

Benchmarking

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Introduction

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Traditional approaches to benchmarking tend to be centred on the commodity elements of delivered services. In fact, any service that has a low level of variability, a maturity of specification and a strong market for competitive supply can be benchmarked against a market comparison. This is the basis for consumer surveys, price indices and, ultimately, metric or research-based benchmarking.

This paper is designed to provide the reader with a high-level overview of the differing and evolving approaches to benchmarking, the importance of its initial timing and ongoing use, its purpose and key benefits when establishing and managing outsourcing contracts.

What is Benchmarking?

"The man who says he is willing to meet you halfway is usually a poor judge of distance." Laurence J. Peter

While Dr. Peter's wisdom is clearly understood, when it comes to commercial contracts and the tensions between the supplier's need to make money and the client's desire (often) to reduce cost, some form of middle ground is needed to act as the basis for the parties to agree to the right price for the right service. Benchmarking is about the objective analysis of processes to measure the gap between industry 'best practice' and the client's current performance.

It can be used prior to outsourcing to act as the measure against which the service provider must perform, or as a post deal measure to show over the lifetime of the contract, how well the service provider is performing relative to current and accepted norms or indices.

Benchmarking can also be a tool of business process re-engineering, comparing processes before and after re-engineering and then ultimately against 'best practice.' 'Best practice' in this context is the most appropriate cost and performance for the objective. This may be lowest cost, stripped out / slimmed down services, or high contribution services centred on innovation, depending upon the requirement.

A definition of benchmarking

Benchmarking within any business support service is a set of processes, options and procedures that generate confidence for the customer that the supplier is meeting the service objectives at a performance and cost consistent with the market.

What is 'best practice'?

Best practice is about doing things in the most effective manner. Any organisation can learn from how other companies operate even from an entirely different sector. Service providers are a good source of best practice as they work with a myriad of clients and thus bring translatable concepts to the table, which facilitate a world-class approach.

Types of benchmarking

There are three primary types of benchmarking commercially available:

- metrics and research-based benchmarking
- value assurance
- market testing

Metrics and research-based benchmarking

This form of study is usually done against a 'basket' of remote and abstract research into those elements of the service that can be delivered as commodity, such as seat price or cost per FTE. Ideally, such basket benchmarking compares clients within the same industry sector and country to create a peer group. The measures are essentially a comparison of cost versus workload rather than a measure of the value derived from services. It should be noted, however, that it is not uncommon for clients to be compared with companies from other industries or different countries to capture 'best practice.'

When undertaking comparisons that are not completely like-for-like, considerations need to be given to the underlying factors that may affect the data. For example, a number of

U.S. deals are based around shorter-term bottom line cost reductions rather than U.K. and European deals that are focused more on sustained reductions within sophisticated improvement programmes. Any such adjustment is typically referred to as 'normalisation.'

Value assurance

Value assurance is focused on the specifics of the supplied services in the explicit context of both the service objectives and the market for supply. This is not abstract or research led and, therefore, requires specific practitioner knowledge and experience to achieve real value.

This form of benchmarking affords the best opportunity to view the quality and performance of any service against the capability of its service provider and the market at a given point in time. A key feature is the setting of objectives upon which to make comparisons with similar companies undertaking comparable activities, using measures to determine a relative level of performance, cost or quality. In an ideal world, the objective will be to identify good industry practice and to measure the gap between it and the supplier's performance.

A follow-on objective could then be to determine how and whether those practices could or should lead to the provision of best practice, assuming that a) best practice is required and/or b) can be afforded by the client.

Usually, customers default to client-on-client industry comparisons, which are easier to quantify, but may allow the service provider to make undue profits due to its buying power, work practices, degrees of automation, methods of service delivery, consolidated helpdesk functions, etc. This is of course quite acceptable where commercial transparency is part of the contract and elements such as risk/reward are in place to 'balance out' any excessive service provider profiteering.

Prior to signing a contract, however, a client organisation may not have a clear idea of how its services compare to industry-typical service offerings. This is often a good start to an outsourcing feasibility study and contributes toward building a business case.

Improved and measurable services are often key business drivers and objectives for outsourcing in the first place. Understanding current practice and the 'gap' is important in setting expectations for the user community. Too often, deals are considered not to have worked when the expectations are for 'Ferrari' performance when a 'Fiat' is being paid for.

Market testing

Market testing was introduced in 1993 by the U.K. Government's Treasury Department for public services in central government, testing their efficiency by exposing them to competition from external providers. It was less relevant whether the service was actually contracted to the private sector, but rather that it was subjected to competitive challenge. Market testing was also seen as a 'softer' evaluation of services than Compulsory Competitive Tendering (CCT) provided. In the current environment, both public and private companies undertake market tests from time to time as a useful 'temperature check' of their own service provision or that of their external service provider(s).

