

CHERUB

ADVISORY & CONSULTING
IT Sourcing for Maximum Value

Benefits of Price Benchmarking

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PREFACE

This paper presents insights into Cherub thinking on the subject of Price Benchmarking. Price Benchmarking can identify areas for cost savings, spend alignment to Peer organisations, and overall value for money.

This paper discusses when and why Price Benchmarking can be used at different stages of the sourcing lifecycle. When used prudently it can add value to your decision making.

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What's the problem?

At an ever-increasing rate, organisations are challenged with identifying cost saving opportunities, improving efficiencies, delivering improved or changed business outcomes; or even, all these issues at once!

The demands for rapidly identifying improvement opportunities are placed on all parts of the business. None more so than IT which, whilst it is seen as an enabler, can also be seen as a cost overhead. This dual perspective can result in significant focus being placed on IT in the desire to reduce cost, improve efficiency, and improve business outcomes.

With IT often considered an overhead there is a need to demonstrate value for money, as well as hard cost savings.

This paper focusses on how an organisation's IT department can, by using benchmarking in a prudent manner, identify areas for cost savings, spend alignment to Peer organisations, and overall value for money.

What's a IT benchmark?

IT Benchmarking is a measure of productivity – either labour productivity or dollar productivity (i.e. spend effectiveness).

It can be an internal comparison from one period or circumstance to the next, or it can be an external comparison to Peer organisations for equivalent workloads.

Rule of Thumb

'Rule of Thumb' metrics are often sought and referred to gain insight on comparative spending of a service.

Examples of "Rule of Thumb" are '*IT Spend as a % of Revenue*', '*Total contract spend per service delivery FTE*' or within specific service towers such as '*Spend per End User*', or '*IT Service FTE per End User*'.

These measures provide useful insights at a high level. They can be used to gain 'directional' information.

Using the 'Rule of Thumb'

The new CIO of one of our clients, did a 'back of envelope' calculation to sanity check the existing Managed Services Agreement. The CIO compared the 'Total Contract Spend per Service Delivery FTE' to what she would spend if she employed the equivalent number of in-house heads at an assumed rate per head. She also compared that measure to the number of in-house heads that the contract spend could buy. This quick check suggested that the organisation may be over spending on their outsourced Managed Services.

The problem with this approach, as the CIO knew, is that the quick metric has the implicit assumption that all of the contract spend goes towards the visible 'on the ground' service delivery headcount. It assumes that the Managed Services Agreement is no more than a Utility style, 'keep the lights on' BAU infrastructure operations service.

The CIO was cognisant that the arrangement wasn't a Utility style service; and nor was it the type of service arrangement that she ultimately wanted for the organisation.

Whilst the Rule of Thumb did not completely answer her question, it did reinforce in her mind that a deeper analysis with a Price Benchmark was worth doing, particularly as this was a provision already allowed for under the Agreement.

What's wrong with Rule of Thumb?

Nothing - provided you know the assumptions that underpin the metric and are sure that your situation fits those assumptions. Rule of Thumb metrics are broad-brush indicators and should only be used and interpreted as such.

The previous example of where one of our clients did just such an analysis illustrates the point.

Most Managed Services Agreements with which we are involved today go beyond pure Utility and are Enhancement style deals. Enhancement deals look to the supplier to deliver improved services often in the form of Continuous Service Improvement and Innovation. Increasingly Cloud style, Autonomous Service Delivery¹, and IT As A Service deals are being sought. Many of these types of deals can also be Transformational in their nature.

What's Price Benchmarking?

Price Benchmarking examines if your Service fee is competitive in the market place – for equivalent services. It can be used to assess costs of your current outsourced Managed Services against the market. It can also be used to assess the cost of services provided with internal staff against the market for equivalent outsourced services.

The focus on 'equivalent services' is a very important aspect of Price Benchmarking. Cherub does its Price Benchmarks by selecting a Peer Group of enterprises from our database of recent Service Agreements and calculating a projected service fee based on our client's workload. We simulate our client's workload for each of the Peer entities using the Peer's contract service fees per work unit item. The workload measures vary from Service Tower to Service Tower; and within each Tower, there can of course be

multiple measures. For example, in IT Infrastructure towers assessing devices such as servers by operating system and the level of configured failover redundancy; or within networks the device volumes in the core, distribution, and edge access layers of the network.

Price Benchmarking provides you with independent validation of value-for-money spend as well as an assessment of how you compare against your peers.

What Price Benchmarking is NOT

Price Benchmarking does not calculate the Total Cost of Operations. Equally, Price Benchmarking is not Cost Benchmarking.

Why Price Benchmark?

