

HOW TO BUILD A VMO:

# Lessons Learned and Keys to Success

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## EXECUTIVE SUMMARY

Executives tasked with overseeing outsourcing relationships today must manage increasingly complex contracts and service delivery structures, as well as meet increasingly high expectations regarding business value, performance measurement, continuous improvement and compliance to a changing regulatory landscape. Specifically, today's business stakeholders want to know how their outsourcing relationships are – or aren't – contributing to the bottom line and managing risk.

In this environment, the Vendor Management Office (VMO) has emerged as a critical governance and oversight tool. Designed to facilitate collaboration within the sourcing model as well as alignment between the sourcing model and the business, the VMO is uniquely positioned to act as a bridge that connects myriad stakeholders and aligns operations with business strategy. In many cases, however, VMOs fail to fulfill their potential, reverting to a cost-focused role of managing contract minutiae rather than ensuring value realization.

This ISG white paper – co-authored by a senior VMO executive with a leading North American insurance firm – examines opportunities and challenges related to the VMO. Drawing on their experiences across a wide range of enterprises, the authors examine the roles and functions assumed by VMOs and outline the key challenges, success factors and lessons learned related to deploying and managing vendor management initiatives.



## A CHANGING ENVIRONMENT

After years of moderately positive to disappointing experience with outsourcing, many executives are now asking probing questions about how outsourcing is supporting operating imperatives and contributing to the achievement of key business objectives. VMOs face growing pressure to address those questions, and to assess and communicate to senior management the value being delivered by service providers. Meeting these expectations presents a challenge, even for providers who have been marginally successful at demonstrating their value propositions over time. In many cases, moreover, VMOs face additional obstacles that include process immaturity, lack of cooperation from providers and business stakeholders, and inadequate tools and analytics.

The traditional cycle of how enterprises treat outsourcing is another consideration; namely, executives apply inordinate focus to the early stages of the relationship, and soon after other priorities intervene and business interest dissipates. This too, is changing, as boardrooms are being assigned more responsibility to oversee provider partnerships and demonstrate the value of outsourcing.

## THREE LEVELS OF MATURITY

VMOs in today's enterprises have features that broadly place them in one of three categories.

In some cases, VMOs are formed as an extension of the sourcing or procurement function. The drawback here is that the VMO struggles to move beyond a narrow focus on cost and, rather than monitoring value creation, operates as a compliance cop and contract manager.

Other VMOs are spun off from specific business units. While these can be more effective in terms of linking sourcing operations to business results, they are challenged to reduce silos and develop an enterprise-wide perspective to maximize leverage.

At the highest level, a strategic VMO oversees value creation – and prevention of value leakage – throughout the sourcing delivery model and across the business. By focusing on key supplier relationships and providing transparency deep into the chain of service delivery across the entire enterprise, this type of VMO is able to effectively and consistently monitor the pulse of the relationship, gauge results and identify problem areas.

The varying levels of maturity displayed by VMOs often reflect the maturity level of the enterprise itself. That said, an effective VMO can play a critical role in developing enterprise maturity by standardizing processes, governing relationships holistically at an enterprise level and monitoring the contractual obligations that are weaknesses within many organizations. In other words, the VMO can eliminate the process fragmentation that drives sub-optimized value realization within sourcing relationships.

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## MANAGING CHANGE

Standardization can help companies work better and smarter. Driving process standardization and consistency is therefore a key VMO objective, and enables the transparency essential to identifying the sources of value creation and leakage. Organizations that leverage standardized processes, reporting and governance to improve vendor management will gain an advantage in an increasingly competitive and compliance-oriented environment.

The change management required to *achieve* standardization, meanwhile, is perhaps the VMO's biggest challenge. The reason: Managing change requires dealing with the basics of human nature; specifically, with personal relationships and people's sense of ownership, discomfort with letting go, doing things in a new way and fear of mistakes or problem areas being exposed.

Consider the task of contract rationalization: Distributed enterprises are typically characterized by myriad contract types, all with different SLAs and terms and conditions. The VMO's job is to identify the inconsistencies, redefine the terms and then implement a new standardized form aligned with operational processes that drive efficiency. To do this, much more than paperwork and rewriting terms and conditions is involved. The rationalization process typically exposes the deeply entrenched practices, conflicting interests and different layers of relationships within the organization. Specifically, any single service provider can have multiple relationships with multiple stakeholders at multiple levels within an enterprise; similarly, perceptions of service provider performance can vary within an enterprise, depending quite simply on who and when you ask. Most organizations struggle to gain an enterprise-level view of vendor performance or of the overall relationship, since these are managed at an individual rather than an enterprise level.

An effective VMO must untangle these complexities and drive visibility across the various touch points within the service delivery model. Transparency among internal stakeholders, effective communication (asking the right questions) and strong service provider relationships are imperative to address the risk of mixed messages and skewed perspectives. Over-communication regarding operational alignment around standardized processes early in the change effort – coupled with ongoing executive support – can help address these challenges.

