



MOVING INTO THE FAST LANE

Challenging Conventional Wisdom in B2B Services

LOOKING UNDER THE BONNET

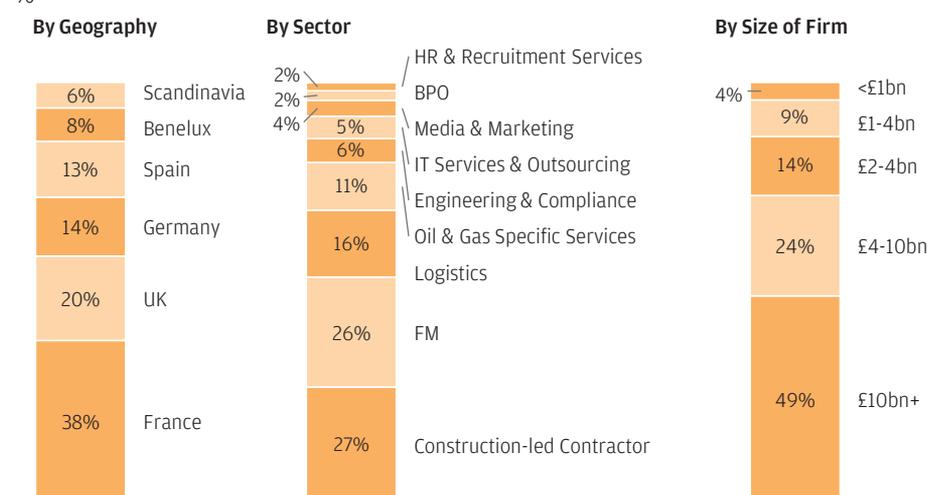
The B2B Services sector is a huge and profitable market, but poorly understood, and typically given much less attention than more mature consumer-facing industries. As a result, grasping the realities of how this sector functions can be a source of tremendous value.

Having worked with a range of the participants and numerous investors across Europe and indeed around the world, evaluating B2B Services businesses, OC&C has seen some excellent examples (and plenty of bad ones) of how to win long-term in this marketplace, by establishing genuinely differentiated, value-adding client relationships.

OC&C has examined 100 leading European B2B companies to identify five fundamental misconceptions about B2B, and highlight the strategies driving the emerging leaders to the front of the pack. Crucially, these strategies are relevant across a very broad range of B2B Services sectors, they are internationally applicable, and there is still scope for most B2B players to move through the field by sharpening their strategy accordingly.

To provide a rigorous basis for our assessment of strategies in B2B Services, we have examined the performance of the top 100 listed B2B firms over the last five years. The 'B2B 100' is a diverse set of companies, geographically and functionally, but shares several key features, having primarily contract-based relationships with corporate or government clients, and providing services rather than physical product.

Top 100 Publicly Listed Western European B2B Services Firm Revenues



Source: Datastream, OC&C analysis

B2B Services 100 Index: Company Inclusion Rules

1 Large Publicly Listed Companies

- Companies must be listed in Western European stock exchanges
 - London Stock Exchange
 - Deutsche Borse
 - Paris Bourse
 - Amsterdam Stock Exchange
 - Brussels Stock Exchange
 - Euronext Lisbon
 - OMX
 - Oslo Borse
 - Nordic Growth Market
- Revenue of at least £470m

2 Headquartered in Western Europe

- Companies must be listed and operating in Western Europe with Headquarters in:
 - UK
 - Germany
 - France
 - Spain
 - Benelux
 - Scandinavia

3 B2B Services Business (OC&C Scope¹)

- Categories included:
 - Engineering & Compliance
 - BPO
 - FM (Soft, Hard and Waste Management)
 - HR & Recruitment Services
 - Logistics and Transport
 - Media, Marketing & Advertising
 - Construction
 - IT Services & Outsourcing
 - Oil & Gas Specific Services
- Categories excluded:
 - Financial Services
 - Goods Manufacturer / Supplier
 - Utilities Supplier
 - Real Estate Investments & Services
 - Asset Rental Services
 - Software
 - Publishers

1. Excludes financial services, providers or manufacturers of physical goods and assets, and companies which have significant asset ownership or exposure to risk

DRIVING IN THE WRONG DIRECTION?

The evidence of the B2B 100 is that many of the commonest perceptions about B2B Services are simply untrue. Recognising that some of the conventional wisdoms are myths has major implications for how firms and investors can create value.

