



**BEST PRACTICES
FOR EFFECTIVE & EFFICIENT
VENDOR MANAGEMENT**

TABLE OF CONTENTS

1. Introduction	4
2. From IT vendor management to strategic partnership	8
3. Vendor Management Tools and Mechanisms	10
4. The successful vendor selection process	22
5. Benefits of implementing Vendor Management	26
6. Case study of Financial Services IT outsourcing project	27
7. Summary	30

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1. INTRODUCTION

Long-term development in the business environment has become much more difficult to anticipate due to globalization, digital innovation, more demanding customers, shorter product life cycles, continuous pressure on costs, as well as social and ethical issues. In addition, vendors are finding that the world is rapidly changing as we move into the digital era.

While responding to the changing business environment, organizations are using new organization models, modern management methods (i.e. lean management or Six Sigma), or innovative sourcing approaches (i.e. crowdsourcing). Outsourcing and vendor management have become the key factors in enabling organizations to build a successful business and achieve business goals.

Regardless of the business you're in, vendors play a key role in the success of your organization. If you had asked automobile manufacturers 20 years ago how they selected car parts suppliers, they would probably have said it was based on price in the first place, then the supplier location and preference. Customer demands, governance and the rapidly changing and growing IT industry have put a stronger emphasis on safety and quality, so evaluating and selecting the right supplier today has become a much more critical and complex process for each organization, not only automobile manufacturers. According to Gartner, by 2019, 50% of the external service and solution expenses of global 2000 companies will be through less than 10 strategic vendors in an organization's vendor ecosystem¹. This shows how important vendor management is.

WHAT IS VENDOR MANAGEMENT?

According to Gartner's definition, Vendor Management is "a discipline that enables organizations to control costs, drive service excellence and mitigate risks to gain increased value from their vendors throughout the deal life cycle."² In keeping with Gartner's definition, Vendor Management should help each organization, regardless of the size and the industry, to:

- select the right vendors;
- categorize vendors to ensure the right contract, metrics and relationship;
- determine the ideal number of vendors;
- mitigate risk when using vendors;
- and establish a vendor management organization that best fits the enterprise.³

Good vendor management allows your organization to build a successful and stronger relationship with your suppliers or service providers. These partnerships will not only strengthen both businesses, but also allow you to focus on building and delivering products and services at the optimal level of quality and add value to your clients.

The list below is a good starting point for figuring out the types of deal your company needs. You should take a brief moment to answer these questions. All answers help your organization to match the vendor management model to your organizational goals and objectives.

- WHO ARE YOU? - YOU SHOULD HAVE A CLEAR UNDERSTANDING OF YOUR ORGANIZATION'S EXPECTATIONS AND PRIORITIES;
- WHY DID THE COMPANY DECIDE TO IMPLEMENT A VENDOR MANAGEMENT PROCESS?
- WHAT IS THE SUITABLE NUMBER OF PEOPLE TO COMMIT TO THE VENDOR MANAGEMENT FUNCTION?
- HOW ESSENTIAL ARE VENDORS' PRODUCTS AND SERVICES TO THE ORGANIZATION?
- WHAT METRICS SHOULD BE UTILIZED TO MEASURE THE EFFECTIVENESS OF THE VENDOR MANAGEMENT MODEL?
- WHO WILL BE RESPONSIBLE FOR THE VENDOR MANAGEMENT PROCESS?
- WHICH PROCESS IS RESPONSIBLE FOR MANAGING RELATIONSHIPS WITH VENDORS AT THIS MOMENT?
- WHY SHOULD OUR ORGANIZATION CARE ABOUT RELATIONS WITH VENDORS?
- WHAT ARE THEY CAPABLE OF?
- WHAT VALUE DOES IT BRING TO THE ORGANIZATION?



2. <http://www.gartner.com/it-glossary/vendor-management/>
3. <http://www.gartner.com/it-glossary/vendor-management/>



VENDOR MANAGEMENT LIFE CYCLE

Large, international organizations often have hundreds of vendor relationships to make effective relationships and manage them. Increasingly, these relationships are drawing scrutiny from regulators, stakeholders (i.e. boards of directors) and internal / external auditors. With this increasing dependence on vendors, it can be challenging for organizations to effectively monitor and manage these relationships. The following steps should be performed to identify, validate and operationalize all requirements. It's also important for organizations to follow these stages to ensure a comprehensive plan is put in place to reap the benefits of the vendor management process.

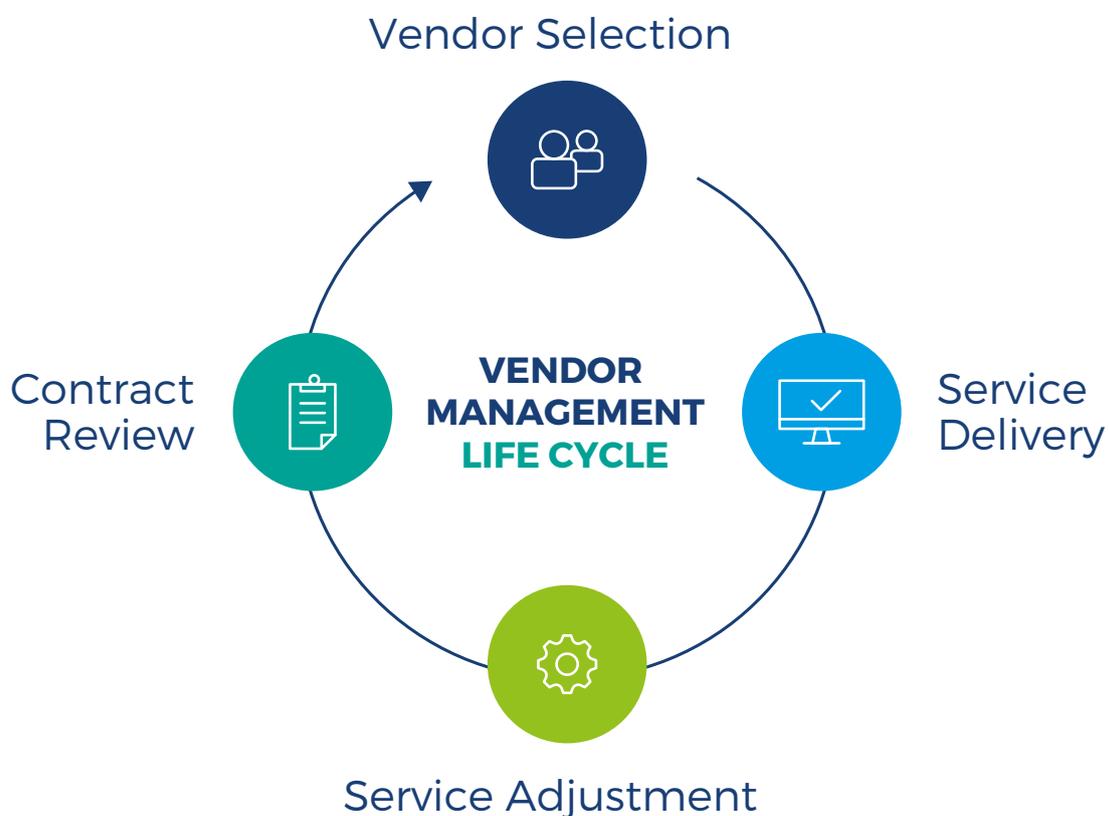
- **Develop the strategic vision** - a strategic vision for vendor management is critical to the development of the framework. The vision defines the desired organization, capability and scope of vendor management activities. The vision should be created with the input of all key stakeholders (e.g. business units, finance department, legal and compliance, etc.)
- **Design and documentation** - the strategic vision is brought to life through the design and documentation of the framework. Each of the elements is documented to facilitate the validation, roll out and ongoing execution of the framework.
- **Validation and Implementation** - key stakeholders should be provided with the opportunity to validate and vet the framework to confirm that their specific requirements have been addressed. Validation of the framework will support the development and execution of roll-out plans, while creating improved awareness for vendor management.
- **Reporting and continuous improvement** - executing the new vendor management framework usually includes making company-wide changes to accommodate the new governance processes, operational roles and responsibilities. Additional implementation activities may include changes in management and communication, process re-engineering, progress reporting, as well as system requirement definition and selection.

