pillsbury

CostMarking

Price is often a stumbling block in the negotiation of IT infrastructure services contracts. Even in a competitive situation, customers may be left wondering if they really got the right price for the scope of services or, in a "bundled" price solution, whether each major component is priced reasonably.

Pillsbury's CostMarking methodology is a proven tool for establishing a fair price based on the underlying cost of delivering the services.

The Challenge

In a competitive procurement situation for IT infrastructure services, suppliers attempt to bid the work at the highest possible price without losing to their competitors.

In a sole source transaction, the customer is always left wondering how much less they could have paid without incurring the time and expense of running a competition.

Given the significant changes in IT delivery technology and solutions that can occur during a contract term, customers often find that pricing that looked good at the beginning of
the term doesn't look so good later on.

Customers engage in these negotiations at a disadvantage because they do not have access to supplier cost models and pricing algorithms. In any case, getting to the "right price" for a complex IT services relationship can be time consuming and expensive for all involved.

Two Questions

Pillsbury believes that pricing of IT infrastructure services must address two basic questions:

For the customer

Am I paying the right price? In other words, a price that will allow the supplier to earn a reasonable margin while delivering market-competitive efficiency and quality of service.

For the supplier

Can my company make a reasonable return without being exposed to unnecessary risk? In other words, does the pricing model reflect the true requirements, risks and costs of delivering the service?

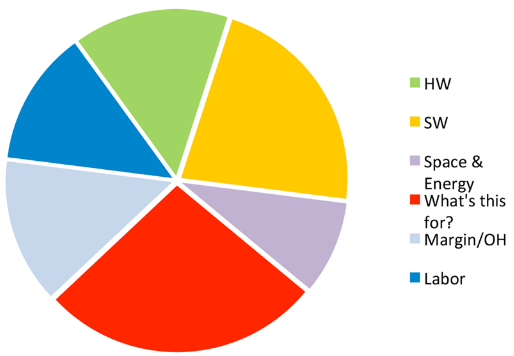
These questions are equally valid at the beginning of an outsourcing program, during mid-term reviews, and upon re-sourcing or re-negotiation at the end of a term.

Traditional market price benchmarking may provide some guidance, and is particularly useful in comparison of labor rate cards for commodity services. But for more complex services or unit of output type pricing (e.g., cost per image managed), price benchmarking often devolves into disagreements about normalization factors and comparability of results. For that reason, benchmarking exercises are typically time consuming and often result in negotiation impasses.

The Solution: CostMarking

Pillsbury's CostMarking methodology helps customers and suppliers address the two critical questions quickly and with less guesswork and contention. The methodology can be applied with equal success in competitive bidding, sole source and mid-term review situations.

Example: ITO CostMarking Analysis



Our CostMarking methodology is designed to predict the results of the pricing models used by suppliers to develop their pricing. The tool builds a set of target prices based on expected input costs, industry productivity factors and industry margins. If the supplier's prices are significantly different, the methodology allows the parties to openly discuss what the underlying root cause of the differences are in the model assumptions and address them. For example, perhaps the assumed cost of the supplier's data center space is too low given its location. If, after making reasonable adjustments the supplier's pricing remains significantly higher, the model provides a solid foundation to challenge the supplier's productivity (labor) assumptions and/or profit margins.

CostMarking has been used to obtain significantly better pricing even in a competitive situation by challenging the "sell high" desire of many suppliers. In addition, we have reviewed pricing mid-term to challenge the efficiency of the supplier's solution and challenge the supplier to reduce contract costs.

CostMarking can effectively disaggregate the bundled pricing of "all in" deals (e.g., hardware, software, hosting and services) to challenge what are typically the most subjective components of cost – labor cost, productivity and margin. This transparency allows the customer to enter pricing negotiations on more equal footing and ensures "unknown" or unaccounted-for charges are either justified or removed from the price.

About Our Global Sourcing & Technology

Transactions Practice

The team has been at the forefront of the IT outsourcing industry since its inception. Beginning in the late 1980's, we were the first law firm in the world to establish an outsourcing practice for customers of large-scale technology outsourcing arrangements.

Over the last 20 years, we have assisted many clients with a broad array of IT-related engagements, from focused transactions, such as software licensing, to complex global business transformation initiatives.

We guide clients through all phases of the sourcing life cycle, including the development of an IT delivery model and supporting sourcing strategy, conduct of the bidding and negotiation process, contracting, implementation and mid-term reviews and workouts. We also advise clients on the design and implementation of retained IT functions including vendor management, and we provide training for IT and vendor management professionals in the specific aspects of complex outsourcing transactions.

Technology Experience

Our ITO experience is comprehensive and includes:

- Infrastructure Outsourcing, including variations based on cloud computing and system virtualization
- Applications Development & Maintenance (ADM)
- SAP and ERP implementations
- SAAS, PAAS and similar service delivery frameworks
- Business Transformation agreements
- Desktop Outsourcing
- Telecommunications contracting
- Network Outsourcing

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EDUCATION SERVICES COMPANY

SITUATION

Our client faced a familiar dilemma: whether to sole-source with its incumbent provider or initiate a competitive process designed to obtain a competitive bid from the incumbent. Alternative approaches like benchmarking and reference pricing were judged to be cumbersome, time consuming, and unreflective of pricing that could be obtained through a competitive process.

ANALYSIS

CostMarking gave our client a higher degree of confidence in its assessment of the incumbent's pricing proposal without having to incur the expense, time and organizational disruption that comes with a competitive process.

OUTCOME

Our client was delighted with the results: significant cost savings and a high degree of confidence that the deal price was competitive and fair. In fact, the CostMarking estimate was only a few percentage points away from the actual deal price.

FINANCIAL SERVICES COMPANY

SITUATION

Our client was looking to consolidate facilities, improve operations and reduce costs tied to a very diverse configuration of multiple mid-tier computing and storage platforms. As a result, they were pursuing a sole source procurement as a means to determine price competitiveness with the market.

ANALYSIS

Using CostMarking, we demonstrated that the supplier had offered a fair run price, but revealed that it was attempting to harvest additional margin through overpriced transition pricing.

OUTCOME

With this information in hand, our client elected not to pursue the sourcing and continued to operate its infrastructure on its own.

FINANCIAL SERVICES HOLDING COMPANY

SITUATION

Our client, a publicly traded financial services company, was in flight with two large-scale, multi-billion dollar sourcing initiatives. The company planned to make its saving forecasts public and was seeking to confirm its projections before doing so.

ANALYSIS

CostMarking revealed that our client was using overly optimistic savings estimates that would require rates significantly below market to achieve. We were able to make several recommendations that would allow them to better mitigate risk of poor supplier performance, and help them find other areas where cost savings could more realistically be achieved.

OUTCOME

Our client was able to reach its hoped-for financial benefits without jeopardizing the sourced performance outcome. They were able to reduce costs by pursuing lower pricing on major hardware and software assets, an approach that does not run the risk of lowered performance as with labor-intensive services.

Pillsbury Winthrop Shaw Pittman LLP | 1540 Broadway | New York, NY 10036 | 877.323.4171

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