1. MYTH: SHRINKING PROFITS

Profits are shrinking as the market matures and commoditises, limiting opportunities for revenue growth and squeezing margins

REALITY: GROWING PROFIT POOL

Strong revenue growth, resilient margins and a growing total profit pool

2. MYTH: HOMOGENOUS PLAYERS

There is very little differentiation between B2B Service businesses – most players provide a similar service and are remunerated in line with commodity delivery

REALITY: WINNERS AND LOSERS

There are significant winners and losers within each B2B Services sector

3. MYTH: SECTOR IS KEY

Certain sectors are inherently unattractive places to play, irrespective of the approach taken

REALITY: STRATEGY NOT SECTOR

All B2B sectors have pockets of attractiveness which can be exploited with the right strategy

4. MYTH: BIG IS BEAUTIFUL

Tier 1 players are increasingly consolidating the market as they win share, and establishing a virtuous circle between share gain and revenue growth

REALITY: RISE OF THE CONTENDER

'Mid-sized' firms (revenues in the £2-4bn range) have performed best 2006-10

5. MYTH: WHITE COLLAR IS MORE VALUABLE THAN BLUE

There are strong differences between blue-collar and white-collar B2B markets, with distinct players and different margin and growth profiles

REALITY: PROFIT IS COLOUR BLIND

The provision of blue- and white-collar services is converging, with opportunities for growth across the value chain

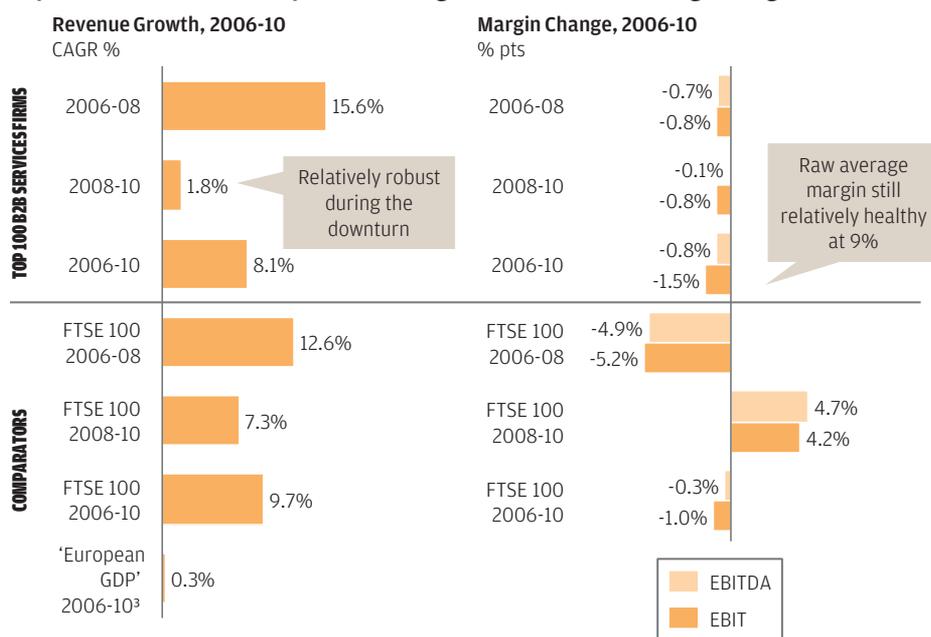
1. GROWING PROFIT POOL

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Compared to other, more cyclical markets, B2B Services has been a great place for the Top 100 European players in recent years. Despite the apparent maturity of their markets, the leaders have averaged revenue growth at c.8%, and even allowing for slight contraction in percentage margin, this has led to a c.22% growth in the total profit pool since 2006.