These stages can also be shown in a slightly different way.

- **Vendor Selection** - during this stage, the vendor management strategy should be executed. It is based on relationships with vendors, commodities and services procured, and past performance metrics, etc. Evaluation criteria together with KPIs are also defined at this stage. Additionally, vendors should be measured against the terms and conditions agreed in the current contract.
- **Service Delivery** - during this stage, the selected vendor provides services, which need to be monitored and managed. Based on the defined strategy and evaluation metrics criteria, performance should be collected from various sources. All collected data should be measured and reported in an appropriate form to be shared with both parties.
- **Service Adjustment** - this stage provides the opportunity to optimize already established

relations with the vendor. Previously defined KPIs can be used to identify areas to change, optimize or improve.

- **Contract Review** - during this stage, review meetings should be conducted with vendors as per the strategy defined earlier. The review meetings should be held periodically i.e. once a month, quarterly, half yearly or yearly. This depends on the strategy and client expectation. The agenda of these meetings should include the following points:
 - Discussion of performance as regards various metrics;
 - Action points from previous review meetings;
 - Areas of improvement;
 - Support needed to drive project improvement, etc.

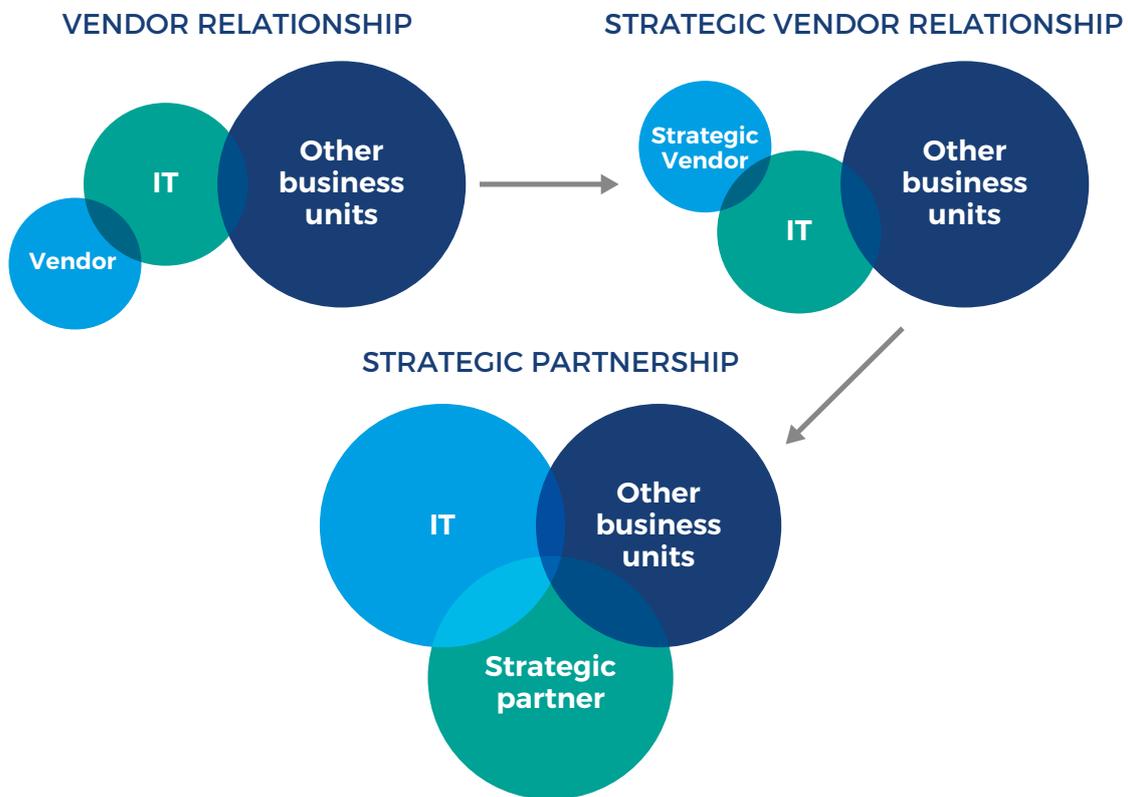


2. FROM IT VENDOR MANAGEMENT TO STRATEGIC PARTNERSHIP

For many years, customers have used vendors to support various IT and business activities. In a fast-changing business environment, they are interested in increasing the direct business value of IT by developing strategic partnerships. Strategic partnerships are becoming more critical to enterprise success. But what is the meaning of strategic partnerships and how can they be built? According to Gartner's definition, "strategic partnerships (SPs) are external relationships that directly support key business processes, outcomes and revenues. They are integral to IT's ability to deliver business results to the enterprise. An SP that fails to deliver results will create a business risk."⁴

In accordance with Gartner's definition, customers see vendors as strategic partners if they deliver effective systems and services that support the creation of value for the enterprise. Below is a figure which shows how an enterprise evolves step by step. First, from "simple" vendor management to strategic vendor management, and finally to strategic partnership management. Strategic partnership management is a new level of vendor relationship management. Managing strategic partnerships is a very different approach from the traditional strategic vendor management.⁵

EVOLUTION OF VENDOR RELATIONSHIPS



↔ Indicates direct relationship

Note: Relative size of circles indicates extent of responsibility for business/enterprise risk

Source: Gartner



“

Strategic partnerships is more like process, not an occasional event.

Małgorzata Zabieglińska - Lupa

One of the main reasons why enterprises are evolving to strategic vendor management is that the price aspect is no longer the crucial key factor in the vendor selection process. The result of this change is that the vendor relationship model has switched to strategic business partnerships.

Strategic partnerships are more like processes, not occasional events. To establish strategic partnerships, the entire business environment has to evolve to a higher level of collaboration. The true effectiveness of strategic partnerships can be achieved only through the mutual development of complementary skills.