Price benchmark helps you learn whether what you are paying is competitive in today's market or to learn what you could expect to pay in today's market for particular services from vendor's with particular capability sets you see as being of value

Clarity of contract costs

Price Benchmarking can uncover information about large, complex services contracts that may not otherwise be visible. It can, for instance, identify if you are paying expected fees for infrastructure under management.

This information may be used to allow you to make decisions about the benefits of using that infrastructure (e.g. if it's legacy and expensive, are there opportunities to retire it?); confirm that you are paying acceptable price for the management of the infrastructure; or challenge the Vendor as to why charges for specific line items appear out of alignment with Peers.

Comparison against Peers

Understanding how your IT spend aligns with Peer organisations will inform you if the overall cost is as expected. This external view on your costs compared with others can be very important. It can answer the fundamental question of “Is what I’m paying fair and reasonable?”

If the answer is “yes” and yet you still need to reduce costs, Price Benchmarking can provide some clarity as to where costs could be reduced.

Identifies areas of underspend and overspend

The data can identify service towers or categories within towers where you may be overspending compared with Peers. Equally the benchmark can indicate where you may be underspending.

Either way, you are better informed allowing you to make business decisions to address your challenges.

A client IT Executive was challenged by his Board on the overall cost of IT. Through a Price Benchmark it was identified that the cause of the high costs compared with Peers, was much greater than average Cybersecurity spend.

All other categories of expenditure were in line with or below the Peer group. The IT Executive and the Board accepted the validity of the expenditure in Cybersecurity; thus, the benchmark quickly satisfied all parties as to the merit of the overall spend.

Value For Money

A Price Benchmark in itself cannot determine Value for Money. What it can do is inform on the relative spend, allowing you to better determine the overall Value of that spend.

Improving decision-making using Price Benchmarking

Price Benchmarking through the Sourcing Lifecycle

The figure below illustrates the Sourcing Lifecycle.

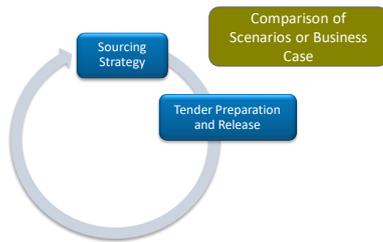


There are six defined stages within the lifecycle, which can be broken down into multiple sub stages.

Price Benchmarking can be a valuable tool at a number of these stages. When used appropriately, it supports effective decision-making. For example, supporting an insource/outsource decision, supporting the business case to extend a managed services contract, or to support a negotiation strategy.

Following is a discussion as to how best to use Price Benchmarking throughout the Sourcing Lifecycle.

Sourcing Strategy and Tender Preparation



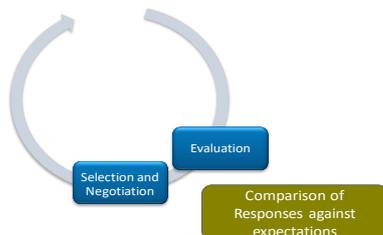
A sourcing strategy will often include a financial assessment in the form of a Business Case, or a financial assessment of differing scenarios.

There may also be a requirement to undertake a Price Benchmark prior to the release of a Tender. This should be done if it hasn't already been completed in a recent strategy. The Price Benchmark will help validate the financial reason for undertaking a tender process. It will also help correctly set internal expectations as to what you can expect to pay for the tendered services.

Recommendations

1. Undertake a Price Benchmark analysis of likely charges for identified Managed Services or Project labour rates.
2. Undertake a Total Cost of Operations (TCO) of the current state.
3. Compare Benchmarked service costs against the current state TCO to understand differences.

Evaluation and Negotiations



Price Benchmark data is very valuable when evaluating responses to a Tender or when negotiating a final deal.

It provides a guide of expected prices of the like-for-like services. Evaluators can compare these results with submitted responses. It is particularly useful in a sole source scenario where there is no comparative pricing from other competition to the sole bidder. The Price Benchmark provides de facto competition in this regard.

Recommendations

1. Use Price Benchmark data to compare submitted responses against Peer organisations on a like-for-like services basis.
2. In situations where a single bidder is being evaluated, use Price benchmarking to give de facto price tension.

Vendor Management



During the term of the Agreement there may be provisions in the contract that allow for benchmarking. Undertaking a Price Benchmark during the term will allow both the customer and the vendor to better understand current market pricing. Depending on contractual requirements there may also be the opportunity to adjust prices during the term of the contract based on the benchmark findings.

Price Benchmarking can also be undertaken if a contract is approaching an extension or renewal point. Many contracts have inbuilt mechanisms allowing customers to exercise an option for an extension. Benchmarking in preparation for this provides critical information to any extension decision.

