



**institute for  
supply management**

Session Code: GE  
**SERVICE CONTRACTS –  
WHAT IS THE RIGHT PRICE?**

Clark Terrill, C.P.M.

Manager Procurement and Contract Services

The J. Paul Getty Trust

Tuesday, May 6, 2008

2:30 p.m. – 3:30 p.m.

# Clark Terrill, C.P.M.

Clark has been an educator and lecturer in procurement for over 28 years. He is a Past-President of NAPM-Los Angeles and has earned the Lifetime C.P.M. professional designation.

In April 2007, Clark joined the J. Paul Getty Trust as Manager, Procurement and Contract Services. The Trust is an international cultural, educational, and philanthropic organization focused on the visual arts. Responsibilities include supporting its four programs— J. Paul Getty Museum, Getty Research Institute, Getty Conservation Institute, and Getty Foundation.

Clark was previously the Manager of Corporate Purchasing for American Honda Motor Co., Inc. His staff of 13 buyers had responsibility for approximately \$1 Billion in spend nationwide.

Previously, Clark was a Purchasing Consultant at American Express. He conducted diagnostic analyses of corporate purchasing systems and assessed how organizations might increase their efficiency and effectiveness.

Clark spent most of his professional life at American Airlines, where he rose to the position of Western Division Manager of Purchasing and Contract Administration. His geographical area of responsibility ranged from Denver to Honolulu, and all of Canada.

Clark was a featured speaker in the Purchasing Executive Program at The Anderson Graduate School of Management at UCLA. He is the author and presenter of the groundbreaking series entitled “The Advantage System.” He has developed and conducted numerous seminars in cost savings, p-cards, negotiations, service contracts and supplier diversity. In addition, he has been a featured speaker at numerous MWBE events, trade fairs and organization meetings. He has also been a speaker at ISM affiliate meetings, the 2006 and 2007 ISM International Conferences and the April 2007 ISM Satellite Seminar.

# Service Contracts


**Over the past several years, purchasing departments have increasingly moved from strictly procuring goods to the tasks associated with procuring services.**

**We go through our process to select a service provider, draft a contract, write a statement of work, and manage the service agreement.**