Here are some hallmarks which help to build a successful strategic partnership:

- **Get the basics right first.** Being responsive and providing stable solutions and services are still the main factors of a successful strategic partnership. Customers should identify and remove obstacles that limit vendors' responsiveness and stability.

- **Communication is a two-way street.** Communication between customers and strategic partners still leaves a lot to be desired. The weaknesses of partnerships largely consist of one-sided communication.

- **Building trust.** There is no long-term relationship without trust. Focus on building trust in relationship with your partners.

- **Be process- and metrics-driven.** Currently, business decisions are mostly data- and metrics-driven. The value for business needs to be quantified. Customers should focus not only on "hard" metrics, but also the "soft" side of relationship metrics.

- **Evaluating your relationship.** Both parties, customers as well as vendors, should make sure the relationship is sustainable in terms of financial and strategic business objectives.

3. VENDOR MANAGEMENT TOOLS AND MECHANISMS

RELATIONSHIP DEVELOPMENT

Developing good relationships with vendors is not so complicated, but in real life where humans need to interact with each other it requires good interpersonal skills. Take the time to get to know your vendors, be communicative and tell them of your needs and standards.

One of the best practices is to maintain proactive and multi-level contact. You should start from establishing multiple points of contact at the vendor. Effective vendor relationship development depends on:

- Effective communication with the vendor – this is the most important aspect, which helps to establish long-term and profitable relationships;
- Timely and constant measuring of performance – this helps to analyze whether companies' expectations have been met;
- Understand how your vendor works - to create good partnerships you need to know as much about your vendors as the vendors know about you;
- Clearly define roles and responsibilities at each level;
- Share information intensively, but also selectively - keep vendors aware of what's going on in your company, about changes in key personnel, new products, special promotions and so on;
- Formulate a vendor selection process for your company;
- Choose vendor management models (centralized, decentralized or hybrid) which best suit your organization's needs;
 - Centralized (company-wide) – vendor management functions managed and coordinated centrally;
 - Decentralized (business units, sites, region) – vendor management functions not managed centrally;
 - Hybrid – vendor management split across the organization; for example: contracts centrally, performance locally.



Developing good relationships with vendors is not so complicated process, but in a real life where humans need to interact each other it requires good interpersonal skills. Take the time to get to know your vendors, be communicative and tell them of your needs and standards. In today's world, managing the vendors is all about strengthening and developing relationships that can make your business.



CONTRACT MANAGEMENT

Contracts establish more than just terms and conditions. There are a number of different contract definitions. According to the simplest definition, contract management is the process of managing contracts from vendors, partners, customers or employees. The most complete definition is that “contract management is the process of managing contract creation, negotiation, execution and analysis to maximize operational and financial performance at an organization”⁶

The main goal of contract management is to ensure that all contract participants fully meet their expectations and obligations in order to deliver the objectives required from the contract. **One part of the contract management process is building a good business relationship between the client and service or product provider.** Another part is to help your organization manage proactively in order to anticipate future needs, as well as reacting to situations that arise. The contract management process includes the following steps:

- 1. Enabling contract management.** In this phase the contract management process begins by identifying contracts, the verification of roles, responsibilities and procedures.
- 2. Contract authorization.** Writing a contract by hand is a time-consuming activity, but through the use of automated contract management systems the process can become quite streamlined.

- 3. Contract negotiation relies on the completion of the draft contract.** Employees who take part in negotiations should be able to compare all versions of the contract. The main point is to ensure that the best possible contract is available to all sides.
- 4. Approving the contract.** The instance in which most bottlenecks occur is getting management approval. Users can preemptively combat this by creating tailored approval workflows, including parallel and serial approvals to keep decisions moving at a rapid pace.
- 5. Execution of the contract.** Executing the contract allows users to control and shorten the signature process through the use of eSignature and fax support.
- 6. Obligation management.** This requires a great deal of project management to ensure deliverables are being met by key stakeholders and the value of the contract doesn't deteriorate through its early phases of growth.
- 7. Revisions and amendments.** Gathering all documents pertinent to the contract's initial drafting is a difficult task. When overlooked items are found, systems must be in place to amend the original contract.

6. <http://www.businessnewsdaily.com/4813-contract-management.html>

8. Auditing and reporting. Contract management does not simply entail drafting a contract and then pushing it into the filing cabinet without another thought. Contract audits are important in determining both organizations' compliance to the terms of the agreement and any possible problems that might arise.

9. Renewal. Using manual contract management methods can often result in missed renewal opportunities and lost business revenue. Automating the process allows an organization to identify renewal opportunities and create new contracts.



During day-to-day operations, you probably ask yourself why you should manage contracts. Your organization needs to manage contracts:

- to achieve the agency's **business outcomes** and deliver savings/efficiencies;
- as part of the agency's ongoing risk management; and
- to meet various governance, legislative and audit compliance requirements.

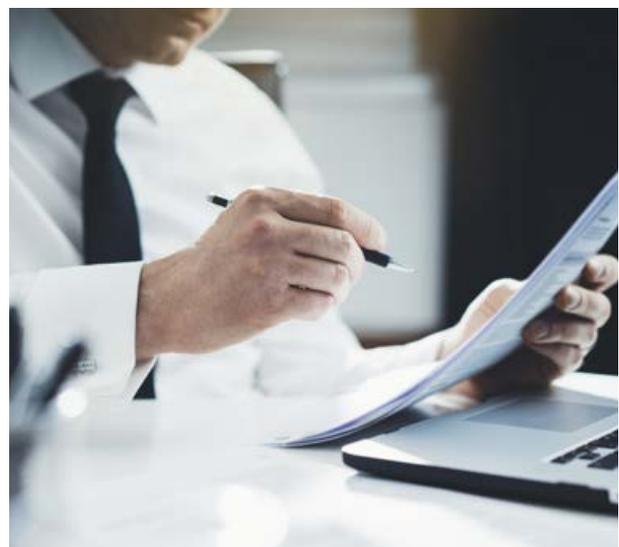
Successful contract management is more than just the management of documents, terms, conditions and a few signatures. Effective contract management relies on the implementation of successful post-award and upstream activities. Contract management is successful if⁷:

- the arrangements for service delivery continue to be satisfactory to both parties, and the expected business benefits and value for money are being realized;
- the expected business benefits and value for money are being achieved;

- the supplier is co-operative and responsive;
- the organization understands its obligations under the contract;
- there are no disputes (supported by no inconsistencies in the contract);
- there are no surprises;
- a professional and objective debate over changes and issues arising can be had;
- efficiencies are being realized.

A good contract management process does not only ensure that the agreed terms and conditions of the contract are being met. This is just one step, but the first of many that should be taken. No matter how well the contract negotiation process runs and the scope of the contract, there will always be some tensions between the different perspectives of the customer and provider. The idea behind a good contract management process is about resolving these tensions as soon as possible to build a partnership relation with the provider.

These relationships should be based on mutual understanding, trust, open communication and benefits to both sides. In that way, contract management could be compared to project management, because each contract is like a mini-project. It has unique goals, consumes resources, has a beginning and end date, and requires coordination and planning of relevant activities, as well as documentation in a contract file throughout the process. And each contract is different and should be treated separately.



