The Complete Guide to Effective Vendor Management

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Most organizations underestimate and underinvest in the management of their vendors. Most organizations realize the importance of vendor management (VM), but don't develop a disciplined approach to VM. Instead, they spread VM responsibilities and activities throughout their organizations, if they perform them at all. As organizations rely more heavily on IT vendors and create more-complex multivendor models, they should realize the importance of disciplined VM. This approach goes beyond merely managing the contract terms and conditions (T&Cs) and extends into the area of collaboration, innovation and vendor performance.
Key Issues

1. How can vendor management improve vendor performance?

2. What are the primary disciplines, roles and responsibilities for vendor management?
The goal of a VM program is to:

• Gain control over vendors supporting the business

• Optimize spending by understanding your vendor spending and classification of vendors, as well as instituting controls on vendors that can be used in the enterprise

• Determine gaps and overlaps for VM tasks/activities

• Drive value from your vendors through vendor classification and management

• Understand organizational skills to manage vendors and where they exist in the enterprise. Identify gaps and ensure the right personnel, with the right skills, are in place to manage vendors. Leverage vendor management best practices across the enterprise

• Articulate to vendors how you will manage them, starting with the RFP

• Reduction of risk when using vendors, especially those supporting critical business applications and processes
For many organizations, VM emerges as a discipline after they sign a vendor contract. However, IT, sourcing, procurement, technology and vendor managers should start thinking about VM before they sign any vendor contract. They must also contemplate which individual, organization or group in the enterprise is best-suited to initially engage with the vendor, evaluate, select and negotiate the contract, as well as manage that particular vendor over the life of the deal.

Enterprises must examine who is currently performing VM-related activities to see where overlaps and gaps occur.
Not every organization is the same, nor can every vendor be managed in the same fashion. Upon examination, IT organizations find that they typically use four categories of vendors. Hardware vendors sell or lease physical products and sell related support such as repair and maintenance. Software vendors sell commercial off the shelf (COTS) products, or offer licenses to an existing product line. Enhancements to products, maintenance and technical support are also offered. Service vendors can be either long term, such as an outsourcing annuity-based contract, or short term, such as staff augmentation services used to supplement enterprise personnel. Telecommunications vendors supply telephones, networks, circuits and network services.

Examining what categories of vendors are used will help enterprises determine what individual, group or organization is best suited to management of that vendor. It will also determine what type of management is needed. For example, hardware vendors are driven primarily by strong contract terms and conditions and price negotiations. This may be well served by a procurement department. Service contracts, however, are generally more relationship-driven and therefore require the vendor manager to have an understanding of the business requirements, value expectations and fluctuating business demand to better manage the contract.
Vendor relationships vary from tactical to strategic, but management attention should not be equal in all cases. IT organizations must be careful to distinguish between various vendor relationships. The selection process begins with asking the IT organization questions on the following: Dependence (switching cost) — How dependent on the vendor is the organization? Is the vendor readily replaceable? Investment (sunk cost) — How much does the company have invested in the vendor's products, such that walking away is not an option? Potential (future investment) — Is there a desire and propensity to spend more with a vendor? Breadth of product capability — Can the vendor span markets and provide a multitude of products and services?

There are four general vendor categories that help separate responsibilities: Strategic — High-dependence, high-cost exposure vendors, as well as vendors that the IT organization wishes to increase business with over time. Emerging — Vendors with a small initial presence, but one that is expected to build over time. Legacy — Vendors that have been in place for a sustained period but are not considered strategic. Tactical — Vendors that are small in cost and exposure or that are in a commodity environment.

Once successfully categorized, most strategic vendor management programs begin with a handful of top vendors and expand over time.
Strategic vendor management (SVM) programs can improve vendor cooperation through the systemic use of rewards. When vendors are rewarded for performing in alignment with customer strategic objectives, customers can successfully improve vendor performance and behavior.

Customers should:

- Clearly identify what rewards will be offered as part of an SVM program.
- Manage rewards closely; they are special and require significant oversight.
- Ensure systemic adoption of the SVM program through executive support.
- Ensure that rewards do not violate any corporate ethic policies.
- Invest corporate resources into strategic vendors, as appropriate.

Customers sometime believe that these rewards are "no big deal" when, in reality, they can help the vendor secure more business across the entire organization. In addition, SVM programs should be conducted with the realization that historical negotiation practices can conflict and potentially impair long-term customer and vendor relationships. Instead, SVM programs should ensure that all negotiations involving strategic vendors are managed in concert with SVM goals and objectives.
The vendor manager is at the hub of a virtual team, consisting of all of the stakeholders in the relationship. Developing and servicing this virtual team is not an ancillary activity for a vendor manager — it is a critical core function.