There are two main forms of a market test:

- Blind bid
- Full procurement process

Blind bid

It should be borne in mind that this approach can be dangerous as, in order to secure a client's interest, some suppliers will deliberately bid low and then fall back on due diligence and subsequent negotiation to 'adjust' their charges. At best, this approach will only provide a broad indicative comparison.

Additionally, suppliers often see limited value in participating in such an exercise and may qualify themselves out of the opportunity especially if they have little or no relationship with the client organisation, reducing the sample size.

Full procurement

A full procurement is the better of the two approaches as, depending on the level of detail furnished, this will provide a more accurate level of pricing. The downside is the time, effort and cost in undertaking such an activity. In our experience, this can take anywhere between three and 12 months depending on the scope and complexity of services being contracted and the procurement requirements of the public versus private sector. As with a blind bid, supplier appetites for such a process will be limited by their (perceived) prospects of success (measured against the level of confidence that they have around whether the client will actually follow through and select them).

Why would you undertake a benchmark?

Having discussed the different approaches to benchmarking, what are the drivers behind the decision to benchmark and what are the overall benefits?

Benchmarking facilitates:

- Ongoing processes for a Continuous Improvement Programme (CIP)
- Identification of improvement areas, which will make a significant difference to key areas of the service, the business' agility or even the speed to react to new market forces
- Creation and alignment of standards for those key indicators that make up prevailing and accepted 'best practice'

- Establishment of how the 'best companies' and service providers meet these standards
- Adaptation and implementation of these lessons and ideas to meet and exceed these standards
- Discussion around contract negotiations
- Resolution of commercial conflicts between the client and supplier as both will have acquired a common knowledge through the benchmark process

The benefits of benchmarking

It is EquaTerra's view that if approached openly, benchmarking provides both the client and the supplier with the following benefits:

To customer

- Ensuring that the deal is aligned to business needs
- Ensuring that value for money is understood and, if it is not achieved, an action plan to achieve it can be developed
- Reassurance for all stakeholders
- Effective use of management time
- Stronger negotiating position

To supplier

- Opportunity to re-align the deal
- Improved customer satisfaction
- Assurance to customers of value for money service
- Improved contract retention

To both parties

- Challenges assumptions
- Maintains flexibility in long-term outsourcing relationships

Used prior to outsourcing, it can also allow cost correction and reduction before inviting in the professional service providers who will further decrease costs.

The EquaTerra value assurance process

Value assurance is a complicated undertaking when service complexity or geographic considerations are taken into account. However, the process flow of this style of benchmarking is straightforward and follows the following key stages and activities:

Organise and plan

- Select subject area
- Define the process to be assessed
- Identify potential benchmarking partners
- Identify the data required, its sources and appropriate methods of collection

Gather data

- Select benchmarking partners (sometimes there may be a contractual stipulation that the benchmarker is chosen by mutual agreement with the incumbent supplier)
- Collect the data (if prior to contract signing, the onus will naturally fall on the client, if during the term of a contract the onus usually falls on the incumbent supplier)
- Identify the comparator set

Analysis and report

- Review gathered data against comparator set
- Normalise as necessary and appropriate
- Determine the performance gap (cost/quality)
- Establish, understand and document the difference in the process between client and the market
- Document and report
- Target future performance

Action and review

- Communicate and obtain commitment (from the business and supplier)
- Adjust targets and develop the improvement plan
- Implement and monitor
- Review progress and re-calibrate service, quality and/or price as appropriate

It is essential within this process that client and supplier engagement is full and open. Typically a joint steering committee shall be formed to ensure:

- Responsibilities are understood and adhered to
- Each stage and event is signed off by all parties to avoid dispute at the end
- No surprises are evident at the end of the process

Context and when to use benchmarking

An EquaTerra value assurance benchmark is a useful tool to gain an understanding of key drivers and opportunities within the current situation from a market perspective.

- When considering benchmarking, the following should be borne in mind. Ideally, no contract should be signed without the client having 'reviewed' its internal service very carefully prior to externalisation.
- The rights to benchmarking the services must be secure with the client at the time of striking the deal.
- Benchmarking is a useful tool not a panacea or silver bullet and must be used with discretion.
- Choice of action following a benchmark must be with the client.
- Benchmarking can be stressful, costly and time consuming and must therefore be done at intervals in manageable/logical pieces.
- The more complete the data, the better the results, however, clients should not underestimate the effort involved in obtaining and compiling the data.
- In using metric based benchmarking, there is a need to review the companies within the 'basket' to ensure that a valid comparison is being made.
- At the very least, services should be formally benchmarked prior to any contractual breakpoint or formal extension to the contract or competitive re-compete.

Positioning for benchmarking

Some form of benchmarking or periodic review should be encouraged and is almost a given these days. Contracts should assume benchmarking as the 'norm' and allow for at least annual (partial or complete) testing of the service.

