

## CASE #2a:

## Doing IT Right

### Commodity Type: Service – IT Consulting Services, Australia

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Nigel Anderson had recently joined SM Fisher, a large financial services firm headquartered in Melbourne. As Senior Procurement Manager, he was responsible for the firm's spend on professional services. Vicky Stewart, Director of Human Resources, recently requested him to help negotiate a project with Star Corp, a reputed IT consultancy.

The project involved the implementation of one more module of a major ERP system and a redesign of the firm's Human Resources processes. Consequently, in addition to system implementation the project also required HR process expertise, which Star possessed. Star had implemented two modules of the same system at Fisher two years ago. That engagement had gone very smoothly.

Star's performance on the previous engagement was one of the main reasons why Vicky had selected it as the consultancy of choice. While she was very reluctant to switch to another service provider, she was willing to negotiate the price with Star. Nigel decided not to argue Vicky's selection. He was delighted to be invited to help and viewed it as an opportunity for him to demonstrate the value that procurement could bring to Fisher's internal stakeholders.

To accomplish his objective, he knew that he would need to build a cost model. On Nigel's request, Rebecca Ponting, the Account Executive at Star provided him with the following information:

<b>Project Time</b>	40 days
<b>Resource requirement:</b>	Senior Level Software Design Supervisor – 2 (20 days) Mid-Level Computer Programmer - 8 (40 days on-site)
<b>Fees:</b>	
2 - Senior Level Software Design Supervisor @ A\$ 4,700/day each	A\$ 188,000
8 - Mid Level Computer Programmer @ A\$ 2,500/day each	<u>A\$ 800,000</u>
<b>TOTAL FEE:</b>	<b><u>A\$ 988,000</u></b>

### Team Profiles / Roles and Responsibilities

- 2 Senior-level Software Design Supervisors:
  - Senior level consultant with 10-12 years of experience
  - Responsible for all technical work on project
- 8 Mid-level Computer Programmers:
  - with 3-5 years of experience
  - 2-3 years of experience in product implementation

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Nigel proceeded to gather the data he thought was necessary to build his model. The results of his research are below.

### INDUSTRY DATA

#### 1. ANZSIC CODE (AU)

70 - Computer System Design and Related Services

#### 2. INCOME STATEMENT AVERAGES

Using the past two years financial statements of five major players in the industry, Nigel computed the following table:

Table 1:

Companies -->	A	B	C	D	E
Total Sales	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of Sales	60.0%	55.4%	70.7%	64.6%	53.4%
General, Selling, Admin (GSA) & Other Expenses	33.4%	35.8%	24.9%	23.3%	35.4%
Profit Before Tax (PBT)	6.6%	8.8%	4.4%	12.1%	11.2%

#### 3. LABOUR DATA

Obtain the Total Sales and Wages & Salaries for the year 2020-21 from the annual Economic Activity Survey (EAS) from the Australian Bureau of Statistics ([www.abs.gov.au](http://www.abs.gov.au)) to enter in the table below

Table 2:

ANZSIC	Description	Year	Total Sales	Wages & Salaries
70	Computer system design and related services	2020-21		

#### 4. DIRECT LABOR % of TOTAL LABOUR AND UTILISATION RATES

Based on a primary research report, Nigel determined that, on average, Direct Labor accounted for 87.5% of Total Labor Costs. Utilization rates in the industry were 75% for senior software design supervisors and 85% for mid-level computer programmers according to his prior experience.

#### 5. SALARY INFORMATION

Nigel typically uses a website called SalaryExpert to obtain salary information.

Download the salary for Computer Programmer and Senior Software Design Supervisor from [www.salaryexpert.com](http://www.salaryexpert.com)

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To help Nigel with this project, please complete the worksheets and questions that follow.

### Worksheet 1: Calculation of Industry Cost Profile percentages

#	Element	%
1	Cost of Sales as a % of Total Sales	
2	General, Selling, Admin & Other Expenses as a % of Total Sales	
3	Profit Before Taxes as a % of Total Sales	
4	Total Labor Cost as a % of Total Sales	
5	% of Total Labor Cost attributable to Direct Labor	
6	Direct Labor Cost as a % of Total Sales	
7	Service Overhead as a % of Total Sales	

### Worksheet 2: Summary of Industry Averages (% of Revenue)

Element	%
DIRECT LABOR	%
SERVICE OVERHEAD	%
<i>Sub Total: Cost of Sales</i>	<i>%</i>
GENERAL, SELLING, ADMIN & OTHER EXPENSES	%
PROFIT BEFORE TAXES	%
<b>Total Revenue</b>	<b>100.00%</b>

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**Worksheet 3: Calculation of Daily Direct Labor Cost per consultant**

#	Details	Computer Programmer	Software Design Supervisor
1	Annual Salary (www.salaryexpert.com)	\$	\$
2	Bonus (www.salaryexpert.com)	\$	\$
4	<b>Total Salary + Bonus (Sub-total)</b>	<b>\$</b>	<b>\$</b>
5	Total annual hours	2,080	2,080
6	Utilization rate	%	%
7	Number of billed hours	hrs	Hrs
8	Direct Labor Cost per hour	\$	\$
9	<b>Direct Labor Cost per day (1 day = 8 hours)</b>	<b>\$</b>	<b>\$</b>

**Worksheet 4: Calculation of Daily Billing Rate (Should Cost)**

Cost Element	Ind. Avg. (%)	Per Computer Programmer	Software Design Supervisor
<b>Direct Labor Cost</b>	%	\$	\$
Service Overhead	%	\$	\$
<b>Subtotal: Cost of Sales</b>	%	\$	\$
General, Selling and Administration	%	\$	\$
Profit Before Taxes	%	\$	\$
<b>Daily Billing Rate (Should-Cost)</b>	<b>100%</b>	<b>\$</b>	<b>\$</b>

**Worksheet 5: Calculation of Contract Amount (Should Cost)**

Consultant	Number of Consultants	Daily Billing Rate	# of Days	Total
Mid-Level Computer Programmer		\$		\$
Senior Software Design Supervisor		\$		\$
<b>Estimated Total Contract Amount (Should Cost)</b>				<b>\$</b>

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### **Questions:**

1. What strategy should Nigel use to negotiate the contract with Star?
2. Nominate two members from your team to participate in a negotiation with Star (two members from another team). Note your observations on the negotiations below.
3. List additional costs that constitute the Total Cost of Ownership for this scenario (e.g. cost of installation)