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Levers to Optimize the Sourcing Business Case

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Executive Summary

Numerous factors influence the financial business case of an information technology outsourcing (ITO) initiative, including general market conditions, competition, and service provider strategies and motivations. While those are all very real inputs to the economics of a transaction, a firm seeking to generate operating savings through sourcing must focus on the factors that it can influence or control.

There are many decision points along the procurement process that affect the final outcome. The business case reflects the aggregation of these many choices and assumptions: from building the initial requirements in the request for proposal (RFP), to collaborative solution sessions, and into final negotiations of terms and conditions. This paper highlights those decision levers to inform buyers of the choices and provide a means to optimize the business case.

Table of Contents

Introduction

The purpose of this document is to identify the primary cost drivers that influence pricing proposals from information technology outsourcing (ITO) service providers and to outline the key levers that a buyer can use to adjust the pricing outcome. Although IT infrastructure services are the reference point for some examples, many of the principles addressed in this paper also apply to managed network services (MNS) and application development and maintenance (ADM).

The paper is divided into three parts:

1. **Overview of Service Delivery Costs**: provides a basis for understanding the underlying deal cost structure
2. **Service Provider Cost Drivers**: service-related cost drivers and levers, such as scope, scale, service levels, transformation
3. **Key Terms and Conditions Affecting Price**: contractual terms and their impact on price

1. Overview of Service Delivery Costs

Traditional IT infrastructure services include the support of mainframe, servers, and print and mail services. Within the ITO services sector, these are considered mature offerings that, once transformed, are commodity services with predictable and typically declining year-over-year cost structures. As an overview of service provider costs to provide services, it is helpful to better understand both the internal client financial base case and the primary cost components of infrastructure service delivery.

1.1 Base Case

The internal client financial base case is a projection of the costs to continue to deliver the in-scope services in a business-as-usual manner. The inclusion of the base case as part of the RFP generally allows for a more efficient procurement process, provides the bidding service providers with a measure to rationalize their own cost buildup pricing model, and reduces risk to all parties through transparency of cost and underlying components of cost (e.g., staffing levels, third-party contracts, equipment inventories, etc.).

In scenarios where the services are already outsourced, the basis of the base case is the client's cost to procure services under the existing service contract. This presents both advantages and disadvantages to the client and the bidding service providers. The primary advantage is it reduces the uncertainty of full disclosure of current costs that can often be a challenge in a base case constructed from the financial data of multiple business units providing service in-house. The main disadvantage of building a base case from an outsourced service model is the lack of a detailed cost buildup by expense category (e.g., labor, hardware, software, facilities, etc.).

Although we strongly recommend releasing a base case during the RFP process, great care must be taken to ensure an appropriate level of cost detail is provided – but not too much. Existing contractual arrangements or regulatory requirements may not allow disclosure of items such as unit cost or certain labor-related information.

1.2 Primary Service Provider Cost Components

The infrastructure services service provider cost structure is composed of the same major spend categories as the internal financial base case: labor, software, and hardware. Each of these spend categories are influenced by a number of factors that impact the total cost to deliver services and ultimately the total price to the client:

- Labor
  - Generally, service providers are able to take advantage of productivity, process, and standardization efficiencies to improve support ratios and drive down the number of full time equivalents (FTEs) annually.
  - Productivity improvements are offset to some degree by the inflationary effect of labor costs.
- Software
  - Software maintenance costs generally increase slightly year over year, as they are labor-intensive and subject to inflationary impacts.
- Hardware
  - Although hardware maintenance is labor-based as well, it is managed more efficiently through footprint reductions associated with virtualization and the price performance trend of both hardware and hardware maintenance year over year (i.e., the cost of hardware computing power declines significantly each year).