GOVERNANCE AND STEERING MECHANISMS (INCL. KPIs)

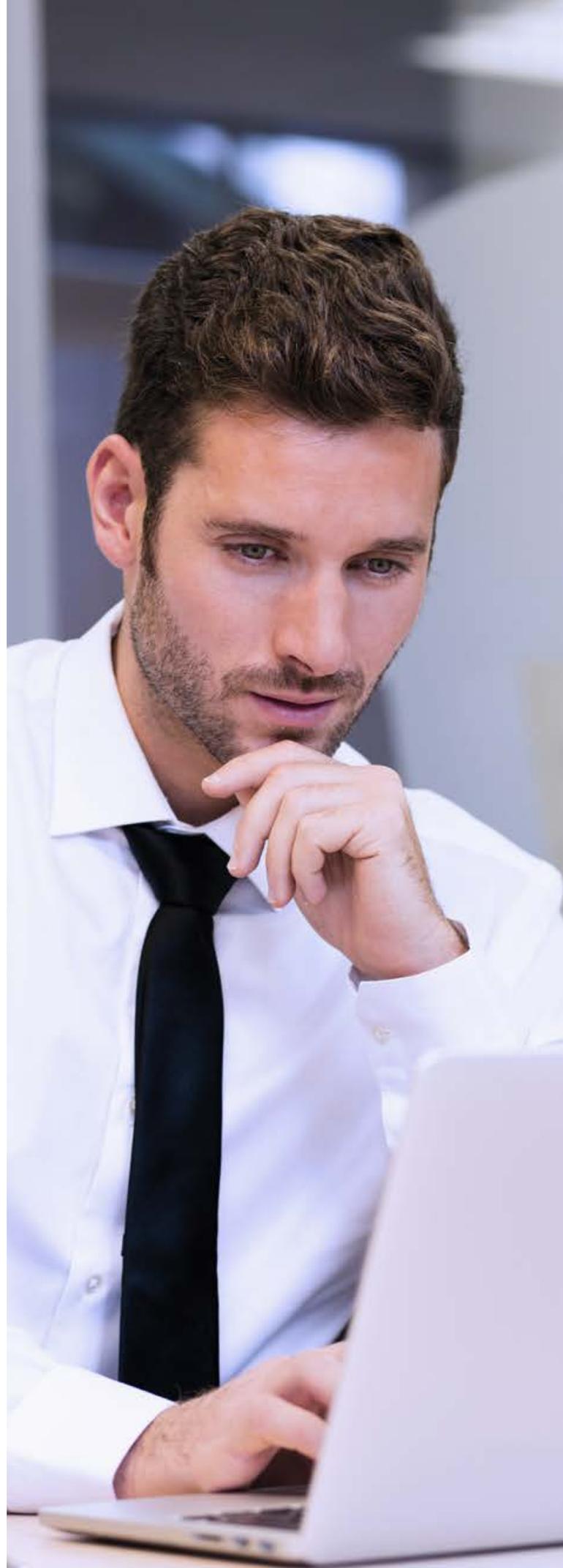
A governance model describes the organizational structures and roles that project participants can take on and the process for decision making and reporting within the project. A lack of governance can be considered a major threat to proper vendor relationship management. The nature of the governance model covers the following elements:

- **Strategic** – at this level, governance focuses on overall strategic performance, strategic KPIs and contract management;
- **Tactical** – at this level, governance focuses on relationship, performance management, including penalty and incentive systems, monitoring service improvement initiatives, escalation process, contracting, financials and KPIs;
- **Operational** – at this level, governance focuses on local day-to-day operational work.

To ensure efficient and effective periodic formal communication at the different steering levels, between all involved parties, meetings should be structured. This leads to a more constructive use of time.

Having clear communication lines between the client and vendor and assigning roles at each level is an important success factor of the cooperation between both parties. This is especially true if business processes are not working or some parts of agreements are unclear. That's why both parties should have clear knowledge about communication flows and the first person of contact at each level. This helps to solve problems quickly. There are different meetings defined on operational, tactical and strategic levels.

- **Strategic Meeting** – the purpose of this meeting is to ensure that both sides' objectives can be achieved in a balanced manner. For example, meetings with regional boards.
- **Tactical Meeting** – the purpose of this meeting is to assess whether the service portfolio continues to meet the current and future needs of the client.



- **Operational Meeting** – the purpose of this meeting is to ensure the timely and smooth implementation of planned and ongoing projects, releases and changes in which the vendor is involved
- **Business Continuity Meeting** – the purpose of this meeting is to discuss business continuity matters. (Business) Continuity Management makes sure the client’s business operations can continue during and after a disaster at an agreed level until normal business operations resume. Continuity management is also aimed at pro-actively preventing discontinuity and avoiding extended disruption.
- **Security & Compliance Meeting** – the purpose of this meeting is to discuss new developments and the progression of affairs and activities concerning security and compliance in relation to the services the vendor will deliver under the agreement. These meetings could have an on-demand character and be triggered by the Tactical Committee.

Steering Mechanisms should consist of two areas:

- Penalty and Incentive systems;
- Performance Management together with Key Performance Indicators (KPIs).

First of all, we would like to concentrate on penalty and incentive systems. They should be reasonable, systematically applied, and anticipated by the supplier. In practice, penalty and incentive clauses should be included in the SLA (Service Level Agreement) as a critical part of any vendor contract. It should also be mentioned in the letter of credit (if applicable) and on purchase orders. It is very important to make sure the supplier is aware of penalty and incentive systems. This system should refer to the compensation agreement and penalty and incentive clauses that determine the level of vendor compensation. Below are five ways in which penalty and incentive systems can make for a better business:

- Use penalties together with incentives – punishment cannot be used effectively without incentives. Penalties should be used to keep vendors on track. In the same way, incentives should be used as an encouragement to provide better services or products. This will benefit both parties.
- Communication is critical – all metrics and goals should be visible and clear to vendors. Additionally, regular communication helps both parties avoid potential threats.
- Establish the escalation process, which is important to solve any critical issue as soon as possible.



- Focus on your critical vendors – not all vendors are equal for your business. That’s why you shouldn’t try to apply penalty and incentive systems to all your vendors. The company should look at all high-risk vendors. An additional advantage is that the added attention will help you support and develop ongoing relationships with vendors.
- Different goals for different vendors – if you have a large number of vendors across different industries, don’t use the same metrics and key performance indicators to review the level of provided services or goods.

Sometimes a penalty system is not the best solution for your business. Use alternatives to a penalty system to support the development of your vendor relationships:

- Introduce a system of vendor rating for fairness and transparency;
- Exclude vendors from your approved list of vendors / suppliers;
- Collaborative root cause analysis;
- Timely planning of reviews and call off strategies to solve problems;

- A continuous vendor evaluation stage as part of the company procurement risk migration process;
- Meeting vendors on a regular basis.

