Benchmarking

Benchmarking costs against the suppliers' competitors is a recognised method of avoiding cost 'creep' and ensuring best value.

Benchmarking should be undertaken prior to and throughout the life of the contract. It can be used for:

- ensuring incumbent suppliers remain competitive in the market
- keeping abreast of the market rates
- a negotiation tool for cost reductions

Step One – What to benchmark

Open or close

Decide which spend category(s) you wish to perform the benchmarking exercise for.

1. Complete a spend analysis on what you have purchased in that area for at least the last 12 months (by line item)
2. Sort the data from the highest to lowest spend (cumulative)
3. Highlight the top 80 percent of the spend

This 80 percent will normally be no more than 20 percent of the number of line items. You now have a manageable amount of data to go out into the market place with.

This does not cover every aspect of the potential scope of supply. In certain circumstances additional items may need to be added, such as bottle-neck and specialised items. The aim is to gain an estimation of the market rates.

The incumbent supplier should be made aware that you are planning to perform a benchmarking exercise before you go out to the market place.

Step Two – Going to the market

Open or close

Having selected the items you want to benchmark, you can now approach the market to understand the current prevailing costs.

Benchmarking is generally an informal process and the Management Information Hub is a good source of information, as is the internet. You can also contact a number of suppliers directly. However it is important to ensure that these suppliers who receive requests for information understand that you are conducting a benchmarking exercise and that this is not a business opportunity. The request should be simple enough for the suppliers to provide the information without having to spend a great deal of time doing so.

Step Three – Results analysis

Open or close

You are now ready to compare the results of your benchmarking exercise. To compare the results you could, for example, enter all prices into a spreadsheet and determine the price difference between the incumbent supplier's prices and the prevailing market rates. By doing this you can determine where the incumbent supplier(s) sit against the best, worst and average market rates.

Step Four – What next?

Open or close

If you are happy with where the incumbent supplier’s pricing sits then the supplier is competitive and no further action needs be taken.

If you are not comfortable with where the incumbent supplier’s pricing fits, invite them to a meeting. Give them the opportunity to explain why they are not competitive against the current market rates. On no account should you divulge the competitors' names or pricing information.

If the supplier is willing to accept their prices are not in line with the market rate, this will be a relatively pain free cost reduction for you. If the supplier is unwilling to negotiate a reduction, you should initiate the escalation process. Include this as an agenda item at the next Review Meeting.

Where benchmarking indicates that a supplier’s pricing is not aligned with prevailing market rates, this presents an opportunity to seek a cost adjustment in a transparent and constructive manner. Where the supplier is open to this discussion, an agreed price realignment may be achieved with minimal disruption. Where agreement cannot be reached, you may be able to work with the supplier in some way to reach an agreed price realignment, using methods such as open book costing , for example.

If price realignment cannot be achieved, the matter may be be progressed in line with the contract’s escalation and governance arrangements and tabled as an agenda item at the next scheduled contract review meeting.