For the vendor manager to represent the client's interest in the relationship, it is necessary to have a detailed, multifaceted understanding of the wants and needs of all the client stakeholders. In many respects, VM must first be an internal-facing role to be effective as an outward-facing role.

In simple situations, in which there is a single line-of-business manager who is responsible for the budget spent with the vendor, the vendor manager can develop a detailed understanding of the value required by the budget holder. However, most strategic vendors will be serving multiple budget holders, project managers and operational managers. Under these circumstances, the vendor manager will need to develop a detailed understanding of the many and varied (and frequently conflicting) requirements of all these different stakeholders.
Over time, the focus of deals have changed, from a pure technical target to optimize the operational infrastructure management, to a business outcome focus that relates to transitional relationships, where the target is to increase value to the business (and as such to the stakeholders). To realize these deal targets, responsible managers at the client organization initially came out of the technology corner of the internal IT organization. They knew all about the technology and how to measure the operational targets. However, while deals had to follow the business demand and at an increased pace — often fueled by hyped market offerings of prudent service providers — deal focus changed, and the required human capital management lagged behind.

In current deals, the actual knowledge level of vendor managers on average fails the competence threshold regarding the business process, information and technology knowledge that is required to optimize deal output. Simply stated, technology and service potential have moved a lot faster than the capabilities of individual managers to completely understand and control them in a contractual engagement.
Enterprises used to getting IT delivered by internal resources often struggle when a decision to outsource is made, and work is transitioned to a vendor. When IT was run internally, stakeholders had visibility into how the work was done, how many resources were assigned to the effort and could change IT priorities easily.

With the outsourcing decision, the enterprise will need to be re-educated how IT work is accomplished and how performance is measured. Service-level agreements will be put in place to manage vendor performance through effective use of penalties and earn-back contract clauses. The enterprise must also learn to measure performance based on outcomes, not on all the steps it takes to get the work effort accomplished. Vendor management becomes pivotal to communicate enterprise expectations of the agreement, ensure that the contract is adhered to by the vendor, and act as an escalation point regarding any vendor delivery and/or performance issues.
Good VM should follow a framework that clearly identifies the set of activities, tasks, functions and expected outcomes. Vendor management is responsible for managing the external spending of an organization and includes negotiating contracts, analyzing and improving supplier performance, driving greater value from supplier relationships, and mitigating vendor risks. Vendor risks exist during good and bad economic times and are not just limited to the financial stability and well-being of a particular supplier. Organizations should adopt a framework model for managing all vendors, with specific emphasis on managing those vendors that are critical to overall business performance and success.
VM is an emerging discipline that is necessary to invest in to ensure that your organization is working effectively with vendors and that you are, indeed, generating the business and service outcomes you require from the deal. The relationship manager builds and governs the partnership and relationship with one or more key providers and is the owner of one or more relationships. The lead relationship manager ensures that relationships are working effectively across all service providers and with the overall organization with a focus on achieving the tactical business outcomes required. The performance manager ensures the agreed services are delivered and service levels are met with each vendor and from an end-to-end perspective.

Specifically, the focus here is on ensuring the operational service outcomes are achieved and that the provider is also undertaking appropriate tactical activities to ensure service delivery management beyond the day-to-day delivery of services. The contract manager ensures the effective deployment of sourcing initiatives through the establishment and management of coherent practices (people, governance, schedules, and terms and conditions) across all sourcing relationships. This is typically an ad hoc role, being strongly involved during contract negotiations, contract performance review and when the contract baseline changes as the business outcomes required change over the life of the deal.

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### Key VM Roles and Responsibilities

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The best consumer is one that is educated before negotiating or making a buy decision and remains educated through the life of the deal. Clients should thoroughly investigate current market trends. Who are the providers in this space? What are current service offerings and pricing methodologies in the market? What types of contract structures are being used for best-in-class deals?

