INFO~TECH
RESEARCH GROUP

What Is Vendor Management?

Info-Tech's Five Vendor Management Pillars of Excellence.

By Steve Jeffery and Phil Bode

Introduction

Tired of a One-Size-Fits All Approaches to Vendor Management? Here Is a Common-Sense, Practical Approach That Is Configurable to Your Situation

After attending a recent procurement conference where vendor management was discussed, Steve left dismayed at the roundtable debate about the definition or interpretation of vendor management. During his long flight home, he had many hours to reflect on the state of vendor management. Upon his return, Steve said to Phil, "We really need to write the article we've been talking about. People think vendor management is managing vendors. If that's a definition, it's dysfunctional, not helpful, and definitely not meaningful!" And that is the genesis and thesis of this article.

In researching the topic, we discovered that every supplier providing vendor management advice and services has its own definition. In many instances, the definitions supported a "proprietary" way of approaching vendor management … one that supported a product or service being sold by the company. Next, we looked at vendor management job openings posted on the internet. This only clouded the issues since there was little overlap between job descriptions and the vendor management definitions espoused by consulting companies. Many of the job descriptions focused narrowly on components of vendor management: category management, finance, third-party risk, supply chain management, and managing subcontractors. We recognize that these *can be* elements of vendor management; however, each by itself is not broad enough to be a good definition of vendor management.

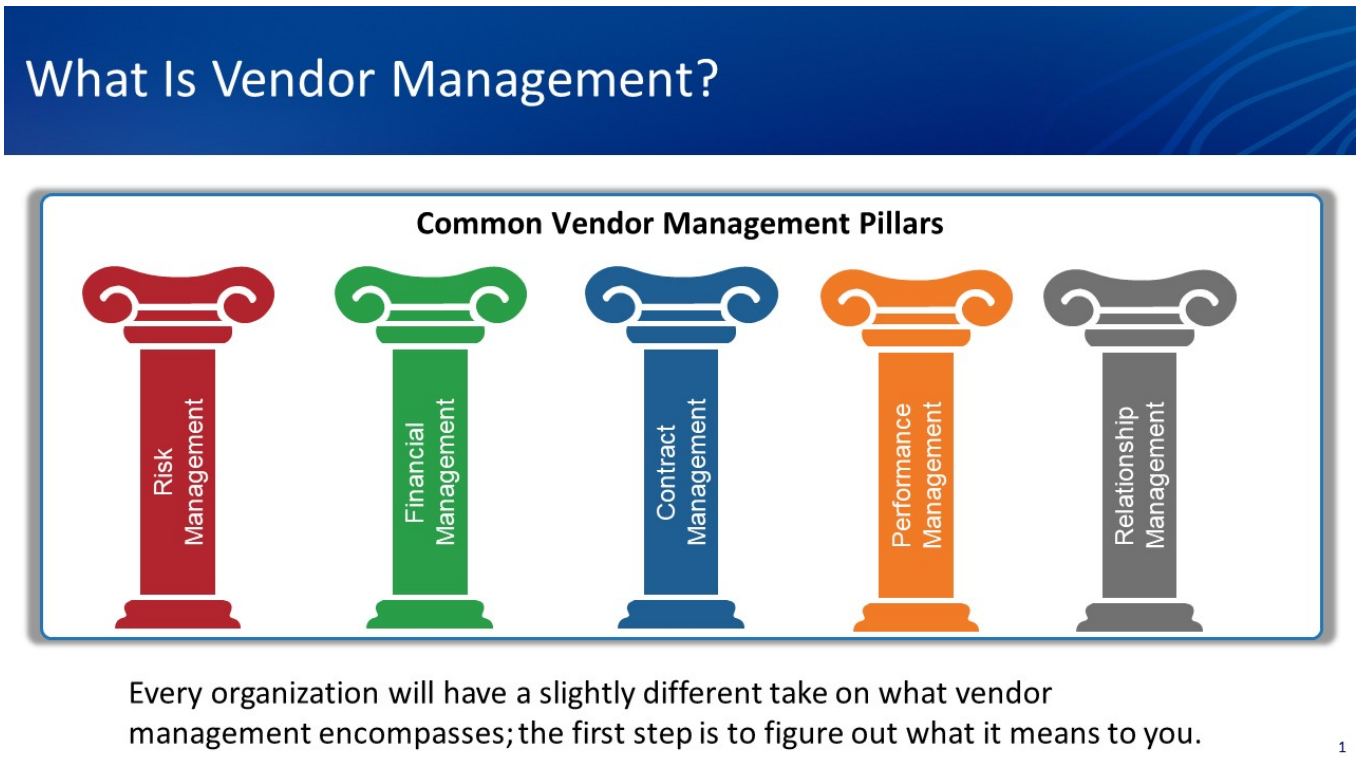
Vendor management has become very popular in the last five years, despite a history going back more than 25 years. The problem is that vendor management has evolved, but definitions and perceptions are being limited by archaic views. When looking at COBIT (and others), vendor management is not purely financial management; when done properly, it is part of the strategy and governance category.

