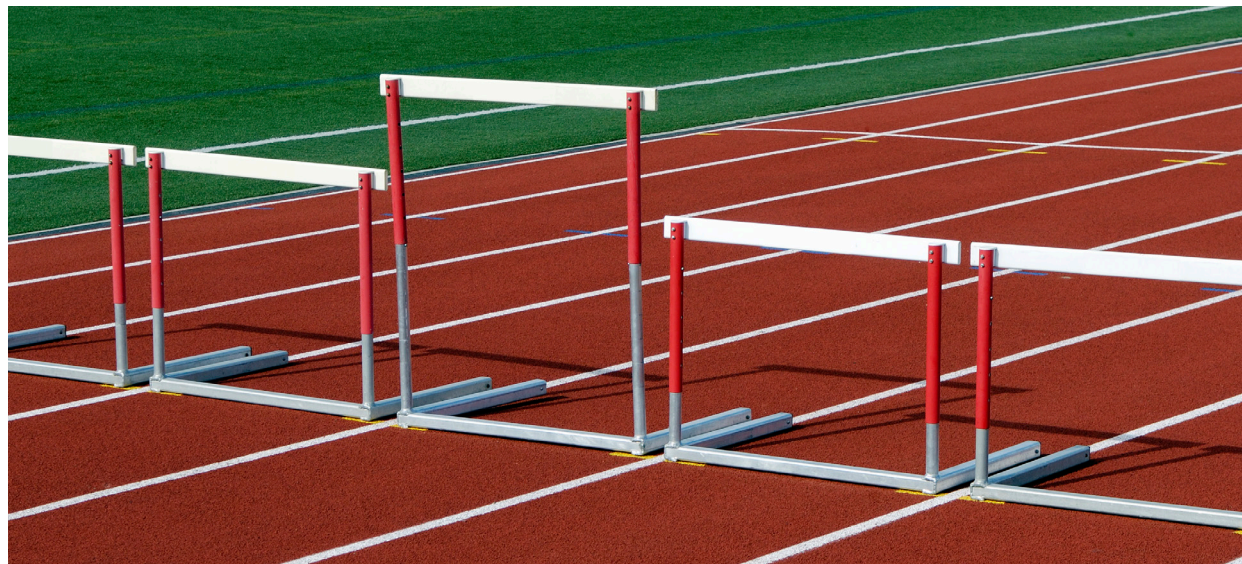# Deloitte.

The Vendor Management Program Office (VMPO): Five Deadly Sins of Vendor Management

Are hurdles blocking you from getting the most out of your third party relationships?

Introduction

As outsourcing continues to go mainstream, organizations are not only considering opportunities to offshore processes but also to outsource them within the originating country. Traditional processes such as information technology, finance, and human resources continue to be the main focus, although others, such as legal, procurement, and sales/marketing, are becoming more common. Meanwhile, some companies are moving in the opposite direction of bringing off-shored processes back in-house[1]. Even this latter trend, however, does not diminish the requirement for a broad Vendor Management Program Office (VMPO). Whether vendors are being engaged on-shore, offshore

or by a captive organization, companies increasingly need a strong and capable VMPO. This need is being driven largely by governance, risk and compliance obligations. In the wake of the global financial crisis, regulators are increasingly scrutinizing how companies track, measure, manage and report supplier risk and third-party compliance requirements. This scrutiny is driving companies to institute new vendor management functions or to increase the scope of their existing ones. Nonetheless, many organizations are not achieving the business objectives they intended when establishing or expanding their VMPOs. Their limited achievements can likely be attributed to some of the following misperceptions and challenges.

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1 Deloitte's "From Bangalore to Boston: The trend of bringing IT back in-house" 2013

The five deadly sins of vendor management

1. **Sourcing and procurement vs. vendor management:** Companies generally have limited appreciation for the specialized skills of vendor-management professionals. As a result, they often call upon staff members from other functions, who are ultimately less effective in this role. Many organizations also underestimate the interdependencies between supply chain functions and the VMPO.

2. **Reliance on the service provider to "run the show":** Organizations often assume contracts are robust and service providers will automatically manage successful transitions as well as provide ongoing benefits associated with innovation, productivity and continuous improvements.