## TOOLS AND ANALYTICS

Tools designed to monitor performance and capture and analyze data on transactions, functions and processes are essential to a VMO's ability to provide insights into value creation. While capabilities in these functions are currently at a generally low level of maturity, tools providers are responding to increased demand and competition and are stepping up efforts to add new functionality. In addition, the burgeoning field of Intelligent Process Automation (IPA) offers the potential to not only save costs but to drive transformative improvements in vendor management capabilities in areas such as compliance, auditability and reporting. Finally,

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enterprises are gradually recognizing the VMO's ability to provide analytical insight and are showing increased willingness to invest in new technology, capability and talent.

However, these positive developments carry a potential risk. We've observed instances where VMOs that test the waters of analytics set unrealistically high expectations for the business. Once stakeholders get a sense of the value of the insights the VMO can deliver, the appetite for more grows insatiable.

All that said, in most cases the larger issue with analytical capabilities lies not with the tools but rather with the processes the tools are designed to oversee. In addition, the process maturity and tool functionality needed to meet existing procurement requirements present an additional challenge. Put simply, the best tools in the world won't be very useful in an immature environment.

### **THINK GLOBAL, ACT LOCAL**

Over the past five years or so, as governance and operational transparency become increasingly important, the role of "vendor management executive" has emerged as a distinct profession. The role involves working across multiple teams in a variety of functions, and requires contractual and market knowledge, data collection and analysis and the ability to evaluate metrics. A combination of technical, financial and communication skills is imperative. Three key tasks can be defined as:

- Analyze
- Create
- Communicate

Ultimately, vendor management combines a high-level perspective on governance and oversight, coupled with rigorous attention to detail; indeed, granular analysis and knowledge of contracts is a prerequisite to effectively managing the big picture.

While the skills required are diverse, innate people skills are perhaps paramount. That said, the soft "people skills" element of vendor management involves much more than good governance and taking suppliers out to lunch. The role extends to understanding and addressing the business objectives and individual needs of internal and external sourcing stakeholders and developing a holistic enterprise view.

Assembling a qualified team with the requisite skill sets presents a significant challenge, and experience suggests an optimal approach is a combination of an in-house staffing strategy complemented by support from third-party specialists.

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## ROLES, RESPONSIBILITIES AND STRUCTURE

A VMO oversees five disciplines of service delivery:

- Contract
- Finance
- Relationship
- Performance
- Compliance

Each discipline involves different functions and activities, with the vendor manager overseeing a certain number of strategic providers – a ratio of three to five providers to one vendor manager can be considered a rule of thumb, with compliance potentially requiring additional focused resources and support of the organization’s risk management and compliance functions.

The specifics of how the five disciplines are divided and consolidated across the VMO can vary widely, as can the VMO’s interaction with other enterprise functions such as Sourcing, IT, HR, Compliance and Procurement. The less mature the organization in terms of sourcing capability, the more likely that the VMO will be viewed as a territorial threat, particularly by Procurement and by internal managers who may resort to micro-managing each interaction to maintain control of the relationship. In addition, if too much of the VMO’s responsibility falls to Procurement, the focus can revert to contract policing rather than managing value.

Since role of the VMO will vary at different stages of the sourcing lifecycle, the end-state of VMO vision in laying out the function must be considered. During the “pre-nup” phase of the RFP, the VMO must assess business needs and play a supporting role in transition execution. The VMO subsequently plays a central role post-contract in ongoing relationship management. When embraced by business unit stakeholders, this role can provide senior executives with important monitoring, reporting and trending analytics that show where and how operating innovations can be discovered and implemented. The impact on operating results can be significant for those who embrace and utilize what a capable VMO has to offer.

### THE VMO AND REGULATORY COMPLIANCE

The VMO is uniquely positioned to play a central role in regulatory compliance in financial services, as banks struggle to respond to new requirements from the OCC and other bodies. In the insurance sector, the VMO can help enterprises navigate the regulatory complexity resulting from the fact that rules for how insurers operate vary significantly from one state to another. With each state in effect requiring a different set of standards around contracts and relationships, the VMO can structure consistency in dealing with a wide range of unique requirements. These include identifying and managing vendor risk, coordinating audit

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activities, ensuring adherence of compliance to findings and reshaping contracts through governance. These critical activities demonstrate consistency that mitigate enterprise-level risk, a key to what regulators look for. *(For an analysis of regulatory compliance requirements in banking and their implications for vendor management, [download this ISG white paper.](#))*

## SUMMARY

By virtue of its organizational structure and role within the enterprise, the VMO has the potential to take the pulse of the service provider relationship and apply analytics, knowledge and insight to answer key questions that the business on its own cannot. Specifically:

- Is our outsourcing model delivering value?
- Are there alternatives we should be exploring?
- What metrics can we apply to better measure and demonstrate business value?
- Do we have consistent performance and are we preventing value leakage?

## ABOUT THE AUTHOR

### **HOW TO BUILD A VMO** **Lessons Learned and Keys to Success**



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ISG Managing Director Craig Nelson has worked for 25 years as an advisor, provider and buyer of outsourcing services. An acknowledged thought leader in operational governance, Craig's expertise represents a unique blend of ITO and BPO insights giving him a highly unique strategic perspective on outsourcing effectiveness across multiple functions.





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