Recommendations

1. Undertake a Price Benchmark prior to executing any contract extension or decisions to go back to tender. The decision should consider the latest Price Benchmark data.
2. If a contract allows for benchmarking during the term, we recommend you exercise this option and undertake the Price Benchmark to validate that the deal is financially competitive. We recommend that the outcomes be used to review with the Vendor potential cost adjustment opportunities.

Simply requiring the Vendor to reduce costs to match current benchmark results may not always be in a customer's best interests. Under this scenario there is the potential that the Vendor will have to reduce internal costs elsewhere, thereby reducing services, to meet the benchmark requirements. Working with the Vendor to deliver improved outcomes as a result of the benchmark may result in a better overall result for you.

Conclusion

Price Benchmarking can be a valuable information tool throughout the sourcing lifecycle.

Price Benchmarking aids:

- *Strategy and business case decisions*
- *Evaluation and selection decisions*
- *Negotiation points*

Use Price Benchmarking prior to any contract extension as validation of future pricing.

CHERUB

ADVISORY & CONSULTING

Cherub is a Sourcing Advisory and Consulting firm that specialises in providing practical and actionable insight and consulting spanning the entire sourcing lifecycle.

Our single-minded focus is on understanding the Australian IT Sourcing marketplace and leveraging our unrivalled practical experience and market perspective to provide our clients with pragmatic and actionable sourcing advice, solutions and consultancy and help you answer critical questions such as:

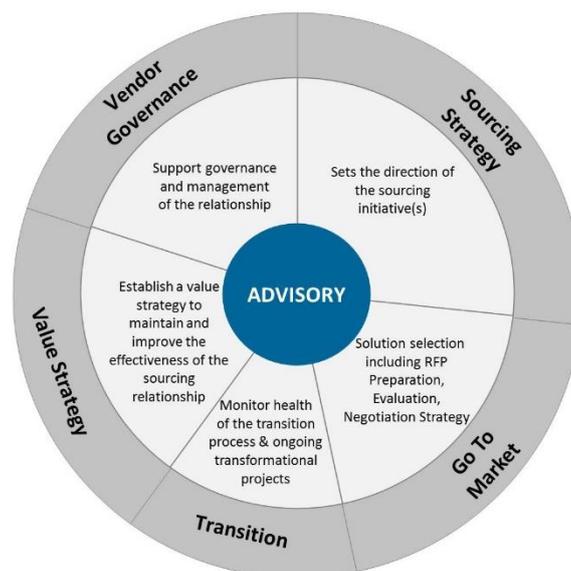
- Am I getting value for money today from my current deal?
- Is my strategy optimised to business needs?
- How can I get the right vendor, with the right services, backed by the right deal?
- How do I realise the goals and objectives of my strategy?
- What should I do to ensure success?

We know that the sourcing journey has many stages. Our Lifecycle Solutions Framework is pivotal in helping our clients to understand each stage of the journey and where their sourcing initiative fits into the overall sourcing journey.

It provides a platform from which clients can have a clear and informed view of the foundational activities and steps that have preceded the journey to date; as well as understanding what activities and steps need to follow to ensure success.

At the heart of our Lifecycle Solution Framework is Advisory Services which is the foundation of everything Cherub does and delivers. Our understanding and appreciation of both the 'hard' and 'soft' aspects of Advisory means that we are able to extend 'thinking' into 'doing' through the application of our best practice approaches, methods and tools.

Figure 1. Cherub's Lifecycle Solutions Framework



This is achieved through our Consulting Solutions that can be used to complement a client team's capacity or capability. Alternatively, a client may opt for a targeted sourcing consultancy where Cherub delivers an end-to-end solution. Such sourcing consultancies can focus on some or all aspects of the sourcing lifecycle, including:

- Sourcing Strategy to set the direction;
- Go To Market to select the solution;
- Price Benchmarking to evaluate the deal, set the price baseline and inform the business case;
- Transition to monitor the health of transition and ongoing transformational projects;
- Value Strategy to review, refine, and if necessary, undertake rectification of a service contract to help maintain and improve the effectiveness of the sourcing relationship between the customer and the supplier; and
- Vendor Governance to support excellence in governance and management of the relationship, including where required, the design and establishment of the vendor management office and toolsets.

We pride ourselves in our flexibility to either 'roll our sleeves up' and work closely with clients; or to simply provide expert guidance in a more advisory role.

We believe it is our many years of real-world experience combined with our deep functional expertise that provides lasting value to our clients.

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¹ Refer Cherub's White Paper on *Autonomous Service Delivery - How can it enable significant cost savings?*