Last but not least, performance management. Here we would like to find the reasons why you should measure vendor performance, as well as what and how should be measured. Don’t forget - the vendor’s performance must be monitored constantly from the beginning.

With increasing numbers of vendor relationships, it can be challenging for your organization to effectively monitor and manage each process. This should include the requirements that are most critical to your business. In order for the performance management process to be efficient and effective, you should implement and review it consistently. The vendor performance management process is an ongoing practice, definitely not a once-a-year task. It should show vendors the continual direction and feedback they need to improve and achieve. Here is a list of best practices in performance management

- Performance metrics must be established for each critical element / service and should be set realistically in view of other performance requirements;



- Metrics should also be maintained at an acceptable required level of performance;
- Vendor performance metrics should be subject to penalty and motivation systems;
- Vendor performance metrics as the focal point of all performance measurement should be both quantitative and qualitative in nature and developed according to the value objectives of the relationship;
- The most important of all metrics are Key Performance Indicators (KPI). KPIs should be defined and regularly evaluated under the contract.

Establishing effective metrics related to vendor performance management allows your business to:

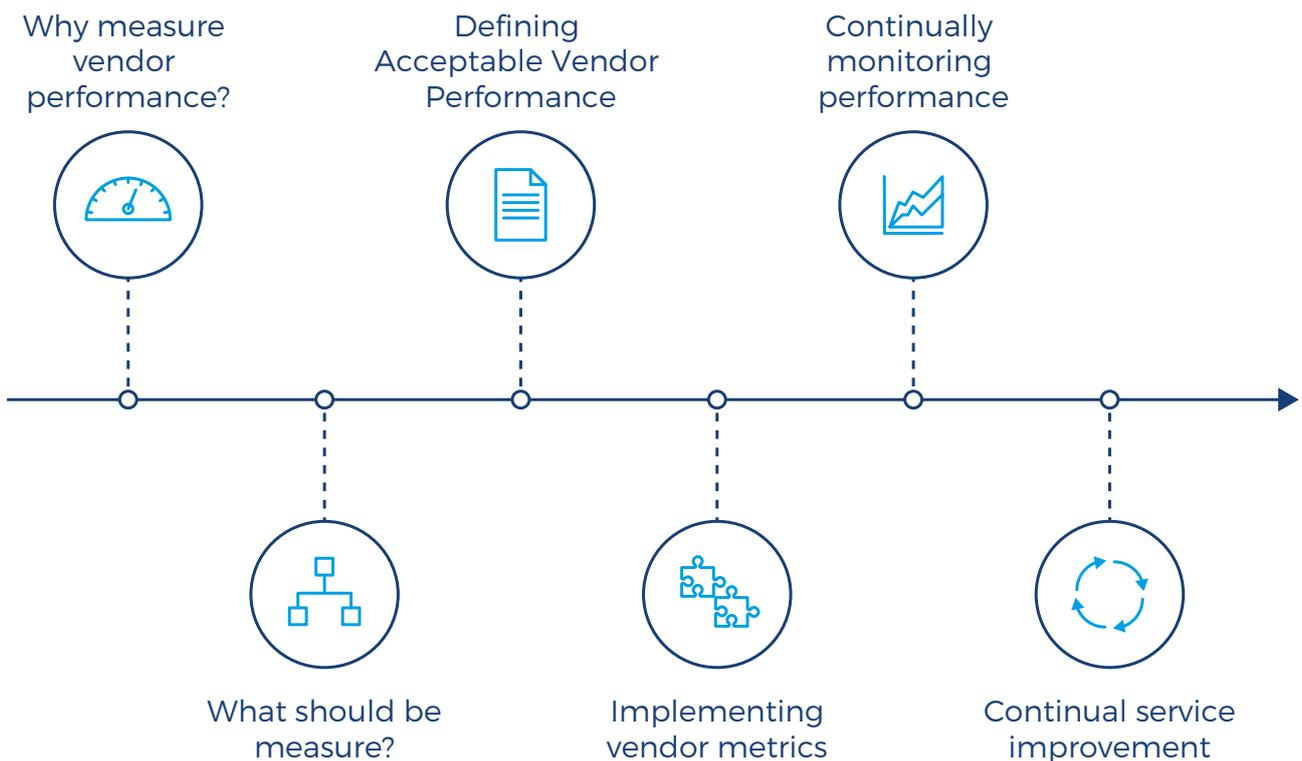
- Implement a future vendor selection process based on past performance metrics;
- Implement penalty and incentive systems based on performance;
- Adjust purchasing strategy based on accurate performance data;

- Effectively evaluate vendor performance for the expected level of quality and standards;
- Enforce expected service levels;
- Improve processes so problems are anticipated and prevented.

In choosing effective metrics, decide what is most critical for your business. The most important goal of any vendor performance metric is to motivate the appropriate behavior of both the client and the vendor. Sometimes less means more. It is better for your business to avoid choosing too many metrics. All metrics produce a voluminous amount of data, so if you choose an excessive number of metrics, no-one will have time to analyze them. Depending on the provided service, different types of metrics can be monitored. Below are some examples:

- **Priority 1/2/3/4 incidents are resolved within the hours as specified by the SLA:** Resolution is measured as a percentage of incident tickets successfully closed within the defined target;
- **Service Level Availability / Unavailability:** Availability is measured as the percentage of time a service should have been available vs. the

EFFECTIVE VENDOR PERFORMANCE





actual time the service was available per server (no average). Availability is counted as follows: the % that a service is below target is weighed in the formula of the average availability;

- **Defect rates:** Numbers or percentages of errors in major deliverables. Examples: incomplete backups and restores, coding errors/rework, missed deadlines etc.;
- **Service and Change Requests delivered on time:** The Service and Change Request (SCR) is measured by the number of SCRs delivered on time vs. the total number of SCRs;
- **Security:** Measuring security metrics, such as anti-virus updates and patching, etc.;

- **Satisfaction:** Measuring satisfaction metrics, such as stakeholder satisfaction and end-user satisfaction, etc.

Defining the right vendor metrics is just half way to success. To be useful, the metrics must define acceptable levels of vendor performance. The following factors ensure the effectiveness of performance measurement:

- the vendor performance management process review is performed in a timely manner;
- key stakeholders are engaged and support the process with agreed improvement plans and actions;
- measures align with the service level defined in the contract.

EXAMPLES PERFORMANCE MEASUREMENT METRICS FOR VENDOR MANAGEMENT⁸



VENDOR PERFORMANCE AND RISK REPORTS

- Total annual spend (by vendor)
- Aggregate internal risk assessment score across services / contracts (by vendor)
- Number of subcontractors violations by vendor type
- Vendor performance (on-time delivery, etc.)
- Percentage of SLA nonconformance (incident resolution, on-time delivery, etc.)
- Percentage of Wescalation issues (aged)
- Number of full-time employees assigned to the engagement / engagement spend
- Available capacity dedicated to client
- Percentage of invoices with price variance from contract



INTERNAL AND EXTERNAL CONTROL, COMPLIANCE, TEST AND QUALITY REPORT

- Percentage of quality assurance nonconformance issues by vendor
- Number of occurrences of noncompliance to contract terms
- Number of compliance nonconformance acceptances by vendor



FINANCIAL RISK

- Percent profit margin
- Percent debt to equity
- Credit capacity



EXTERNAL NEWS / MANAGEMENT REPORT

- Frequency of risk reporting
- Percentage of negative news returns per quarter



FINANCE AND COMMERCIAL MANAGEMENT

Financial Management covers the functions and processes responsible for managing vendor budgeting, accounting and charging requirements. It provides the business and vendor with the quantification, in financial terms, of the value of provided services and the value of assets.