3. **Optimal vendor management operating model:** Many companies are shifting from centralized vendor management models to hybrid programs, which remain sub-optimal in many instances due to lack of common controls, policies and procedures.

4. **Importance of service integration:** Service integration (SI) continues to be a commonly misunderstood concept that is typically underleveraged and ineffectively deployed. Consequently, many organizations with multi-vendor operating models have yet to develop and reap the benefits of a SI function.

5. **Consistent risk management processes:** Third-party risk management processes are often adopted inconsistently. Additionally, executives frequently do not understand the type and degree of risks involved, which inadvertently exposes the organization to risks that could otherwise be effectively mitigated.

Sourcing and procurement vs. vendor management
The role of the vendor management professional is typically not well understood. This often creates the misperception that people with sourcing and/or procurement experience or relevant degrees are well suited for vendor management roles. Indeed, organizations have historically staffed vendor management positions with procurement professionals who have led or been involved in the contract negotiations with the outsourced service provider. This common staffing approach can be detrimental.

Although the vendor management function is interrelated with the sourcing and procurement functions, there are distinct differences (Exhibit 1). While sourcing and procurement functions focus on the transactional areas of selecting service providers and coordinating orders and payments, vendor management focuses on teaming with the service providers to improve overall performance and drive efficiencies once contracts are executed. In other words, the sourcing and procurement functions are responsible for "creating the outsourcing program," and the vendor management function for "maximizing the benefits of the outsourcing program."

Exhibit 1: Interrelation between Strategic Sourcing, Procurement Operations and Vendor Management
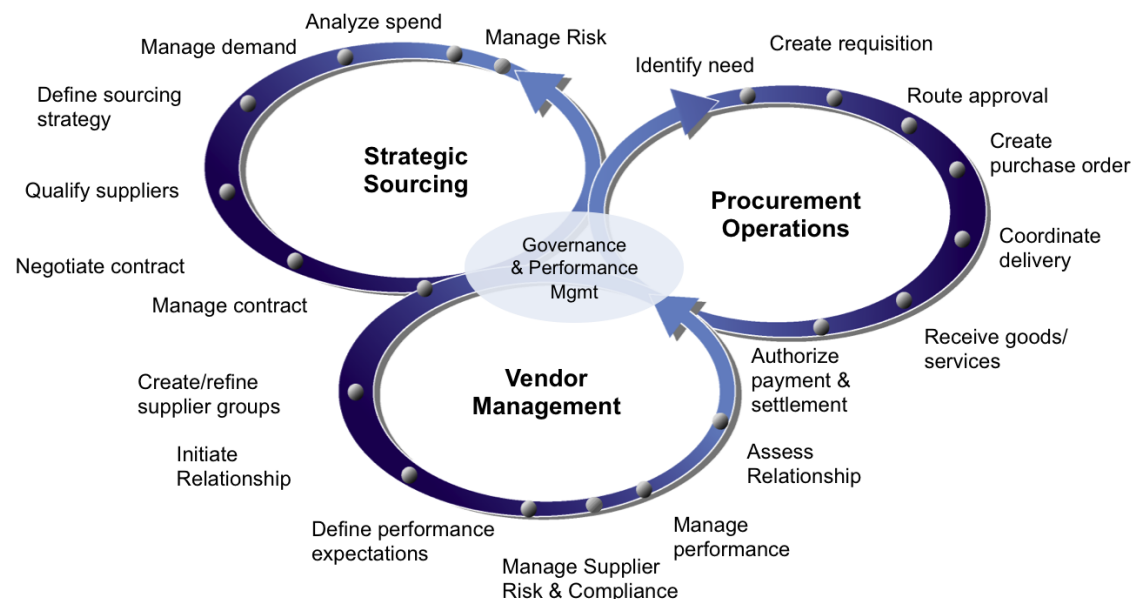
Typically, organizations invest significant time and effort in "creating the outsourcing program," while they pay limited attention to deploying the appropriate resources for "making the outsourcing program work." While negotiating an optimized, robust contract is the first step in the journey, service provider relationships need to be effectively managed from inception, focusing on activities related to transition, transformation, governance and change management. Otherwise, significant business value can be eroded, or even worse, entire programs can be derailed.