Top 100 B2B Service Companies Average Revenue¹ and Average Margin Growth²



1. Revenue growth includes acquisitions
 2. Revenue and margin evolution based on a raw average of Top 100 firms, FTSE 100 index excludes firms with exceptional financial activity
 3. 'European GDP' comprises the countries in which a company in the study is based (ie Denmark, Germany, France, Netherlands, Norway, Spain, Sweden, UK)
 Source: Datastream, OC&C analysis

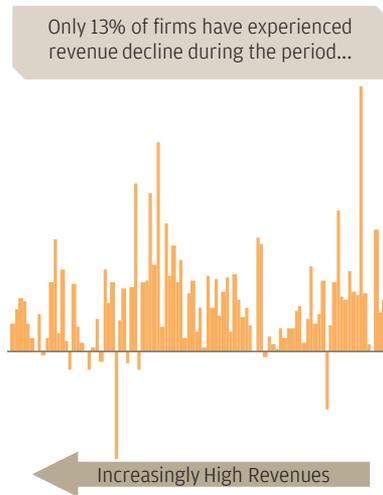
This impressive growth pattern has been relatively consistent across the B2B 100; despite a severe recession affecting all the European markets, only 13% experienced revenue decline.

At the same time, margins have been squeezed (c.1.5% points 2006-10), but the average EBIT margin remains a healthy 9%.

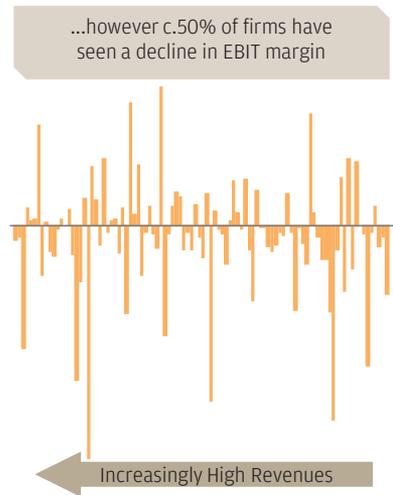
Compass Group is one example of a firm that even in a relatively unfashionable and apparently commoditising FM market, has grown revenue (9% pa) and margin (c.2% points) over this period.

In aggregate then, the picture is far from the low-growth, low-margin doom loop that some portray. B2B Services still represents an attractive place to operate, with real potential for doing so profitably.

Revenue Growth Distribution of Top 100 B2B Firms, 2006-10



EBIT Margin Growth Distribution of Top 100 B2B Firms, 2006-10



Source: Datastream, OC&C analysis

2. WINNERS AND LOSERS

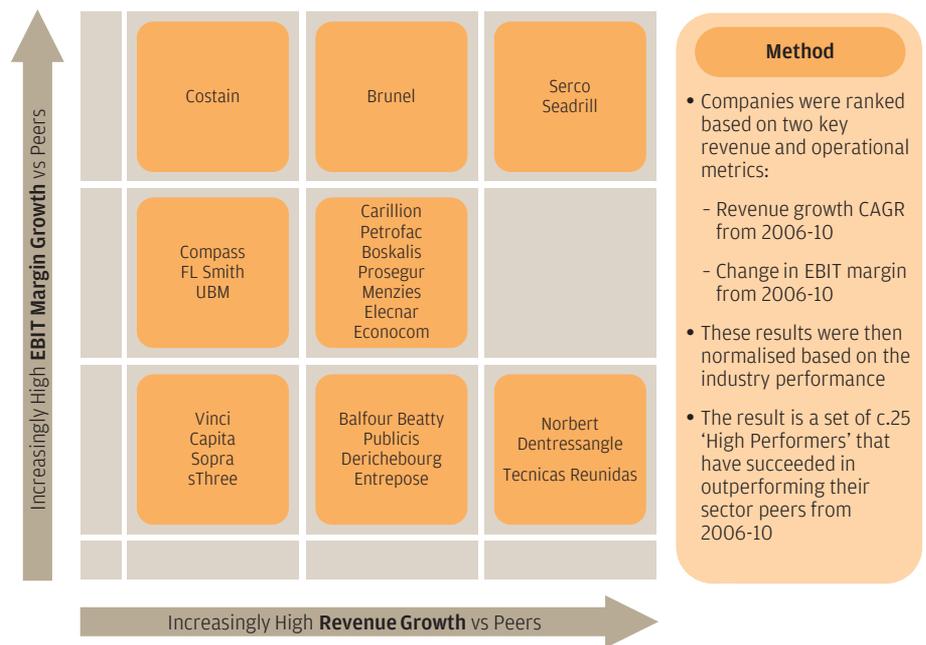
MYTH: HOMOGENOUS PLAYERS - There is very little differentiation between B2B Service businesses - most players provide a similar service and are remunerated in line with commodity delivery

REALITY: WINNERS AND LOSERS - There are significant winners and losers within each B2B Services sector

Normalising for sector-average performance highlights a set of industry champions who significantly out-perform their competitors, on both revenue growth and margin expansion metrics.