**What is the right price?**

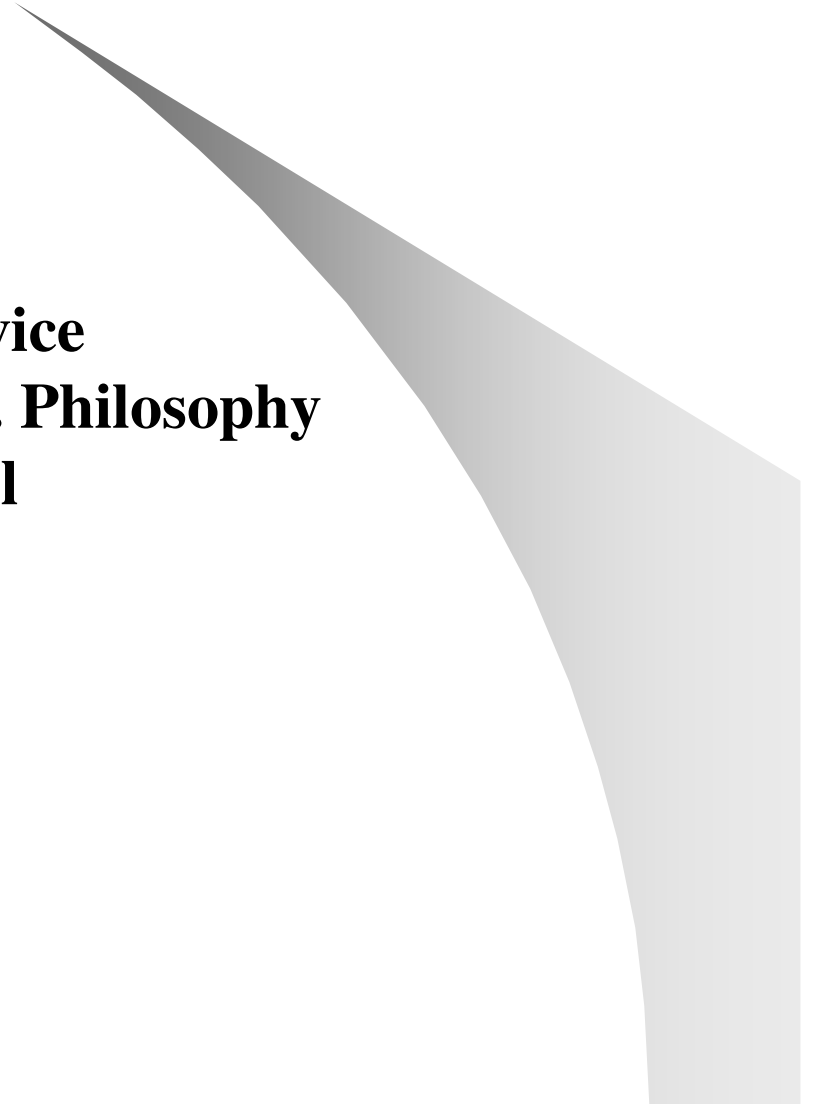
# Service Contracts

## **Similarities to Purchasing Hard Goods:**

- **Follows a traditional sourcing purchasing process**
  - **Leverages supply and demand of the market**
  - **Requires both sourcing experts and organizational subject matter experts**
  - **Requires a solid contract with specific deliverables**
  - **Requires regular reassessment of contracts**
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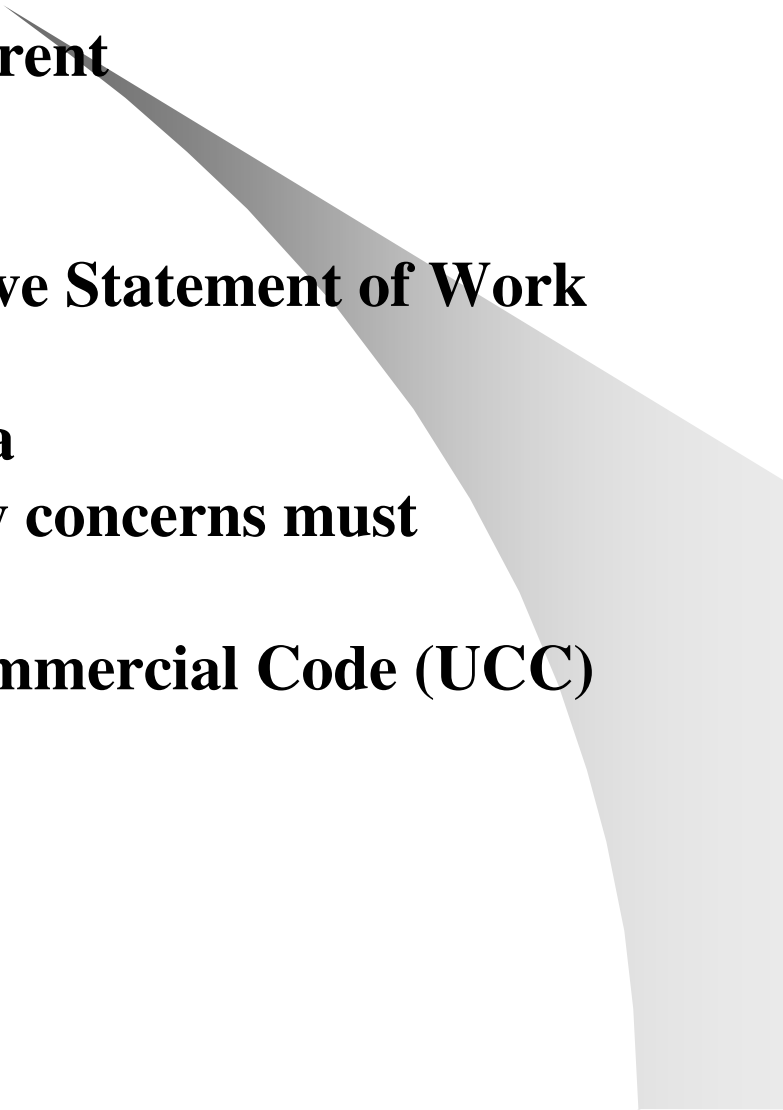
# Service Contracts

<b>S</b>	<b>=</b>	<b>Safety</b>
<b>Q</b>	<b>=</b>	<b>Quality</b>
<b>C</b>	<b>=</b>	<b>Cost</b>
<b>D</b>	<b>=</b>	<b>Delivery / Service</b>
<b>M</b>	<b>=</b>	<b>Service Mgmt. Philosophy</b>
<b>E</b>	<b>=</b>	<b>Environmental</b>
<b>F</b>	<b>=</b>	<b>Financial</b>