Exclusive of volume changes, these cost dynamics impact the direction of the charges on an annual basis over time in the following manner:

		Annual Cost Impact Trends	
Tower	**Charge**	**Increase**	**Decrease**
Mainframe	Bundled service charge (labor/hw/sw)	Labor inflation, software, power	Productivity, hardware unit cost
Server	Support excluding hw	Labor inflation, software, power	Productivity
Server	Server hardware	N/A	Hardware unit cost, virtualization
Server	Bundled storage charge (labor, hw/sw)	Software, labor inflation	Hardware unit cost
Network	Services excluding carrier	Labor inflation	Productivity, hardware unit cost

Network	Carrier charges	N/A	Bandwidth and voice
EUC	Support excluding hw	Labor inflation	Productivity
EUC	Hardware	N/A	Hardware unit cost
Service Desk	Bundled (labor/hw/sw)	Labor inflation, software	Productivity
Applications	Support and tools	Labor inflation	Productivity

From a functional service tower perspective, the ratio of fixed to variable costs can also have a significant impact on the business case, depending upon anticipated volume consumption trends:

- **Mainframe and bulk print and mail**
  - Mainframe systems are generally very reliable, but the underlying fixed nature of the equipment and software that is designed for high throughput means high volumes of processing must be maintained to stay price-competitive. The production environment for bulk print and mail has a high fixed cost and low incremental variable unit rate.
- **Server**
  - Server environment hardware and software price points are lower and more variable than mainframe, but the labor component tends to make up a greater percentage of total cost as the number of servers supported per person (support ratio) can be low in a diverse environment supporting multiple platforms.

As a result of these cost structure dynamics, if consumption volumes increase annually across the board, the mainframe and print and mail costs will remain relatively flat while server spend will increase sharply.

The other contributing cost factors that a service provider must address in delivering service are data center LAN expenditures, tape and other consumables, third-party service contracts providing ancillary services such as off-site tape storage and disaster recovery services, and data center facility expenses. In addition, power and cooling consumption within raised floor data centers can drive significant costs in today's environment. Similar to server hardware spend, these environmental costs are another cost category that service providers can address through efficient use of server virtualization technologies.

2. Service Provider Cost Drivers

There are a number of factors that impact the service provider cost model. This section examines the factors that most heavily influence pricing proposals. In addition, it describes the main cost control levers available to the client and the service provider to adjust the pricing model.

2.1 Scope and Scale

2.1.1. Description

The scope and scale of work influence the value proposition that a service provider can deliver to a client. Scope refers to the types of work activities that the service provider is bidding on and is typically described in the Statements of Work (SOW). Scale refers to the volumes of work activities the service provider will assume and is documented in the resource baseline volume attachment in the RFP, as well as the various RFP appendices that more fully describe the current environment. A service provider can generally maximize the value proposition in a transaction that has a narrow, focused, well-defined scope of work in a large-scale volume setting. This combination of tight scope that limits risk exposure with the economies of scale in a high-volume transaction allows the service provider to drive down unit cost and minimize contingencies built into the pricing model.

As a part of this scope and scale dynamic, it is important to recognize the incentives that drive the behavior of the service provider pursuit executive. Pursuit teams are incented to maximize revenue, and delivery teams are incented to maximize profit margins. The pursuit executive will always push for more scope and scale and try to convince the client of the economic benefits. No one would disagree that scale provides a greater financial return for all parties, but broader scope with a single service provider may not necessarily benefit the client's business case.

2.1.2. Pricing Levers

The most significant cost driver that will influence overall price is the scope and scale of the services being provided. In most cases the scope issue is not one of necessity but rather determining the most efficient way to provide the service and by whom. The identification of the demarcation points is an evolutionary process that begins in the RFP construction phase. A sourcing advisory firm can assist on where to draw the line on services to source through a discussion of objectives and an understanding of capabilities, both internal and in the marketplace. The market response to an RFP will begin the process of determining if the scope of services as described in the SOW is best provided by the responding service providers or if the client should consider alternative sourcing options.

Clients typically will enter an RFP process with an all-in approach and later remove pieces that are found to be inefficient. The items listed below are areas of scope that are commonly reviewed and adjusted throughout the sourcing process to determine optimal delivery models.

