Leading organisations have understood for some time that active vendor management, as opposed to simply procurement, can generate benefits for both the organisation and the vendors, above and beyond direct financial savings.

For some organisations, vendor management now drives cost accountability and innovation through active management of vendor performance, and ensures sustainability through compliance and measurement. They have also reaped significant potential benefit in being able to prepare against any vendor-related performance issues or risks through a deeply cooperative ongoing vendor relationship.

Other organisations struggle to leverage the full potential of their vendor relationships. It’s fairly straightforward to leverage the benefits coming from a vendor due to their specialist skills and economies of scale, but difficult to build on those savings.

How, then, can your organisation get the most out of your vendors and build sustainable, mutually beneficial relationships with improved benefits?

**Maturing from ‘procurement’ to vendor management**

One of the key reasons for not reaping full potential benefits is that many organisations are still focussed on a process driven procurement function; in other words, capabilities in managing and processing RFQs, purchase orders and invoices.

In addition, some organisations driven by short-term cost pressures have focussed on outsourcing services without giving due consideration to the relationship management and delivery model.
In larger, multinational organisations, where vendors are spread across different countries, those vendors are often still managed by individual business units. Each of these business units tends to have their own procurement teams, creating procurement silos. This leads to duplication of vendors, cost variances and no holistic view of vendor performance. In this situation, procurement or vendor managers end up spending most of their time on the day-to-day operations of managing vendor contracts and purchasing, rather than looking at strategic long term goals and planning.

A mature approach to vendor management requires an organisation to understand that vendor management can be more than an operational function; it can become a key tool in supporting and delivering business strategy.

With the constant quest to meet customer expectations of quality and on-time delivery while cutting costs and achieving efficiencies, organisations need to put their focus on establishing strategic win-win relationships with vendors that can deliver results in key business areas.

**HOW DOES AN ORGANISATION MAKE THE TRANSITION TO EFFECTIVE VENDOR MANAGEMENT?**

- **Create an internal vendor management practice**

  Effective vendor management requires the combination of two sets of activities that are increasingly performed by two different practices: procurement and vendor management. Both practices play a critical role in managing vendors and ensuring the long-term health of key vendor relationships.

  While procurement manages sourcing and selecting the most appropriate vendors, vendor management generates additional value from those vendors through active analysis and management of vendor performance. This also allows the organisation to plan against any vendor related performance issues or risks.

  However, not all organisations currently have a vendor management practice. For those that do, their level of adoption still varies greatly in maturity, scope and alignment with the overall organisation strategy. The most mature adoptions place the vendor management practice at the centre of relationships.

- **Develop a clear vision for vendor management**

  A successful vendor management program is designed with a clear vision and an understanding of its desired culture. These should be based on the broader organisational vision and culture, thereby ensuring the vendor management function is supporting business strategy.

  The vision and cultural aspirations drive other elements such as organisation, people, support systems, and most importantly, its policies and procedures.
• **Build strong relationship with the rest of the organisation**

In addition, successful vendor management is highly dependent on close collaboration with the rest of the organisation. When vendor management bases its vision on the corporate vision, it shares strategic objectives and understanding of business requirements with the rest of the business, and can therefore have deep relationships based on these. In return, the business will better understand vendor management’s objectives and potential benefits for them.

The example below provides an insight on how a global Networking Solution Provider successfully improved their strategic vendor management.

**How a large Networking Solution provider improved Strategic Vendor Management**

A global leader in networking solutions, this firm had an enormous IT infrastructure budget. Each of its office had complex IT requirements but a lack of consistent procurement process meant that they could receive 20 different agreements for the same service with the same vendor. Agreements in different countries would have different prices, lengths, terms, and service levels. In addition to the complexity of these agreements, the lack of strategic planning began to cost the firm significant amounts of money.

In 2001, the IT Infrastructure division of this firm formed a vendor management office (VMO) with their primary goal to develop a strategic, consistent approach to select WAN infrastructure vendors in EMEA that would reduce both cost and risk for the firm. It chose to work only with vendors strategic to their needs, marketplace, and business. Within a short period of time they had successfully renegotiated contracts and repaired relationships, which attracted attention within the other divisions of the firm.

The VMO became a global IT group in May 2002. Its mandate was expanded to include managing strategic vendors that supply hardware infrastructure, software, storage, telecom services, and outsourced infrastructure services. In addition, the VMO started providing value and expertise in process and business development, asset management, and vendor engagement.

Since its establishment, the VMO has achieved:

• **Increased Flexibility and Simplicity** — process consistency, contract simplification, consistent contract terms and conditions, and contracts with lower cost commitments.

• **Lower Costs to the firm** — better pricing based on higher volume of goods and services purchased from strategic vendors.

• **Lower Costs to the Vendor** — smaller number of strategic vendors which receive more business leading to economy of scale benefits and reduced contract management costs.