The construction industry provides a good example of how heterogeneous B2B Services is - and how this is continually evolving. Balfour Beatty has developed from a UK centric construction player into a firm with capabilities across construction, professional services, support services and infrastructure investments around the globe.

Industry 'High Performers' - Top Performing B2B Players



Caveat: industry classifications are relatively wide-ranging, hence firms compared within the same category may deliver somewhat different services.

3. STRATEGY NOT SECTOR

MYTH: SECTOR IS KEY – Certain sectors are inherently unattractive places to play, irrespective of the approach taken

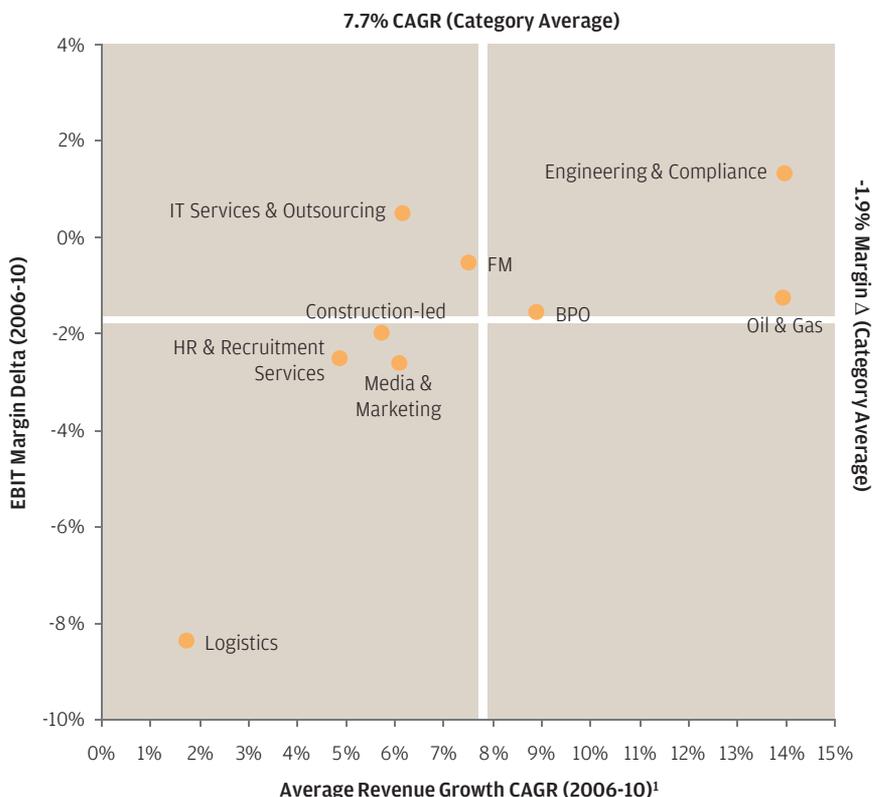
REALITY: STRATEGY NOT SECTOR – All B2B sectors have pockets of attractiveness which can be exploited with the right strategy

It is true that some sectors within B2B have performed better in the 2006-10 period; in aggregate, the profit pools in Oil & Gas or Engineering & Compliance have increased rapidly and outstripped the growth in Logistics or HR & Recruitment.

Yet this does not mean that the latter sectors should be dismissed as fundamentally less attractive, because within each there are areas of activity that have offered good returns, strategies that have been successful, and individual firms that have prospered – despite their sector and despite the global recession around them.

To take the example of Media & Marketing – a low-growth sector hit hard by cost-cutting in the recession – WPP stand out financially for their success in driving top-line growth at the same time as maintaining margins.

