to these business drivers, the number one imperative of call centre operators has become the need to develop a multi-channel, multi-function call centre capability, fully integrated into the business.

As a fully enabled direct channel, integrated with the business, the call centre can play a key role in the organisation's value chain by reducing cost, enabling focus and adding value to its product and service offerings – this role in the business value chain will shape the charge out and transfer pricing strategies of the call centre.

This document addresses a complex challenge facing many call centre operators in South Africa today, the challenge of charge outs and transfer pricing from the call centre to other business units within the organisation.

The challenge arises from the need to effectively integrate the call centre, as a direct channel, into the mainstream of the business and to use it to improve customer service, to build direct relationships and to retain the organisation's profitable customers.

Developing a multi-channel, multi-functional call centre that fully integrates with the business is the number one development planned in the South African call centre industry over the next two years.² Such integration spans a number of levels, including IT & telephony, processes, people & culture and financial integration. This challenge is presented by the need to integrate the financial aspects of the call centre into the broader business and it is the focus of this document.

The position adopted, views expressed and models presented in this document are based on experience gained over the past two years while working with a number of prominent South African institutions, all positioned in the top four of their respective industry verticals.

There are a number of key and interrelated matters that impact transfer pricing and charge outs. I have chosen to address these in the following sequence:

¹ Source: Dimension Data Proactive Insight South African Contact Centre Benchmarking Report - 2002

² Source: Dimension Data Proactive Insight South African Contact Centre Benchmarking Report - 2002

- The business context for transfer pricing within an organisation
- Understanding the full cost of ownership of your call centre
- Understanding your internal and external customers
- Differentiating your service offerings and pricing
- Developing the value proposition for your customers
- Charge outs and transfer pricing – various methods
- The migration from cost to profit

While the messages relating to each of these matters are relevant to most organisations, the way in which each organisation defines and implements its charge out and transfer pricing strategy is likely to be unique.

2. The business context for charge outs and transfer pricing from the call centre to business units within the organisation

The business drivers for call centres have changed over the past few years from being wholly focused on operational efficiency and cost reduction to now being focused on the need to add value by improving customer service, creating direct relationships and retaining profitable customers – with effectiveness and customer centricity being the key themes. These themes are at the very heart of any profit focused organisation.

Hypothetically speaking, a call centre able to respond fully and effectively to these business drivers (as a strategic and profitable direct channel), would add value in the end-to-end processing of interactions and transactions with the organisation's customers. In this context the call centre would both recover its full cost of operation and it would contribute to the margin between the price paid for the sales and services delivered and the associated cost of delivery.

This role of the call centre in the value chain of the organisation (refer to Figure 1) drives its charge out and transfer pricing strategy which is shaped by the organisation's strategy to differentiate, lead on the basis of cost or to focus on a particular segment of the market.