First of all, we would like to concentrate on two aspects: pricing models and reporting. We will try to explore and understand that different pricing models exist in Vendor Management. Customers must use the right pricing model to meet their business objectives. They should remember that each pricing model has benefits and risks for both sides. Before choosing a right price model for your business, remember that the organization, not the provider, should define the pricing model. In addition, one of the most important factors in the context of pricing models is risk. Remember to make pricing model decisions early and revisit them often.⁹

Below are six factors which play a key role in the decision making process with regard to pricing models:

- Scope of work
- Client involvement
- Client – Vendor relationship
- Revenue & Value
- Risk
- Transparency

The most commonly used pricing models:

- **Time and Materials Model (T&M)**¹⁰ – this model is based on labor supplied at negotiated labor rates (such as hourly, daily or monthly). The vendor is obliged to supply the appropriate skills for the work to be performed or meet deliverables, milestones, schedules or service levels. The provider is reimbursed for the cost of the materials used or other costs incurred, such as travel expenses.
- **Fixed Price Model** – the model is based on a fixed amount, in preset periodic increments, for a fixed scope of work (SOW) at the completion of the project or when milestones are achieved.
- **Cost Plus Model** – In the cost-plus model, customers pay the provider for the actual cost of doing the work, plus an additional negotiated profit margin.
- **Open Book Model** – In the open book model, customers pay the provider for the actual cost of service delivery, plus an additional negotiated profit margin.
- **Gain-Sharing Pricing Model**¹¹ – a pricing model based on the value delivered by the vendor beyond its typical responsibilities, but deriving from its expertise and contribution. This payment model is best for customers who want to create a true alliance with IT vendors. Both sides work together to obtain a common goal, that's why the model encourages collaboration and creative problem-solving. On the other hand, the gain-sharing pricing model requires a high level of trust with equitable distribution

9. "Pricing Model Definitions, Benefits and Risks for IT Services and Outsourcing Contracts"; Gartner

10. "Pricing Model Definitions, Benefits and Risks for IT Services and Outsourcing Contracts"; Gartner

11. <http://www.cio.com/article/2397240/outsourcing/4-new-it-outsourcing-pricing-models-gain-popularity.html>

of potential risk and reward. Of course, it is not without significant upfront investment.

- **Incentive-Based Pricing Model**¹² – a pricing model based on bonus payments. This model is for those vendors who are able to achieve specific performance levels above the contract's service level agreements. This model is often used together with a traditional payment method, such as time-and-materials or fixed price. This model is best for customers who are able to identify specific vendor investments in order to deliver a higher level of performance.

- **Consumption-Based Pricing Model (Unit-based/ Use-based Model)** – a pricing model based on amounts of services that customers use or consume. Costs are allocated based on actual usage (e.g., gigabytes of disk space used or help desk calls answered). This model is best for cloud computing providers.
- **Shared Risk-Reward Pricing Model** – the provider and customer jointly fund the development of new products, solutions and services with the provider sharing in rewards for a defined period of time.



RISK MANAGEMENT

Your successful business operations depend on suppliers, distributors and other third parties. You need to be confident about who you're doing business with and what business you're doing business with them.

According to Gartner's definition, risk management in vendor management is "the process of ensuring that the use of service providers and IT suppliers does not create an unacceptable potential for business disruption or a negative impact on business performance. Vendor risk management technology supports enterprises that must assess, monitor and manage their risk exposure from third-party suppliers that provide IT products and services, or that have access to enterprise information."¹³

When an enterprise outsources business processes to an external vendor, sensitive data may be transmitted, stored and processed on both company and vendor networks. Risk management

should be a comprehensive plan for identifying and decreasing potential business uncertainties and legal liabilities.

Risk management is a risk-based approach to managing vendor relationships through:

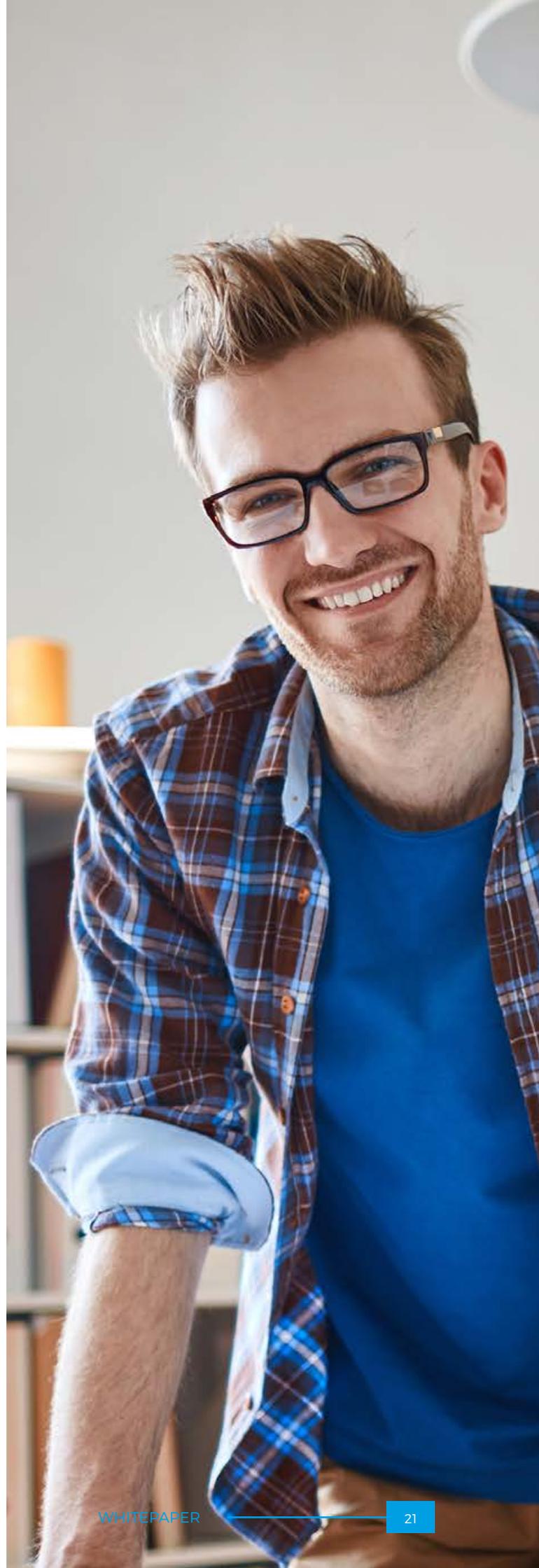
- Identifying potential risks
- Risk prioritization
- Analyzing risks and their potential impacts
- Developing effective vendor risk management strategies
- Vendor due diligence
- Continuous risk and vendor monitoring / Ongoing risk management