B2B Services: Revenue Growth vs EBIT Margin Growth, 2006-10



4. RISE OF THE CONTENDER

MYTH: BIG IS BEAUTIFUL – Tier 1 players are increasingly consolidating the market as they win share, and establishing a virtuous circle between share gain and revenue growth

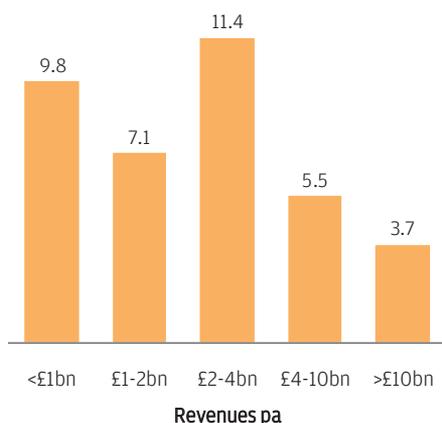
REALITY: RISE OF THE CONTENDER – ‘Mid-sized’ firms (revenues in the £2-4bn range) have performed best 2006-10

The huge multinationals (>£10bn revenue) have experienced a more subdued growth profile than their smaller peers in the last 4 years. Simply maintaining such large revenues is admirable, but the very largest appear to have difficulty in maintaining their previous strong growth, and on average they have had to sacrifice some margin to hold their leadership positions.

Smaller firms have grown fastest, although the sub-£1bn players in the B2B 100 have suffered the worst margin pressure.

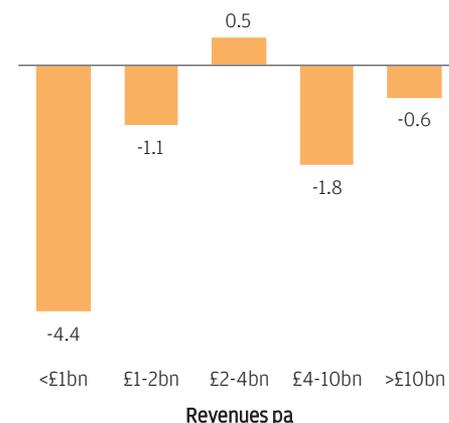
However, the real out-performers have been the mid-sized players (£2-4bn revenue), who on average have achieved double-digit annual revenue growth rates while maintaining (in fact slightly enlarging) margins.

Revenue Growth Distribution of Top 100 B2B Firms, 2006-10



Source: Datastream, OC&C analysis

Margin Growth Distribution of Top 100 B2B Firms, 2006-10



An interesting example of this is Tecnicas Reunidas which has combined international expansion with domestic growth and evolving its service range (now including energy engineering, procurement and construction work).

5. PROFIT IS COLOUR BLIND

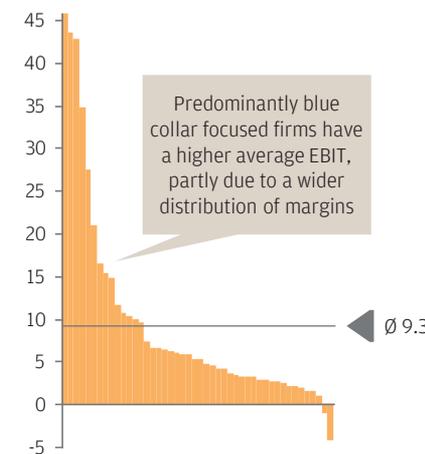
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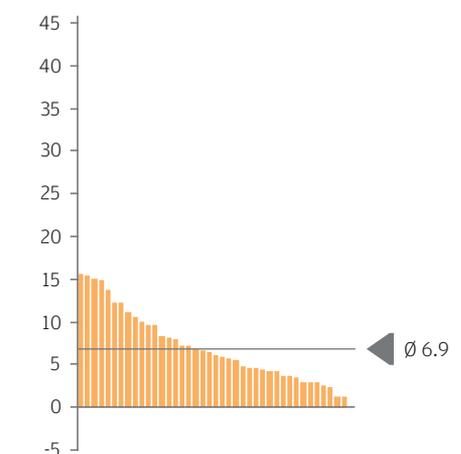
The historic model of blue- and white-collar providers being separated into distinct silos is an anachronism: firms now play across the value chain incorporating elements of each. The critical issues are level of value-add and how the breadth of activity is translated into real value to the client.

The assumption that white-collar work is more valuable appears to be wrong: of the B2B 100, those predominantly focused on blue-collar activity average 9.3% EBIT margin, clearly above the 6.9% average for those doing mainly white-collar work.