The following are common to most sourcing initiatives:

- **Service unit volumes**
  - In general, clients should seek to maximize unit volumes to allow service providers to take advantage of economies of scale.
  - Although there may be good reasons to exclude certain volumes (e.g., regions, business units) from the RFP, assumptions should be tested internally and with the service providers to identify efficiencies.
- **Size of the project pool**
  - The client should work with the service providers throughout the process to determine the service and price impact of adjusting size and composition of resources in the project pool.

- **Asset/contract ownership**
  - Service providers are likely to propose potential cost savings opportunities available to the client by retaining ownership of select assets and/or third party contracts through elimination of service provider overhead and margin.
- **Financial and contract administration**
  - Areas may exist within chargeback and third-party contract administration that could be provided at a discount internally.
- **Other areas for consideration**
  - Security and background checks
  - Disaster recovery planning and testing

The following are specific to server sourcing initiatives:

- **Server monitoring**
  - The client should test price sensitivity of adjusting requirements in the RFP to determine the cost benefit of the minimum monitoring baseline requirements.
- **Remote servers and database administration**
  - Some business units may have the ability to leverage existing resources to provide an improved service at a lower cost than a service provider.
  - An internal shared services organization could be developed to provide select services to the participating business units.
- **Network services**
  - The client network organization may be able to offer a more compelling value proposition than service providers in some server transactions.

2.2 Service Levels

2.2.1. Description

The design and engineering of the service provider solution are driven by the prescribed service levels of the agreement. Higher levels of service may require upgraded or redundant infrastructure, increased testing, or more support staff. Additionally, service providers tend to price a risk premium for ensuring a level of quality via service levels. It is important for the client to understand its own reasoning behind choosing specific metrics, targets, and calculation methods. This reasoning typically is a desire to maintain current or better performance but also may be driven by specific internal or external customer requirements.

One of the primary objectives of the solution team negotiations is to determine the sensitivity of service level adjustments on the quality of service and pricing.

2.2.2. Pricing Levers

Service level pricing levers may be divided into two categories: service quality level and methodology-related.

2.2.2.1. Service Quality Levers

The following are examples of service-related items to consider when attempting to influence cost. Note that as stated above, the reasoning for selecting metrics and targets should be well understood before making adjustments, and levers should only be moved if the customer understands the change and accepts the service impact.

- **Infrastructure availability, system performance**
  - Server, network, and other infrastructure availability are most often increased via investments in new or redundant equipment, increased support staffing, or more testing – all of which have a direct effect on cost.
  - Even maintaining current service in an out-of-date environment may require one-time investments.
- **Response time, resolution time**
  - Response time and resolution time can be increased through improved support processes and tools (which should be part of the standard proposal in a new outsourcing arrangement) but primarily will occur through increased staffing.
  - Levers to adjust include both the time itself (in hours or days) and the percentage target at which those time windows are hit successfully (e.g., 90%, 95%).
  - Additionally, some clients consider setting up shared support arrangements such that several providers may share local staff onsite for minor fixes.
- **Collapsing or disaggregating service tiers or delivery locations**
  - Clients may group applications or systems in performance categories (e.g., Gold, Silver, Bronze); additionally, locations such as central hosting facilities typically expect higher performance than remote branch office data closets.
  - Consolidating tiers into single metrics has positives and negatives, and each situation is different; clients should consider the impacts on customer expectations for transparency, pass/fail rates for individual or aggregated metrics, and the variability in the underlying data before making these adjustments.
- **Process-oriented metrics (e.g., configuration management database accuracy, report delivery, project management performance)**
  - A service provider typically will bring its own tools and processes when entering a new environment; in fact, this is often a significant reason a client may be considering outsourcing: to dramatically improve processes and reporting.
  - It is not necessarily appropriate to “baseline” the current environment performance in process metrics because the process should be replaced.
  - Process and performance quality metrics should be almost entirely in the service provider’s control following transition (and in limited cases, some transformation).
  - In solution negotiations, the client should seek to understand which process areas would really require additional service provider staff to improve, and therefore what adjustments may be made to affect cost.