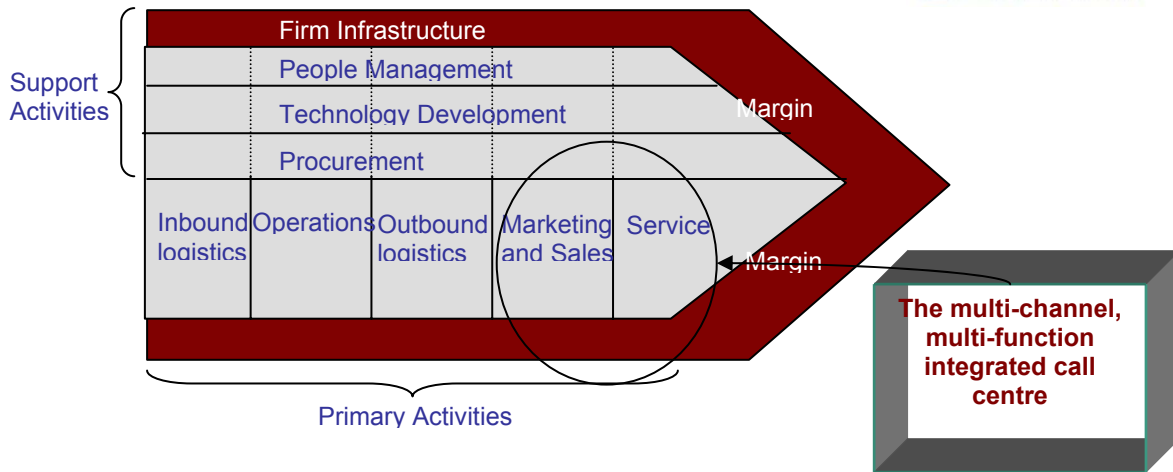


Figure 1: The Generic Value Chain – illustrating the role of the call centre

For example, an organisation with a cost leadership strategy is most likely to utilise the direct call centre channel as a means to reduce its marketing and sales costs, its distribution costs and its operational costs in order to compete on price. An organisation with a differentiated strategy might choose to utilise its direct call centre channel as a means to provide its customers with a superior service to its competitors by offering them a greater choice of channel, 24X7X365 access and a consistent and excellent experience.

Today's reality is that few call centres have the luxury of such a simplistic and easily defined role in the value chain. Many of today's call centres operate marketing, sales and service desks that perform many and varied activities for internal business units who serve different customer segments with different value propositions.

While the call centre, as a direct channel, has the **potential** to play a key role in the value chain of an organisation by providing it with a cost effective means of acquiring new customers and enabling it to retain and grow existing customers profitably through effective relationship management, this potential has not yet been fully realised for two key reasons: firstly, today's call centres do not typically have the operational capabilities (people, process, IT & telephony and information) required to play the role of a fully integrated channel and; secondly, the issue of who owns the customer has not been properly resolved. Both these issues complicate the relationship of the call centre within the broader business and contribute to the challenge of developing and implementing a suitable and effective charge out and transfer pricing strategy.

The fact that the call centre typically does not own its IT & telephony infrastructure (this is usually owned by the Group IT department or some similar centralized business unit / department providing support services) creates a hard dependency of the call centre on an outside party for the provision and

maintenance of its core technical capability and for the determination of the costs that it is charged for this capability.

The fact that the issue of customer ownership has not been practically resolved by most organisations makes it difficult for the call centre to determine who it should charge and for what services and at what price. There is a real battle underway in many of the larger organisations for ownership of the customer. The battle between marketing, product business units, segment business units and channel business units rages with the call centre caught up in the middle.

So, while call centres must recover their capital and operating costs from somewhere internally and / or externally it is not always clear from whom they should recover these costs, how much they should recover and what margin, if any, they can reasonably place on their services.

3. Understanding the full cost of ownership of your call centre

Call centres are complex configurations of people, business processes and IT and Telephony systems that can be operated from one or many physical locations and can consist of owned, shared or outsourced infrastructures.

The physical infrastructure configurations that are available today enable a call centre to own and host its own IT and Telephony platforms and systems or to elect to outsource this ownership and hosting service to internal business units within the organisation or to external service providers. The people ownership options available allow an organisation to own and manage its own people or to outsource this responsibility to one of many specialised service providers.

Factors driving the decisions around ownership include: the high capital costs and associated financial constraints that go with owning and maintaining facilities and infrastructure; the pace of change in technology developments; the high costs associated with managing a team of permanent employees through the peaks and troughs of variable demand; and the matter of what is and what is not core to the particular business.

All of these factors come to play when trying to understand the boundaries of ownership and hence the full cost of ownership of a call centre.

To determine the full cost of ownership of your call centre you need to identify all those things that you own in the operation and all those things that you lease / rent. You should be familiar with your ownership model.

Your asset register should be the starting point to identify what tangible and intangible assets are yours while a review of your income and expenditure

statement will quickly surface the costs associated with products and services supplied to you by other parties.

Having identified the assets that you own and having differentiated them from those you don't, you need to estimate the ongoing costs associated with both sets of assets to maintain them, upgrade them and replace them over time. To get this right you should have a well constructed infrastructure configuration plan so that you can identify the impact of a change to one item on other items. With a good understanding of the useful life of these assets, you can determine the costs of depreciation and you can estimate the costs of maintenance, upgrades and replacement reasonably comprehensively.

A similar exercise needs to be conducted with the other elements of your call centre i.e.: the people, process and facilities elements until you end up with a complete picture of what it costs you to run your call centre operation including your provision made for upgrades and replacement.