Vendor management professionals who are well trained and have the requisite skill-sets understand the importance of these activities and can help organizations to focus on them with enough intensity to keep their outsourcing programs on track. A common question with most companies is: Where can these skilled professionals be found? Historically, identifying and selecting vendor management resources with the appropriate skill-sets has been a big challenge. This situation is now improving as the discipline of vendor management matures, with both industry and the provider community growing the pool of experienced resources.

Despite differences in skill-set requirements for vendor management professionals vis-à-vis sourcing and procurement resources, close interaction between these two functions is imperative. In order to "maximize the benefits of the outsourcing program," vendor management professionals often have to work hand-in-hand with their sourcing and procurement counterparts either to support the negotiations around new services and scope changes or to manage and resolve contractual issues. One way to integrate these functions is to have appropriate sourcing and procurement personnel participate in governance committees so they are aware of ad-hoc requests and have clear lines of communications.

In the end, vendor management remains a specialized function whose purpose is to bring maturity and process discipline to the many aspects of governing and managing the performance of service providers. Additionally, it brings a view of the service provider as a partner, thus enabling information-sharing and alignment of incentives, which in turn generates greater value for both parties. Effective vendor management can improve productivity, enhance performance, maximize the business case, mitigate risks, and reduce overall costs related to third-party providers.

More and more companies are recognizing these benefits. Although vendor management functions have traditionally focused on strategic outsourcing programs due to their value, risk and criticality, companies are increasingly expanding them to encompass many types of third-party relationships.

Reliance on the service provider to "run the show"

There is a general misperception that once the outsourcing contract is executed the service provider should "run the show" with limited oversight and/or management. This misperception usually arises during the transition phase — often considered the "honeymoon period" — as expectations are high and the relationships between the company and the service provider are at their best. Soon, however, declining satisfaction typically sets in, as the organization fully perceives the complexity and lasting consequences of the change. Additionally, the service provider is typically in a dynamic state during the transition as new teams ramp up, but as time passes, delivery pressures mount and execution becomes a reality. Most providers are ill-equipped to navigate these changes on their own: The "show" must go on, but they can't do it themselves.

Recent research supports this assertion. According to Deloitte's 2012 Global Outsourcing and Insourcing Survey, more than 50% of respondents reported business disruptions during the transition phase. This underscores the importance of having a vendor management function with clearly defined roles and responsibilities in place from the very beginning to effectively manage the transition.

Companies have also historically relied on service providers to produce ongoing, incremental benefits, such as innovation and greater productivity within the outsourced processes. Indeed, many outsourcing contracts include targets for continuous improvements, but as organizations become enmeshed in managing day-to-day operations they tend to lose sight of the longer-term benefits beyond immediate cost savings that the service provider is expected to deliver. A vendor management function with a broad mandate can help the organization to "keep its eye on the prize" over the long run, so it has a better chance of realizing the full range of anticipated benefits from its outsourcing arrangement. But what should the mandate of a broad vendor management function encompass? Based on Deloitte's field experience and knowledge of leading practices, it should span most of the following ten pillars (Exhibit 2).