2.2.2.2. Methodology Levers

The following levers are common features of the service level management methodology recommended by outsourcing advisory firms. Key components of the methodology allow the client to maintain a level of management control to make tweaks based on changes in focus or customer requirements. They also encourage the service provider to take on appropriate risk to deliver quality and continuously improve services.

- **Number of service level metrics with credits associated**
  - The more metrics with credits, the more likely a service provider is to miss one.
  - A client should associate credits with only a subset of its total count of service level metrics.
- **Number of critical deliverables or holdbacks**
  - A client should associate credits with certain one-time or periodical obligations (such as transition gates, periodic disaster recovery tests, etc.), but should keep these limited and focused on the most critical items.
- **Invoice amount at risk**
  - The total amount of monthly credits is typically capped by a total "at risk amount"; additionally, this number may be oversubscribed via a "multiplier," which increases the amount that can be applied to individual metrics.
  - Both the at-risk amount and the multiplier should be industry standard to maintain an efficient price point.
- **Other levers affecting the service level risk contingency**
  - Notice period for changes
  - Co-dependency and service provider excuse
  - Documented history of performance

2.3 Transition and Degree of Transformation

2.3.1. Description

Service providers have dedicated teams that specialize in the transition of services from the client's current solution, either in-house or already outsourced, to the new service provider delivery team. Transition services generally include all human resource activities to put the service delivery team in place, including "re-badging" existing service delivery personnel, relocating service provider staff, and recruiting and hiring new employees and contractors. In addition, transition services include all the preparation activities to ensure "Day 1 Readiness". These activities include knowledge capture of the existing service delivery processes and procedures, establishing and documenting the new processes and procedures, as well as legal, financial, and procurement activities to ensure that the necessary assets, contracts, and tools are in place to deliver services. Transition services are typically a small percentage of the total contract value.

In contrast to transition, transformation services can be a significant cost driver depending upon the degree and complexity of transformation built into the solution. Transformation is defined as a fundamental change in the service delivery model designed to provide a more consistent, efficient delivery of service by taking advantage of the latest advancements in technology and process. Clients expect to see a return on investment from transformation (e.g., lower unit costs of service delivery). Not all transactions include

transformation, although most commercial clients in the market today are at a minimum looking to take advantage of labor arbitrage available in offshore delivery transformations. Historically, many outsourcing engagements were established merely as a cost savings initiative under a "same mess for less" model with no transformation.

Client requirements for transition and transformation often exceed the current operating environment and can create an incremental layer of cost.

2.3.2. Pricing Levers

2.3.2.1. Transition

A number of factors will influence the cost (and success) of the service provider transition, including the following:

- **Assumption of Existing Service Delivery Staff**
  - Whether a service provider is required (or simply allowed) to assume client staff, how long they are committed, and terms of transfer, such as continuing benefits obligations, can all significantly affect price. Clients should work closely with their internal human resources departments to understand firm commitments, regulatory issues, union contractual obligations, and management strategy for treating personnel before establishing such requirements in an RFP and while negotiating them with service providers.
  - From a pure transition cost perspective, as well as for general risk mitigation, the greater number of existing service delivery personnel that transition to the new service provider the better. The recruiting and hiring of new personnel is an expensive endeavor that requires time and dedicated resources. Each service provider will try to optimize the blend of existing and new delivery staff for both service and cost purposes. As critical as making the right decision in terms of number of offers is the identification of key personnel and ensuring those individuals are incentivized to continue delivering service.
  - A potentially significant cost driver is the assumption of carry-forward of years of service as the staff transitions from in-house or from one service provider to another. Service providers may want to transition staff to reduce upfront risk but may ultimately transform the delivery team with a more leveraged model and will have to factor the severance cost into the model.
  - Although related to ongoing service delivery charges rather than transition, another personnel-related cost driver typically built into the Base Charges is the assumption of degree of turnover in dedicated delivery staff. This is another reason service providers try to maximize the units of work that can be provided by leveraged resources.
- **Knowledge Capture**
  - Knowledge capture is the process of understanding and documenting the existing service delivery processes and procedures that will allow the new service provider to assume delivery of service in a non-disruptive manner. The scope (and cost) of this upfront effort will be determined by the:
    - Number of existing service delivery staff that transition to the new service provider
    - Breadth and quality of the existing documentation
    - Assessment of knowledge capture risk that the service provider will make as part of due diligence

- Degree and timing of change in service delivery models; for example, a print and mail service provider who plans to immediately begin leveraging its own print facility may not choose to invest in as thorough a knowledge capture process as another service provider who plans to continue delivering service using the existing staff, facility, and processes.

