Executive Dilemma: Is Benchmarking the Right Path to Defining Opportunities for Improvement?

By Dave Brown, Principal, and John Masley, Senior Manager, Shared Services and Outsourcing Advisory

Maybe. Historically, benchmarking has been the first step. But it’s a long and often expensive road to travel when you’re looking for results right now.

Benchmarking Documents and Compares Processes, then Costs

Benchmarking, at its most effective, is built in and ongoing—it’s part of a thoughtful, overall strategy that drives continuous improvements toward major goals over many years. It’s not a silver bullet, it’s an operational philosophy that’s tied to long-term business goals.

In the competitive world of outsourcing, benchmarking tends to become all about cost and price comparisons. It’s a process for determining how your processes and cost structure—either for an internal or external solution—stack up against others in the market at a single point in time. Such a comparison is an important means of assessing whether you’re getting the best value while also identifying opportunities for improvement.

With some organizations having up to 80 percent of their IT budget going to a third party, it’s all the more important to ensure that the price for outsourced service is fair and reasonable in comparison with the current market. CIOs also need to measure and continue to educate their organizations about the value of different service delivery models.

But too often, conventional benchmarking is done as a one-time project to prove a point. Whether you’re invoking the benchmarking clause in your outsourcing contract or trying to determine if a full benchmark is needed to launch a cost-reduction or process-improvement initiative, you’ll face some problematic realities. The good news is, if you haven’t been benchmarking all along, there are some other ways to compare processes, costs and service delivery in a short, meaningful timeframe.

The Issues with Conventional Benchmarking

If you’re looking to benchmark a process, like-to-like comparisons in an outsourced environment is challenging—in fact, nearly impossible—as virtually every outsourcing deal is unique. It’s particularly challenging if your processes are deemed to be strategically differentiating and/or the goals of your processes aren’t clearly defined. And even if you do find like processes, make sure you’re measuring the right things. Call centers, for example, had historically benchmarked call time, which ironically had tended to lower customer service.

You may take an applications approach, but as today’s engagements involve thousands of different applications ranging from in-house legacy applications to unique service provider solutions you may be left with trying to compare the number of function points within applications. This approach, like measuring call time, hardly relates to continuous improvements and optimized cost structures.

A Real Language Barrier

Comparisons are also influenced by the taxonomy that customers and service providers use to decompose their processes. While one company’s desk-side processes might include sub-processes, such as software distribution, others may not. In the absence of a classification system from one deal to the next, it’s difficult to achieve meaningful comparisons.

Geographies, service levels and other complexities also come in to play. Add these complexities to the benchmarkers “bench” of very few outsourcing deals similar to yours, and compound that with how recent they might be. Due to the lack of similar deals, some benchmarkers broaden beyond your industry in an attempt to make a reasonable market comparison.
Validity of Comparison

Add it up, and it’s virtually impossible to get a true, statistically valid marketplace comparison. To compensate for the apples and oranges, some benchmarking providers will promise to “normalize the data” – which is little more than a subjective adjustment for the anomalies, i.e. smoothing the curve. Benchmarking may be presented as a fair and balanced price comparison, but in the end, 12 weeks and hundreds of thousands of dollars later, the report almost always favors the customer who’s buying the benchmarking service.

It’s no wonder many outsourcing service providers loathe the process and may see use of the benchmarking clause as a hostile act. Of late, many outsourcers and sourcing advisors are not including them in contracts just because they are so difficult to manage and evaluate—no matter which side of the table you might be on. So while conventional benchmarking may be positioned as an opportunity to improve a relationship, it can do just the opposite, creating bad blood and reducing the desired outcome of better service and/or reduced price. With all this in mind, it certainly can become less-than-optimal.

Market Assessment—A Mindful Alternative

So what is a conscientious executive to do? Instead of trying to compare disparate data through a magical normalization process, KPMG recommends evaluating data based on a market range. By taking processes in logical, large “chunks” and comparing them across a market range, you’ll likely get the information you need to get on with your optimization and improvement efforts faster, and with money left over.

A market assessment approximates your cost per process component compared to a similar range of contracts in the market. For example, if you want to assess the cost of help desk services for 30,000 seats in North America, you can work with a firm whose robust database of recent client engagements can generate similar data based on deal scope, service levels, volumes and geography. That data will form a market range, and where your deal sits on the range will approximate a quartile or quintile positioning in comparison with the current sourcing universe. KPMG views this illustration as “directionally correct” as it relates the client data compared to the market. The resulting data point, combined with your advisor’s market intelligence, provides a more realistic and valid picture of your cost structure as compared with the rest of the market.
The Assessment is Not the Goal

Importantly, a market assessment should not be a ‘one-and-done’ process; rather, it should be the beginning of a forward-looking plan for improvement. A market assessment may determine, for example, that you’re paying $10 per seat for your help desk while other companies in the market are paying $7 per seat. Instead of just reporting the gap, your advisor should help you develop an action plan for understanding it and closing it. Your advisor might explain, for example, that despite the savings available in the market, your company’s unique situation may require $6 million in transition expenses to get you to that same cost level. An expert advisor should be able to use the findings from the market assessment to model various scenarios and help you develop a pro-forma business case for different solutions.

