Moving Beyond Price Benchmarking Towards Outsourced Spend Management

Price benchmarking highlights only the tip of the iceberg in diagnosing pricing problems. It does not address the root cause of the problems and therefore may fail to provide a comprehensive solution.

By Ross Tisnovsky, VP Research, and Sarthak Brahma, Senior Research Analyst

In the current recessionary environment, companies are bracing for slow growth, and it is increasingly important to focus on spend management. For buyers of outsourced services, spend management includes, among other things, reviewing supplier pricing in order to maximize outsourcing returns.

Over the past two quarters, Everest Group has witnessed an increase in buyers' demand for price benchmarking (on both input-based and output-based pricing models) in current and future outsourcing deals.

Though benchmarking is an effective technique for diagnosing whether there are pricing problems, it is not necessarily effective in identifying the underlying reasons behind the pricing problems. Without knowing the root cause of the problem(s), the outcome from a price benchmarking exercise is usually limited to finding the symptom of price misalignment with the market. Unfortunately, this is just the tip of the iceberg. With this approach, the return on investment from benchmarking is limited.

Effective benchmarking looks beyond the iceberg tip to optimize overall pricing structure

Outsourced-Spend Management. Everest's approach to effective, comprehensive, price benchmarking takes a broader perspective, looking beyond the iceberg tip of misaligned prices by evaluating the financial design, governance, and all other elements that impact pricing. We conduct this "Outsourced-Spend Management" activity as a follow-up engagement to the initial price benchmarking.

The Outsourced-Spend Management (OSM) approach is necessary for optimizing the overall pricing structure for outsourced functions. Often in such engagements for our clients, we find the following significant factors:

- Some root causes of pricing misalignment are attributable to the buyer organization
- There are several areas for renegotiation that can drive greater financial impact than simply reducing the supplier's price

For purposes of illustrating the beneficial outcomes of price benchmarking and an OSM follow-up, consider the following case study. The "client" and situation in this case is a composite modeled after multiple real-life clients' requests and engagements with Everest.

Case Study

Client. The client is a diversified multi-national corporation with operations in multiple geographies and a global delivery model across onshore, nearshore, and offshore locations. Its sourcing portfolio includes global and Indian third-party relationships and two medium-sized captives in India and the Philippines.

Scope of services. The scope includes IT applications and infrastructure, as well as select BPO functions.

Benchmarking objectives. The client's objectives for price benchmarking include (a) renegotiating contracts up for renewal, (b) assessing offshore savings potential for in-house processes, (c) reallocating the supplier portfolio between Indian and global suppliers, (d) evaluating alternate delivery locations, and (e) benchmarking captive versus third-party costs.

Benchmarking and OSM results. Everest performed an extensive price benchmarking of the client's input-based and output-based pricing models across multiple outsourced functions. Our analysis was based on (a) direct Everest-led deal data, (b) bottom-up price estimates based on operating costs and margins, and (c) supplier outreach for pricing data. Our benchmarking analysis highlighted renegotiation opportunities for the buyer. **Exhibit 1** illustrates typical results output from such a benchmarking analysis.

EXHIBIT 1

Typical results achieved in an Everest price benchmarking analysis

Source: Proprietary Everest database

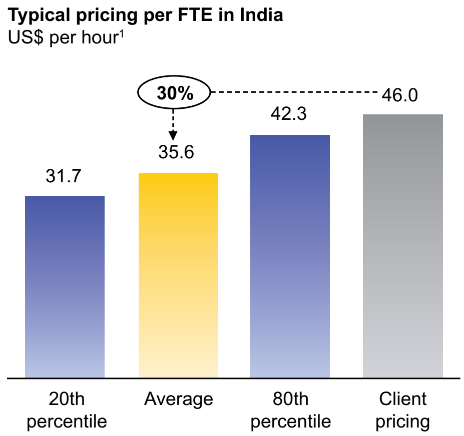
Role characteristics

Tenure: 5-7 years

Competency Management

Description:
Performs program initiation and planning. Requires leadership and communication skills, execution, controlling and closure.

