

*A Jolt Consulting Group Whitepaper*

# *The Benefits of Performance Based Service Contracts*

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## 1. What are Performance Based Service Contracts?

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Performance-based service contracts (“PBSC”) are results-oriented *and* focused on the outputs, quality, or outcomes of deliverables desired by the customer and provided by the service organization. PBSC places an integrated solution set for customers’ needs at the forefront of the service strategy.

Companies who offer performance-based service contracts are considered best-in-class service providers in Jolt Consulting Group’s Service Excellence Curve<sup>SM1</sup> and achieving this status is a long-term and challenging journey that requires a series of fundamental building blocks of people, processes and tools in place to be successful.

Instead of providing a predetermined set of services (e.g., semi-annual preventative maintenance visits, break/fix SLAs, covered parts and labor, etc.), performance-based service contracts focus on outcomes the end customer desires. Equipment uptime and output are common outcomes that customers desire. An example of a PBSC is an x-ray machine service provider guaranteeing a 99.9% x-ray machine uptime to a medical provider. Ultimately, a medical provider or hospital is only concerned how much time the x-ray machine is available to deliver high quality performance to their patients and is not concerned with how many times a year a technician visits to service the equipment.

A fundamental shift in a PBSC orientated structure is that the risk to provide the uptime guarantee is borne by the service provider regardless of the number of field technician visits, required parts, etc. In exchange for this added risk, there are benefits service organizations may realize as a result of structuring their service contracts in this manner, including higher service contract revenue.

## 2. The Benefits of Performance-Based Service Contracts

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Performance based service contracts offer a number of potential benefits to service organizations and in this whitepaper, we will focus on revenue opportunities, customer satisfaction and operational efficiencies.

### 2.1 New and Additional Revenue Opportunities

In the x-ray machine example described earlier, service organizations that effectively position and communicate the value of a performance-based service contract can charge a premium over traditional contract values for guaranteeing uptime. However, this can only be profitable to the service organization if they have the service data and analytics to effectively price and support this service uptime guarantee.

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<sup>1</sup> “The Service Excellence Curve: Achieving Best-in-Class Service Delivery”, Jolt Consulting Group, August 2017, <http://joltconsultinggroup.com/service-excellence-curve-1/>

Some companies have taken it a step further by providing “Product as a Service” where they no longer sell the customer the product or asset but rather deliver outcomes. For example, for an on-going subscription revenue, service organizations will own, maintain, and service the asset while guaranteeing the performance or outcomes the customer desires. This creates a predictable, stable, on-going revenue stream for the service organization. A good example is Philips; no longer are they selling lightbulbs but are providing “light as a service” and the customer pays for the light they use with no capital investment, maintenance or replacement costs.<sup>2</sup>

## 2.2 Customer Retention and Satisfaction

Essential in providing a PBSC is that the service organization will have access to and collect relevant equipment and service information, either by IoT, remote access or technician capture while on-site. The capture and analysis of this data can provide multiple benefits. This provides the service organization an opportunity to discuss with the customer their method of keeping a customer’s equipment operating and how the service business uses integrated, intelligent systems opening lines of communication to build a stronger, collaborative partnership.

According to Aberdeen, collecting and providing customers transparency into this data has a direct correlation to client retention<sup>3</sup>. Table 1 below shows the year-over-year change in performance of leading organizations that provide customer-facing data insights versus all others. As can be seen, leading service organizations realize a 78% and 36% improvement over other firms in service contract renewal and customer satisfaction, respectively.

Firms Utilizing Customer Facing Insights		
Year over Year Change	Customer Visibility into IoT Data	All Others
Service Contract Renewal	+ 9.1%	+ 5.1%
Customer Satisfaction	+ 8.7%	+ 6.4%

Table 1

## 2.3 Operational Efficiencies

While service organizations have their customer’s best interests at heart and attempt to provide a superior level of service and retain customers, traditional service contracts can be an impediment to achieving these objectives. Traditional service contracts identify the number of visits per year, service level agreements (“SLA”), services performed, parts covered, etc. While their use is wide-spread and

<sup>2</sup> Philips Outcome Based Lighting, <http://www.usa.lighting.philips.com/services/managed-services>.

<sup>3</sup> “IoT and Self-Service: Putting Power in the Hands of your End User.”, Aberdeen, October 2017, [http://v1.aberdeen.com/launch/report/research\\_report/16932-RR-iot-self-service.asp](http://v1.aberdeen.com/launch/report/research_report/16932-RR-iot-self-service.asp)

has been the backbone of many successful service organizations, they tend to be internally focused and may not drive fundamental game changing service strategies.