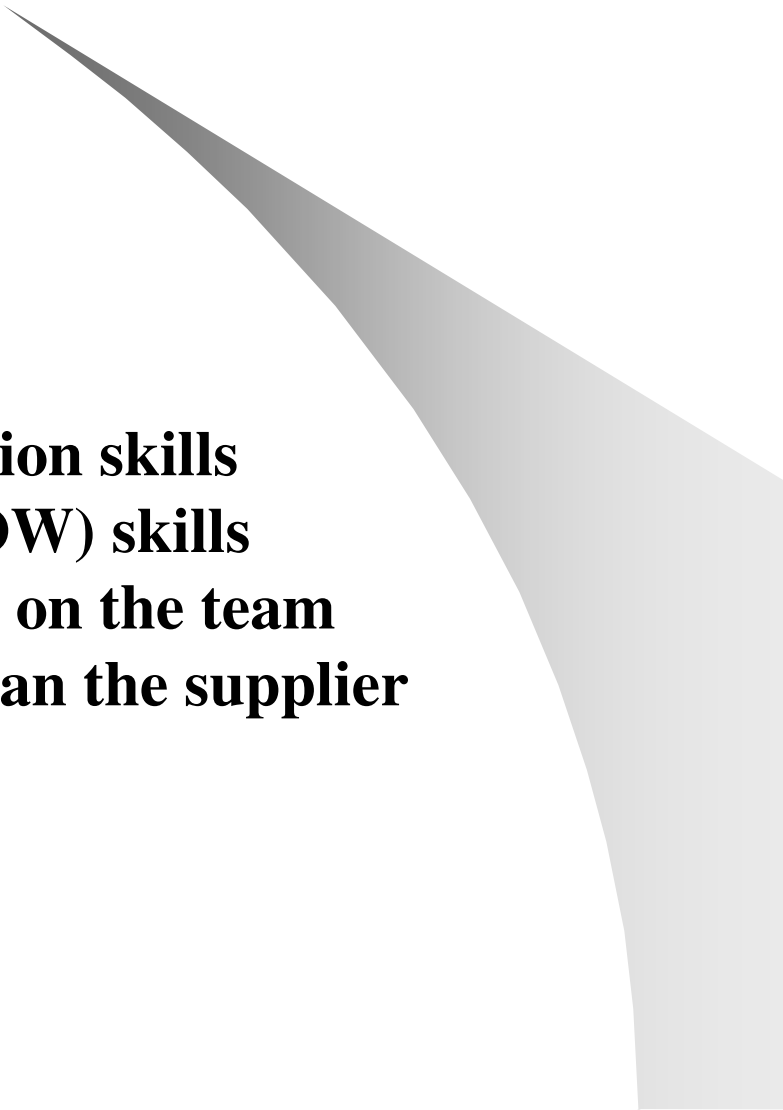
# Service Contracts

**Ways that buying services is different from buying hard goods:**

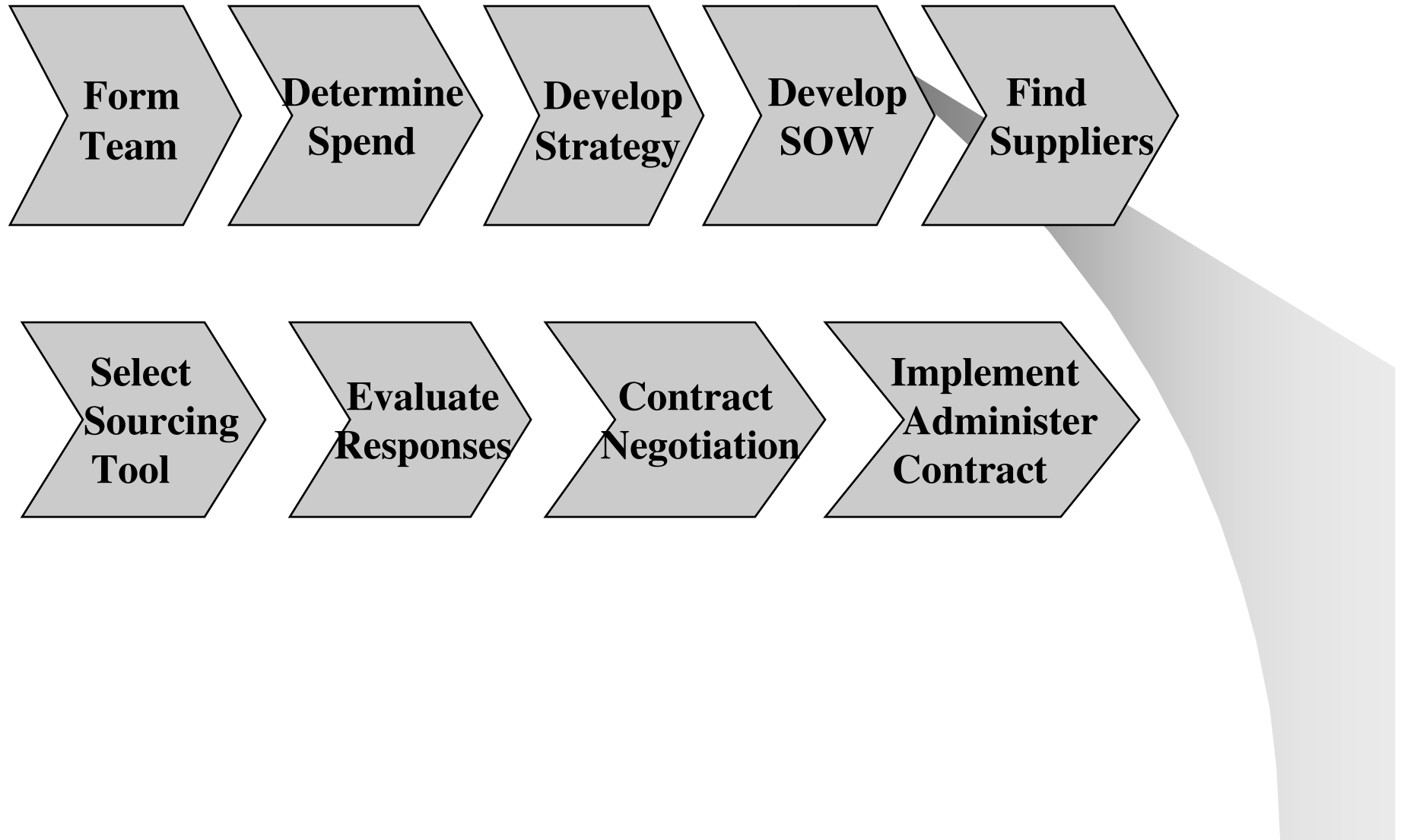
- **Difficult to write a comprehensive Statement of Work**
  - **Bad service is not “returnable.”**
  - **More subjective decision criteria**
  - **Background checks and security concerns must be addressed.**
  - **Not covered by the Uniform Commercial Code (UCC)**
- 

# Service Contracts

## **Service Buyers Need:**

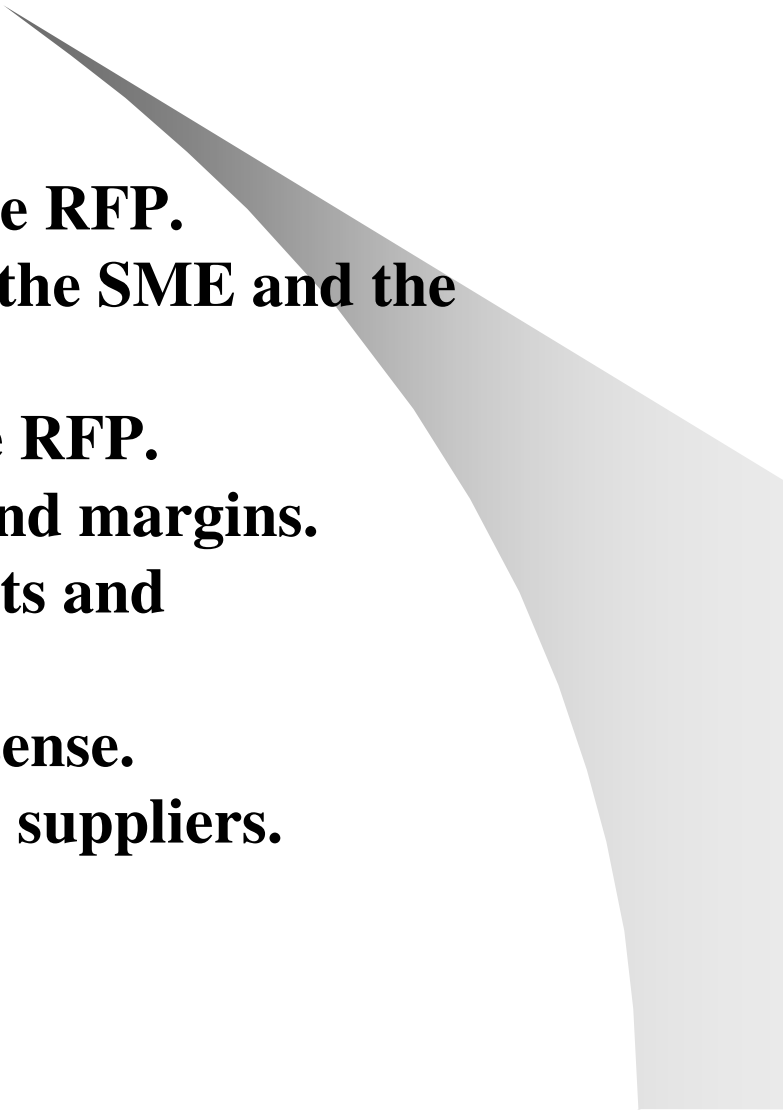
- **Analytical skills**
  - **Negotiation skills**
  - **Project management skills**
  - **Verbal and written communication skills**
  - **Detailed Statement of Work (SOW) skills**
  - **A Subject Matter Expert (SME) on the team  
knows as much or more than the supplier**
- 

# Service Contracts Process



# Service Contracts

## **Other Process Considerations:**

- **Include ALL requirements in the RFP.**
  - **Determine scoring criteria with the SME and the user department.**
  - **Include contract language in the RFP.**
  - **Understand suppliers' pricing and margins.**
  - **Understand volume commitments and consequences.**
  - **Use technology where it makes sense.**
  - **Develop a process to “weed out” suppliers.**
- 