One element of your asset base that is often overlooked is the intellectual capital acquired and developed over time relating to the operating of an effective direct call centre channel in your business. There would be an expense associated with having acquired and developed this intellectual capital which would be amortised over a reasonable period of time and which would form part of your full cost of ownership.

Examples of typical call centre assets would be:

- Facilities – including buildings, parking facilities, catering facilities etc
- Network infrastructure – including internal and external voice and data networks, switches and routers
- Hardware – including your data and application servers, your ACD, dialers, voice loggers, your UPS boxes, your PCs, telephones, headsets, fax machines, printers and other such items of equipment that you use to run your call centre operation
- Software – software for all the operating systems and applications such as your CTI software, you CRM software, Quality management software, MIS software etc.

Examples of typical call centre operating expenses would be:

- Facilities charges – including rental, insurance, light, electricity etc.
- IT and Telephony charges – including purchases, repairs, consumables, depreciation
- Call charges – in and outbound calls, emails, sms messages etc.
- People charges – including recruitment, salaries, fringe benefits, allowances, exit costs, overtime, maternity & paternity leave, training, incentivisation, coaching

- Other operating expenses – including communication, travel and entertainment, printing and stationery, marketing and advertising, procurement, etc.
- Overhead charges – made up of your fixed costs (includes finance and other administrative support services) necessary for the conducting of day to day business

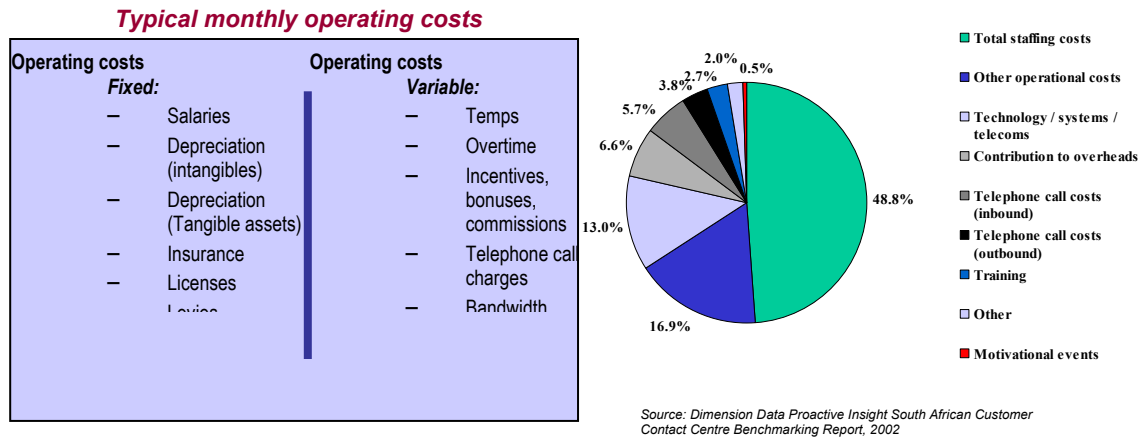


Figure 2: Example of the monthly operating cost profile of a call centre

With you balance sheet and income statement comprehensively put together; accounting for all elements of the operation, you can reliably determine your full cost of ownership of your call centre.

Should you be operating a multi-desk operation, it is most likely that you incur different costs for your different desks, based on the functionality required by each desk, the skills of the people operating the desk and the operating hours of the desk. You should attempt to determine the different costs associated with each desk, where possible, allocating overheads on the basis of some reasonable factor. This allocation of activity based costs is key to enabling you to differentiate your price effectively for your different customers.

Figure 3 illustrates the point that the total cost of ownership can be decomposed to the level of the different call centre desk groupings e.g.: marketing, sales, service and admin and that, once such decomposition has taken place, the unit costs per seat change based on the different functionality offered, skills required and operating hours.