What Is Vendor Management?

Vendor management is a proactive, holistic, and strategic approach to interacting with vendors from cradle to grave (i.e. onboarding through offboarding). It comprises five main *Pillars of Excellence* with each *Pillar* comprising unique processes that are complementary to the other *Pillars*. In addition, vendor management exists as a spectrum: at one end you will find formal, well-staffed, and robust vendor management offices (VMOs), and at the other end you will find a part-time person using some vendor management practices, tools, and/or templates to improve their exchanges with their important vendors.

In talking to our members, it became readily apparent that many organizations live (or want to live) somewhere between the two extremes of the spectrum. Initial discussions about VMOs were met with head shaking, hand wringing, and exasperation. For that reason, we needed a new term to explain vendor management – the term VMO repelled people rather than attracting them. We decided on the term vendor management initiative (VMI) as a way of getting people to understand that their desire to implement some vendor management leading/best practices could live on the spectrum (and be successful) without having to invest in a robust VMO. To date, people have been receptive to the new term, and they have begun to embrace vendor management as a result.

By now, you have probably figured out a few things: 1) vendor management can mean a lot of different things based on who you talk to and what that person's goals are, 2) vendor management is too broad to be defined simply, and 3) vendor management is highly customizable or configurable depending upon an organization's needs and desires. Vendor management is the unifying foundation for five main *Pillars of Excellence* (see chart below).



Info-Tech's Five Vendor Management Pillars of Excellence

While it is not necessary to incorporate all of these *Pillars*, the more elements and *Pillars* present in a VMI, the more strategic and impactful it can become.

The Five Vendor Management Pillars of Excellence

We'll explore in greater detail below each of the *Pillars of Excellence,* but it is impossible to address all the components comprehensively in this short article.

Pillar 1: Risk Management

Historically, cybersecurity has been the risk most organizations have focused on. When the COVID-19 pandemic hit, supply-chain risk, including the availability of parts and human resources, came to the forefront as well. Third-party risk management (TPRM) has become a hot topic because of the importance of reducing the negative impact of a vendor's inability to perform. While cybersecurity risk and supply-chain risk get a lot of attention (and deservedly so), the VMI must look beyond those two risks. The VMI should be an active participant in identifying, assessing, measuring, managing, and reporting the organization's exposure to various risk categories. Here are a few common types:

- Security
- Supply Chain/N-Party
- Financial
- Reputational
- Operational
- Legal
- Strategic
- Regulatory and Compliance

Risk events from any category can have a significant impact on a customer's organization. To help you identify and quantify the risk, consider using the What If Game and corresponding Risk Impact Tools developed by our colleague Frank Sewell. The game and tools prompt discussion on potential risks, help create a comprehensive risk strategy, and educate senior leadership. (For more information, download *Identify and Manage Financial Risk Impacts on Your Organization* from our vendor risk management series.)

Pillar 2: Contract Management

The VMI's involvement with contract management includes negotiating the initial contract, amendments and other modifications, statements of work, and other contract-related documents. The VMI is an integral part in renewals, renegotiations, terminations, and deficiency notices. In addition, contract management focuses on contract compliance – the customer's and the vendor's. It is critical that deficiencies be identified early in the process and before they have had a chance to become impactful. Initiating corrective actions

early is less costly, less time consuming, and less emotional than waiting until an event has gained significant size and momentum. In short, the VMI must be knowledgeable about contracts in general and the specific contracts with critical vendors. Under the *Contract Management Pillar*, the VMI will be a source of knowledge for internal personnel and an ally in ensuring contracts meet the organization's needs during their lifetime.

Pillar 3: Financial Management

Financial management is a critical starting point for VMIs. Collecting and understanding your historical, current, and forecasted spend is the first step to exploring your vendor ecosystem. Financial information is an integral part of the vendor classification or segmentation process, which arranges an organization's vendors into categories based on their relative importance. A vendor's classification category dictates the resources a customer allocates to vendor management activities for that vendor. As a *Pillar of Excellence*, financial management establishes the baseline for tracking forecasted and actual savings, cost avoidance, and value creation activities of the VMI; it provides governances to safeguard payments related to contract activities (e.g. vendors are paid timely, only valid invoices are paid, credits are received by the customer); and it supports the VMI's return on investment calculation, which is often essential to the VMI's survival as it matures. Financial management plays a significant role in vendor management and determining the VMI's level of success.