In older contracts, if this right has not been previously established (via the contract or a change note), should a client decide to invoke benchmarking, the service provider can become quite resistant, seeing this as a 'threat,' as abnormal and as a prelude to potential conflict or a loss of

the contract, revenue and profit, not forgetting that any downside risk on their part would unlikely to have been factored into the original deal pricing.

Co-operation and openness is to be encouraged and checking the service provider's attitude to routine benchmarking is a key 'cultural' indicator to be tested and monitored in the selection stage. Both parties will usually benefit from the open debate and actions that result from a discussion or negotiation around benchmarking.

What a 'metrics-based' benchmark should cover and deliver

Typically, the indicators should be shown against other companies within the client's peer group, the client's figures, the average for the peer group and the average for all clients of the benchmarking partner. Comparable indicators would typically include price per unit (charges), answer times/fix rates (performance) availability of infrastructure, networks and applications (quality).

What a value assurance benchmark should cover and deliver

It is important to distinguish between a value assurance benchmark undertaken as a prelude to an outsourcing arrangement and a value assurance benchmark performed during the life of the outsourcing contract. Undertaking such an exercise prior to contract signing without revealing too much commercial data to the potential service provider(s) is the ideal situation, for the following reasons.

Engaging the market and revealing detailed costs, service and quality prior to understanding the true effectiveness of the in-house service is not a recipe for success. Classically, service providers will offer to 'guarantee' 15-20 percent savings where cost saving is seen by the client as a key business objective. This offer is usually made in order to accelerate the client's decision-making process and to ensure that the process will not be competitive.

Any identified savings that can be made should be achieved or at least flagged prior to challenging the service providers to compete. Thus, if the client recognises service delivery changes ahead of compiling the Request for Proposal (RFP) these savings 'belong' to the client ahead of other innovations that the service providers can and will make. For example, accepting that a helpdesk does not have to be in-

house and on site means that it can be very efficiently rolled up into the service provider's infrastructure and its lower cost base. This can typically take a 10-person team and allow it to be run by only three Full Time Employees (FTEs). Not only that, but the office space is freed up, infrastructure and software licences, etc., are also saved.

Without a pre-contract value assurance assessment, all such savings are likely to be given away to the winning service provider. Costs can be significantly cut merely by identifying how the professional service provider will seek to change the methods of delivering the service and then challenging them, within the RFP, to go further. The investment in any identified change does not have to take place prior to signing a contract; it is part of the transition to the service provider. It should be noted that clients who can identify and implement such changes and investments are often those who do not see the need to externalise their services. Many client organisations who can identify such changes and investments often can't implement them (well, not to any acceptable timescale) and these organisations most often do externalise their services.

Once a contract has been signed, value assurance can be undertaken on a regular basis to ensure that value for money is consistently being achieved. It should be remembered that the outsourcing market is changing very rapidly and commoditisation can be extremely quick, so the market will certainly change beyond recognition over the usual three to four years of a contract's life.

Benchmarking thus ensures that services reflect change in the client's needs, the service provider's capabilities and the emerging and dynamic offerings coming from within the outsourcing market.

Conclusion

EquaTerra believes that throughout the lifecycle of a service, there is a time and place for all types of benchmarking or value assessment. Research-based assessments for commodities, commercial-based assessments for strategic review and 'relationship check-pointing.' These, in EquaTerra's opinion, are two fundamentals that provide a successful business-responsive service. So provision for introducing or changing the benchmarking method should be encouraged in the setting up of any contract to allow for the dynamics of:

- Rapid change in the delivery of services
- Changes within the outsourcing industry in general
- The changing relationships between customers and their suppliers
- Significant business change on the client's side (i.e., is the contract still fit for purpose?)

In EquaTerra's view, all outsourcing contracts should stipulate the frequency and charging mechanisms for benchmarking during the life of the contract and the handling of the results of agreed benchmarks. Failure to include such provisions frequently leads to disputes between the client and supplier regarding the cost of the benchmark, access to data and commercial adjustments resulting from the benchmark findings. Outsourcing engagements and the associated contracts are complex. The level of financial engineering varies but it is always present. The amount of transformation activity required may also vary. It is vital to understand these critical elements in order to draw meaningful conclusions for the customer.

About EquaTerra

EquaTerra sourcing advisors help clients achieve sustainable value in their IT and business processes. Our advisors average more than 20 years of industry experience and have supported more than 2,000 transformation and outsourcing projects across more than 60 countries. Supporting clients throughout the Americas, Europe, and Asia Pacific, we have deep functional knowledge in Finance and Accounting, HR, IT, Procurement and other critical business processes. EquaTerra helps clients achieve significant cost savings and process improvement with internal transformation, shared services and outsourcing solutions.

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