# Service Contracts

## Sources of Information

- **The Internet**
  - **Purchasing Groups**
  - **Functional Colleagues Inside and Outside of Your Industry**
  - **Trade Associations**
  - **Government Agencies**
  - **Ex-employees of Supplier Firms**
  - **Incumbent Suppliers**
  - **Trade Journals**
  - **Small Business Directories**
- 

# Service Contracts

**The Pursuit of Value:**

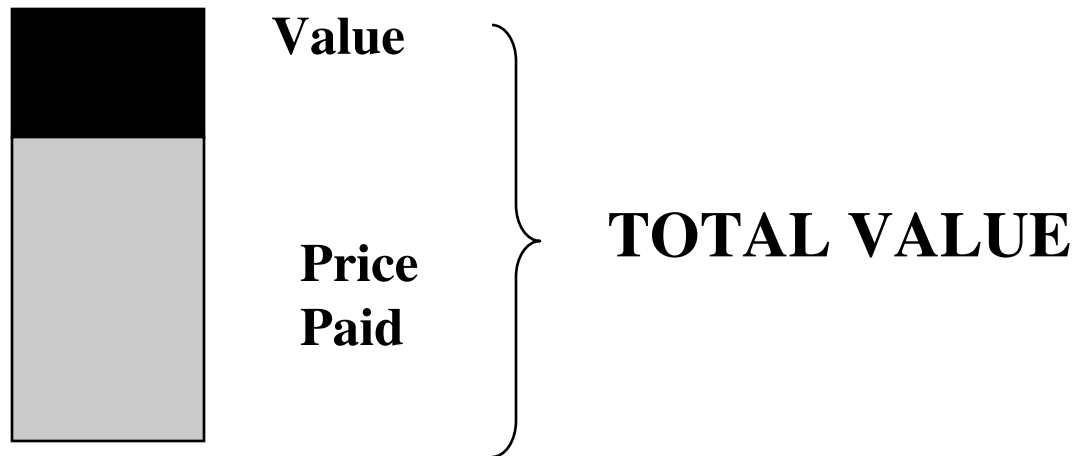
**The ultimate objective is to maximize the value of each professional service dollar that is spent.**



# Service Contracts

## Value Orientation

We buy services based on a combination of price and the intrinsic value (What you get) the Service provides us.

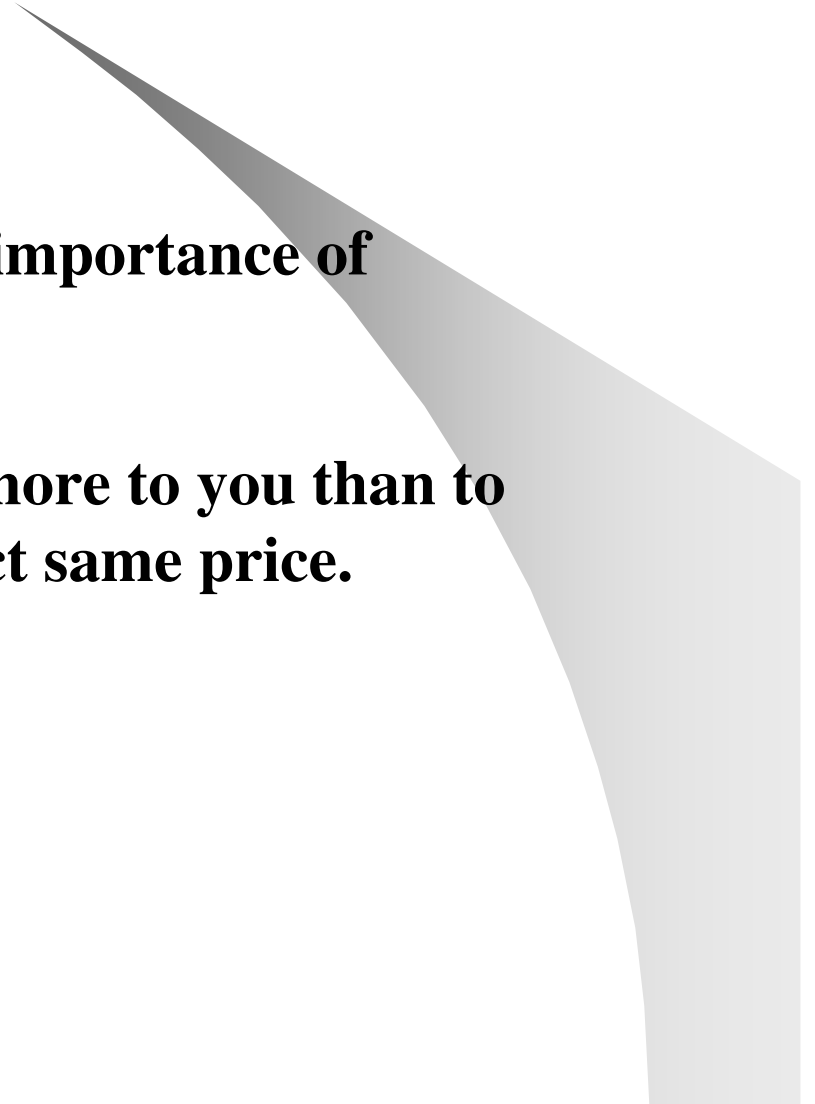


# Service Contracts

## **Value Decomposition:**

**As buyers, each of us weighs the importance of intrinsic components differently.**

**The same service may be worth more to you than to me, even though we paid the exact same price.**



# Service Contracts

## **Intrinsic Value Components:**

- **Reputation of the Firm**
- **Location of Supplier**
- **Service Received During Sale**
- **Ease of Purchase**
- **Customer Support After Sale**
- **Quality of the Individual**
- **Supplier Diversity**
- **Political or Community Considerations**
- **Others**