Blue Collar Margin Distribution, 2010
% EBIT Margin



White Collar Margin Distribution, 2010
% EBIT Margin



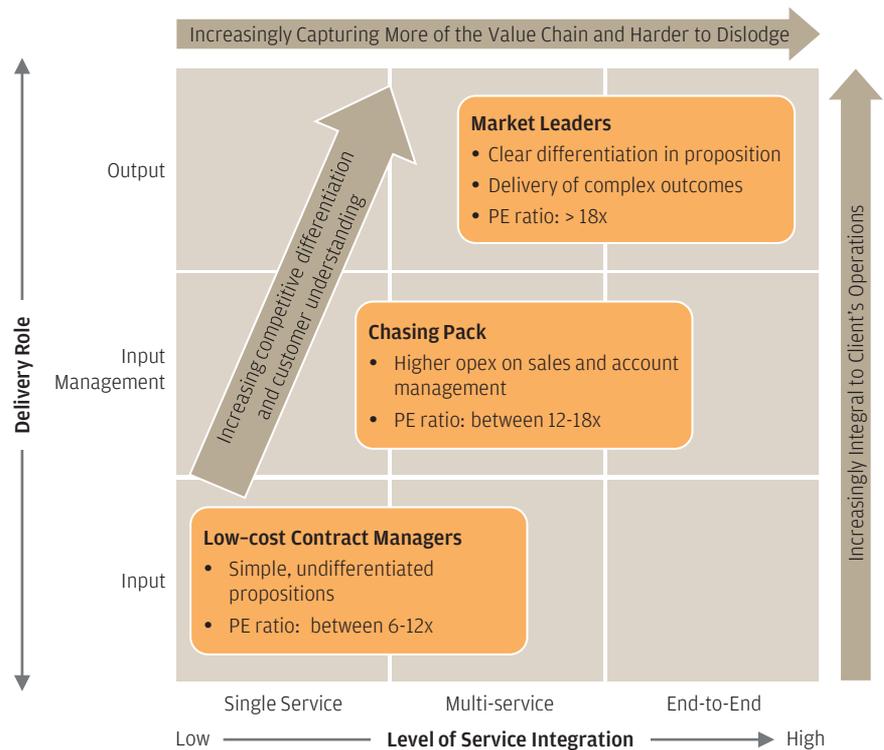
In the BPO sector, Serco demonstrate this well, successfully blending white- and blue-collar skills to drive strong revenue growth and solid margins; part of its success has been to understand clearly where it can best work with its public sector clients, which has rarely

been simple a white- or blue-collar-only role. Its growth has been primarily organic, boosted with acquisitions that have extended scope rather than just adding scale.

LESSONS FROM THE LEADERS

Understanding the realities of B2B Services allows us to identify a major prize for the winners, in terms of profit, sustainability, and valuation (the chart on the right shows just how much higher the multiples are of the leaders than the rest). The current winners are not untouchable, which means not only that they need to work to stay ahead but also that there is genuine scope for others to catch up or overtake them. OC&C's analysis suggests that there are some practical lessons that senior decision-makers can apply in B2B, including making some hard choices about the breadth of activity conducted and the nature of the delivery role they take on. Two areas in particular are vital:

- **Service Integration:** successful firms are typically those who can integrate multiple activities to provide a cross-value chain proposition
- **Delivery Role:** winners tend to have a measurable output-orientation, focusing on the results that matter most to their clients and aligning their delivery to them



Increasing the value-add and integration of services has the benefits (to the provider) of greater customer understanding, a more protected competitive position, and a perception of differentiation based on creating value for the client over a long-term relationship.

Capturing the prize will not be easy: there are practical challenges in developing compelling propositions and aligning organisations to deliver them to a high standard, as well as in communicating clearly why a particular B2B company is

differentiated. There is also a high-speed competitive race going on as rivals strive for leadership - but geography and sector are not a barrier to pulling ahead of the pack, and simply being a B2B Services business is certainly no obstacle to success.

There are four simple questions every B2B Services firm should ask itself to ensure its strategy can 'FUEL' profitable growth

FOCUSED: Am I sufficiently focused in my target customer segments and capability development to offer tailored propositions to clients and execute these effectively?

UNIQUE: Is my proposition to clients differentiated and defensible versus the competitive set?

EMBEDDED: Am I adding value to my clients through embedding myself in their organisation, reviewing and redesigning processes and taking an increasing ownership stake in the delivery of their operations?

LINKED: Am I integrating my customer's activities together in broader activity sets to realise synergies and generate value for the customer as well as increasing my share of wallet?

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