12. <http://www.cio.com/article/2397240/outsourcing/4-new-it-outsourcing-pricing-models-gain-popularity.html>

13. <http://www.gartner.com/it-glossary/vendor-risk-management/>

Vendor risk categories:

- Financial risk (vendor unable to meet contract obligations due to financial difficulties)
- Operational risk
- Environmental / Market risk
- Compliance risk (e.g.: violations of applicable laws, rules, regulatory mandates)
- Business continuity risk
- Geopolitical risk (country-specific factors, i.e. government, climate and politics)
- Technology / Information security risk
- Reputation Risk (e.g.: negative public perception and opinion of vendors)
- Service Delivery (vendor unable to meet client service standards or SLA parameters)Successful risk management strategies should include:
 - A contract which should have a clear description of what the vendor is to provide (i.e. deliverables and obligations), service levels required (i.e. SLAs), the financials of the relationship (e.g. prices, how billed, invoice disputes), and exit procedure (in case of the need to change vendor).
 - A contract outlining the business relationship between the organization and the business.
 - Consistent monitoring of vendor performance to ensure that contract stipulations are being met.
 - Guidelines regarding who will have access to what information as part of the vendor agreement.
 - Stipulations to ensure that vendors meet regulatory compliance guidelines for your industry, and methods to monitor this compliance.





4. THE SUCCESSFUL VENDOR SELECTION PROCESS

One of the initial phases of the vendor management cycle is the vendor selection process, which can be a very complicated and emotional process if you don't know how to successfully approach it from the very beginning. The vendor selection process consists of a multi-stage framework to evaluate not only what

the supplier can do, but also the way it's done. It's important to know that the vendor management process takes some time and usually lasts between 6 - 12 months. A good vendor selection process should consist of the following steps:



- **STEP 1:** Define your objectives and goals
- **STEP 2:** Find out all you need to know about the vendor – Plan the RFI
- **STEP 3:** Prepare the RFP
- **STEP 4:** Evaluate the response
- **STEP 5:** Proof of Concept (PoC)
- **STEP 6:** Choose the Vendor Conclusion

If the scope to outsource is small or organization resources are limited, the aforementioned steps can be narrowed, i.e. by not conducting the RFI or RFP processes.

STEP 1: DEFINE YOUR OBJECTIVES AND GOALS

First of all, you should start with selecting a team of people who not only have knowledge and expertise in vendor management, but also have a common interest in this specific vendor selection process. Together with the team, you should analyze all business and technical needs. This is the toughest part, but success here will put you on the right track in selecting the right vendor. At the end of this stage, you should have defined the outcome (product, material or service) you want outsourced together with the technical and business requirements. Defining all these needs helps your company explain where you are right now, show where you want to be in the near future and how to get there. You should also specify what your business goals are through outsourcing. While formulating your objectives, remember to answer the following questions:¹⁴

- What do you want to outsource?
- What type of outsourcing agreement are you looking for?
- Fixed Price contracts (fixed project, fixed monthly recurrent fee)
- Time and Material costs (i.e. agile projects)
- Hybrid (Costs plus Fixed fee)
- What are the nearshore and offshore outsourcing locations that you are interested in?



- What are your goals in outsourcing?
- What services do you expect a vendor to provide?
- How much do you plan to spend?
- What are the risks associated with such an outsourcing agreement?

Selecting the type of outsourcing agreement is an important aspect of the vendor management process. The three definitions below present how different IT service consultants can measure their services to clients.

In **Fixed Price contracts**, both the price and the scope of work are set in the SOW and neither change without agreement from both parties. With Fixed Price contracts, the vendor is an IT professional who bears the risk. These types of agreements are negotiated usually where reasonably definite specifications are available, and costs can be estimated with reasonable accuracy.

Time and Material Cost contracts are agreements under which the client agrees to pay a set amount per hour (actual cost of direct labor) plus the actual cost of materials and equipment usage. Time and Material Cost contracts are typically contracts for construction, product development or any other piece of work. With Time and Material Cost contracts, the client bears the risk.

Hybrid forms of agreements are outsourcing agreements where portions of a Cost Plus agreement are combined with a Fixed Cost Agreement. The main idea is to provide the best of both types of agreement.

STEP 2: FIND OUT ALL YOU NEED TO KNOW ABOUT THE VENDOR – PLAN THE RFI

The vendor selection process would not be complete without listing the criteria that the vendor itself must meet. The Request for Information (RFI) shares information about the features or capabilities you are looking for in a vendor and helps you with the first rounds of vendor evaluations.

RFI should also help you with defining a shortlist

of qualified vendors for the next step of selection. You can find potential suppliers through a variety of channels. It's best to identify as many third party vendor candidates as possible with consideration of the available resources to manage the selection process. Each of the selected vendors should receive the RFI from you. Based on the received responses, you will be able to create a shortlist of vendors.



STEP 3: PREPARE THE RFP

The next step is to develop the formal Request for Proposal (RFP). The RFP should be sent to at least three short-listed suppliers. After evaluation, you should select the best vendor that matches your requirements. Information collected during the second step of the vendor selection process should be included as the solution-requirements section of the related RFP. A good RFP sent to vendors should consist of the following information:

- Introduction and Executive Summary
- Brief project / service overview
- Project goals and target audience
- Instructions to vendors in terms of structure of the proposal, proposal language, contact for questions, timeline
- Scope of Work & Deliverables
- Business and technical requirements
- Vendor profile
- Expected vendor methodology

- Infrastructure
- Financial conditions

Here is the outcome which should be delivered by vendors:

- Vendor profile (incl. vendor financial situation)
- Technical Solution Architecture
- Service Catalog (Scope of Work & Deliverables) and SLA levels
- Service Implementation or Transition Project (incl. expectations toward client)
- Track Record (references)
- Pricing Matrix and Financial conditions

STEP 4: EVALUATE RESPONSE

Start by building an evaluation sheet based on the RFP (which again reflects your requirements). By providing a weight to each of the criteria and evaluating each vendor response against these criteria, you will get a total score per vendor. After you get the information you need, fill in as much of the evaluation sheet as possible. Your goal is to see if any vendor fails to meet your “must have” requirements.

STEP 5: PROOF OF CONCEPT (POC)

During the Proof of Concept (PoC) stage, you will have the opportunity to check the vendor’s actual capability to deliver the required services or products. This is also a good opportunity to get an overall impression of the vendors and check their ‘soft factors’ (i.e. culture).

STEP 6: CHOOSE THE VENDOR CONCLUSION

After all the steps, it is now time to make your choice. Identifying and selecting the right vendor is crucial to a project’s success and the eventual adoption of any new system or process. **Making the final decision means signing a contract.** An outsourcing contract should clearly define the performance measures, team size, team members, pricing policies, time frames, regular reviews, business continuity plans, and overall quality of work standards.

