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SOURCING VENDOR MANAGEMENT AND GOVERNANCE:

House in Order? Or House of Cards?

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Mature enterprises today recognize the importance of Vendor Management and Governance (VMG) to an effective sourcing strategy. In complex environments with multiple providers, VMG is essential to overseeing the contractual, financial and operational obligations of each vendor in the delivery mix. Moreover, by driving consistency and standardization across providers, VMG enables the integration of multiple vendors and the implementation of the end-to-end, outcome-based service models that have emerged as the gold standard of sourcing strategy.

Client organizations have in most cases relied on internal resources to build their VMG capabilities. However, savvy executives are finding that engaging a specialized third party to assume many of the routine transactional and administrative functions of vendor management can yield important benefits – specifically, cost savings in the range of 30 percent coupled with improved service quality. As with any operational strategy, the key to successful VMG is to retain strategic functions and to outsource commodity services to optimize cost efficiency.

This ISG white paper examines the role of VMG in the sourcing strategy of large global enterprises and describes options available to client organizations. The author also outlines challenges associated with VMG, key success factors to engaging a third-party vendor management provider and examples of processes that are ideally suited to outsourcing as well as those that should be retained.

DEVIL IN THE DETAILS

Any single contract for IT or business process services is characterized by a wide range of recurring commitments, deliverables and obligations. These include day-to-day activities related to service delivery such as identifying, tracking and closing incidents and problems, responding to and implementing change requests, resolving problems and collecting and reporting data. These daily activities, in turn, inform contractual documentation such as monthly activity reports and invoices, annual compliance reports and Certificate of Insurance statements.

A fundamental responsibility of VMG is to ensure that a provider's contractual, financial and operational obligations are in fact performed in a satisfactory manner. Effective oversight of the myriad daily tasks involved in these obligations establishes the operational layer at the base of a governance strategy pyramid.

Clearly defined and consistent data, processes and reporting mechanisms provide an operational foundation for sound decision-making and continuous improvement. Meanwhile, flawed data, inconsistent reporting and one-off processes compromise the foundation of the governance strategy and limit the business' ability to drive value from the outsourcing relationship.

THE LANGUAGE BARRIER

Effective contractual oversight at the detailed operational level of daily activities presents a significant challenge. While the Information Technology Infrastructure Library (ITIL) framework provides a widely accepted set of standards around basic operational activities that include managing incidents, problems and changes, different service providers tend to apply subtle but unique flavors to their interpretation of ITIL guidelines.

This creates the potential for inconsistencies to arise when different providers execute and report basic tasks and functions.

For example, Provider A might classify an incident as closed when the technician reports that the incident has been resolved. Provider B, meanwhile, might classify the incident as closed only when the user who reported the incident indicates that the incident has been resolved. This subtle difference has a significant impact on the performance metric of incident resolution time. Specifically, resolution time will be notably faster under Provider A's approach, which does not factor the time it takes the end user to send an email to close the incident. At the same time, Provider A's approach doesn't account for situations where the technician closes the incident, but the user is still having a problem.

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Even this subtle difference in reporting procedures – if repeated thousands of times a day across multiple processes and multiple vendors – creates inconsistency in data collection that can have a significant negative impact. Rather than collecting consistent operational data to be analyzed to drive continuous improvement, the business gathers sloppy data, seriously compromising the effectiveness of the governance function. Put differently, if the granular data comprising the base of the governance pyramid is flawed, the strategy layer at the pyramid's peak will yield minimal value.

DRIVING STANDARDIZATION

The responsibility for clarifying the interpretation of process standards lies with the VMG function. In practical terms, ambiguity surrounding reporting requirements can be resolved through the Statement of Work (SOW) documentation that guides a service provider's activity. In the case of the incident resolution example described earlier, the SOW can stipulate clearly that incidents will be considered closed only when the user signs off. By establishing a clear and consistent standard, this step helps to drive data consistency, which in turn enables more meaningful and actionable performance metrics.

For several reasons, many enterprises today fail to take this essential deep dive into clarifying the nuances of how different providers interpret standards that are seemingly clearly spelled out.

A typical SOW will require that "the provider will adhere to ITIL definitions." The provider will dutifully check the box and the client will wrongly assume that a standard and consistent process is in place.

Another issue is the depth of administrative minutiae that characterizes operational governance. The level of attention to detail required is both tedious and time-consuming, leading many enterprises to abdicate their oversight responsibility, either through a lack of commitment or a lack of resources. This dynamic is changing, however, as enterprises increasingly recognize VMG as a cornerstone of a comprehensive sourcing strategy.

The question now becomes, what's the best approach to structuring and managing the VMG function?

BUILD VS. BUY

The VMG function has traditionally been retained by the client organization. Intuitively, this approach has certain merits, as it enables the VMG team to provide consistent oversight to multiple agreements. Increasingly, however, mature enterprises are exploring the potential benefits of engaging third-party specialists to manage the day-to-day oversight of transactional activity and collection of operational data.

