

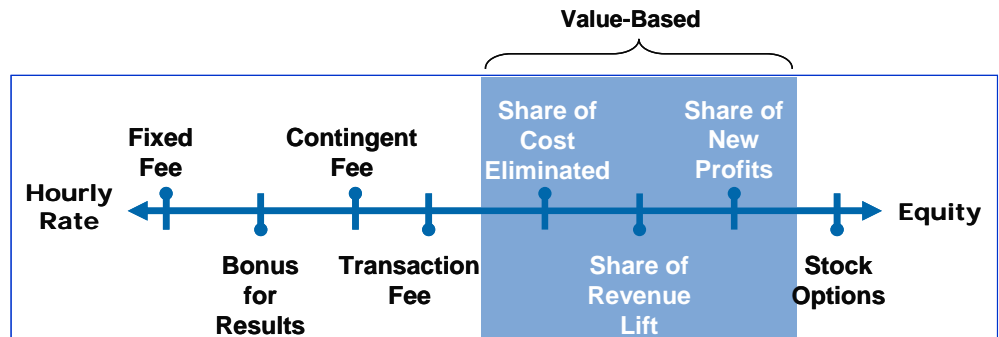
# When It Comes to ERP Services, You Get *How* You Pay For

## How Value-Based Fee Models Drive Client Success in ERP Engagements

### The Ascent of Value-Based Billing

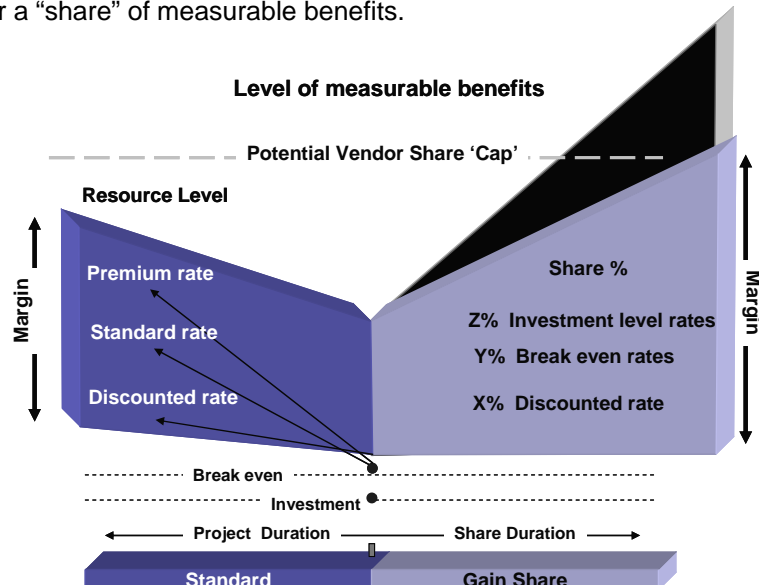
For years, clients of service providers have argued the advantages and disadvantages of various fee models. Some prefer the perceived predictable costs of a fixed fee. Others argue that fixed fee merely provides predictably higher costs than time and expenses. And over the past ten years, we have seen a rise in mixed fee engagements (see below) and a growing trend toward value-based billing.

Consider the spectrum of ways in which service providers are remunerated.



The most common arrangements are those to the left of the spectrum. Moving across the spectrum, clients and service providers are more and more in a true partnership. When value-based fee models are applied, measurement is a necessity as service providers are paid according to the measurable value brought to the client as a result of an engagement.

In a gain sharing arrangement, the systems integrator will reduce consulting fees in exchange for a "share" of measurable benefits.





The pivot point around the share percentage is the level of discount afforded as systems integrators may reduce rates to below a break-even and, as such, are making an investment. In such a case, a share percentage will be higher and/or the duration of benefit sharing will be longer.

In every lengthy ERP consulting engagement, additional potential benefit (not included in the project plan) is identified, usually in the course of business process design. Project scope may be altered in order to gain these additional benefits, thus extending budgets and deadlines. In standard fee arrangements, the consulting compulsion is to set this scope aside for a subsequent, perhaps add-on, project phase. In a gain-sharing arrangement, the compulsion may well be to include the benefit, and subsequent scope, into the existing engagement. In such a situation, project management is compelled to master potential scope explosion.