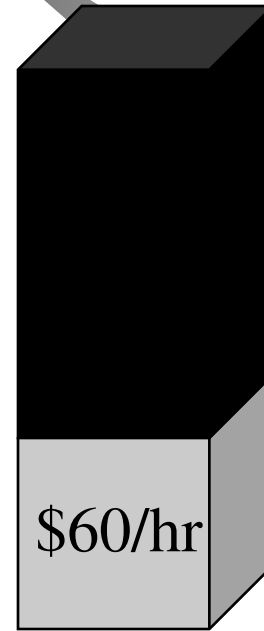
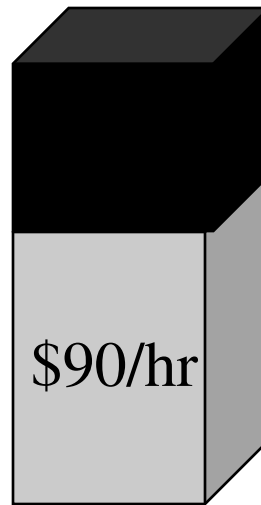
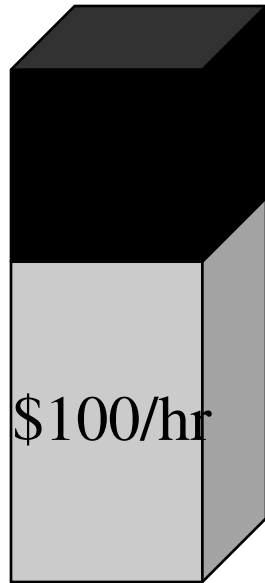


# Service Contracts

**The Value Equation:**

**Total  
Value**

**Price  
Paid**



**A**

**B**

**C**

# Service Contracts

**Three “mathematical” ways to get more from the value equation:**

**1.**

**Strategy: Increase “What You Get” while keeping “What You Pay” constant.**

**Negotiate to receive additional goods & services at no additional cost.**

# Service Contracts

**Three “mathematical” ways to get more from the value equation:**

**2.**

**Sourcing: Keep “What You Get” constant and reduce “What You Pay”**

**This is the traditional sourcing approach. Get the same for less.**

# Service Contracts

**Three “mathematical” ways to get more from the value equation:**

**3.**

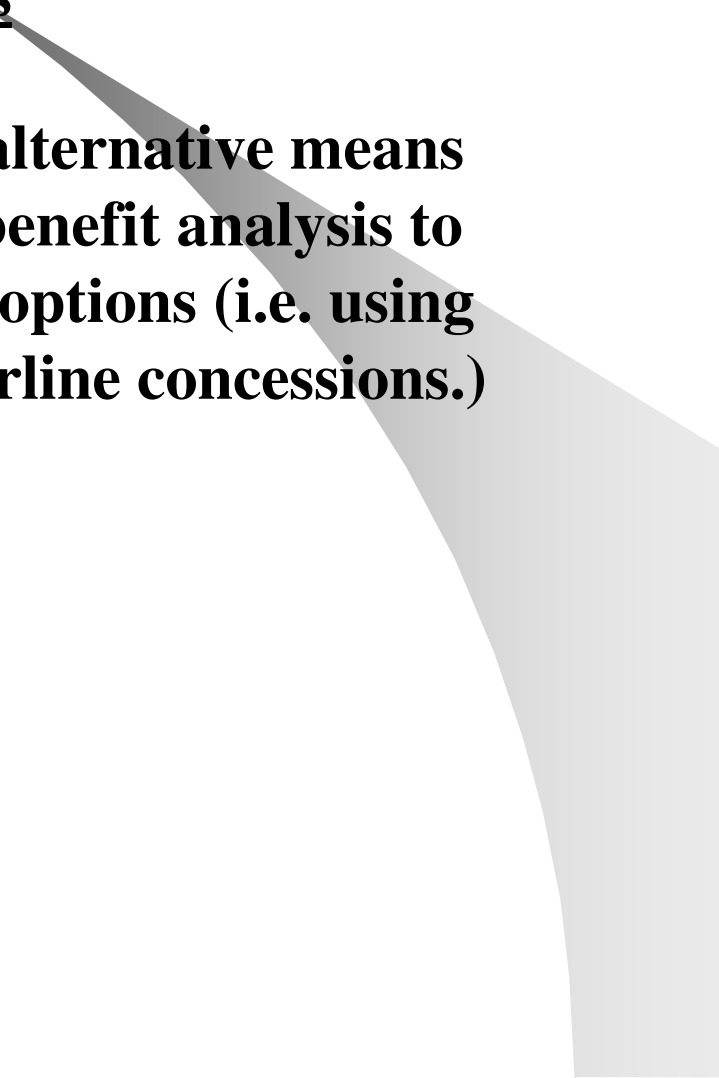
**Grow Wisely: Increase “What You Get” at a more rapid pace than “What You Pay” for it.**

**Over time, prices tend to rise. If you pay 3% more, get 4%+ more.**

# Service Contracts

## Define the Terms

**Strategic substitution – identifying alternative means to desired ends or performing cost benefit analysis to determine the relative value among options (i.e. using videoconferencing vs. negotiating airline concessions.)**