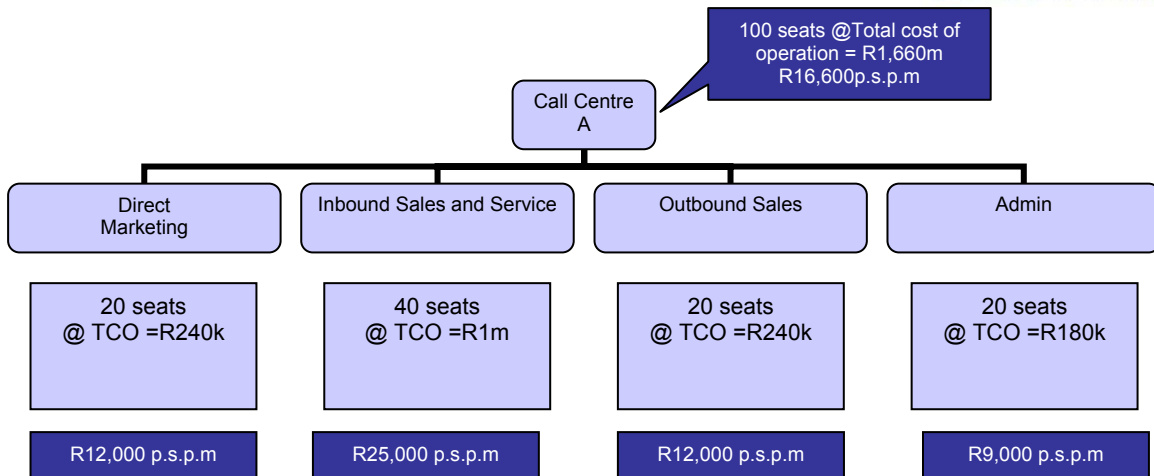


Figure 3: Total cost of ownership (monthly operating cost) decomposed to functional / desk level

4. Understanding your internal and external customers

Having determined your full cost of ownership and having unbundled this into activity based costs i.e. costs based on the different seats you have in your call centre, you need to shift your attention externally to your customers.

The call centre, as a direct channel, will interact with end users (consumers and businesses), with other functions within the business (back office departments) and with other internal business units (product and segment business units), with a different value proposition for each customer grouping.

It is essential to understand who is buying your call centre services from you and what their expectations are of your service delivery, quality and price.

For most call centres, operating within a larger organisation, your internal customer should be the marketing department as they are the ones to determine which products to sell to which customers through which channels and at what price. Your external customers should be the consumers and businesses that buy the organisations products and services.

In reality your internal customers are the other internal business units (BUs), product BUs, Segment BUs and Channel BUs for whom you provide direct channel services. The external customer is usually owned by one or more of these BUs (refer to illustration in Figure 4).

The business objectives for your internal customers of using the direct channel to market, sell and service to their customer base should be clear to all parties and

their expectations regarding the levels and price of service should be managed by means of carefully constructed Service Level Agreements (SLAs).

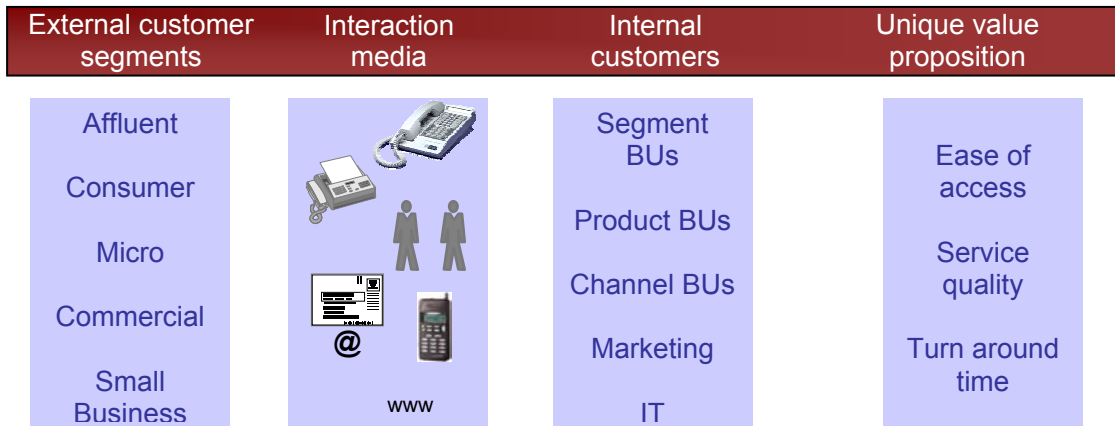


Figure 4: Service model illustrating possible external and internal customer segments, interaction media and value proposition elements

Having understood the unique requirements of each of your internal customers (representing the external customers) you are in a position to construct a differentiated pricing strategy.