In comparison, performance-based service contracts shift the focus to guaranteeing equipment uptime or output regardless of how many times the technician visits or what services are provided and is a fundamental change in the service business model. This customer outcome focus and increased risk borne by the service organization fosters an environment of new and creative thinking to drive service improvements and problem solving to customer challenges.

For example, a common change will be an emphasis on equipment data collection, remote triage and proactive maintenance avoiding costly reactive dispatches. The benefit to the service organization is any gain in operational efficiencies fall straight to the bottom line to profits.

This is proven out in practice as Table 2 from Aberdeen data shows the year-over-year change in performance of leading organizations with customer-facing insights versus all others<sup>4</sup>. As can be seen, leading service organizations realize a 4-5x improvement over other firms in service workforce productivity and customer service cost reductions, respectively.

Firms Utilizing Customer Facing Insights		
Year over Year Change	Customer Visibility into IoT Data	All Others
Service Workforce Productivity Increase / Decrease	+ 5.7%	- 1.5%
Customer Service Cost Reduction	- 2.2%	- 0.4%

Table 2

### 3. Approaches to Performance-Based Service Contracts

There is no one-size fits all method to develop, structure and implement successful PBSC due to the significant variations between industries and customer expectations. However, a common theme is the focus on customer outcomes. Below are two (2) examples of how leaders in their respective industries are approaching PBSC.

#### 3.1 Confidential Paper Machine Service Provider<sup>5</sup>

A confidential global paper machine service provider, a Jolt Consulting Group client, is undergoing a transformational service shift. This machine service provider and their end customer (i.e., the company

<sup>4</sup> "IoT and Self-Service: Putting Power in the Hands of your End User.", Aberdeen, October 2017, [http://v1.aberdeen.com/launch/report/research\\_report/16932-RR-iot-self-service.asp](http://v1.aberdeen.com/launch/report/research_report/16932-RR-iot-self-service.asp)

<sup>5</sup> March 14, 2018 interview with confidential paper machine service provider.

operating the machine to produce paper) entered into a multi-year PBSC that typifies aligning the objective of both service provider and customer. The service provider and customer agreed to a baseline production output (i.e., paper tonnage) and the service provider is paid bonuses or penalized based upon whether production is above/lower than the baseline, respectively. The service provider has complete ownership of recommending and performing the service and maintenance required to optimize paper production.

In this PBSC use case, the customer has realized an 8% production increase equivalent to an additional \$9 million in annual revenue. The service provider has realized a corresponding percentage increase in earnings based upon performance above the baseline.

### 3.2 University Mechanical Contractors<sup>6</sup>

University Mechanical Contractors (“UMC”) is a 100-year-old Washington State company providing full mechanical services to the industrial, health care/life sciences, data centers, manufacturing and commercial industries. Over a year ago, UMC started a strategic shift in their service model towards PBSC and UMC now structures service agreements that focus on three critical operational and maintenance areas:

Area	Focus	Objective	Activity
Preventative	Time Based	Extend Asset Life	Traditional PM inspections and checklists.
Predictive	Conditions Based	Improve Reliability	Specific asset testing to predict failure or reduce future maintenance on assets requiring lower levels of service.
Proactive	Operations Based	Increase Efficiency	Data analytics to improve system operational performance and energy efficiencies (e.g., humidity, temperature).

This approach has yielded significant benefits as a typical UMC customer has achieved 10%-20% energy savings while UMC has been able to reduce their labor costs 50%+ associated with providing these solutions to their customers. This approach has also established UMC as a “trusted advisor” to their clients better positioning UMC for future installations, upgrades, etc.

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<sup>6</sup> March 13, 2018 interview with Bob Frey, Director of Sales Operations, University Mechanical Contractors.

## 4. Conclusion

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Performance-based service contracts are results-oriented *and* focused on the outputs, quality, or outcomes of deliverables desired by the customer such as equipment uptime and output.

Companies who offer performance-based service contracts are considered best-in-class service providers in Jolt Consulting Group's Service Excellence Curve<sup>SM</sup> and achieving this status is a long-term and challenging journey that requires a series of fundamental building blocks of people, processes and tools in place to be successful.

Industry leaders will accept the inherent risk in a PBSC model, as they have the confidence in their people, processes and technology, all of which are required to implement PBSC. These leaders will enjoy the fruits of their investments measured in greater customer loyalty, improved financial performance and competitive differentiation. Jolt Consulting Group is a strong advocate of PBSC and is proud of the work we've done to date to help our clients realize the benefits associated with PBSC deployments.