Supplier Management for Complex Outsourced Services: A Strategic Framework

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Abstract. Your sourcing was flawless, but the deal did not deliver the value predicted. It’s the vendor’s fault – right? Maybe not. Research shows that twenty-five percent or more of the total contract value is “leaked away” or lost as a result of failing to effectively manage the supplier relationship after the deal is inked. This risk is amplified when the procurement is for complex outsourced services.

We will explore the rationale for implementing a supplier management strategy, and will propose a framework for implementing a strategic supplier management program. This framework is specifically tailored for supplier relationship managers and supply management professionals responsible for complex outsourced service agreements such as mail, food, travel, print, facilities management, HR, F&A, and employee benefits.

Definition – What Is “Strategic Vendor Management?” (Please note that for our purposes, we use the terms “supplier,” “vendor,” “supply partner,” or “service provider,” interchangeably.) We must define strategic supplier management in terms of its effect on our organizations, functions, finances, and business partners. For our purposes, strategic vendor management is a program whose intent is to:

- align performance to meet organizational objectives
- handle changing requirements
- strategically plan for the future
- continuously improve the value of the deal
- effectively communicate throughout the organization
- mitigate risks
- promote transparency

By designing, developing, and implementing a strategy to accomplish the above goals, the supplier manager will align the goals of the organization and the stakeholders with the sourcing initiative. Whether the desired results of the initiative were to obtain the best product, secure the cost effective delivery of the service, increase customer satisfaction, or increase shareholder value – strategic vendor management provides the framework to ensure that the ongoing relationship with the service provider(s) accomplishes these results.

Why Should You Have A Vendor Management Strategy? As a function, the attention and pressure is on supply management to deliver the value and savings promised as a result of sourcing efforts. Business units are looking to supply management to make them more competitive by simultaneously reducing expenses, increasing quality, and reducing cycle times. And yet – sourcing initiatives routinely fail to deliver the full value expected.
Reasons why strategic sourcing as a practice and the associated investments in technology solutions have not delivered the desired results include:

- inflated expectations of the capabilities of e-sourcing platforms
- underestimation of the level of effort or difficulty in implementing technologies and/or managing change in our organizations
- failure to acknowledge and execute on the critical supplier management tasks which succeed sourcing

The economic impact of failing to effectively manage supplier relationships is tremendous. In a 2004 survey of the most frequent causes of outsourcing failure conducted by the Outsourcing Center, sixty-two percent of all outsourcing failures were attributed to poor supplier and/or relationship management. Only eight percent of failures were attributable to poor performance by the vendor.

In 2006 Expense Management Solutions conducted a survey on “Strategic Vendor Management,” in which respondents cited losing an average of 20% to 30% of the value of their outsourcing contracts because of inconsistent or ineffective vendor management. In a survey on “Leading Outsourcing Indicators,” over forty percent of respondents felt they lost between 10% and 25% of the value of their outsourced contracts as a result of poorly managed outsourcing relationships. Twenty-one percent felt that they lost more than 25% of the contract value. The bottom line: We leave on the table, or allow to “leak away” millions or even tens of millions of dollars when we fail to exercise competent stewardship over our supplier relationships.

Components of a Comprehensive Supplier Management Strategy. So how do we construct a vendor management strategy that exhibits copious and transparent communications, fosters a high degree of trust, enables collaborative and creative problem solving, results in a mutual understanding and shared goals, exposes conflicts and tensions early, and provides the mechanisms with which to accept differences and resolve disagreements with mutually acceptable solutions? Within our implementation framework, we have found that there are several key elements which enable effective vendor relationship management. These include:

- Supplier segmentation
- Demand management
- Market management
- Performance management

We will discuss each of these elements, examine how they combine to provide a comprehensive solution framework, and identify the differences between managing supplier relationships for materials or commodities, and managing relationships for complex outsourced services.

Supplier Segmentation. You have a limited amount of time, energy, and resources to invest in managing supplier relationships. You must strategically allocate these scarce items to ensure your efforts are aligned with the organizational goals. Segmenting your supplier base will help you do this.
Segmentation approaches vary by organization and environment, and often take the form of a four-quadrant matrix comparing two variables. One segmentation comparison may be strategic importance of the current vendor versus difficulty of switching to a new vendor. Alternatively, you could compare the specialization levels of the service versus the amount of annual spend for that service. Criteria for use in segmentation may include:

- degree of interdependence between customer and supplier
- level of spend
- strategic importance of supplier
- number of business units served by supplier
- complexity and frequency of changes in contract requirements
- type and number of products and/or services provided by supplier
- cost and difficulty in switching suppliers

A common mistake associated with segmenting your supplier base is to think that you only have to develop a vendor management strategy and perform supplier relationship management for those vendors in the “upper right” quadrant. You must actively manage all your vendor relationships - the difference is that your supplier relationship management strategy and tactics will vary by segment. For a commoditized service such as cleaning, your supplier relationship management approach may be for the business unit or commodity manager to handle the day-to-day interactions, manage by exception, and to utilize an annual review to gauge service delivery reliability and performance. At the other end of the spectrum, strategic partnerships such as outsourced clinical trail services for a pharmaceutical company will require a dedicated, cross-functional governance team, scorecards and other formal performance management tools and programs, quarterly and annual performance reviews, and compensation structures with at-risk fee components.