Arguments about value-based billing have been even more heated than the general debate over fee models as both clients and systems integrators often claim that value-based billing or gain-sharing models are too complex, too cumbersome, and just plain don't work. And, as most arguments go, both sides have, to date, mostly anecdotal evidence to offer. That includes this writer who for years has been able to cite a number of successful value-based ERP engagements but tends to get shouted down when extolling the virtues of the model. So it fell on Performance Monitor to follow the CSI model and go to what cannot lie: the evidence.

### **ERP Fee Model Comparisons**

In a recent Performance Monitor study of 2,004 ERP engagements of leading ERP systems integrators, findings reveal that engagement patterns and outcomes vary according to the fee model that was applied. Respondents reported upon four standard pricing models applied by ERP systems integrators:

- Fixed fee, by which a predetermined global fee is applied and which may or may not include expenses. Clients opting for fixed fee seek to reduce cost risk and place a greater responsibility on the systems integrators for results. As a consequence, they tend to take a lesser level of client ownership.
- Time and Materials, by which a budget is established and a systems integrator bills time at a daily or hourly rate as well as expenses as incurred.
- Mixed fee engagements tend to include time & expenses for client-dependent phases (e.g. design) and fixed fee for vendor-dependent phases (e.g. configuration) as a way of reducing risk with a balanced time and cost adherence mindset.
- Value-based, such as gain sharing or benefits sharing. Clients opting for value-based fees reduce risk by paying lower rates in return for a percentage of measurable financial gains. Such clients are more motivated to gain measurable benefits than to simply adhere to time and cost. This model requires a high level of client ownership.



Our 2,004 ERP clients reported three levels of goals attained with their systems integrator: Fell Short, Met, or Exceeded. We compare the results of projects for each pricing model when it comes to exceeding targeted goals and 1,773 of our respondents told us the following:

ERP Goals Exceeded by Pricing Method					
Goals Studied	Overall	Fixed Fee	Time & Expenses	Mixed Fee	Value Based
<b>Number of Respondents</b> <i>(differs by goal)</i>	1773	539	477	717	84
Streamline financial mgmt/performance	35%	34% L	36%	37%	52% H
Improve business process	36%	34% L	35%	38%	49% H
Reduce other business costs	28%	29%	32%	25% L	47% H
Consolidate or replace IT systems	34%	33% L	36%	33%	46% H
Meet regulatory requirements	30%	31%	34%	28% L	45% H
Increase revenue	28%	31%	28%	26% L	45% H
Reduce production costs	29%	29%	33%	27% L	44% H
Reduce supplier costs	29%	30%	33%	27% L	41% H
Implement scalable, adaptable systems	32%	35%	33%	31% L	36% H
Reduce IT costs	29%	31%	32%	28% L	34% H

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While only five (5%) of all engagements used a value-based fee model, client expectations regarding goals have been exceeded more often in such engagements for all ten goals.

The most dramatic difference is found in “reduce other business costs” where this goal is exceeded 47% of the time compared to an overall average of 28%. There were only two goals in which the difference was less than 10%, those being ‘reduce IT costs’ and ‘implement scalable adaptable systems’. All others exceeded the group average by at least twelve percent.

Another intriguing view of contrasting results by fee model is how clients rated their systems integrator across twelve performance criteria:

- ### Performance Criteria and Definitions
- Vision (understood and enhanced our project vision)
  - Project Delivery (fulfilled project requirements)
  - Timely Delivery (delivered the project on or ahead of schedule)
  - Agility (adapted to changing project conditions)
  - Industry Focus (applied industry best practices)
  - End-User Training (trained our end-users for post-go-live)
  - Post-Implementation Planning (readied the organization for post-go-live)
  - Knowledge Transfer (prepared us to operate and improve the systems)
  - Methodology & Tools (applied proven methods and tools)
  - Reporting (provided means to generate appropriate reports)
  - Measurement (provided means for business performance measurement)
  - Partnering (worked well with the software vendor)

Scoring was on a scale of 1=Low to 10=High.

