

Benchmarking Basics

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Most technology outsourcing arrangements are likely to involve at least some discussion in respect of benchmarking, either to consider its relevance to a particular project, or to determine its application and associated consequences.

It is an area which can give rise to contention between customers and suppliers, as it is something which is available in a variety of different 'flavours' – the trick of course is to pick one which can achieve both parties' objectives as closely as possible.

Benchmarking - What is It ?

Benchmarking in an outsourcing arrangement, can be considered to be a mechanism to measure certain parameters and then compare them against either publicly available data, or against data of other companies in a particular industry, in order to analyse how a service offering compares to the 'industry norm.'

Benchmarking – Why is it used ?

Benchmarking is often used to help an organisation either achieve better performance or value from its suppliers, or to help it assess how it is positioned to competitors operating in the same industry.

The objective of course is to fuel improvements, as benchmarking can be used to help identify which processes, costs or areas need to be addressed and why.

Business & Legal issues

So from an 'assessment' perspective, it seems an innocuous enough concept, but the difficulty arises from issues such as:

1. What is being measured and how it is being measured:
 - 1.1 If a customer has free reign to benchmark any element of a service, then this can give rise to resistance from a supplier, as it might be that a supplier is providing services in accordance with the contract, but that a particular element of the service is not being undertaken as efficiently as it could be, due to time, cost or other constraints. Benchmarking could identify this and require a resolution in circumstances where the supplier is feeling that it has done nothing wrong, as it has complied with the pre-agreed service levels or pricing arrangements.
 - 1.2 If a customer requires supplier input, co-operation or assistance in order to undertake benchmarking, then this may result in the supplier having to release or supplement resources for the purposes of the benchmarking exercise. This in itself could give rise to disruption to the existing service offering, or the supplier's other business arrangements, or it could give rise to additional costs for the supplier.
 - 1.3 If a customer can measure the relevant parameters in an objective manner without the assistance of the supplier, then that is clearly better from a

supplier perspective for the above reasons, but unless the data which is collected by the customer can be subsequently verified by the supplier by reference to data which it has also been collecting as part of the service delivery, it could result in a disagreement as to the accuracy of what has been measured.

- 1.4 If a customer is reliant upon the supplier to collect the necessary data, either because the customer does not have access to the data or the internal resources or expertise to undertake the task itself, then the customer is wholly in the supplier's hands as to the accuracy of the data which is collected.
 - 1.5 If a third party on behalf of the customer is collecting the relevant data, then this gives rise to various issues in respect of confidentiality and competitor advantage.
2. What the service offering is being compared to:
 - 2.1 Once the data has been collected from the supplier, there will be data from a range of companies against which it can be compared. However, it is not as simple as making a comparison against a competitor of the supplier, as there will be various issues which will have a bearing on the comparison, including:
 - (a) Geographic region of the different service providers;
 - (b) Whether the benchmarked elements can be isolated from other factors which would otherwise be regarded as having an effect on the parameters being compared;
 - (c) Financial standing, brand and quality of different service providers (these types of factors are particularly relevant when benchmarking parameters such as pricing).

3. What are the consequences of benchmarking:

3.1 This can be an extremely contentious area for both parties, as there is a marked difference between the results of a benchmarking exercise being used for discussion purposes as part of the ongoing relationship between the parties, as opposed to the results having an automatic consequence on the relationship between the parties, such as giving rise to:

- (a) Termination rights;
- (b) Automatic 'matching' requirements on pricing or performance.

Ways of dealing with those issues

So there are many issues which benchmarking can give rise to, but none of the issues are necessarily insurmountable.

Let us consider some ways to deal with some of the issues mentioned above:

4. Contract duration:
 - 4.1 When benchmarking discussions are to occur, it is worth both parties considering the term of the intended relationship. Typically, a longer term relationship spanning a number of years is more amenable to benchmarking than one which is to last for only a short period of time. Consequently, a supplier might use a customer's request for benchmarking to justify a longer term for the contract.
5. Pricing arrangements:
 - 5.1 If the customer has been aggressive in pricing negotiations, then a supplier may decide to resist benchmarking where this is likely to result in automatic consequences, as further curtailment of fees or a requirement to increase resources, might make the deal commercially and practically infeasible.