5. Differentiating your service offerings and cost

It is quite common to find that a small percentage of service events (15%-20%) account for up to 80% of activities performed in a service call centre. It is also not unusual to find that at least half of these events are performed for the customers who are the least profitable for the organisation.

Given the strategic role that the call centre should play in the organisation's value chain, it should be a primary objective of the call centre to provide the right service to the right customer cost effectively (reducing the overall unit cost of sales and service) through the direct channel. Interaction cost and potential interaction value are key drivers in the decision to automate or manually service an interaction.

A comprehensive analysis of the service events that take place in a call centre by channel, by customer segment / type, by cost and by potential value will provide information that will be essential to the development of a differentiated serving strategy.

Having understood the economics associated with the different service events, the channels / media being used to interact through, the processes being performed, and having understood your customers and their expectations, you are in a position to develop a differentiated service strategy and to construct the differentiated service model for your customers.

In the model, cost should be differentiated on the basis of the services offered and volume and price on the basis of the potential value of the service events and interactions. Typically, these services are provided by means of a combination of some or all of the following:

- A specifically configured seat – e.g.: configuration can range from basic to custom depending on the functionality provided to the workstation. Functionality could include some or all of the following: Soft-phone, CTI, voice logging, quality management, a standard operating system, and a work package such as MS Office, a CRM application, a web interface (portal), and workflow.
- A number of specifically skilled Advisors - typically there are three agent skill levels in the industry – Level 1 to Level 3. The desk could require an admin agent or a specialist, such as a financial advisor.
- A direct management overhead that includes operations management, training, Subject Matter Experts (SMEs), quality assurance, MIS, and other non-call-handling resources.
- Connectivity and call charges, and
- An overhead contribution for value-added services such as relationship management, research, development, business analysis, etc.

Based on the type of functionality and skill required to deliver the required service cost effectively, a number of configuration options can be developed. This flexibility caters for cases in which the customer wants to own their own people, or part or all of their IT and Telephony infrastructure, or where they want to provide Subject Matter Experts (SMEs) to the operation to assist with query escalations. It allows a customer the opportunity to pay for what they use rather than to pay one price for all types of functionality and skill required.

This differentiated model can be developed using a spreadsheet to enable easy navigation through the various configuration options (refer to Figure 5).

Configuration option	A	B	C	D	E
IT Config					
Simple	R 3,500			R 2,500	
Standard		R 6,000			
Custom			R 8,500		R 9,000
	<u>R 3,500</u>	<u>R 6,000</u>	<u>R 8,500</u>	<u>R 2,500</u>	<u>R 9,000</u>
People Config					
Level 1	R 5,500				
Level 2		R 6,500			
Level 3			R 7,500		
Admin				R 4,500	
SME					R 9,500
	<u>R 5,500</u>	<u>R 6,500</u>	<u>R 7,500</u>	<u>R 4,500</u>	<u>R 9,500</u>
Overhead					
	<u>R 2,000</u>	<u>R 2,200</u>	<u>R 2,500</u>	<u>R 1,500</u>	<u>R 3,500</u>
Value Add					
Rel Mngmt	R 500	R 500	R 500	R 500	R 500
Research	R 0	R 0	R 250	R 0	R 250
BA	R 0	R 0	R 1,200	R 0	R 1,200
Other					
	<u>R 5,400</u>	<u>R 4,900</u>	<u>R 4,400</u>	<u>R 2,450</u>	<u>R 1,950</u>
Total - Monthly seat cost					
	<u>R 16,400</u>	<u>R 19,600</u>	<u>R 22,900</u>	<u>R 10,950</u>	<u>R 23,950</u>

Figure 5: Differentiated costing model based on various configurations of infrastructure, people, overhead and value add services

The monthly costs, illustrated in the pricing model are effectively the budgeted fixed and variable costs per month. However, the unit costs of service, such as the cost per call and the cost per call minute will reduce as volume increases beyond a particular point and will increase once volumes reduce below the same point.

With the differentiated costing model in place, you can now develop your value proposition and price, for each customer grouping.