Exhibit 2: Vendor Management Pillars
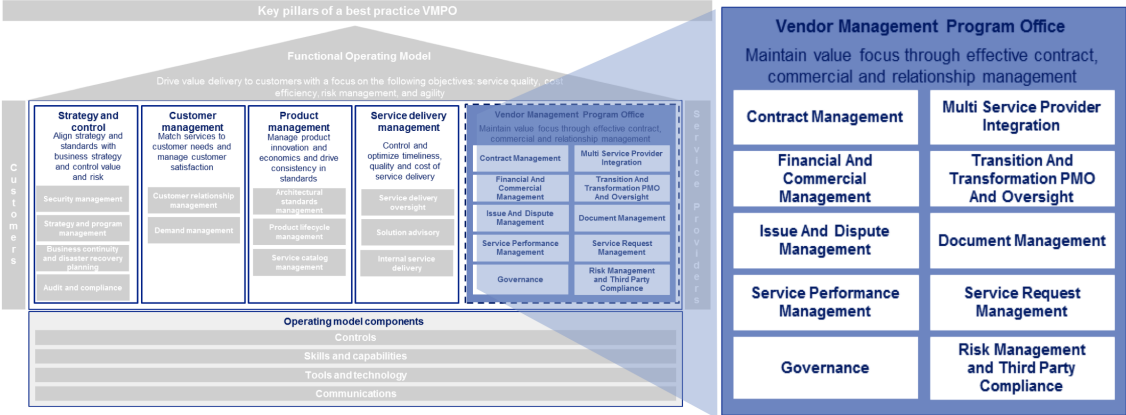
Some subject matter specialists believe that spanning these ten pillars is still not enough. Some organizations that have been effective in implementing broad vendor management functions have gone beyond these supporting elements to: 1) gain a clear understanding of the service provider's capabilities via a thorough selection process; 2) negotiate a contract that meets both current and future business requirements and is aligned with enterprise strategy; 3) proactively manage the transition and transformation phases via stakeholder involvement and appropriate governance forums that include stakeholders with the authority to make decisions; and 4) develop a holistic view of service provider performance across quantitative and qualitative measures, including service level agreements (SLAs), executive performance indicators (EPIs)[2] and operating level agreements (OLAs)[3]; Collectively, these activities further support organizations in their efforts to manage outsourcing costs, reduce risks and improve overall service quality.

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2 EPIs are an increasing common metric used to measure a service provider's progress in innovation, productivity, continuous improvement, staff retention and overall quality of the service provider relationship.

3 OLAs are a common contractual vehicle used to facilitate collaboration and seamless issue resolution between companies and their service providers.

Optimal vendor management operating model

Centralized, decentralized or hybrid? Organizations are often perplexed about which vendor-management operating models to adopt and how often they should re-evaluate them. In Deloitte's 2011 Vendor Management survey, 62 percent of the respondents reported using a centralized vendor-management model whereas 29 percent reported using a decentralized one. In choosing between a centralized and a decentralized model, examining the ways in which the vendor management functions add value can be helpful in determining where to place them (Exhibit 3).

Nonetheless, determining an optimal vendor-management operating model has become more of an art than a science as the purview of the vendor management function has expanded from managing select vendors to managing a broad cadre of service providers across the enterprise. While an enterprise-wide approach to vendor management is often desirable, organizations frequently struggle to implement it because several barriers stand in the way of attaining the requisite visibility and collaboration across multiple business units and stakeholders. These barriers include:

- **Lack of standardized and centralized vendor management processes** — often leads to inconsistent vendor management activities and value erosion.
- **No formal single point of contact for enterprise vendors** — frequently limits enterprise-wide visibility into the overall performance of vendors who work across business units
- **Decentralized risk management practices** — potentially leads to inconsistent risk management processes and duplication of effort
- **No overarching governance authority** — usually makes it difficult to evaluate the performance of vendors, owners and overall programs
- **Lack of dedicated and trained vendor management resources at a centralized location** — typically leads to inconsistent implementation of vendor management processes, tools and templates
- **No central repository** — often creates challenges in storing and retrieving contracts and vendor-related information
- **Limited adoption of vendor management policies** — potentially increases exposure to risks since vendors may be engaged without executed contracts

Exhibit 3: Placement of Vendor Management Function

Relationship to the Business

Decentralised (business unit, site, region)

Local Support
- Requires business knowledge and domain experience
- Requires direct, personal interaction to meet objectives
- Captures local input, regional programs, and unique business requirements
- Value is realized through efficiency of throughput for business specific activities
- Manual or end-user intensive

Business Partner
- Requires business knowledge and organizational competencies
- Requires business and management input to achieve objectives
- Strategy aligned to the goals and objectives of business units
- Value realized through specific and customized solutions
- Decision focused and action intensive

Centralised (company wide)

Transaction
- Requires company wide operational knowledge and process expertise
- Provides standardized services to various part of the organization, covering countries, regions, and business units
- Adheres to corporate mandates
- Value is realized through efficiency of throughput for company wide activities
- Process intensive