# **Service Contracts**


## **Service Contracts Pricing and Evaluation**

**What is the right price?**



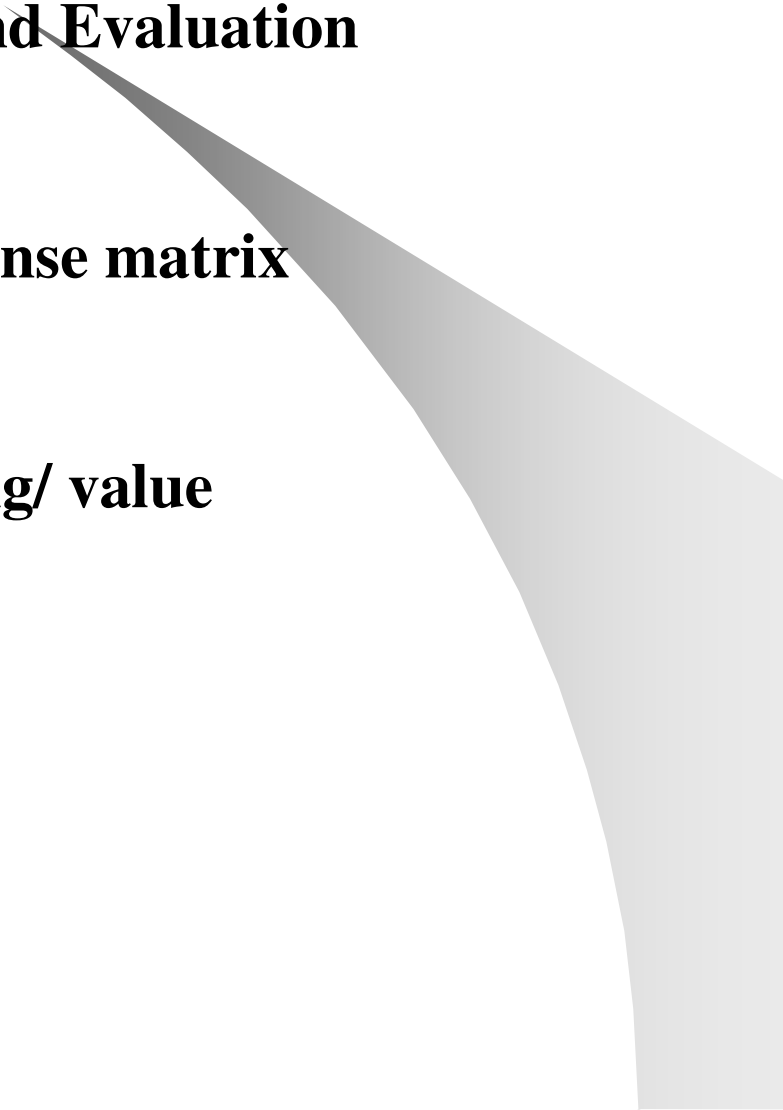
# Service Contracts

## Service Contracts Pricing and Evaluation

- **Price components breakdown**
  - **Develop templates for what you buy**
  - **Use of RFI to define specs and cost components**
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# Service Contracts

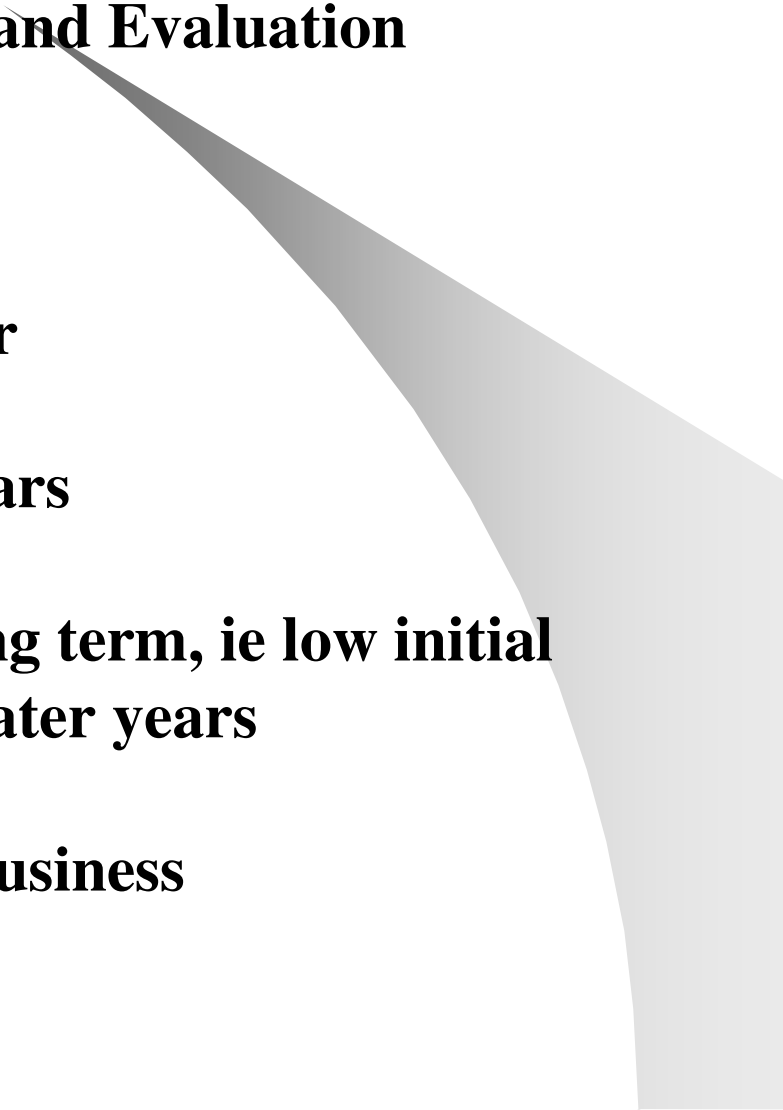
## Service Contracts Pricing and Evaluation

- **Decision Making and bidder response matrix**
  - **Benchmarking for standard pricing/ value**
  - **Value of longer terms contracts**
- 

# Service Contracts

## Service Contracts Pricing and Evaluation

**Value of longer terms contracts:**

- **Don't have to touch each year**
  - **Amortize costs over multi-years**
  - **Visibility to cost increases long term, ie low initial price - high maintenance later years**
  - **Value to suppliers of stable business**
- 

# Service Contracts

## Service Contracts Pricing and Evaluation

- **Overtime rate myth**
- **Cost Savings Methodology**
- **Negotiate each component. Just like parts of a supply chain or analysis of goods pricing .**