6. Developing the value proposition for your customers

With the various seat configurations understood and the costing per configuration calculated, you can now develop your value proposition for each customer grouping.

Creating the value proposition and positioning the value is part of a process of value creation and delivery. This process can be illustrated as follows:

The value creation and delivery sequence

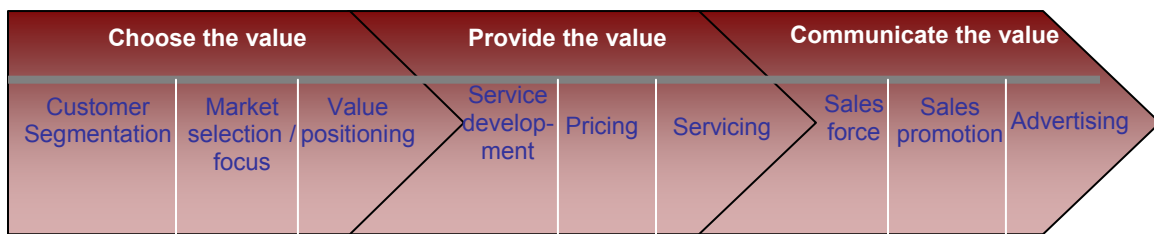


Figure 6: The value creation and delivery sequence

The proposition should meet some or all of the following criteria:

- Importance – how important is the service offering to the customer’s business
- Distinctive features of the offering – how distinctive is the offering from others that are available
- Superior nature of the offering – how superior is the offering to that offered by other service providers / competitors or to that currently provided by the organisation itself
- Communicable – how easily can the benefits of the offering be communicated
- Affordable – how affordable is the service to the customer
- Profitable – how profitable could it be for the customer to introduce the service offering

The value proposition is the key selling point for your customers. The premise is that customers will purchase services from only those organisations that they perceive will offer the highest customer delivered value at the most affordable price.

7. Models for charge outs and transfer pricing

With the value positioning worked out, the price can be determined to complete the value proposition for the customer groups.

First it is worth considering a definition of customer delivered value.

Customer Delivered Value can be defined as “the difference between total customer value and total customer cost. Total customer value is the bundle of benefits customers expect from a given product or service. Total customer cost is the bundle of costs customers expect to incur in evaluating, obtaining and using the product or service.”³

With the volumes of interactions estimated and the cost of the particular service having been calculated based on the services required by the customer and the configuration of the call centre seat (infrastructure, people, overhead and value add), the price of the service can be determined.

If the services being delivered by the call centre are for internal customers then the price that is determined will be transferred to the internal customer to factor in to the final price to the end user or external customer.

Price will always be somewhere between a figure too low to be profitable and too high to sustain demand (think of the price elasticity and inelasticity of demand).

There are many methods to be used in combination or alone when determining the transfer price. The conventional methods include:

- Mark-up pricing – adding a standard markup to the cost of service
- Target return pricing – pricing to achieve a targeted Return on Investment
- Perceived Value pricing – pricing on the value of the service as perceived by the customer
- Value pricing – charging a fairly low price for a high quality offering (the bargain deal principle)
- Going rate pricing – pricing on the basis of the going rate that competitors charge
- Fixed rate pricing – fixed prices quoted in a bid or contract

It is at this point that we must again refer to the strategic role that the call centre channel is expected to play within the value chain of the organization. If its primary function is to reduce the cost of service delivery through the direct channel then it is most likely that only a very small margin, if any, would be placed by the call centre on the services delivered to internal customers. The pricing models used in this case would most likely be the mark-up and target return models with the price and return being determined by the organisation and not by the call centre and being most likely based on cost recovery.

³ Kotler,P(1997): Marketing Management, 9th Edition, Prentice Hall International, New Jersey

On the other hand, should the call centre be required to play a more strategic and value adding role as a direct channel in the organisation's value chain, it is likely that the call centre will package additional services into its services "bundle" and that it will charge for this value add. In this case the price would be set so as to place a margin on the cost of services delivered and the call centre could make a profit out of its operations.

