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Benchmarker Beware: How to use benchmarking Successfully in Outsourcing

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Benchmarking vs. Market Intelligence

Benchmarking may be the most misused tool in outsourcing. HfS Research has observed hundreds of outsourcing relationships, both Information Technology and BPO, and concluded that enterprises rarely apply benchmarking results successfully. Many clients and providers point to the contract clause that *allows* for benchmarking as the reason their benchmarking efforts have failed to produce acceptable results.

A good benchmark is a valuable tool, but not a silver bullet. There are several capable IT benchmarking companies, but BPO benchmark offerings lag far behind and are generally less credible and less useful. Companies that use benchmarks successfully employ the technique as part of a larger program of *market intelligence*, and understand that even the best benchmark is just a data point in a highly complex.

"Nobody does it like we do"—so why did you benchmark? The Limitations

HfS Research has never seen a benchmark that could not be debunked by a sufficiently motivated person. A client executive who does not like the results will find any number of issues with the comparators in the study, and generally will only do so after the study is finished. A provider can easily do the same—and they in fact have data of their own (all their other deals) that can be compelling. This is the main limitation. HfS Research recommends to clients that engage in benchmarking to be prepared for challenges from any party that stands to be embarrassed by the results. Benchmarking companies have robust methodologies and it is a good idea to get everyone to agree that the methodology will produce a valid result before the benchmarking study is conducted. In other words, find out if someone is going to allege incomparable uniqueness before you spend the money on the study.

Human nature often affects how benchmark results are received, but even more alarming is that even the best benchmarking methodologies do not yield accurate results because they tend to compare things like rates and unit costs, not the *total cost of the solution*. Even when certain costs are factored into the total benchmark (the more obvious ones like financed transition costs, pass-throughs, severance, and fixed operating costs) calculation, many less tangible costs and benefits are not considered. For example, how can you quantify the amount of management focus not spent on the back office relative to others? How about speed to implement a change order? Revenue lost or gained as a result of outages? There are so many variables that it is literally and practically impossible to benchmark the *value* of the relationship. But on the most basic of levels, benchmarks compare price, not the quality of service associated with that price. Because of this, we often see benchmarks that result in downward price adjustments and value erosion at the same time.

Benchmarking provisions are generally (grudgingly) agreed to by the parties during contract negotiations. They tend to be one of the most sensitive and momentum-destroying topics of a negotiation. The provider wants severe restrictions and the buyer tends to want very liberal rights. The interesting thing is that HfS Research data shows that less than 20% of deals are ever benchmarked. So clients and providers spend lots of time and money (and "relationship capital") arguing over the minutiae of a provision that isn't likely to ever be used, and is even less likely to be implemented if it ever is used, and if accepted could have the exact opposite result it was intended to have! HfS Research suggests clients and providers agree to reasonable terms that aren't punitive but provide incentive to the parties to come back to the table to discuss issues. If they cannot agree on a resolution, a graceful, low-cost, low-disruption, amicable termination should be the remedy for either party.

"Why are we different?"—Using benchmarks effectively

Even with all of their limitations, benchmarks, in particular the IT variety can be useful. The most mature users of benchmark data collect it as one of many data points, and only make decisions in conjunction with all of the other data they gather. HfS Research calls this data collectively "Market Intelligence" and believes it is a continuous program rather than a snapshot in time—in fact our programs for outsourcing buyers are built to deliver market intelligence in support of management decisions at any point in the sourcing lifecycle. Sophisticated enterprises employ their VMO to collect insight from benchmarking, networking, industry data, and current sourcing strategy and best practices. In the context of all of this information, benchmarking data is useful.

Most enterprises would like to know that they are receiving a fair deal. But even more, they would like to know that they are getting the most value from their sourcing activity. Benchmarking should begin this conversation—not end it. If a benchmark suggests that you are overpaying, that's not necessarily bad.

- Are you getting a higher quality of service?
- Perhaps a revenue lift those competitors aren't getting?
- Are you highly satisfied with the relationship?
- It may be that the provider has invested more senior resources in keeping you happy—is that something you would like to change?

A surprising number of benchmarks (about half) tell clients that they are in fact *underpaying* relative to the market. Accepting this at face value is equally dangerous. Perhaps you require a lower level of service and commensurate price—you may have no need for what the comparators require. Or maybe you have been missing out on some benefits available to everyone else. Benchmark results must be *investigated* before valid sourcing decisions can be made.