Center Of Excellence
- Requires some business knowledge and organizational competencies
- Produces solutions that are applicable across all lines of business
- Strongly aligned to corporate interests and objectives
- Value is realized through common solutions and goals
- Issues and knowledge intensive

Transactional
(low cost / defined service level)

Knowledge Rich
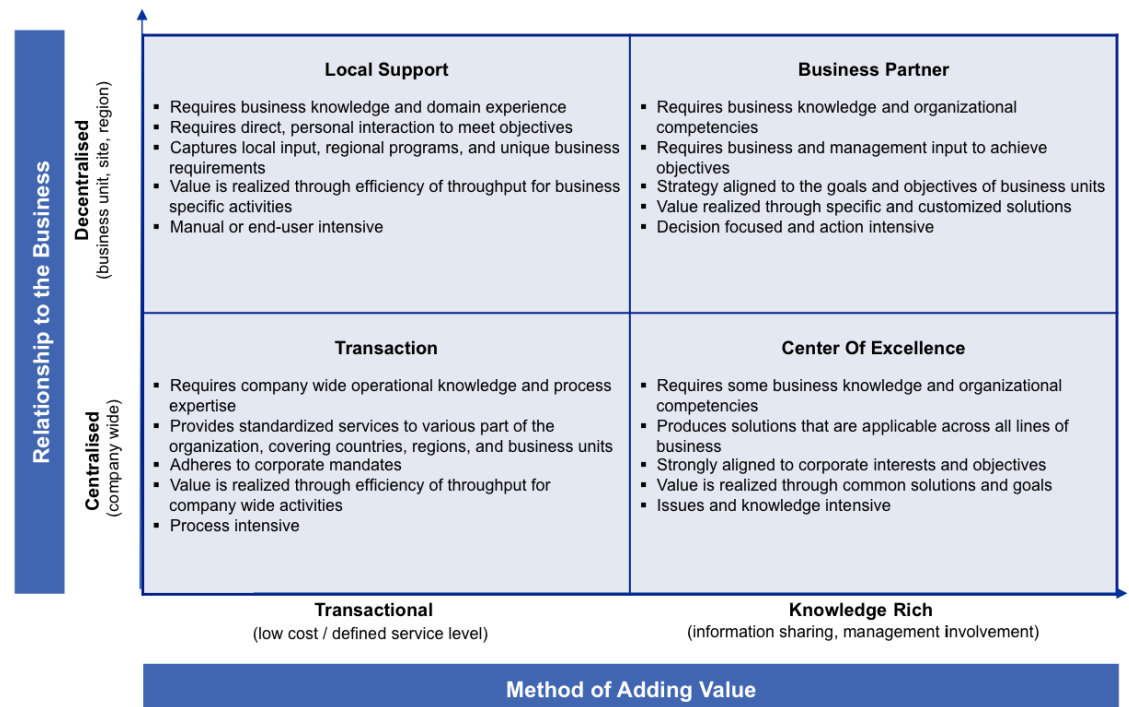(information sharing, management involvement)
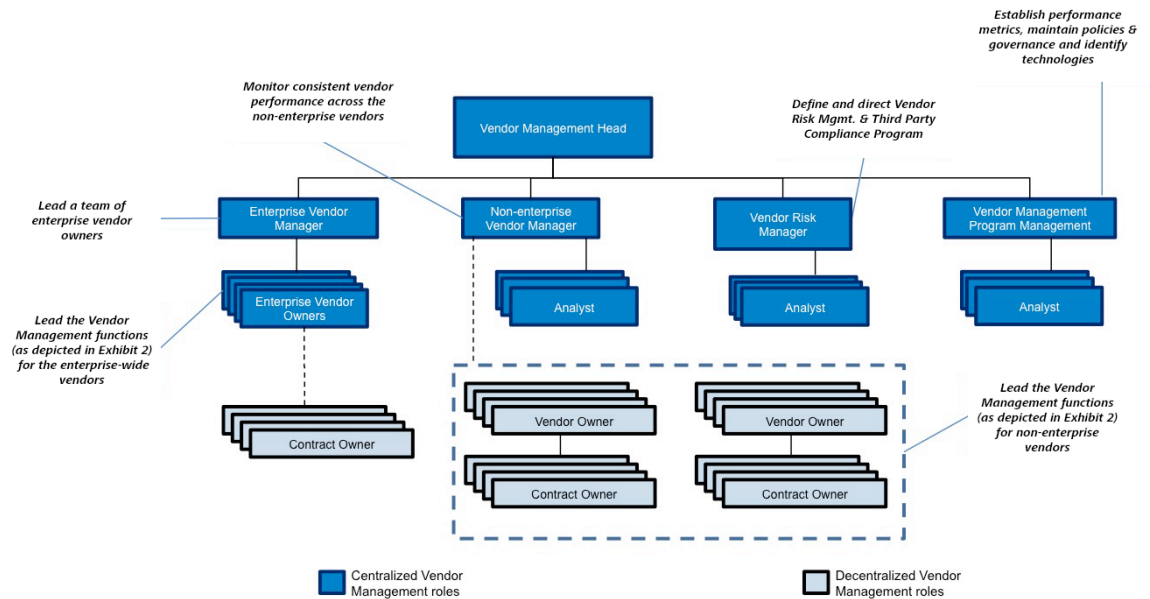
Method of Adding Value