In addition to the conventional pricing methods addressed in the previous section, there are other pricing methods suitable for call centre services. These models include:

- Fixed capacity models (customer pays for a fixed capacity for a corresponding service level)
- Outcome based models (customer pays for the outcome e.g. sales closed, and the call centre recovers the cost of operation from this revenue)
- The fixed cost per subscriber model (the customer pays a fixed monthly rate per subscriber – usually with a known ratio of calls / contacts per subscriber), and
- Activity models in which the customer pays per activity e.g. per call handled

There are, of course, hybrid models that could be considered too.

8. The migration from cost to profit centre

Recently, there has been much said about the migration of call centres from cost to profit centres. This imperative, to be a cost centre or a profit centre, will be determined by the role that the call centre plays as a direct channel in the value chain of the organisation.

It is unlikely that call centres that are set up with the primary purpose of providing a low cost channel for the marketing, sales and service delivery will become profit centres as this would defeat the purpose of their existence. Their focus would most likely remain on achieving levels of operational efficiency and effectiveness that would enable the organisation to compete on the basis of price. These call centres would operate as "**cost centres**".

Those call centres that are set up with the dual purpose of reducing the cost of service through the direct channel and of creating customer value through direct marketing and selling are likely to find themselves operating as "**not for profit centres**" with a hybrid model of cost recovery and margin making.

Those call centres that operate with the primary purpose of adding value to the organisations product and service offerings are likely to operate as "**profit centres**".

While the planned strategic role of the call centre will determine the intent to operate on the basis of “cost”, “not for profit” or “for profit”, the actual operational capability of the call centre will determine whether the operation can or cannot perform this role.

Call centres consist of complex configurations of people, processes, information and IT&Telephony aligned to deliver a specific customer strategy. It is only at an integrated level of operational capability that a call centre can truly fulfill its role in the organisation’s value chain and, consequently, only at this stage of development that a call centre can really operate effectively as a “profit” centre.

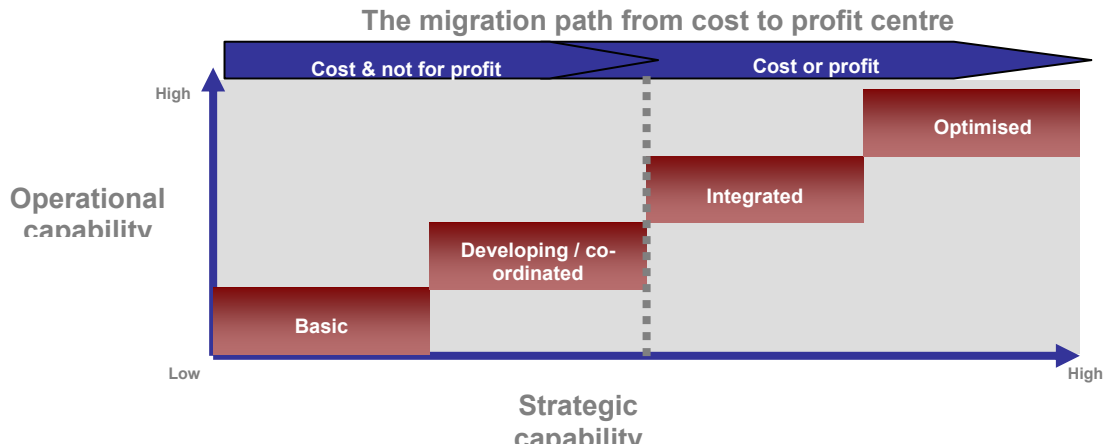


Figure 7: The migration path from cost to profit centre

9. In closing

The fundamentals of planning, selecting and implementing transfer pricing models for call centre operators who sell services to internal business units within the organisation have been addressed in this document.

There are no rules regarding transfer pricing for call centres that apply in all cases all of the time. Rather, each situation needs to be assessed on the basis of the internal and external environment in which the particular call centre operates. Pricing models and prices should be determined on the basis of the strategic role of the call centre and, more importantly, driven by the proposition that was proposed to and accepted by the customer.

To prevent disappointment amongst those operators who wish to implement complicated costing and pricing strategies, the point must be noted that before you can price, sell and deliver the service effectively you must have the operational and strategic capability to enable you to do so. The journey from cost to profit is a long and expensive one, albeit potentially very rewarding, as the call centre is a complex environment which if not properly structured, configured and fully integrated into the main stream of the business will fail to bear the expected fruits. Making such a journey requires effort, time, money and commitment.