### Performance Criteria by Pricing Method (Full Data Base)

Performance Criteria	Fixed Fee	Time & Expenses	Mixed Fee	Value Based
<b>Number of Projects</b>	<b>539</b>	<b>477</b>	<b>717</b>	<b>84</b>
<b>Vision</b>	<b>7.13</b>	<b>7.05 L</b>	<b>7.13</b>	<b>7.43 H</b>
<b>Project Delivery</b>	<b>7.22</b>	<b>7.05 L</b>	<b>7.23</b>	<b>7.24 H</b>
<b>Timely Delivery</b>	<b>7.12</b>	<b>6.95 L</b>	<b>7.08</b>	<b>7.23 H</b>
<b>Agility</b>	<b>7.09</b>	<b>6.92 L</b>	<b>6.99</b>	<b>7.20 H</b>
<b>Industry Focus</b>	<b>7.04</b>	<b>6.97 L</b>	<b>7.07</b>	<b>7.38 H</b>
<b>End-User Training</b>	<b>7.14</b>	<b>6.93 L</b>	<b>7.03</b>	<b>7.22 H</b>
<b>Post-Implementation Training</b>	<b>7.05 L</b>	<b>7.07</b>	<b>7.06</b>	<b>7.15 H</b>
<b>Knowledge Transfer</b>	<b>7.21</b>	<b>7.07 L</b>	<b>7.11</b>	<b>7.35 H</b>
<b>Methodology &amp; Tools</b>	<b>7.30</b>	<b>7.31</b>	<b>7.24 L</b>	<b>7.58 H</b>
<b>Reporting</b>	<b>7.20 H</b>	<b>7.12 L</b>	<b>7.12 L</b>	<b>7.13</b>
<b>Measurement</b>	<b>7.05</b>	<b>6.98 L</b>	<b>7.00</b>	<b>7.33 H</b>
<b>Partnering</b>	<b>7.25</b>	<b>7.13 L</b>	<b>7.19</b>	<b>7.51 H</b>
<b>Overall Performance</b>	<b>7.18</b>	<b>7.09 L</b>	<b>7.20</b>	<b>7.35 H</b>

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Again, the results are conclusive as clients with value-based engagements report higher performance criteria scores for 11 of 12 criteria.

The one criterion where scores are not higher for value-based engagements is Reporting, which scores highest for fixed fee engagements.

Many of the differences are negligible (for example, there was scarcely a difference in scores for project delivery amongst all four fee models) but it is nonetheless clear that systems integrators' provision of value-based engagements yields better performance ratings, most especially when compared to time & expenses arrangements.

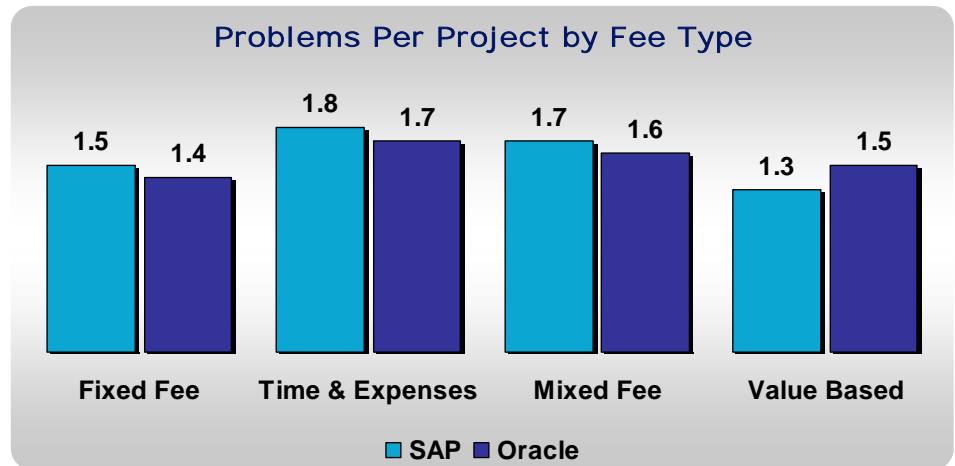
Want more?

Clients were asked to identify the types of problems that arose in the course of their engagement.