2.3.2.2. Transformation

When strategizing about what to source, clients should analyze and document which tasks represent transformation from the current environment. If the changes are needed, they should be included in the RFP, even if (and within reason) the anticipated cost may be excessive. The true cost will not be known until service providers are engaged.

The negotiations process must be structured to allow solution and finance teams to distill what aspects of transformation are driving service provider price and weigh whether the cost is worth the value. Value may be measured in terms of a simple cost/benefit proposition (e.g., investing in server consolidation now may save operational cost later), or there may be customer or regulatory requirements for change (e.g., legislation requiring additional security or compliance for financial services firms).

Market pressures from a competitive procurement along with service provider innovation and financial engineering of the initial investments help to contain the price upfront.

- **Consolidation**
  - The primary transformation initiative in infrastructure services is server and storage consolidation. This consolidation typically involves a platform and technology consolidation as well as a data center footprint consolidation. There are several pricing levers to consider in these initiatives.
  - The consolidation of the server and server storage environments from legacy data centers and remote locations into a centrally managed center(s) provides both short and long-term benefits to the client, including:
    - Greater standardization of platforms and utilization of equipment
    - More efficient management and administration of systems and facilities
    - Enhanced physical and logical security
    - Improved disaster recovery and business continuity programs
    - Reduction in footprint of client facilities housing IT equipment
  - From a pure cost perspective, existing operating environments often run lean and attempt to balance risk, customer satisfaction, and labor efficiencies. The status quo cost structure leverages legacy investments but eventually requires a capital infusion to avoid operational disruption. Although there are real costs incurred by the business units (hard costs and soft opportunity costs) as a result of a low-investment current operating model, the backlog of required investments will be visible cost inputs in the outsourcing contracts and may require the client to make selective decisions related to the overall affordability of transformation.
  - Another factor affecting the total cost of consolidation in the business case is the role and responsibility accepted by the participating business units. This element will present itself in two primary ways:
    - Service provider pricing will be impacted by the degree of participation required of the business units to enable consolidation (e.g., data gathering, planning sessions, willingness

to standardize, approval of plans, commitment to plans, remediation responsibilities, user testing, etc.).
    - The business case will also need to capture the level of anticipated application remediation the client will need to invest in separate from the service provider direct cost.

- **Redundancy**
  - Another significant driver of change is a move toward increased (or in some cases, decreased) redundancy.
  - Many clients come to the realization – often through a serious incident – that their disaster recovery capabilities are inadequate. These issues can drive consolidation, purchase of new or redundant hardware or circuits, and significant process, documentation, and testing changes. Although the cost of this transformation is easily quantifiable based on the service provider's charges, calculating the benefit of risk avoidance is difficult. Before engaging in an RFP process toward these types of changes, clients should have a view of the value of a more reliable environment as well as the budget for change.
  - In some cases, clients seek ways to save money via outsourcing and realize they have historically overinvested in staff or equipment for the required levels of service. This can drive a transformation toward a reduction in redundancy, but it may actually require a large one-time investment to accomplish, perhaps via change to a more efficient solution, write-off of existing assets, or buyout of legacy contracts or employee obligations.