**Change the shape of the table**

**Mark Up vs Direct Labor ratio**

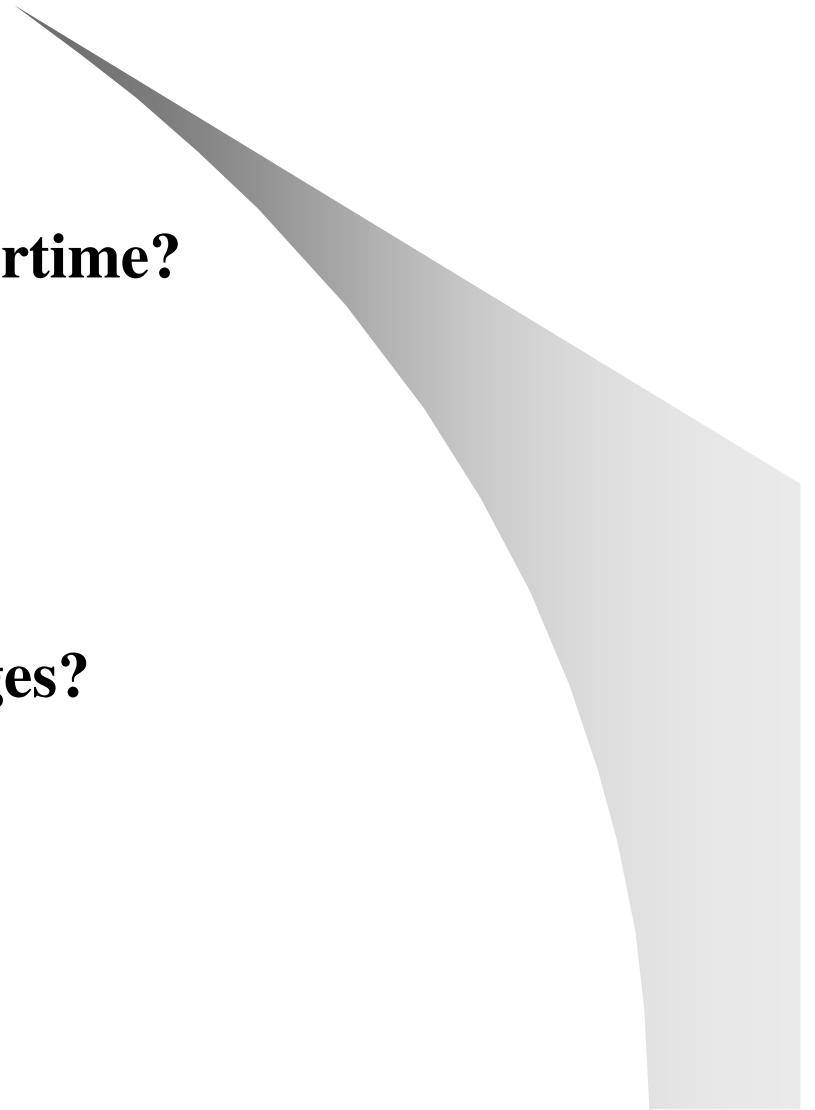
# Service Contracts

**Overtime pay might be 1.5 times.**

**What is the Billable Rate for Overtime?**

**Is it 1.5 as well?**

**Are all costs 1.5 more or just wages?**



# Service Contracts

## Service Contracts Pricing and Evaluation

- **Overtime rate myth**
- **Cost Savings Methodology**
- **Negotiate each component. Just like parts of a supply chain or analysis of goods pricing .**

**“Change the shape of the table”**

**Mark Up vs Direct Labor ratio**

# Service Contracts

## Mark Up vs Direct Labor Ratio

**Contracts are priced as a percentage of Direct Labor. (DL)  
DL is what the employee is paid.**

**Result: the higher the DL, the lower the mark up.**

**Percentage of Direct Labor (DL): 66.5%**

**\$12.50 wage divided by .665 = \$18.80 Billable rate**

**Mark up Percentage = 50.4%**

**\$12.50 x 50.4% = \$6.30 + \$12.50 = \$18.80**

# Service Contracts

**The lower the percentage of DL, the more expensive it is for you.**

**Three bids, in percent of DL**

**Company A: 64.98%**

**Company B: 66.66%**

**Company C: 68%; successful bidder**

# Service Contracts

	Percent		Percent							
<b>Revenue</b>	Wage		Revenue							
Company/ Division		6,456,000.00	80.1%							
Company/ Division		1,600,000.00	19.9%							
<b>Total</b>	158.7%	<b>8,056,000.00</b>	<b>100.0%</b>							
Direct Labor	63.00%	5,075,280.00	100.0%							
Holiday Premium (6@4hrs.)	1.15%	58,365.72	0.7%							
Sick Days (6)	2.31%	117,238.97	1.5%							
Non Sched OT	3.00%	152,258.40	1.9%							
Vacation (80 hrs.)	3.85%	195,398.28	2.4%							
<b>Total Direct Labor</b>		<b>5,598,541.37</b>	69.5%							
FICA	7.65%	428,288.41	5.3%							
FUTA	0.80%	44,788.33	0.6%							
SUI	3.50%	195,948.95	2.4%							
Work Comp	7.00%	391,897.90	4.9%							
Gen Liability	5.00%	279,927.07	3.5%							
<b>Total Direct &amp; Burdens</b>		<b>6,939,392.03</b>	86.1%							
Healthcare	4@\$317	15,216.00	0.2%							
Health Staff	42@\$231	116,424.00	1.4%							
Vehicle - Electric	5	10,500.00	0.1%	Autos	Elec Carts					
Vehicle - Gas	14	77,000.00	1.0%	1800	600	Annual Maintenance				
Uniforms	\$0.19	47,852.00	0.6%	2700	1500	Annual Insurance				
				1000	-	Registration				
<b>Indirect</b>		<b>266,992.00</b>	3.3%	5500	2100	Annual Total per Vehicle				
Administrative										
Administrative	Location A	44,720.00	0.6%							
Administrative	Location B	37,440.00	0.5%							
Administrative	Location C	44,990.00	0.6%							
Administrative	Location D	31,200.00	0.4%							
Administrative	17.95%	28,423.83	0.4%							
Administrative	Corporate	48,000.00	0.6%							
Administrative	Corporate	43,500.00	0.5%							
<b>Total Administrative Salaries</b>		<b>278,273.83</b>	3.5%							

# Service Contracts

	Percent Wage		Percent Revenue				
<b>Revenue</b>							
Company/ Division 1		6,456,000.00	80.1%				
Company/ Division 2		1,600,000.00	19.9%				
<b>Total</b>	<b>156.3%</b>	<b>8,056,000.00</b>	<b>100.0%</b>				
Direct Labor	64.00%	5,155,840.00	100.0%				
Holiday Premium (6@4hrs.)	1.15%	59,292.16	0.7%				
Sick Days (3)	1.15%	59,292.16	0.7%				
Non Sched OT	3.00%	154,675.20	1.9%				
Vacation (80 hrs.)	3.85%	198,499.84	2.5%				
<b>Total Direct Labor</b>		<b>5,627,599.36</b>	<b>69.9%</b>				
FICA	7.65%	430,511.35	5.3%				
FUTA	0.80%	45,020.79	0.6%				
SUI	3.50%	196,965.98	2.4%				
Work Comp	7.00%	393,931.96	4.9%				
Gen Liability	5.00%	281,379.97	3.5%				
<b>Total Direct &amp; Burdens</b>		<b>6,975,409.41</b>	<b>86.6%</b>				
Healthcare Supervisors	4 at 317	15,216.00	0.2%				
Healthcare Officers	42 at \$160	80,000.00	1.0%				
Vehicle - Electric	5	10,500.00	0.1%				
Vehicle - Gas	14	77,000.00	1.0%				
Uniforms	\$0.19	47,852.00	0.6%				
<b>Indirect</b>		<b>230,568.00</b>	<b>2.9%</b>				
Administrative							
Administrative	Location A	44,720.00	0.6%				
Administrative	Location B	37,440.00	0.5%				
Administrative	Location C	44,990.00	0.6%				
Administrative	Location D	31,200.00	0.4%				
Burdens	17.95%	28,423.83	0.4%				
Administrative	Corporate	48,000.00	0.6%				
Administrative	Corporate	43,500.00	0.5%				
<b>Total Administrative Salaries</b>		<b>278,273.83</b>	<b>3.5%</b>				
Travel	1.19%	96,000.00	1.2%				
Finance Interest	1.00%	80,560.00	1.0%				
G & A	2.78%	224,000.00	2.8%				
Miscellaneous (List)							
<b>Total Administrative Expense</b>		<b>400,560.00</b>	<b>5.0%</b>				
<b>Total Cost</b>		<b>7,884,811.23</b>	<b>97.9%</b>				
<b>Profit/Loss</b>		<b>171,188.77</b>	<b>2.1%</b>				