Compared with conventional benchmarking, a market assessment is a great option to determine opportunities for improvement through various levels, while providing a reliable view of internal costs or an outsourcing relationship’s position in the marketplace. It is also more streamlined and, therefore, more affordable. While conventional benchmarking can take several months, a market assessment – designed to provide a quick, meaningful view based on a market range – takes just three- to six weeks.

When to Perform a Market Assessment

Companies are challenged to reduce costs and improve the performance of their current IT organization or other internal business functions. Many executives ask questions such as, “Where are the opportunities for improvement?”, “How do we get started on the improvement journey?”, “Do we need a benchmark?”, and, “Once we have the data from the benchmark, then what steps are next to build a path to the desired quartile?”

The pressure to improve financial results is constant. The process is a lot like healthcare: you may feel fine, but you still see a doctor for regular tests and checkups to make sure. KPMG recommends a market assessment price check approximately every 18 months. No matter where you are in your process improvement lifecycle or outsourcing contract, you can use a market assessment to get a good analysis of your contract’s current pricing in comparison with the rest of the marketplace. And if there’s a large enough disparity, you can use that information to open a dialogue with your service provider – a constructive dialogue about the future—rather than aggressively invoking the benchmarking clause in the contract.

An Example: Say you benchmarked your information technology outsourcing contract three years ago and negotiated your annual price down by four percent. Since then, the market has changed due to economic shifts and advancements in service provider technology. That original 4 percent could now be 15 percent that you’re missing out on – and that your competitors are getting in the deals they’re signing. Only a market assessment would reveal this kind of cost information.
A Combination of Assessments—What’s Right for You?

Despite the benefits of benchmarking, it usually is all about price, which is why KPMG rarely recommends it as a stand-alone tool. Many times, in fact, companies that invoke the benchmarking clause in their outsourcing contract do so because the relationship is in trouble. However, as we’ve discussed, price is only one part of the value equation. What about factors like service quality, service levels, innovation or organizational alignment?

That’s why ongoing benchmarking is best used as one of several periodic assessments to holistically evaluate overall operating performance. For outsourcing, these assessments can spark a forward-looking dialogue that identifies sustainable opportunities for improvement. For an internal solution, they can help determine whether the current service model is achieving its objectives and, if not, uncover the underlying causes. Assessments can range from contract reviews to relationship diagnostics and other services to ensure that sourcing engagements are truly delivering the best value for your company.

A Quick Diagnosis:

A diagnostic, or rapid assessment, is best suited for an organization that needs to focus more on the future and less on specific historical data. The diagnostic helps quickly frame the market situation and uncovers opportunities for improvement. For many companies challenged with producing near-term results, a diagnostic is an outcome-oriented project enabling forward momentum for process improvement and cost reduction projects.

A Contract Review:

If you have outsourced, you may consider a contract review to analyze the terms to ensure they’re still serving you in today’s market. For example, are the service-level methodology terms consistent with those in today’s contracts? Are there terms in your contract that are limiting the success of your outsourcing engagement?

A Health Check:

A governance diagnostic, or relationship “health check,” can help you and your provider identify, prevent and fix problems in your overall relationship. These problems may deal with service delivery, costs, reporting, misaligned expectations, trust level, culture or myriad other issues that threaten the success of the outsourcing engagement. This type of assessment can help set the foundation for a new relationship, help both parties work through a troubled relationship, or aid in uncovering opportunities for continuous improvement.
When performed correctly, benchmarking and other assessment services can help increase value in areas such as service delivery, cost savings, contractual terms and the relationship. However, given rapid changes in the market, benchmarks and assessments should not be one-time surveys of price or performance. Nor should they end with just a report. Rather, benchmarks, assessments and diagnostics are only as valuable as what you do with the findings. To get the best return, choose the right kind of assessment for your situation, and then convert your learning into a strategy for improvement.

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<tr>
<th>Business Problem or Situation</th>
<th>Suggested Approach</th>
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<tbody>
<tr>
<td>• Time pressure to reduce costs</td>
<td>Diagnostic</td>
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<tr>
<td>• Need to build an improvement roadmap</td>
<td>• Estimate three weeks or less to complete</td>
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<tr>
<td>• Looking to identify opportunities for savings</td>
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<tr>
<td>• No time or need to have specific and exact cost-to-cost comparison</td>
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<tr>
<td>• Looking for a detailed understanding of a current situation or process</td>
<td>Assessment</td>
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<tr>
<td>• Need to build a detailed improvement roadmap. Seeking specific plans and opportunities for savings or improvement</td>
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<tr>
<td>• While not looking for an exact cost-to-cost comparison, a more detailed comparison of the market and peer costs is needed</td>
<td>• Estimate three- to six weeks to complete</td>
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<tr>
<td>• Looking for a detailed cost review of a current process</td>
<td>Benchmark</td>
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<tr>
<td>• Exact cost comparison is critical</td>
<td>• Estimate six- to 12 weeks to complete</td>
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<tr>
<td>• Seeking comparison to peer performance</td>
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<td>• NOTE: benchmarks rarely include subjective assessments of a current situation or an actionable plan of improvement.</td>
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