Additionally, the current service provider should be analyzed to determine its overall company status. Knowing whether the provider is winning or losing deals, what targeted deal sizes it is are pursuing, and financial performance of the company, for example, will give you insight into potential impacts to your deal.
Performance metrics must be established and should be set to the minimum acceptable required level. Performance metrics become the focal point of all performance measurement and should be subject to penalties. If the service level does not have an associated penalty, then it is merely an objective. When the contract openly states that the vendor will use its best efforts to meet service levels, the client's only recourse for consistent nonperformance is arbitration or termination. Both options are costly and disrupt the business.
Vendor managers must link organizational demand to vendors (supply) to control the flow of work and the prioritization of work to be performed given to the vendor. Often, organizations' business units identify changes that are needed to meet their specific requirements. In a stand-alone environment, the change may make perfect sense. But when considered along with other business unit requirements, and together with other services and service providers in a multisourcing environment, the change may take on a different meaning, adversely affecting other business unit processes or even changes that other business units see as critical to meet their objectives. At the same time, the vendor may want to make changes to processes and procedures that it believes will positively impact it and the organization. Unless coordinated and prioritized, these requested changes can, and often do, negatively impact the organization and the vendor. The solution to this troubling dilemma is to have a demand management plan in place that identifies, coordinates and prioritizes the required changes.
Cooperation between competing vendors will not happen automatically, and it comes at a cost. In a multisourced environment, ensuring end-to-end service delivery is often the customer's responsibility. Failure to address this responsibility can lower the value of the services delivered. Gartner experience shows that up to 3% of operational effectiveness can be lost at every significant interface between providers. This can result in lower quality of service and higher costs.

As a part of a multisourced strategy, solve the key question of cooperation between your vendors, internal and external. The solution lies in the service management governance mechanisms, standards and practices that exist between service providers and between service providers and the enterprise. Sourcing agreements in a multisourced environment should contain the requirement to adopt a common service delivery language — for example, that of the Information Technology Infrastructure Library (ITIL). Agreement should also contain standards and measurable obligations for providers to cooperate in the interests of the enterprise. These agreements comprise what Gartner calls operating-level agreements (OLAs). Establishing a vendor management program with overall accountability is the starting point of this exercise.
Communicate and Managing the Outsourcing Message: Know Your Audience

Senior Executives
• Value expectations of the deal?
• Introduction of risk?

Business Managers
• Will outsourcing improve service?
  Help us meet business objectives?
• Will our interfaces be the same?

End Users
• Who will we call? Will service be the same, better or worse?
• Who made this decision and why?

How CIOs and business executives communicate during outsourcing is as critical as what they say. We recommend that executives adopt a tiered communication approach that aligns organizational intent and objectives with team and individual concerns. The tiered approach includes:

• Overall communication to the affected organization, presenting objectives, rationale, intentions and timing
• Management communication to address managers' concerns and identify inconsistencies in the message
• Team communication, with opportunities to question, probe and commiserate with team leader
• One-on-one communication between employees and managers to discuss impact, opportunities and plans
• Ongoing communication that is regular, timely, transparent and tuned to the audience
Goals in vendor management differ per role and, thus, the dashboards must reflect these needs:

- Relationship characteristics are highly variable, dependent on the category — that is, whether the vendor provides products or services.

- The contractual characteristics are common across the categories, but you will change the weight of the factors. For example, the weight of market-competitive pricing is higher for the strategic vendor than for the legacy vendor.

- Performance characteristics are much more aligned with specific roles across the organization and can even extend into business processes, dependent on the product or service. The criteria for evaluating performance should be closely tied to the needs of the consumer of the products and services.

However, there is no unilateral vendor management. For each type of vendor, there must be a compatible response (such as standards, relationships and decisions) on the buyer's side.
Recommendations

- Determine your vendor management vision.
- Structure vendor management as a continuing program.
- Manage all vendors, but classify them to make sure you invest deeper in strategic relationships.
- Plan how multiple vendors will work together in your environment.
- Manage your vendors; consistently assess the value of the relationship and your risks.
- Define your vendor management approach in the RFP.
Action Plan for IT and Vendor Managers

Monday Morning
- Establish your definition of vendor management — a clear definition with a clear purpose. Set strategic objectives.

Your Next 90 Days
- Determine who is performing vendor management activities across the enterprise. Identify gaps and overlaps.
- Classify your vendors, and determine who is strategic versus tactical.

Your Next 12 Months
- Design an organizational construct for the vendor management program:
  - Reporting structure and staffing
  - Clear roles and responsibilities
- Establish how program effectiveness will be monitored.
Related Gartner Research

- Disciplines for Vendor Management in Outsourcing, 2010-2011
  Helen Huntley (G00208945)

- Predicts 2011: Assessing and Revising Vendor Management Programs Key to Driving Value
  William Maurer, William R. Snyder, Christopher Ambrose, Helen Huntley (G00208559)

- Strategic Vendor Management in Outsourcing, 2010-2011
  Christopher Ambrose (G00207454)

- Outsourcing Advisory: Pricing Trends in Infrastructure Services
  David Edward Ackerman (G00212089)