These included:

- Business benefits not realized
- Cultural/geographic differences caused friction, quality erosion, and/or delays
- Did not meet compliance goals or regulation requirements
- Insufficient post-implementation planning
- Insufficient project process, structure, and/or resource mgt
- Lack of client ownership of project
- Lack of product/technology expertise
- Personnel not up to expected levels of expertise
- Results did not meet our expectations
- Results were over-engineered and difficult to use/maintain
- Scope poorly managed
- Service provider was not knowledgeable of our business
- There were hidden costs

Using just the SAP and Oracle data, we tested problem incidence across the various fee models:



#### Key results for SAP:

- Fixed Fee engagements had the highest citation of no problems (44%) with value-based engagements second (38%).
- Value-based engagements had the lowest average number of problems per engagement (1.3 compared to a group average of 1.6).
- There was not a single citation of 'Scope Poorly Managed' in value-based engagements and seven of the thirteen problems were cited least often for this fee model than for the others.
- The time & expense model reflected the highest problem per engagement (1.8) and the highest citation frequency for eight of the thirteen problems.

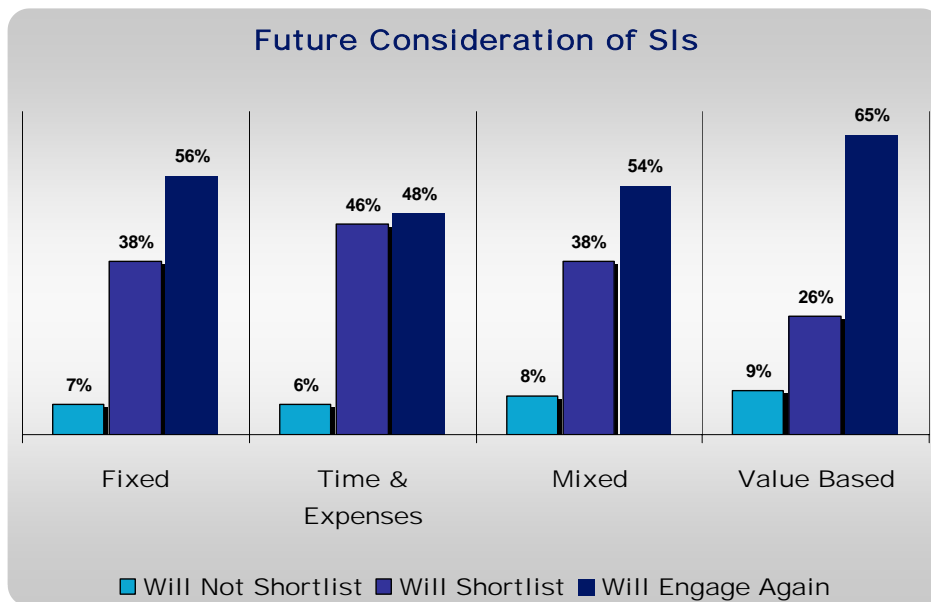
#### Key results for Oracle:

- Only 1 of 30 clients (3%) using value-based billing cited 'Scope Poor Managed' as opposed to a group average of 13%.
- Time & Expenses engagements had the highest citation of six of the problems.
- Clients opting for fixed fee are seeking predictable cost, lower exposure to risk, and less client ownership in the course of an engagement. Fixed fee engagements experience problems related to lack of client ownership than projects with other pricing methods.

## Coming Back for More ERP

While performance criteria, problem management, and goal attainment are all crucial elements ... one “proof-point” regarding an ERP engagement is the future consideration that a client will accord its systems integrator. Clients with a subsequent ERP engagement within the coming 24 months reported what status they would confer.

As the graph below illustrates, clients operating in a value-based agreement reflect the highest outright engagement of all fee models with a slightly higher incidence of not being short-listed.



It should be noted that a shortlisted systems integrator, as an incumbent, has roughly a 50%-50% chance of client retention. Therefore, outright re-engagement is a strong goal of systems integrators.

## Systems Integrator Fee Models

Clients seeking engagements with leading systems integrators should take note of the fee models that have been applied. While there are some differences between the SAP and Oracle practices, general trends can be identified.