- 5.2 If the customer has required open book accounting with transparency as to costs and profit margins, then there is more scope to reject benchmarking, as the customer has entered into the relationship knowing fully well what the deal consists of for both parties, and the customer should not then be attempting to have an automatic arrangement for changing the parameters after the service has begun.
6. Bargaining position:
- 6.1 If the supplier is in a stronger bargaining position, then there is more scope for the supplier to simply refuse to entertain benchmarking, or to have benchmarking results to simply be used for discussion purposes as part of any normal relationship meetings.
7. Timing and frequency:
- 7.1 If benchmarking is to be accepted by both parties, then if the supplier needs to ensure that it maintains its margins for a certain minimum period of time to ensure that the transaction is commercially feasible, then it would be prudent for the supplier to either require benchmarking rights to be only available after this minimum duration, or for benchmarking to be available earlier but only with consequences which are commercially and practically acceptable to the supplier.
- 7.2 It would also be prudent for a supplier to agree to the number of times benchmarking can occur over a particular period, to prevent it becoming too much of a distraction to the supplier's service delivery obligations.
8. The parameters to be measured:
- 8.1 The parties should identify those parameters which will be subject to benchmarking, rather than introducing the uncertainty of having any aspect of a service open to benchmarking, which clear is not satisfactory from a supplier's perspective.
- 8.2 The parameters for benchmarking should be limited to those which are genuinely of interest/importance to the customer, rather than an extensive list (as it will focus both parties' minds as to what is to be involved in the exercise and what consequences will follow from the benchmarking).
- 8.3 The parameters to be measured need to be objective, with the basis for measurement needing to be agreed upfront between the parties.
9. Co-operation/assistance:
- 9.1 If the benchmarking exercise, whether by way of measurement or analysis, is going to require:
- (a) The supplier's input - then:
- (i) the degree of resource which is going to be required from the supplier should be agreed upfront and the charges for this should either be incorporated into the contract price, or it should be made clear how such assistance is going to be charged for;
- (ii) it should be made clear that any benchmarking must be conducted in a manner which does not disrupt the business operations of either party, or if disruption is unavoidable, then the parties should at the outset agree the scope and extent of disruption.
- (b) A customer appointed third party's input (eg an external auditor or consultant) – then the supplier should ensure that:
- (i) The customer should be made responsible for ensuring that the third party complies with

the relevant confidentiality obligations;

- (ii) the customer can not use a competitor of the supplier for the benchmarking exercise;
- (iii) neither the customer nor the third party can use the collected data for any purpose other than for the benchmarking exercise.

10. Comparison:

10.1 The parties need to ensure that when benchmarking is undertaken that like for like is being compared. A new start-up supplier with no financial standing and no established brand, might be offering a cheap service compared to a customer's existing supplier, but it would not be equitable to compare the two.

10.2 As far as possible, the parties should try to ensure that as many characteristics as possible between the companies match when undertaking benchmarking, or the parties should agree upfront to use certain sources for industry gathered data.

10.3 As no two companies are identical, it might be prudent to name which competitors are going to be used for comparison purposes, so that agreement at the outset avoids such issues later in the relationship.

10.4 The number of companies used for comparison purposes should also be agreed upfront if possible, to try to make the comparison representative for the benefit of both parties.

11. Consequences:

11.1 As has been mentioned above, there are various consequences which could follow from a benchmarking exercise. The parties need to consider which of these or others (or a mixture of them) to adopt, depending upon the particular parameters being measured:

- (a) Termination rights – this could be considered a harsh remedy, but it might be appropriate if it is treated as a termination for convenience right, which is available only after a certain minimum period of time, and possibly subject to any termination costs which would normally be payable on exit.
- (b) Performance/pricing match – this is likely to be contentious, as it means that the 'goalposts' are being moved, as what the parties agreed initially is being changed in a way which a supplier may not have agreed to if it knew that it had to contractually comply with such revised performance/pricing requirements. However, the parties might incorporate this either:
 - (i) As a strict matching requirement – this scenario is most likely when the customer has the stronger bargaining position;
 - (ii) A requirement to match the mean, median or mode of the statistics which have been captured;
 - (iii) By the above working both ways, so that there is some risk on the customer from the benchmarking exercise as well, because if the supplier's performance was better than the benchmarking data available for comparison purposes, then the supplier's pricing could be increased or service levels decreased.
- (c) Review meeting discussion – this is the approach which is likely to sit most comfortably with suppliers, as the parties can then discuss the findings and decide collectively what consequences are to follow from a practical perspective, to take into account resources and costs.

This type of approach is more likely to work if the parties are looking for a long term relationship, where there is the incentive on the supplier that if it co-operates with the customer, that the customer is either going to put more business its way, or the customer is likely to extend the duration of the contract.

Final Thoughts

The above illustrates why the common concept of benchmarking does require careful consideration.

Benchmarking should not be seen by a customer as an automatic requirement, but instead the business needs for it should be evaluated, and the associated consequences should be considered – in particular careful thought should be given to whether such consequences are to be unilaterally enforced on

the supplier, or whether a cooperative approach is required to ensure that both parties play the ‘long term game.’

Therefore, the balancing act from a customer’s perspective, is to ensure that benchmarking when used, helps the customer derive value from its supplier, but not at the expense of eroding goodwill between the parties.

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