Reduce to 3 Personal Days

Max. \$80,000 Annual Company Contribution

Autos	Elec Carts	Annual Maintenance
1800	600	Annual Insurance
2700	1500	Registration
1000	-	
5500	2100	Annual Total per Vehicle

Fixed

# Service Contracts

Benefit Questions	% Paid by Vendor	Describe Benefits Provided by Bidder for Temporaries
Does your company offer or provide the following insurance?		
Medical		
Dental		
Vision		
Basic Life		
Group Life		
Business Travel/Accident		
Accidental Death & Dismemberment		
Disability		
Please provide name and contact information of your Worker's Compensation carrier		
Pls. describe method of payment to workers (check, direct deposit, etc.)		

# Service Contracts

<b><i>Personnel hourly billing:</i></b>	<b>Straight Time Pay Rate</b>	<b>Straight Time Bill Rate</b>	<b>Overtime</b>	<b>Overtime Bill Rate</b>
<b>Supervisor</b>	<b>\$ to \$</b>		<b>\$</b>	<b>\$</b>
<b>Security Officer</b>	<b>\$ to \$</b>		<b>\$</b>	<b>\$</b>
<b>ComSec Supv.</b>	<b>\$ to \$</b>		<b>\$</b>	<b>\$</b>
<b>ComSec Officer</b>	<b>\$ to \$</b>		<b>\$</b>	<b>\$</b>
<b>ComSec Officer</b>	<b>\$ to \$</b>		<b>\$</b>	<b>\$</b>
<b>Security Mgr. Salary</b>	<b>\$ to \$</b>	<b>N/A</b>	<b>\$ N/A</b>	<b>\$ N/A</b>

# **Service Contracts Summary**

**Similar and Different from Goods Procurement**

**Service Contracts Process Steps**

**Pursuit of Value**

**Value Equation**

**Price Components Breakdown and Templates**

**Overtime Bill Rate**

**What is in their Costs? That is Where to Negotiate**



# **Service Contracts**

**What is the Right Price?**

**The Lowest Total Cost**

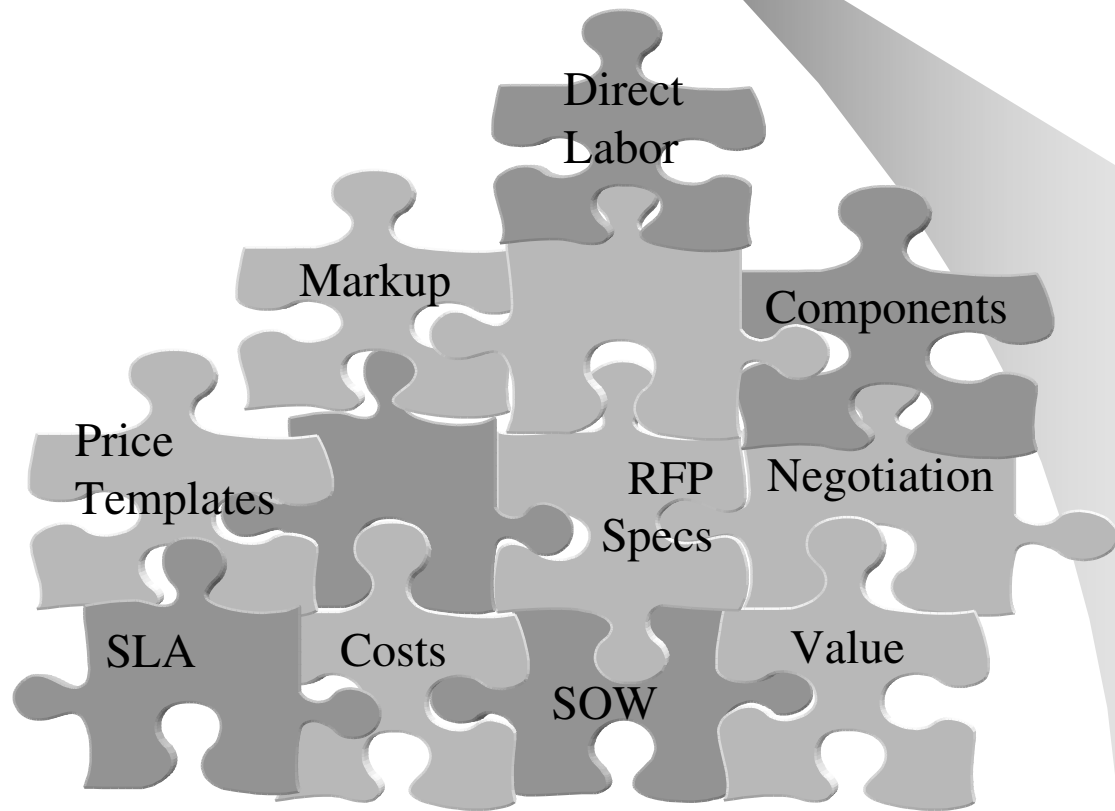
**at the Highest Intrinsic Value**

**Now you Know One More Way to Get There**



# Summary

- The Pieces will all fit together





**institute for  
supply management**

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**Thank you**

The words "Thank you" are rendered in a large, bold, black, sans-serif font. The text is presented in a 3D perspective, with the letters having a thick, orange-brown base. A soft, grey shadow is cast beneath the text, extending from the right side and curving downwards, giving the impression of the letters floating above a surface.