• **Better Communication with Vendors** — consistent fair terms and conditions and SLAs reduce risk from both sides, and the creation of a global bidding process provides consistent criteria and communication with all vendors.
The characteristics of a successful vendor management practice

The next few sections of this white paper focus on some of the critical attributes of a successful vendor management practice. Successful implementation requires a well thought-through approach which must encompass the following elements to contribute to the overall corporate strategy:

- Vendor management strategy
- VMO structure
- Process and controls
- Performance management
- Technology

Vendor Management Strategy

With the increased trend of outsourcing non-core processes as well as entering partnership agreements with key vendors, vendor management has become essential for maximising the value of those alliances and outsourcing deals. Leading organisations are implementing vendor management frameworks to provide structure, consistency, accountability and controls over vendor management activities. The framework forms the foundation from which vendor management activities are driven, by linking strategy, policies and processes together.

The vendor management framework must be designed to support the organisation’s strategy and goals. It must be clearly defined to determine the desired structure, capability and scope of the vendor management activities.

Figure 1: Vendor Management Framework
As depicted in the diagram above, each element of the vendor management framework needs to be tailored, based on specific requirements defined in the strategic vision. Once defined, those elements need to be documented, providing guiding principles that will facilitate the validation, rollout and on-going execution of the framework.

Those guiding principles have to properly define the different approaches required for strategic and tactical vendors as they fulfil different roles.

The focus will be, of course, on the strategic vendors, though tactical vendors should not be neglected as they have a role to play in any organisation. Tactical vendors will usually provide one-off type of projects and will usually not be central to business. The quality of the product/service and the delivery are important but the vendor is not an active contributor to either business solutions or customer success. The responsibility to deal with tactical vendors will usually remain with the procurement team.

Strategic vendors are often ‘mission-critical’ and involved in multiple projects/applications, bringing key value-add to the relationship. They have the potential to be key business partners to the organisation and will be expected to contribute to business solutions and customer success. A solid vendor management framework is essential to draw the maximum value out of this relationship.

**VMO Structure**

Once the vendor management practice has established well defined objectives and guiding principles aligned with the procurement strategy, the focus should then move towards establishing the actual VMO structure, i.e. the governance and reporting lines to achieve those objectives. Establishing the Governance structure will require following steps:

- Governance should focus on the right people having functional capabilities and skills in place to effectively oversee vendor relationships, while also working closely with all the relevant internal business units.
- Individuals need to have clear accountability for top-priority vendor management functions and services.
- Decision making roles and responsibilities should be clearly defined and documented to ensure effective decision-making and avoid duplication.
- Clearly defined performance management processes, incentives and career path to instil confidence and motivation among the VMO personnel.
Process and Controls

Vendor management processes include the end-to-end lifecycle of the vendor relationship: from procurement to performance management. These processes include but are not limited to:

- demand management
- contract management
- change management
- transition management
- risk management
- knowledge management, and
- vendor performance management.

A successful vendor management program requires a balance between the creation of new policy and procedures and the modification of existing policies and procedures to maintain continuity. This includes a clear and concise vision of its effective use of policies and procedures. Policies and procedures should be designed to manage risk, maximize economies, and effectively support the business in securing services. This could include the following principles:

- Contract award and management processes should be well defined, documented and implemented
- A dedicated vendor management function will coordinate effective vendor evaluations and use standard processes for establishing contracts and structuring service level agreements (SLAs)
- All business units, departments, and subject matter experts should be involved in the design of policies and procedures that affect them. Involving these business areas will provide great clarity on the design of vendor management and clearly define roles and responsibilities
- Involve the vendor in developing these processes as this will help the business identify the maximum value that the vendor can add to the business.

Processes need to ensure transparency as well as flexibility in vendor relationship. While transparency will help organisations identify risks and issues and develop the required mitigation strategies, flexibility will enable vendors to adapt to changes quickly and remodel processes if and when required.

ITIL offers a good framework to ensure vendor management processes add value to the relationship. ITIL V3 further integrates service level management processes throughout the end-to-end business and technology processes. This presents an option for organisations to continuously improve the way it builds and maintains relationships with business units, technology groups, and most importantly vendors.
The example below highlights how a large Australian Bank improved its vendor management policy and procedures to gain more control over their vendor management.

<table>
<thead>
<tr>
<th>Primary vendor partnership program ends management strain at a large Australian bank</th>
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<tbody>
<tr>
<td>Despite this bank having an approved list of vendors to fulfil their information technology staffing needs, its business managers had continued to hire contractors through non-approved vendors. These non-approved vendors had different billing procedures, invoices and bill rates for their consultants, resulting into a quagmire of paperwork for the bank and hence loss of time and money.</td>
</tr>
<tr>
<td>To alleviate this problem, the bank entered into a vendor partnership program with a large Resource Management firm. The bank empowered this firm to handle the entire contractors’ recruitment process and become the primary contact for the bank’s contracts with all kinds of vendors of contract resources. Though this Resource management firm was not an exclusive provider, they were able to cover the end to end activities from hiring, contract handling, on-boarding to payment management of the contractors.</td>
</tr>
<tr>
<td>The Bank managers still worked with the non-preferred vendors of their choice, but once the choice was made, the new contractor had to go through this Resource Management firm to secure their contract, access and pay. This firm also handled the pipeline of new opportunities as per the Bank’s Business Units’ needs.</td>
</tr>
<tr>
<td>This program gave the client control of their vendor list once again, which allowed them to ensure all vendors met their quality and performance guidelines and billing rates.</td>
</tr>
</tbody>
</table>

