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NOT JUST A MARKET COMPARISON:

How Benchmarks Can Drive Operational Transparency

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ISG WHITE PAPER

EXECUTIVE SUMMARY

Benchmarking clauses are commonly used in IT agreements to ensure that contract pricing in long-term agreements aligns with market trends, competitive pressures, new technologies and continuous improvement initiatives that consistently drive down delivery costs of services.

However, the benchmarking process has the potential to go far beyond a tactical adjustment of pricing, and can provide transparency into operational structures and vendor management practices that enable more effective IT spend utilization. Specifically, strategic benchmarks can identify causes of value leakage that include poorly negotiated agreements, service level agreements (SLAs) not relevant to the business and misaligned goals and objectives. By extending the analysis beyond the typical scope of pricing, a benchmark facilitates results exceeding the sum of its parts.

This ISG white paper examines how benchmarking initiatives can be used to identify the root causes of value leakage in long-term IT agreements, support a Vendor Management Organization (VMO) and be applied to drive operational transparency, business alignment and successful relationships.

Although the primary focus is on pricing, the benchmarking process offers unique opportunities to identify other disparities; indeed, pricing is often just a symptom of the root cause of other ills in the overall relationship. Areas that a benchmark delivers insight include:

Pricing – Contractual benchmarking clauses normally address only the clearly observed financial aspects of contract pricing relative to market standards. The analysis identifies whether provider pricing is market competitive or if areas exist for pricing improvement. Other potential benefits include gaining insight into unique pricing structures due to customer-initiated requirements to meet short-term cost and financial reporting objectives. Examples of these short-term requirements that can contribute to negative financial results and/or perceptions of an unsuccessful outsourcing engagement include:

- All-in unit pricing including capital, maintenance and all delivery costs to avoid asset reporting on balance sheets
- Unbalanced pricing to achieve immediate price reductions
- Transition costs buried in base charges and unit rates
- Non centralized invoicing structure
- No contract bands for Additional Resource Charge/Reduced Resource Charge (ARC RRC)

The end results of these unique situations can include:

- Lack of pricing transparency
- Inability to identify value-add component in pricing
- Potential additional sales tax issues (in states that assess sales tax on computer services)
- Paying more for the equipment portion of price due to the provider assuming technology risk
- Inconsistent ARC/RRC pricing (e.g., pricing where the ARC/RRC pricing exceeds the base unit price charges, multi-tiered ARC/RRC pricing, etc.)
- Difficulties unwinding contract and exit strategy hindrance

Customer and Provider Actions/Inactions – Once the agreement is executed, co-participation is required by both parties to achieve transition and operational alignment. Over the course of the relationship, client and provider personnel gradually transition out, leaving the next group to provide continuity.

As shown below, poorly executed transformation to the steady state model leads to operational and contractual value leakage. To prevent this, an active customer Vendor Management Office and Governance organization with mirrored capability on the provider side is essential. While these organizations – by virtue of their respective names – may appear to be policing groups for the contract, in fact they are instrumental to quality, innovation and change. Having direct face-off relationships between the customer and the provider facilitates operational alignment and achievement of the outsourcing initiative's original goals and objectives.

Why is VM&G important?

Companies without adequate vendor management capabilities in place, are likely to experience a 20% to 40% erosion in anticipated business value

Alsbridge Research 2013

Along with Program Management, the VMO is instrumental to long-term operational execution. For instance, if collaboration is lacking on establishing the proper architecture, the result can be a mid-sized platform that lacks alignment with the client's IT direction. This leads to degradation of service and increased delivery and exit strategy costs.

Benchmarking supports the VMO by:

- Ensuring that pricing and service levels for managed supplier contracts remain competitive
- Identifying high or low performing suppliers
- Providing an independent framework for suppliers to share information to drive improvements

Moreover, benchmarks can support VMO decision making regarding supplier rationalization, future pricing requirements, likely pricing trends and the impact of changing strategy through moving delivery locations or deploying new technologies such as autonomics.

Contract run books are an effective way to identify scope creep, changes that cause cost increases and areas that have positively impacted financial results. This governance tool allows customers to quickly account for the negative variances from the original business case and implement corrective action to minimize Value Leakage.

Operational Issues – A benchmark may reveal overspend resulting from factors outside the scope of the contract price versus market price/unit cost analysis. Examples include:

- Virtualization: If the provider has not worked closely with the client to maximize server virtualization capabilities, the client ends up incurring more expense due to the provider not leveraging decreased hardware, maintenance and associated software costs.
- Storage planning: A benchmark can reveal if planning for allocated storage has not optimized utilization. Since invoicing is based on allocated storage, the customer will incur costs for excessive capacity and may want to change storage strategy from a dedicated to leveraged storage environment to shift capital responsibility risk to the provider.
- Printer/FTE ratios: Effective managed print strategies use industry standard printer-to-FTE ratios to enhance capital avoidance. Ratios outside the range of best practices may suggest a need to adjust print strategy to maximize asset utilization and cost efficiencies.
- Technology refresh: Benchmarking can reveal a failure to update equipment in a timely manner. While delaying refresh reduces capital costs, total overall pricing actually increases due to additional operating costs for old technology and out-of-warranty devices. Conversely, delaying the original refresh period by extending the asset useful life can generate savings, since forthcoming new technologies can drive additional efficiencies beyond the agreed schedule.

Autonomics software tools allow providers to lower delivery costs by solving issues quickly without human intervention. And when the situation can't be resolved immediately, the tools provide information to identify root cause to provide rapid and permanent fixes.

The continued use of legacy systems and an inability to transition to current technologies contribute to stalled cost savings and hamstring a provider's ability to achieve economies of scale. When old application systems are not portable to cloud or server platforms, the remaining legacy infrastructure results in increased environmental costs.

Service Level Agreements

As a part of the benchmark, SLAs are evaluated in determining a final market price. The process may reveal:

- SLAs misaligned to critical customer measures
- Consistent non-achievement of SLAs by the provider with no consequences
- Non-market based SLAs (e.g., SLAs that may be defined as aggressive in the contract, though are not in the marketplace)

By realigning based upon these findings, desired results can be achieved and the long-term relationship enhanced.

Leveraging the Benchmarking Findings

After a benchmark, the customer and provider typically review the results and agree on pricing adjustments to reflect the current market. However, by leveraging the findings outside of pure price comparisons and by embracing a holistic view, both parties can gain critical insight into the management of total costs and long-term direction of the relationship. Similar insights and benefits may be achieved when benchmarking internal operations.

Again, the results can exceed the sum of the parts.

ABOUT THE AUTHOR

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Managing Consultant Chuck Rosenfield provides over 30 years of experience as a global outsourcing leader with multi-industry experience. He has led ITO initiatives resulting in reduced cost, improved service levels and expanded global market presence. Chuck has worked extensively in Europe, Latin America and Asia Pacific, and has been involved directly in corporate, marketing and vendor strategy, contract negotiations and financial structuring.

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