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As with any sourcing decision, a strategy to outsource the management of an outsourcer must make a distinction between strategic, value-add activities on the one hand, and routine, administrative and tactical activities on the other. Generally speaking, the former should be retained, while the latter are ideal candidates to hand off to a third-party provider. The table below illustrates a hierarchy of strategic and transactional activities related to VMG.
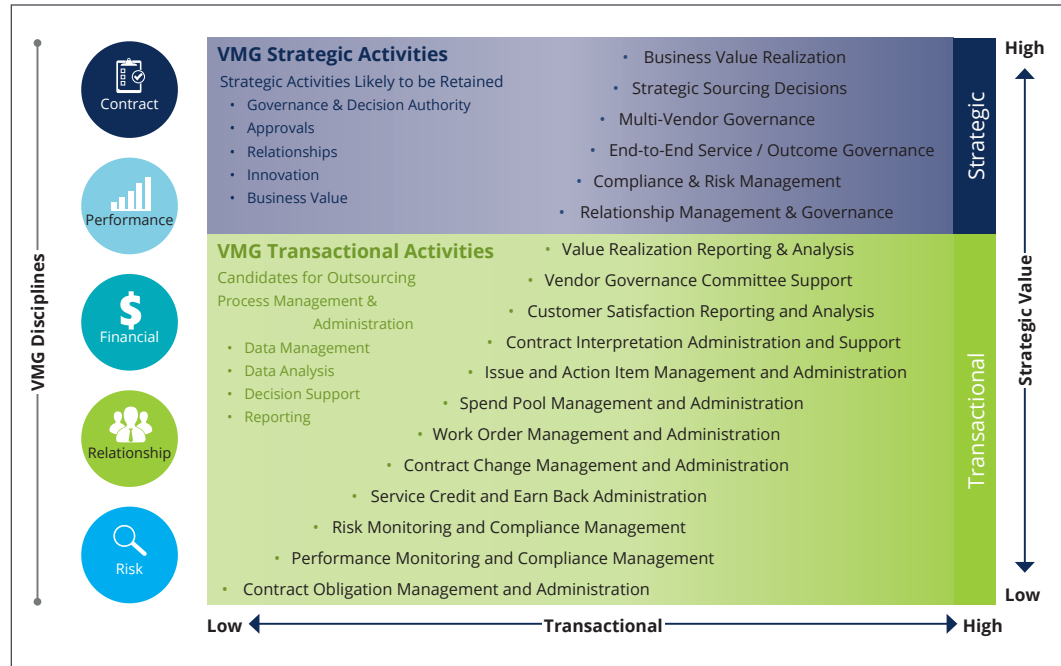
FIVE TO ONE FTE RATIO

The most striking benefit of an outsourced model is in the area of cost savings. By way of illustration, to oversee an IT services contract valued at $25M to $30M a year, a typical in-house VMG function requires a management role supported by contract and financial analysts (approximately five FTEs), together with an investment in asset management and utilization tools. Under an outsourced services scenario, meanwhile, VMG activities are delivered largely by offshore resources, and client staffing requirements are limited to management (typically one FTE). Over a five-year contract period, annual savings average approximately 30 percent.

The outsourced model is also more scalable, since a high proportion of additional workload can be absorbed by cost-efficient offshore resources. While a retained VMG function can effectively replicate standards and process discipline across multiple contracts, an increased volume of work requires the hiring of additional retained – and more expensive – staff.

BULLDOG TENACITY

Another advantage of outsourcing transactional VMG functions is to offload responsibility for recruitment and retention. While talent management is a basic benefit of any type of outsourcing, finding the rare breed of individual with the skills and inclination to be effective at VMG presents an especially daunting challenge.

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A VMG analyst's typical day begins with a list of 15 to 20 overdue obligations that require tracking, inquiries, repeated follow-ups and persistence. In addition to organizational skills and attention to detail, the role requires bulldog tenacity and commitment.

The VMG role, moreover, is by definition characterized by one-offs, exceptions and special cases. As such, while Robotic Process Automation (RPA) is eroding the competitive advantage of labor arbitrage in many areas, VMG remains a people-focused domain requiring a high level of human intervention.

THE HOLY GRAIL OF OUTCOMES

Businesses today seek end-to-end, "outcome"-based sourcing solutions that work seamlessly across multiple providers and business units. While the stuff of C-suite discussions, the goal of a service delivery model that delivers strategic business value and remains aligned with constantly changing requirements begins at a much more mundane level. Specifically, the vision is built on a foundation of details – details related to service management and governance standards, to processes, tools and joint vendor meeting structures – all designed to specify and keep track of who does what, when and how. To achieve true outcome-based solutions, getting these fundamentals right is an essential prerequisite.

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David leads ISG's Vendor Management and Governance Services practice. He has more than 25 years of experience in information technology outsourcing, with expertise in vendor management, governance, change management and strategic advisory. David has worked with a number of global enterprises to support RFP development, provider selection, retained organization design, vendor governance and obligation management. Before joining ISG, David had account management responsibilities at EDS and was a Business Process Reengineering consultant at A.T. Kearney.

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