2.4 Service Provider Leverage Opportunities

2.4.1. Description

All service providers capable of competing for large contracts have talented and highly trained personnel, well established processes, and the latest in productivity tools that are used to deliver services on a number of successful engagements. The key ingredient that allows service providers to offer these services at an attractive price and maintain an acceptable profit margin is leverage. The more service providers are able to leverage their people, processes, and tools, the better the economics become for both sides of the transaction. This is especially true with IT infrastructure deals. Even in a conservative scenario where the client seeks 10% savings and the service provider seeks a 10% pre-tax profit margin, the service provider must eliminate 19% of the existing costs to deliver on these expectations. This has become a high hurdle to clear in the commoditized world of IT infrastructure.

The core elements available to the service provider to generate savings are:

- Year-over-year productivity gains that improve support ratios and drive down headcount
- Implementing best-practice delivery models, including leveraged onshore and offshore resources
- Leveraging tools and process investments across a broad client base
- Eliminating duplicate spend by consolidating facilities, technologies, third-party contracts, and support teams

- Reduced specialization and increased purchasing power through adherence to standards and common platforms

- Exploiting the fixed costs of the service provider to take advantage of shared facilities, resource centers, and third-party contracts

2.4.2. Pricing Levers

It is in the client's best interest to take advantage of leverage opportunities that service providers have to offer. Clients may have real legal, contractual, or regulatory concerns preventing use of shared tools, processes, and people, but it is wise to challenge internal assumptions and aggressively explore solutions other businesses have implemented. It is worthwhile to share the reasoning behind such requirements with service providers during the RFP process and to allow them to propose market-based or other creative solutions that might operate amidst the restrictions. The more options available to the service provider, the more efficiently it can price the solution.

Service providers are eager to discuss all potential leverage opportunities, including:

- **Service delivery locations**
  - Use of service provider facilities in-state and out-of-state
  - Remote staff
    - Out-of-state
    - Nearshore or offshore for select non-customer facing roles
  - Leverage the client facilities to support other provider business
  - Sharing systems, cloud computing
- **Expanding scope/scale to leverage overhead**
  - Pull in all currently excluded service volumes
  - Bundle service components
- **Standardization wherever possible**
  - Choose common email, database, and ID management platforms
  - Limit options of server architecture
  - Aggressive remediation to take advantage of virtual technologies

2.5 Governance, Administration, and Standards

2.5.1. Description

One of the most influential factors affecting the size of the risk premium that the service provider will include in the charges is the perceived effectiveness of the client governance program. The level of administrative requirements of the service provider to provide services to the client will contribute to the overall cost. This includes customer account management, reporting, billing and chargeback, and the general overhead and expectation of the service provider for items such as governance meeting participation, process for approvals, dispute management, and solution request requirements.

2.5.2. Pricing Levers

- **Commitment to Governance Authority**
  - Service providers will seek clarity and transparency of the governance model, including decision making authority, approval rights, and enforcement of decisions from a central governing body to the participating business units.
  - The brighter these lines are and the more they become documented in the agreement with consequences if not adhered to, the more comfortable service providers will get with reducing the risk contingency.
    - Note: Although not passed on to the client in the form of savings, service provider margins generally improve over the term of the engagement as a result of "value leakage": the erosion of client governance that allows service providers to generate highly profitable revenue through change control and new services. While this potential issue is not evident in most sourcing business cases, requirements should be included in RFPs to reduce the likelihood and impact of value leakage. Clients need to maintain a strong governance organization and manage the contract well to fully maximize these benefits over the term.
- **Cross Functional Efficiencies**
  - Clients should be receptive as service providers seek to automate as many user interactions as possible, including service desk, procurement, and billing by taking advantage of systems within a portal environment.
  - There may be opportunities to leverage common tools and processes among the client and other service providers to drive down total cost.
  - Opportunities may exist to leverage existing tools and processes to capitalize on investments the client has already made in the enterprise approach to service delivery.
- **Technology Architecture and Standards**
  - Common hardware and software platforms will lead to improved support ratios and speed to deploy.
  - Common hardware procurement will lead to improved volume discounts.
  - Technology currency can be a price point lever, but the opportunities may be limited depending upon the existing refresh cycles.