Exhibit 4: Hybrid Vendor Management Model

A hybrid operating model can be helpful in addressing many of these challenges (Exhibit 4 above). It first relies on a centralized vendor-management team to develop a standardized set of policies and processes, and then vendor relationship managers within the business units to promulgate them. Within a hybrid operating model, vendor management personnel in the business units additionally provide performance metrics and scorecards so that service-provider performance can be strategically evaluated at an enterprise level. An effective hybrid model also includes a centrally led governance structure to provide appropriate oversight across the relationship managers, thus ensuring compliance with policies, including risk management activities. Overall, the potential benefits of a hybrid model are many (Exhibit 5).
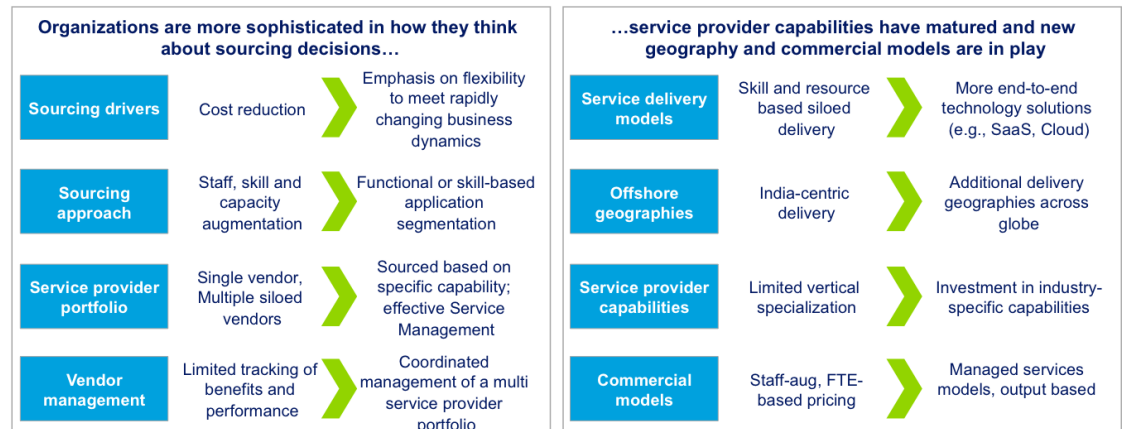
Exhibit 5: Characteristics and Benefits of a Hybrid Vendor Management Model

