IT Procurement Strategy

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Benchmarking

To state the obvious, price is a major consideration when procuring information technology (IT). With the passage of time, IT prices often decrease and products become more advanced. Products that are up to date at day one of the contract will likely not be current one or two years into the contract, and this can result in ongoing shipments of outdated IT products. Benchmarking is one of the various strategies for dealing with this challenge, but it is often overlooked despite its potential for yielding significant benefits. This article briefly explores this important strategy.

What is Benchmarking?

"Benchmarking allows you to compare your data with aggregated industry data from other companies who share their data. This provides valuable context, helping you to set meaningful targets, gain insight into trends occurring across your industry, and find out how you are doing compared to your competition."

Benchmarking is a useful tool that is often either unknown or under-utilized, despite being well-suited for long-term, high-dollar contracts. However, a benchmarking provision is not a substitute for undertaking traditional evaluation methodologies when evaluating the price of IT and related services and ensuring due diligence on contractual terms and conditions.

What is a Benchmarking Provision?

A benchmarking contractual provision typically formalizes a purchaser's right to have a third-party benchmarker compare the price, services, or service levels in the contract against those of other comparable suppliers. However, it is somewhat misleading to call this a 'provision' since the parameters of these rights and the related process are quite complex and are often contained in a schedule to the agreement. Additionally, supplemental agreements with the third-party benchmarkers are usually required.

Benchmarking allows an organization that has purchased IT and related services to understand the competitiveness of its purchase by providing a process for comparison. The benchmarking provision also provides a structural framework for this process, and tries to ensure that an organization is not without recourse in an arrangement where the prices are contractually set and not reflective of current market prices and the services do not deliver as anticipated.

Negotiating benchmarking in a contract can be a challenge for many reasons: suppliers like to have certainty in terms of anticipated fixed revenue for the term of the contract; a provision that decreases the supplier's revenue is not in the supplier's interest; a benchmarking process takes time, can be complex, and requires internal resources to address the procedures; and the supplier will be required to provide confidential information to a third party. However, despite these challenges, benchmarking can be a worthwhile strategy to embark upon and can improve an organization's bottom line.

What Are Some of the Considerations in a Benchmarking?

The following considerations are not exhaustive, and benchmark provisions will typically vary depending on both context and the preference of the parties.

1. Triggering Right and Timing

When a contract provides for a right to exercise its option to have benchmarking performed against suppliers in a Peer Group (discussed below), the timing parameters should be considered. Parties will need to assess a limit to the number of times benchmarking can be undertaken and decide upon a set interval between these times. This recognizes the expense and the time involved.

2. Third-Party Benchmarker

Another consideration is who will perform the benchmarking. The third-party benchmarker is typically a mutually acceptable, independent, and industry-recognized provider of benchmarking services. The supplier and purchaser will need to agree upon the required qualifications, but at a minimum the third-party benchmarker should:

- be independent;
- have demonstrated competence in performing IT benchmarks; and
- agree to maintain the confidentiality of all data, including the purchaser's data.

In terms of practicalities, this three-way arrangement should result in a tripartite agreement.

3. Peer Group

The parties to the contract need to agree on and define a Peer Group, including the number of comparison organizations to be considered (the "Peer Group"). The Peer Group should have significant related experience and meet a number of specified requirements. Depending on the industry, this Peer Group can take time to establish.

4. Costs

Given the costs for a benchmarking procedure, parties should consider and agree on the allocation of the costs incurred before the contract is signed. Additionally, the costs of benchmarking should be agreed to with the third-party benchmarker before any work commences. Cost surprises are rarely a good thing.

5. Confidentiality Agreement

Considering the confidential nature of the information required for undertaking a benchmarking exercise, it is imperative that the third-party benchmarker execute a satisfactory confidentiality agreement with both the supplier and the purchaser prior to receiving any information from the parties. In this respect, the supplier's and purchaser's interests should be firmly aligned.

6. Benchmarking Procedure

The procedures – or the how of including benchmarking – will likely require the most consideration. A benchmarking procedure should be developed and negotiated as part of the contract. As these procedures are complex and vary depending on the circumstances, it makes sense to do the heavy lifting up front. The list of procedural matters should address:

- preliminary matters such as notice, selecting and meeting with the third-party benchmarker, and related contingency plans;
- data to be used, age of the data, factors to be considered by the third-party benchmarker (geographic location, economies of scale, etc.) – if outsourced services are involved,

factors will include the service levels offered, volume of services, and a host of other factors;
- methodology (often the expertise of the third-party benchmarker can assist here);
- benchmark results and reports; and
- addressing the good faith concerns of either of the parties.

Generally speaking, the benchmarking process will be more effective if the parties treat it as a collaborative process. But every process should have its limits. For example, the supplier should not be expected to provide the benchmarker with cost data or related data.

7. Adjusting Price and Service Levels Objectives

And now, the part for which everyone who is interested in this process is waiting: once the results are in, a benchmarking provision must deal with service level objectives and price adjustments. A bigger picture consideration is whether these results and adjustments be binding or non-binding? What are the alternatives if the parties do not agree on the adjustments? If the results of the benchmarking are binding, consideration should be given to limiting these adjustments: for example, a clause can be added stipulating that there cannot be price increases. In terms of practicalities, attention should be given to how adjustments in price reductions are calculated, to the mechanics of implementing those adjustments, and to any change orders that need to be addressed.

A Few More Thoughts

Benchmarking provisions may take time to negotiate. Both skill and patience will be required to achieve a mutually satisfactory position. If a supplier is resisting the inclusion of a benchmarking provision, it may be necessary to have a shorter-term contract to allow for the re-tender after a shorter period. Unfortunately, this comes at a cost.

Even if the benchmarking clause is not exercised during the term of a contract, a benchmarking provision may provide both peace of mind and an advantage in terms of negotiating changes in the agreement with a supplier.

In order to achieve the end game in long-term contracts of best value for money, an organization should consider the inclusion of benchmarking in its next IT long-term contract and obtain the proper legal guidance before embarking on this process.

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