3. Key Terms and Conditions Affecting Price

Terms and conditions that allocate risk to the service provider cause them to rationally price that risk. To the extent that the client can limit service provider risk, it should expect to drive more favorable pricing. A key component of any negotiation strategy is to identify pricing impacts and pricing trades that may result from removal or modification of terms and conditions of service delivery. For example, the number and frequency of benchmarking studies required and the potential consequences for the service provider (based on the results of any benchmark study) are typical pricing trades in final negotiations.

3.1 Transaction Structure

Category	Price Sensitivity Impact
➢ Term	➢ Service provider incented to book higher Total Contract Value (TCV) ➢ > 5-year term should translate to more aggressive pricing and longer amortization on transition and transformation charges ➢ Extension of term may be vital to securing a cost-neutral start; many outsourcing transactions generate savings over the term but have incremental costs in the initial period
➢ Consents	➢ Service provider may negotiate a cap on undisclosed consents or propose right to replace existing license with comparable license
➢ Services, New Services and Projects	➢ Service providers always try to limit scope of services definition and expand project pool work activities ➢ Service providers will push for definition of "materially" different services and "material" level of effort to reduce risk exposure

3.2 Pricing

Category	Price Sensitivity Impact
➢ Payment Terms	➢ Service provider may propose billing in advance for base charges and in arrears for variable charges for more efficient pricing
➢ Inflation	➢ Service provider will push for either escalating annual caps or sharing above defined threshold
➢ Pass-through Markup	➢ More efficient to agree upon percentage than have service provider bake in assumed procurement and administrative support charges
➢ Minimum Revenue Commitment	➢ Service provider will want to negotiate a threshold on annual charges that would trigger an equitable adjustment to pricing ➢ May be able to negotiate more aggressive pricing and more cost certainty through wider bands with this provision
➢ Resource Unit Bands	➢ Service provider will negotiate for tight bands (>25%) to reduce risk of volume-reduction impact on profitability and preserve revenue
➢ True-up Provisions	➢ Transactions that include data gaps that present financial risk to the service provider include true-up provisions to reduce risk ➢ Lack of visibility into inventories, asset valuations, and third-party contract terms and conditions drive the need for true-up provisions that prevent service provider from loading in risk contingencies ➢ Introduces risk to client of price uncertainty

3.3 Other Terms and Conditions

Category	Price Sensitivity Impact
➢ Benchmarking	➢ Frequency and level of adjustment can drive price
➢ Most Favored Customer	➢ Minimal, although typically linked with negotiation of benchmarking terms as a trade-off
➢ Limitation of Liability	➢ An indirect impact on price, typically impacts the range of price reduction in the final round of negotiations
➢ Disputes	➢ Withholding of disputed amounts subject to maximum limit or amounts above limit placed in escrow ➢ Shorten timeframe for dispute resolution
➢ Termination	➢ For convenience, recovery of wind-down charges generally accepted without recovery of lost profits ➢ Service provider will negotiate to recover partial wind-down recovery in other termination events (excluding for cause)

4. Summary

There are many potential cost-driving elements affecting the service provider pricing proposal and many opportunities throughout the procurement process to better understand and address the issues to maximize the value proposition to the client.

Starting with strategizing about what to source, then through building an RFP and finally into negotiations, it is important to bear in mind the ultimate objectives for sourcing and the internal reasons or value for certain requirements. The competitive bidding process should ultimately identify an efficient, market-based price for delivery of those requirements. The negotiation strategy must allow the solution, legal, and finance teams to carefully distill pricing elements and to re-check them against the perceived business value.

When a sourcing strategy is carefully planned and executed, clients are often surprised by the quality improvements that creative and experienced service providers can deliver within the budget.

Document Revision 2013-10-21: Update to company name and contact info.

Integris Applied is an experienced advisory firm dedicated to facilitating complex service relationships where each of the parties' competing and collaborative business objectives are identified, honored, and achieved – both in the short-term and long-term. We expand on traditional sourcing advisory services frameworks as we work with both buyers and sellers by providing mediation support, coaching, and mentoring of executive and operational leaders as well as assisting in the development of sustainable healthy relationship governance competencies.

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