The three providers who work under value-based pricing arrangements more so than the other firms are Accenture, Capgemini, and IBM. CSC tends to use mixed fee pricing more frequently than any other firm, and Deloitte and IBM are more likely to work on a fixed fee arrangement.

**Application of Fee Models by Provider**

<b>Mixed Fee</b>	<b>CSC uses this pricing model quite a bit more than the others</b>
<b>Fixed Fee</b>	<b>Deloitte and IBM have the heaviest mix of fixed fee projects</b>
<b>Time &amp; Expenses</b>	<b>Deloitte, Accenture, and HP use this method more frequently</b>
<b>Value Based</b>	<b>Accenture, Capgemini, and IBM are more likely to use value based billing</b>

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Both BearingPoint (Enterprise Value Creation) and Deloitte (Enterprise Value Mapping) have value-drivers, but these have not been applied with great frequency on their Oracle engagements.

## Conclusion

The results presented here are not limited to ERP engagements. In another recent study completed by Performance Monitor, 864 clients of leading application development and maintenance (ADM) providers reflected similar findings. In our research based on input by 709 clients of leading CRM systems integrators, performance scores were highest and problem incidence the lowest for CRM engagements using the fixed fee model but goal attainment and future consideration results favored value-based engagements.

The foundational key to value-based billing is the ability to measure a client's current performance (i.e. pre-engagement). The next step is to establish measurement of economic and performance gains brought by the engagement. This much should be done for every engagement, whether or not the fee model is value-based.

While gain-sharing and value-based concepts have been around for a number of years, the impediment to their application has been the persistent inability of clients and consultants to reliably measure the benefits derived from a consulting engagement. Myriad IT projects that were initially launched as gain-sharing ventures foundered mid-stream under the burden of unwieldy project and client accounting; such engagements invariably reverted to classic time & expenses arrangements.

Measurement is hard and not all clients are up to task (nor are all system integrators, for that matter). Countless clients have complained that they already have too many key performance indicators. Others claim that the task of measuring their current performance is too daunting. One even said, "The fact is, we don't want to know."

Many clients resist the step of measuring current performance prior to launching implementation on the premise that they already know intrinsically that ERP will be better than legacy and so skip the step of self-measurement. As such, they later join the vast crowd that cites failure to measure as a crucial implementation mistake. Like when the CEO turns to the CIO and says, "Hey, just what benefit did we get from that mega-million dollar project?"

All the same, value-based fee models aren't for everybody. In the real world of business, management is often called upon to just plain not mess things up. In that light, we also did a comparison of fee models to determine which is the safest; that is, which of them results in the fewest citations of falling short of goals.

According to the full data base, the safest way to go if you are seeking cost reductions is with a fixed fee model, which has the lowest incidence of falling short for three of the four cost-reduction goals and is tied with value-based models for the fourth.

If, however, your higher priority goals are related to overhauling IT systems and adapting business processes, the value-based model may be the best way to go as it results in the lowest citation of falling short for three of five such goals.

The results are more varied as value-based projects show the highest incidence of falling short of goal for consolidation or replacement of IT systems and meeting regulatory requirements, while still having a somewhat significantly better record than other fee arrangements for improving business process and streamlining financial management/performance.

In the main, both value-based and fixed fee models appear to be relatively "safer" than time & expenses and mixed fee.



While fee models can make a difference on your engagement outcomes, our data also tells us that one in five clients cite “hidden costs” as an engagement problem. Since this is only cited 8% of the time for value-based engagements, it is clearly too high for engagements using the other fee models.

More than any other factor, the high costs associated with ERP drove the subject of IT into the boardroom. As such, ERP clients require greater evidence of the value derived from ERP investments. To meet a heightened demand for visible ROI, most leading ERP systems integrators have vastly improved their performance measurement methods & tools but they report a persistent client resistance to the deployment of these tools in a value-based scenario.

Hopefully, the direct experience 2,004 ERP clients (and especially those smart clients who ponied up for value-based fees) will enable others to give stronger consideration to value-based fee models for ERP engagements. Think of it as “you get *how* you pay for”.

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