| Characteristics	Potential Benefits
Focuses on specific objectives of risk mitigation, organizational efficiency and cost-effectiveness	Reduced risk exposure from vendor relationships and improved cost-effectiveness
Dedicated vendor management executive who reports to the CIO, COO, or the head of shared services	Successful implementation and ongoing support of vendor management processes and policies
Centrally led vendor management organization responsible for developing and administering vendor management policies	Increased efficiencies throughout the organization from centrally developed, standardized and enforced vendor-management policies
Governance committees with mandates to own and enforce vendor management policies and procedures at executive, tactical and operational levels	Effective implementation and enforcement of vendor management policies and processes with increased visibility into performance
Establishes and monitors a broad set of vendor management metrics that are linked to performance evaluation	Transparency and objectivity in performance tracking and ability to proactively identify risk areas
Formal and consistent end-to-end processes for the vendor management organization	Improved handoffs and interactions among vendor managers, business units and the supply chain
Defined accountabilities and responsibilities for stakeholders across each process and sub process	Clearly identifiable point of contact for each activity
Adoption of industry-leading tools and technology	Better-enabled vendor management processes and increased efficiency from automation

Importance of Service Integration

With greater experience in the outsourcing arena, companies are becoming more aware of the pros and cons of the single "mega-vendor" model. Thus, emerging leading practices include leveraging contract renewal opportunities and creating multi-vendor operating models that facilitate healthy competition among service providers (Exhibit 6). Multi-vendor operating models, however, can create a complex environment since they often comprise a mix of captive, offshore, onshore, and near-shore approaches.

Exhibit 6: Drivers resulting in shift to multi-vendor operating models

Organizations are more sophisticated in how they think about sourcing decisions…		
Sourcing drivers	Cost reduction	Emphasis on flexibility to meet rapidly changing business dynamics
Sourcing approach	Staff, skill and capacity augmentation	Functional or skill-based application segmentation
Service provider portfolio	Single vendor, Multiple siloed vendors	Sourced based on specific capability; effective Service Management
Vendor management	Limited tracking of benefits and performance	Coordinated management of a multi service provider portfolio

…service provider capabilities have matured and new geography and commercial models are in play		
Service delivery models	Skill and resource based siloed delivery	More end-to-end technology solutions (e.g., SaaS, Cloud)
Offshore geographies	India-centric delivery	Additional delivery geographies across globe
Service provider capabilities	Limited vertical specialization	Investment in industry-specific capabilities
Commercial models	Staff-aug, FTE-based pricing	Managed services models, output based

In response to this complexity, a service integration (SI) function is now commonly required. This function primarily integrates services among providers and identifies and mitigates interdependencies among them. Exhibit 7 lists the main building blocks in establishing an SI function:

Exhibit 7: Service Integration Function
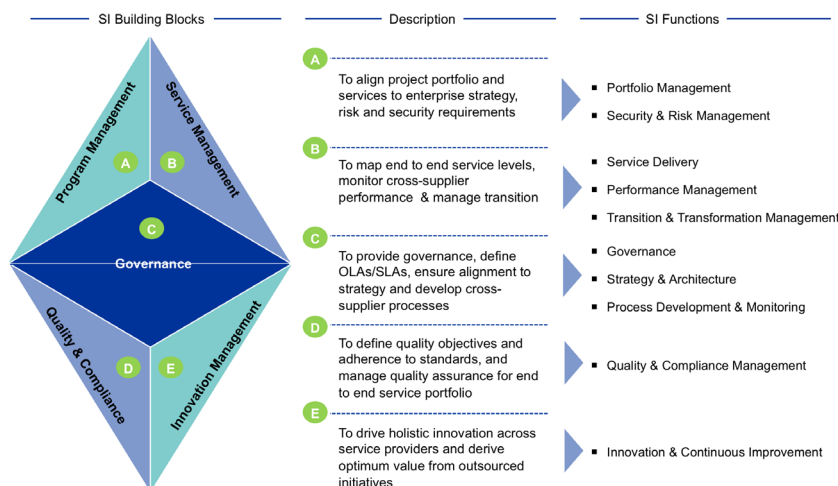
- **Program management** — involves managing the full program portfolio, including prioritizing and tracking individual projects through standardized processes. Status and exception reporting as well as risk and issue management are also important components.
- **Service management** — includes managing operations across the various domains and developing key processes such as incident and problem management, change and release management, escalation management, and configuration management.
- **Governance** — encompasses a governance framework, operating policies, and procedures for the SI organization, including establishing metrics and standards, monitoring operating and service-level agreements, and devising communication plans.
- **Quality and compliance management** — emphasizes defining an enterprise service-delivery charter and quality objectives as well as performing quality assurance (QA) for the portfolio of in-flight services and projects. It often includes recommending and managing processes for service improvement and service-provider management.
- **Innovation management** — leverages a vendor-agnostic organization to drive innovation across the service provider portfolio. This includes fostering a culture of continuous improvement based on refinement of operational processes and standards.