If viewed as a starting point, clients will get a lot more value from benchmarking—the study should be appreciated as much for the questions it raises as it is for those it answers. Likewise, in this mindset, providers should embrace the initiative as it may well yield ways to increase value delivered, becoming a far more strategic partner.

Of course, in very dysfunctional relationships benchmarking can serve the purpose of triggering termination. And in rare cases there is a significant, unexplainable disparity between an individual deal's pricing and the market (keep in mind this disparity is not always in the provider's favor) that should be addressed. If a truly insightful, rich benchmarking exercise is desired, HfS Research recommends a custom benchmark in which both client and provider participate. Carefully selecting the comparators, engaging them to share not just data but experience as well, and shaping the questions that will be answered by the study will yield far richer, more actionable results. Unfortunately, properly performed custom benchmarking is unrealistic for all but the largest deals. That leaves packaged and semi-custom studies available to most enterprise buyers. HfS Research feels periodic acquisition of this type of data is healthy as part of a broader, coordinated Market Intelligence Program.

A note about BPO Benchmarking

In general, HfS Research believes there are many similarities and synergies between ITO and BPO. However, benchmarking is not one of those cases. Simply put, based on the market offerings for BPO benchmarking today, HfS Research cannot recommend to clients that they invest in anything other than a sophisticated custom benchmark. If funds for this kind of study are not available or not justified, we recommend skipping the BPO benchmark altogether. The reasoning for this is as follows:

- BPO deals are indeed very different from client to client. The vast majority opts for bespoke, lift-and-shift type solutions rather than standardized offerings from providers. In addition, industry best practices still vary significantly across most processes typically considered for BPO.
- Labor rates are remarkably consistent across providers—a review of five years of F&A deals revealed a spread of no more than $2 per hour for any rate in a given geography. While two dollars per hour over a large resource pool and over five or more years adds up to real money, there are far easier, more cost effective ways of negotiating with providers to obtain these benefits.

- Services and service levels are far less standardized than in the more mature IT outsourcing arena. Therefore, solution comparisons are incredibly difficult and price comparisons effectively meaningless.

The bottom line

Benchmarking as it exists today can be a useful tool in assessing IT deal performance if used in concert with a robust Market Intelligence program. Companies that rely solely on benchmark results to make sourcing decisions are very likely to come to the wrong conclusions. The issues that benchmarking surfaces are real, and it can be a strong catalyst to engage in important discussions about the value of outsourcing initiatives. Articulating the purpose of the benchmark and securing buy-in for the methodology before the study is undertaken is important from a political perspective and increases the chances that the results will be actionable. IT benchmarking is more mature and applicable, but the nature of the BPO market leads HfS Research to believe that clients without large deals are not well served by the available benchmarks today. HfS Research recommends that clients in both BPO and ITO invest in Market Intelligence to keep their deals current and valuable.

About HfS Research

Horses for Sources (HfS) is the foremost advisory analyst firm and social networking community, focused on helping enterprises make complex decisions with their business process and IT outsourcing strategies.

With 34,000 subscribers, HfS Research provides the most impactful and frequently-visited global collaborative community platform in the global services industry, providing rapid and insightful commentary, analysis and debate of enterprise outsourcing dynamics. The organization is unique in the fact that it integrates personable social networking with market research and advisory services.

The HfS Research mission is to provide a unique environment for collective research, opinion, experience and knowledge across the global outsourcing industry to help enterprises explore new performance thresholds. Led by industry expert Phil Fersht, the HfS Research team is a multi-disciplinary group of analysts across North America, Europe and Asia/Pacific regions, with deep domain knowledge in Business Process Outsourcing, Information Technology Services and Cloud Business Services.

Launched in 2007, the Horses for Sources blog has more than 100,000 monthly visitors across the global outsourcing industry, and is widely recognized as the leading destination for collective insight, research and open debate of industry issues and developments. The HfS LinkedIn community is thriving with over 10,500 industry professionals sharing views and information daily. More information about Horses for Sources can be accessed at www.horsesforsources.com. The company can be followed on Twitter at www.twitter.com/horses4sources and LinkedIn by joining "The BPO and Offshoring Best Practices Forum group."