



Outsourcing Decision Perspectives

OC Research series

Benchmarking

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Benchmarking is an important tool that enables buyers of outsourcing to make informed decisions as they choose their service provider for a new outsourcing initiative. Benchmarking is also a valuable tool for discovering misaligned pricing and services throughout the life of a contract term or when buyers renew a contract.

Although the parties in an outsourcing arrangement initially structure their pricing and service level agreements (SLAs) according to baseline assumptions, they need to build into their contract a mechanism that ensures flexibility to adjust pricing and SLAs as the business situation changes over time. At some point in time, new technology, industry regulations, marketplace expectations, or the buyer's business objectives will change, making the original baseline assumptions no longer valid.

Benchmarking is the mechanism to determine how to bring services and pricing back in line. Most outsourcing contracts now include a provision for benchmarking the provider's services and pricing against comparable situations annually or every two years. Buyers should also conduct a benchmarking initiative before renewing a contract.

Buyers need to keep three crucial points in mind regarding decisions around benchmarking activities:

- What kind of data should the buyer use?
- Should the buyer adjust the benchmark data?
- How can the buyer and service provider take a partnering approach in using the benchmark data rather than taking a push-comes-to-shove approach?

What kind of data should the buyer use?

Not all benchmarking activities result in valid decision-making criteria; some benchmark data are misleading. Data will not present a true basis for initial structuring of services or help pinpoint the root cause of misaligned pricing and services later on unless the data support an apples-to-apples comparison.



Ross Tisnovsky, Vice President Research at global sourcing advisory firm Everest, warns that benchmarking must use:

- Comparable data that support an apples-to-apples comparison
- “Live” data
- All elements that affect pricing

Data comparability. Tisnovsky explains that input-based pricing depends on such full-time employee (FTE) units as function, role, skill set, location, and tenure. “However, the nomenclatures and descriptions for roles and work elements vary among service providers. Data not based on apples-to-apples comparisons (function or location, for example) can lead buyers astray,” he warns.

Live data. Buyers often make the mistake of purchasing syndicated survey-based data or data from requests for information results. Tisnovsky explains that such data are of uncertain quality in that they usually are not “live-deal” data. “When the data are not from live deals, they often do not reflect aggressive prices resulting from actual proposals and signed contracts. A benchmarking initiative relying on such inaccurate data would result in sub-optimal (at best) or even erroneous data,” he states.

Elements. Tisnovsky points out the benchmarking initiatives should also take into consideration the pricing model, governance, whether the process is centralized or decentralized, and any other elements that affect pricing.

Should a buyer adjust the benchmark data?

Benchmarking needs to “normalize” all pricing aspects to match the buyer’s specific situation. Examples of aspects that the buyer needs to adjust to match its situation include:

- Contract term length
- Buyer’s unique requirements/customization resulting in non-standard systems
- Provider’s purchase of buyer’s equipment, software, facilities, and assumption of leases
- Level of commitment to continuous improvements, performance, volumes, and other similar factors



How can the parties take a partnering approach to using the benchmark data rather than a push-comes-to-shove approach?

Benchmarking after the start of a contract usually results in the provider needing to adjust its pricing terms or service level commitments to match the benchmark data. In some cases, buyers even build into their contract at the outset a contractual provision requiring the provider to change its services or pricing to the benchmarked level.

Depending on how the buyer and service provider handle this situation, it can result in an adversarial confrontation that damages the relationship or can result in strengthening the relationship for both parties.

Outsourcing Center's annual [Outsourcing Excellence Awards](#) program studies the world's most successful outsourcing relationships to learn their best practices and keys to success. Two outstanding best practices for partnering approaches – one proactive, one reactive – are as follows.

Case example of a proactive partnering approach to sustaining benchmarked level of services.

In this relationship, the parties agreed up front how they would jointly and regularly compare the provider's services to market forces. The outsourcer provides benchmark data from its other clients, some of which are the buyer's competitors.

In an interview in the awards program survey, the buyer stated, "This helps us really move the needle. Also, our provider is very innovative in the way that they present information to us. They say, 'If you really want to break out of where you are in your industry, look at the benchmark data from best-in-class services in a different industry.' That's really what we've done, and it is helpful knowing what best-in-class service should be."

Case example of a reactive partnering approach to adjusting pricing and services to benchmarked level. The buyer in this relationship conducted a benchmarking study to compare market prices for its outsourced IT services. The buyer is very satisfied with the relationship and the services, but the benchmarking study revealed that the outsourcing provider's services were overpriced.



The buyer related in the Outsourcing Excellence Awards survey how it handled the disparity of its provider's pricing compared to benchmarked data. "We went to the negotiating table with them. Obviously, we wanted the prices to go down, but that was not on their agenda. Then they shared with us their perspective – they actually were not making a profit margin on another piece of business that they do for us. They were very transparent and opened their books to us and let us see that."

As a result of the open, honest discussion and the transparency around pricing, the parties determined how to adjust pricing in their relationship so that it would be a win-win outcome. They negotiated decreased prices for some services and increased the pricing in other service areas. The buyer also decided to allow the provider to perform some of the work using its offshore resources, which would help make up some of the lost margins before the benchmarking study.

The buyer summed up the results of this partnering approach to pricing adjustments. "Even though not reducing the prices on some services was not to our advantage, we wanted to show them that this is a partnership. We want them to make a profit margin so they will have an incentive to achieve our goals."