Pillar 4: Performance Management

Most customers have at least one underperforming vendor that significantly impacts the organization on many levels. Underperformance can include contractual items (e.g. missed SLAs) and noncontractual items (e.g. missed meetings, late reports). As a result, the vendor fails to meet the customer's expected value for the contract. This is not a new phenomenon. Geller and Company published a report in 2003 indicating that as much as 75% of a contract's expected value can disappear within 18 months without active oversight and management. Overall, underperforming vendors force customers to expend more resources; examples include picking up the slack, holding additional "status" meetings, and dealing with the fallout from inadequate remedies. The *Performance Management Pillar* works with the *Contract Management Pillar* but goes beyond the contract. Scorecards, business alignment meetings, and performance improvement plans are some of the tools used to help customers get more out of the contracts and more out of the relationships with their vendors.

Pillar 5: Relationship Management

Often overlooked, the *Relationship Management Pillar* bridges the expanse between the customer and vendor and the other *Pillars*. In addition to facilitating the establishment of peer-to-peer relationships between the customer and the vendor, relationship management encompasses other topics such as:

- Market intelligence: gathering, analyzing, interpreting, and synthesizing data and information about your critical vendors, their competitors, and the industry.
- Relationship assessment: understanding the relationship landscape between the parties, including personal relationships and reciprocity issues.
- Relationship improvement plans: identifying areas for improvement and building and implementing a framework for enhancing the relationship.
- Conflict resolution: acting as the first line of defense in reviewing and addressing contractual and non-contractual disputes.
- Information distributor: conveying information internally and to the vendor (e.g. reports, scorecards, performance improvement plans, relationship improvement plans), and acting as a diplomatic liaison with the vendor on sensitive matters.
- Alignment: to the extent possible, ensuring alignment between the customer and the vendor on roadmaps, fit, functionality, and updates/upgrades to services and products.

Assessing your account team's abilities and qualifications to support your organization is rarely examined as part of the relationship. Assessing the quality of your account team early on provides a strong indicator regarding the success of the relationship. Another colleague of ours, Donna Glidden, created a research document that addresses how best to evaluate your account team. (For more information, download *Evaluate Your Vendor Account to Optimize Vendor Relations*.)

Benefits of a Vendor Management Initiative

There are many reasons to implement a VMI, but there are some common benefits no matter what the initial driver of the VMI is. A VMI typically has a return on investment of three to five times the investment. Actual results are based on scope and other factors, but the VMI should be able to pay for itself even with a limited scope. A VMI will help obtain (and exceed) the expected

value from your contracts with important or critical vendors. This will improve vendor performance and reduce internal resources previously used to deal with vendor-induced headaches. The VMI impacts risk management in a positive way regardless of whether a formal *Risk Management Pillar* is employed; without a formal *Pillar*, risk awareness is a natural byproduct of increased understanding of the vendor and the vendor's industry. Lastly (for the purposes of this article, but by no means the last benefits of a VMI), relationships improve, communication improves, collaboration improves, and things run smoother with a VMI. (For more information, download *Capture and Market the ROI of Your VMO*.)

How Do You Know You Need a Vendor Management Initiative?

As we've learned with our own experiences and those of our members, many organizations are in denial regarding the need for a VMI. Whether you are a small, medium, or large business, a governmental entity, for profit or non-profit, if you answer yes to any of the following questions, we encourage you to investigate starting a VMI:

- ✓ Do you have three or more vendors that are underperforming?
- ✓ Do you have vendors that are not meeting your expectations for return on investment?
- ✓ Is your vendor base growing year over year?
- ✓ Are you spending more of your budget as a percentage on vendors year over year?
- ✓ Is your organization's reliance on vendors to provide you with a competitive advantage growing?
- ✓ Are you leveraging MSPs, the cloud, and other service providers more heavily year over year?
- ✓ Are your vendors contributing to your core products or services more year over year?

If you answered yes to any of these questions, your organization is a good candidate for implementing a VMI. Contact us or download our research to begin configuring the scope, look, and feel of your VMI to specifically meet your unique needs … and begin enjoying the benefits of a VMI within 90 days.


INFO~TECH
RESEARCH GROUP