What’s different for complex outsourced services? Segmenting your supplier base for complex outsourced services is far more difficult than for materials or products. It is relatively simple to distinguish between the strategic importance of the vendor of a stainless-steel screw versus the supplier of the ion-implantation gun used as the heart of a semiconductor manufacturing apparatus. It is far more difficult to discern the strategic importance of your integrated facilities provider, given that they manage everything from janitorial services and landscaping to global real-estate project management and facilities engineering. You need to tailor your relationship management processes and resource investments to align your governance model, negotiations strategy, planning and communications approach, quality management, and performance management activities based on this segmentation.

**Demand Management.** All too often, we focus on what we want the supplier to bring to the table, and neglect to critically examine what should be expected of our own organization.

From within your organization, make sure you are utilizing your preferred vendors, aggregating demand across business units, leveraging contracts where the timing of orders affects the price, and using the appropriate and agreed-upon ordering processes. Ensuring that your internal customers request service levels and quality that are consistent with the performance metrics of the contract will help to control costs by avoiding special services such as unscheduled trash pickup or expedited courier service.
What’s different for complex outsourced services? Managing your organization’s demand can be more difficult when dealing with services than materials or products. Very often, consumption of corporate services is enabled through Web portals or service desks with toll-free numbers. Because of these numerous consumption points, aggregate demand is more difficult to forecast than demand originating from MRP systems – and it changes more frequently. There are often few if any controls on what an employee orders, regardless of whether the service is part of the core contract, or is considered special or expedited services. It is necessary to coordinate employee training, organizational processes, vendor fulfillment processes, and automated systems so that the correct services are ordered from the proper supplier as specified in the contract.

Market Management. Everyone performs a market analysis during sourcing events. You endeavor to understand the markets in which your suppliers operate, and the pressures those markets bring to bear on the suppliers so you can make the best evaluation of the vendors’ offerings. To be effective at supplier relationship management, you can’t do this once every three to five years during a sourcing initiative. This knowledge must be maintained throughout the term of the contract.

Market management entails obtaining a thorough understanding of the environment in which your suppliers operate. This includes:

- marketplace analysis
- product and service analysis
- supplier/buyer analysis
- technology analysis
- economic factors analysis

To effectively manage an ongoing supplier relationship, it is necessary to understand what makes suppliers in this market successful, how the market is structured, who are the key suppliers, what are their core products and services, and how those products and services are delivered. You need to maintain current knowledge of the overall health of the industry, what the total market size is, what percent of that market is owned by your suppliers, and what percent of that market your demand represents. You need to understand how the market is segmented, and if certain suppliers focus on a specific segment – and thus develop expertise and specialization in a particular vertical or geography.

What’s different for complex outsourced services? In many ways, commodity and materials managers are more advanced in this area than managers of outsourced services, and yet, effectively managing outsourced services is often as much, if not more dependent on understanding what is going on in the market. You can be assured that a buyer of components understands the effect of increasing costs of raw materials, or knows when two large competitors in that market merge. As buyers of outsourced services, detailed knowledge of the market will foster a greater understanding of the pressures experienced by your suppliers due to industry expansion or contraction, new legislation or regulations, or geo-political factors, and allow you to more effectively manage those relationships.

Performance Management. Implementing a program to continuously monitor and manage supplier performance closes the “feedback loop” on this cyclical process. Performance
management is critical, and sets the stage for either an effective program of supplier relationship management, or a relationship where disappointment and dissatisfaction fester, performance fails to meet expectations, and a “divorce” becomes inevitable.

A pivotal event is the hand-off between the sourcing team and the relationship manager or management team. A formal transfer process and summary instrument or form is necessary to ensure that deal knowledge developed during the sourcing process is not left behind. They ensure that the relationship manager, who may or may not have been involved in the sourcing effort, is fully cognizant of all the relevant points of the deal. They also provide a final checkpoint to be sure the vendor’s perception of details of the deal and the relationship manager’s perception are in sync.

Formal performance management planning and execution follows, and should include:

- Identification of the vendor representatives and relationship management team members
- Definition of the roles and responsibilities of the members on both sides of the relationship
- Documentation of the organizational structures in which the relationship management team will operate
- Identification of, and creation of the schedule for periodic meetings and reviews
- Review and acknowledgement of performance metrics and targets defined as part of the statement of work
- Design, development, and ratification of service provider scorecards, customer satisfaction surveys, and other processes and instruments used to assess vendor performance
- Design and implementation of a communications and operational coordination process
- Design and implementation of an issue escalation process

What's different for complex outsourced services? Planning and operational coordination are vastly different for complex outsourced services compared to management of the performance for vendors of materials or commodities. At the outset, you must define which members of the team will meet with vendor representatives, and on what schedule. Complex service contracts often require daily operational meetings or conference calls until all processes are working smoothly. Compared to passing incoming quality inspections for materials, customer satisfaction with complex services is far more difficult to assess. And the importance of communicating all aspects of the relationship that affect both customers and the vendor is greatly increased when dealing with complex outsourced services.

Conclusion. Effective strategic vendor management results in a fundamental shift in the way in which we view our relationships with our outsourced service providers. “Getting the vendor to meet our needs” is transformed into “finding a way in which both our needs can be met.” When things go wrong, “blame and punish the vendor” is transformed into “quickly communicate the issue, and jointly find solutions to fix the problem and avoid recurrence.” And “unpleasant surprises” are replaced with “integrated planning and copious communications.”

Strategic supplier management will minimize risks, identify opportunities to avoid and/or reduce costs, monitor and manage demand, and capitalize on the synergies created between you and your suppliers. You may just retain that 30% of the contract value.
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