Comments:
None



1 All data quoted at 2008 rates

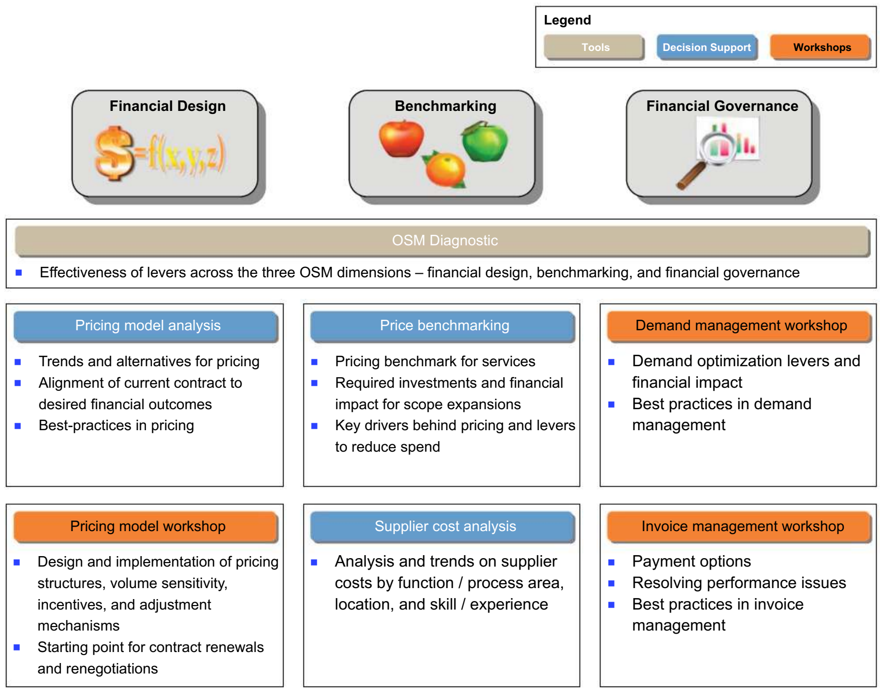
In the analysis and pricing review discussions with the suppliers, we unearthed several areas for driving greater financial impact. Moreover, some of the underlying factors for price misalignment were rooted in the client's organization including, for example:

- In highly volume-centric processes, the client used input-based pricing, making it extremely dependent on the supplier's productivity. A more optimal pricing model would be output-based, not only because it automatically factors change in volume but also because it provides an incentive for supplier efficiency.
- The client had a highly decentralized procurement office. It was faced with multiple sourced FTE roles across several geographies and suppliers at varying price points. Ideally, the number of roles should be rationalized and reduced so as to balance coverage and manageability.
- The client did not leverage its service mix between captives and suppliers, nor its location mix, to the optimum.
- The contracts were not client conducive in treatment of incentives and pricing adjustments (e.g., gain-sharing, volumes, COLA, change orders, etc.).

Exhibit 2 illustrates the components of Everest's OSM methodology.

EXHIBIT 2

Components of Everest Group's Outsourcing-Spend Management Methodology



Conclusion

Price benchmarking is only one component involved in effectively identifying improvement opportunities in an outsourcing relationship. When price benchmarking is conducted alone, it is unlikely to surface the underlying root causes of price misalignment.

Once sources of price misalignment are identified, a more involved set of several targeted efforts is likely to be required. Everest performs this service in a follow-up engagement for Outsourced-Spend Management. OSM usually involves Financial Design (e.g., analysis of the client's pricing model and understanding of the prevalent industry pricing trends) and Financial Governance (e.g., review of best practices in demand management and payment/invoicing).

This end-to-end analysis of outsourcing spend is more likely to lead to negotiating a sustainable mutually-beneficial sourcing arrangement and go beyond a mere short-term savings opportunity. If you would like to further explore these issues surrounding achieving an optimal pricing structure, feel free to contact us.

About Everest Group

Everest Group (www.everestgrp.com) is a global consulting firm that assists corporations in developing and implementing leading-edge sourcing strategies including captive, outsourced, and shared services approaches. Everest helps companies create strategies and sourcing relationships that deliver total value – improving performance and results while managing the risks in such initiatives.

Since 1991, we have completed 300+ engagements, advising clients on complex sourcing issues in more than 30 key business processes worldwide. Our experience spans numerous Fortune 1000 clients in banking, insurance, retail, healthcare, telecom, media & entertainment, and hospitality sectors, among others.

Our breadth and depth of experience enables us to deliver expert analysis and strategic results. Our flexible, collaborative approach analyzes the specifics of each sourcing challenge. Throughout the process, we encourage collaboration between buyers and service providers to spark creativity and lay the groundwork for long-term outsourcing success. The result is a solution that recognizes the strengths, weaknesses, and strategic objectives of both parties.

Everest Group is headquartered in Dallas, Texas and has offices in Toronto, New York, London, Amsterdam, New Delhi, Melbourne, and Sydney.

For more information about Everest Group, please contact:
Everest Group
Phone: +1-214-451-3000
E-mail: info@everestgrp.com

For more information about this topic please contact the author:

Ross Tisnovsky, Vice President
rtisnovsky@everestgrp.com

Sarthak Brahma, Senior Research Analyst
sbrahma@everestgrp.com