Performance Management

With a rapidly changing business landscape, companies are increasingly reliant on vendors for their ability to meet customer requirements in a timely and cost-effective manner. They are under constant pressure to retain the high performing vendors while ensuring all the vendors are in a position to achieve their delivery SLAs consistently.

This requires a clear understanding of the vendors’ overall operational and financial performance as well as the risks.

The three key aspects critical to any vendor’s performance which an organisation must monitor are:

- Financial Health
- Operational Performance
- Risks
Financial Health

For any vendor, financial health is critical for their long term stability, their capability to adapt to future planned and unforeseen challenges and risks, and their ability to implementing growth strategies as required by the buyer organisation.

Therefore any organisation aspiring to establish strategic partnership with vendors needs to regularly monitor the financial performance of their vendors. This can be analysed through their sales, profitability and working capital availability, as well as through the monitoring of market intelligence. The procurement team is usually the best placed to assess the financial health of specific vendors.

Operational Performance

Vendor operational performance is central as it determines if the organisation can meet customer’s cost quality and time requirements for their products. This requires clearly understanding key customer requirements and replicating them into SLAs such as lead times, on time delivery, defects rate and so on. These SLAs need to be captured through SLA agreements as part of the contract. As different products have different customer requirements, SLAs may vary from vendor to vendor.

Vendors’ performance against these SLAs need to be regularly reported on and reviewed and the frequency, content and review process for each report should be well defined during the transitioning in of the vendor. Based on these reviews, organisation and the vendor should agree on improvement actions to continually improve vendor’s performance to meet the end customer requirements. To ensure vendors’ alignment with the organisation’s objectives, contracts should have inbuilt mechanism for credits for better performance and defaults for poorer performance against the SLAs.

A long term strategic partnership between an organisation and its vendors requires close working relationships and open communication. Governance forums provide the right platform for both parties to review the operational and financial performance and also discuss and manage upcoming challenges, projects and future strategies.

Success of these governance forums requires representation from key stakeholders from both parties who can make quick decision on critical issues.

Finally, to ensure vendors are offering best in class service and pricing, your organisation should conduct benchmarking or subscribe to external vendor benchmarking reports. These reports should input into the contract renegotiations if needed.
Risk Management

Due to ongoing concerns about risk in an era of economic uncertainty, organisations need to be aware of industry-specific and vendor-specific risks, and should monitor those risk events that present a potential impact on their vendors. For example, if a new labour law is imminent in the country where the vendor is based, then it becomes a risk for the vendor and the organisation as this can translate into higher costs or changed working practices. Awareness of these risks beforehand will allow an organisation to plan diversifying strategies to minimise these risks.

Most organisations monitor vendor information through their internal systems such as ERP or e-Procurement systems. But these systems do not provide information on market trends or any vendor industry specific news. Additional data from third party sources becomes necessary to identify potential red flags such as credit risk, fraud, legal challenge, regulatory change, and so on.

World class organisations don’t solely rely on reactive information but proactively gather data about their vendors from external organisations. In an Aberdeen report on ‘Managing Vendor Risk’, organisations using third party data to monitor their vendor base had fewer vendors experience catastrophic failure and a higher percentage of vendors demonstrating on-time delivery or meeting project completion dates.

Technology

A key aspect of vendor operational performance review is to have correct and complete data to effectively analyse vendor performance and identify areas of improvement. In many companies, due to multiple systems used across the organisation, vendor information across these disparate systems does not provide a holistic picture.

A recent survey conducted by the Aberdeen Group revealed that many companies feel that vendor Information management is critical for understanding their procurement expenses across vendors and products, and therefore towards effective vendor management. Technology is the key enabler to achieve this outcome.

World class firms rely on Enterprise Resource Planning (ERP) systems for developing a consolidated view of their spend across business units, vendors and products. This not only enables spend analysis but also allows senior management to have a strong focus on the overall spend, leading to better control.
Conclusion

In summary, realising the full benefits of vendor management is a long journey as it requires a strong capability in vendor management built on well-defined strategy, processes, governance and vendor performance management. This must all be supported by appropriate technology and a strong partnership model. This may appear to be a daunting task but once established it can become a key differentiator providing long term benefits to your organisation.

1 The Year of Supplier: Perspectives on Supplier Management, Aberdeen Group, 2011

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CONTACT US

If you require assistance with your process optimisation initiatives, Terra Firma can help. Our experienced consultants can guide you through every step of the methodology from initial planning to benefits realisation, including organisational change management.

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