Best practices for establishing a selection process include:

- Determining the role that an RFP or RFI will play in the selection process;
- Deciding on the appropriate documentation for the deal (contract, SOW, SLAs); and
- Involving third party consulting firms in selecting the right vendor.



5. BENEFITS OF IMPLEMENTING VENDOR MANAGEMENT



The main objectives of vendor management are to help clients meet their business objectives, minimize potential business disruption, avoid deal and delivery failure, and ensure more-sustainable multi-sourcing, while driving the greatest value from their vendors. Good vendor management will accrue the following group of benefits:

Quality and performance improvement

1. Formalizing practices to measure and manage vendor performance through target policies, controls, processes, accountabilities and the governance structure;
2. Improving the time to market of new features, services or products by vendor governance, and the set of KPIs focusing on service agility;
3. The opportunity to engage suppliers and clients in a process of continual improvement of both products and services provided, and of the accompanying service levels; Fewer misunderstandings, less miscommunication and better communication with vendors by regular reviews and improvements in processes, communications and purchaser/vendor interaction;
4. Ensuring vendor processes and policies are compliant with the organization's;

5. Improving internal and external information flow between all the players engaged in the vendor management process;
6. Experienced staff are released from problem solving to concentrate on core-business processes;
7. Increasing vendor performance with metrics.

If the scope to outsource is small or organization resources are limited, the aforementioned steps can be narrowed, i.e. by not conducting the RFI or RFP processes.

Cost optimization

1. Total cost reduction - lower costs for managing the long-term relationship and reduced costs through failures;
2. Management overhead reduction - your internal teams spend less time and more easily manage vendor relationships, existing contracts and negotiate new ones.
3. Risk reduction - fewer incidents, service failures or issues of poor performance, reducing main business process outages and disruptions;
4. Enabling the organization to proactively address issues before they become problems.

6. CASE STUDY OF A FINANCIAL SERVICES IT OUTSOURCING PROJECT

The case is related to the financial services sector, where the client decided to select a provider to:

1. make a transition of IT services from the current offshore provider to a nearshore location in Europe;
2. deliver the managed platform as a service and technical application management.

Both business and IT stockholders were involved because the main driver for this project was the transition and transformation of one of the business lines. The selection process was supported by an external consulting company, which ensured structure and governance for the process.

BUSINESS AND IT CHALLENGE

There were many business obstacles (i.e. HR transfer of business analysts), as well as the following challenges related to the IT project.

1. Tight schedule due to business restrictions:
 - a. Selection and contracting: 3 months
 - b. Service Transition: 4-6 months
2. International team located in different locations spread around the world
3. Incomplete and outdated documentation
4. Outdated infrastructure (lack of life-cycle updates and upgrades)
5. Flexibility of volumes and prices

SOLUTION

Of course, we can look at these topics from different angles: technology, project and resources, service delivery, etc. However, focusing on the vendor management aspect, the following areas are very important and need to be monitored and managed.



- Relationship development
- Contract management



- Governance, Issue & Dispute Management
- Finance and Commercial Management

In the aforementioned case, different stakeholders were involved in relationship development: client representatives (CIO, project manager and change manager, vendor manager, and procurement), a consulting company and the provider (account manager, IT architect, project manager and delivery manager).

Based on this experience, I can say that Relationship Development determines success in IT Outsourcing projects and is very important during each step of the process.

- During vendor selection, it supports the management of business expectations and the understanding of the client’s needs;
- During the contracting phase, it helps to speed up the negotiation process through better communication;
- During the transition project, relationship development helps to speed up the solution of issues and the removal of project obstacles;
- During service delivery, it supports service improvement and alignment with the client’s needs and expectations.

Contract management is not just a contracting phase. This activity should be carried out before contracting – to prepare the contract structure, to identify potential show stoppers and areas to

negotiate. It is important to prepare – during the contracting phase – agreements which can be easily managed after contract signing. I do recommend putting some “regular contract review” clauses/KPIs to Steering Mechanisms.

The governance helps the parties to understand the process/project, to identify responsibility, and defines communication flows. It is important to establish governance for each step of the process (selection, contracting, transition and/or transformation, delivery).

- Who is the single point of contact?
- How often should we hold project meetings and who should participate?
- How can we escalate issues? Who should we contact in case of disputes?
- What are the KPIs (i.e. meeting frequency, reaction time on escalations, etc.)?

Regardless of the answers, we strongly recommend making it simple, doable, and adjusting it to the specific needs.



The Finance and Commercial area has many perspectives and dimensions. Focusing on the case, the main challenge was related to cost variability – correlate changing demand with capacity and costs (pay as you use model). Based on these criteria, a flexible pricing model was developed. However, during service delivery, additional governance mechanisms were added to control the current capacity utilization to better predict future costs.

In this area, it was important to have an adaptive approach, which provides flexibility and supports future demand changes (business upscale / downscale).

CLIENT BENEFITS

We believe that proper vendor management (relationship development, contract management, Governance and finance and commercial management) is a key success factor for IT Outsourcing projects.

By executing that, the following was achieved in the case.

- The IT Transition Project was finished on time, and the business could migrate the product line on time as well.
- The platform was upgraded, so the risk of unavailability was reduced.
- Service quality – confirmed by the end users – is very high
- Demand and capacity management is executed, which helps to align costs with the business needs.

CASE STUDY TAKE AWAY

Here is a list of key elements related to vendor management, which have helped to successfully finish the project and start operations.

- Building relations with the vendor
- Establishing Governance
- Defining goals and KPIs
- Executing Vendor Management



7. SUMMARY

In today's rapidly changing business environment, global companies should constantly evaluate their strategic vendor relationships. As a customer, you should take a closer look at how your company manages its vendor relations, who your **strategic partner** is and what a successful vendor selection process should consist of.

The success of an outsourcing project is not signing a contract with vendors. Here, everything is just beginning. **Your success depends much more on how well you can manage the process before and after signing the outsourcing contract.**

To increase your chances of success, you have to do two things.

- Most importantly, having a truly successful business is based on **building two-way trust**. Trust is a basic condition for each successful cooperation. Based on years of our experiences, trust can take a long time to build and only one short moment to be destroyed. Without trust, real mutual understanding and effective collaborative work are compromised.
- Secondly, you can't forget about **communication** in order to successfully manage projects. **Don't assume that the vendor intimately knows your business or can read your mind.** Don't be afraid to share information and priorities with your partners. Of course, not all information, but information affecting your cooperation. Regular communication will avoid misunderstandings and proactively address issues before they become real problems.

COMARCH

ABOUT COMARCH

Comarch, a global software provider, also offers reliable services related to IT infrastructure. Comarch outsourcing gives customers access to thirteen Data Centres located all around the world. Extensive international experience and the number of international offices allows the company to offer nearshoring services. The flexibility of our solutions convinced global brands, including Thomas Cook, Heathrow and BP, to establish a long-term cooperation with Comarch. For 22 years, the company has helped them to optimise business costs by using the latest technologies and ensuring the highest data security standards.

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