The SI function is typically considered to be a part of the retained organization. However, some organizations transitioning to a multi-vendor operating model lack the skills within the retained organization to effectively perform this role. As an alternative, the retained organization and an external service provider can team up to perform the SI function or a new external provider specializing in SI can be engaged on its own to provide these services.

Consistent risk management processes
Supplier risk management is increasingly becoming a critical component of enterprise risk management (ERM). As third-party providers expand their roles across the value chain, the potential for a supplier failure increases dramatically. While organizations have traditionally focused their supplier risk management efforts on contractual or financial risks, this narrow scope is no longer sufficient.

Since the global financial crisis, companies around the world are generally facing stricter requirements for reporting and managing service-provider risks and third-party compliance obligations. For regulated entities (e.g. financial services institutions, pharmaceutical manufacturers, etc.), robust supplier risk management capabilities are becoming even more critical, as regulatory complexity escalates along with the financial and reputational consequences of non-compliance.

This situation, coupled with the increasing sophistication of outsourcing deals, has caused many companies to invest in developing supplier risk management capabilities built upon robust risk management frameworks. These frameworks are critical for assisting organizations in understanding the risks posed by their service providers at an enterprise level and in providing near-real-time transparency into how certain risks could have financial repercussions and/or damage the company's reputation. Exhibit 8 provides further details on the service provider risk categories and their potential implications. However, these risks can be typically addressed via a robust supplier risk management framework.

Exhibit 8: Service Provider Risk Categories

Categories	Potential Risk
Contractual	Contract language misunderstood or missing critical components
Financial	Supplier unable to meet contract obligations due to financial difficulties
Service Delivery	Supplier unable to meet client service standards or SLAs (e.g. quality, availability, responsiveness)
Reputational	Supplier's security issues affect your company brand
Privacy	Supplier disclosure of confidential data
HR	Supplier not adherent to enterprise employment requirements
Business Continuity	Supplier unable to provide services in accordance with service level agreements
Geopolitical	Country-specific factors (e.g., government, climate, and politics) affect supplier's performance
Information Security	Supplier access to information outside of defined business requirements
Fourth Party Risks	Inadequate controls around supplier subcontract arrangements with fourth parties
Cyberspace Risk	Supplier exposure to threats from organized crime and nation-state sponsored cyber terrorism

In addition to these categories, a robust supplier risk management framework typically comprises four main elements, which are necessary in order to consistently track, measure, manage and report service-provider risk across the enterprise.

- **Filter.** Large organizations may have upward of 10,000 unique suppliers, and it is unrealistic to assess them all in the same way. A filter, based on documented and consistent criteria, can be applied to identify those service providers that require full, partial, or no assessments. By using a filter, only service providers that meet certain thresholds will be short-listed for in-depth risk assessments.
- **Assess.** The assessment process is typically based on well-defined and measurable criteria to ensure that suppliers are reviewed consistently and carefully. Assessments should also be performed on an on-going basis. The objective is to arrive at an aggregate risk rating for a given provider after all relevant risk areas have been evaluated.
- **Segment.** Service providers can be segmented according to the results of the risk assessment. Segments are typically based on the aggregate risk ratings and qualitative risk-related characteristics of the service providers. Providers are subsequently managed according to their segments. For example, Tier 1 suppliers may be subject to enhanced or more frequent reviews.
- **Monitor.** Effective monitoring is proactive and ongoing, including periodic re-assessments of individual suppliers and occasional re-balancing of the supplier portfolio. It also encompasses general risks not related to specific suppliers, such as geopolitical risks, which come into play when services are provided near-shore or off-shore, and concentration risks, where the volume of services provided by a single vendor or originating from a particular country is great.

Although companies are more aware of the need for supplier risk management, developing an appropriate risk management framework has been more onerous than many organizations expected. This is mainly because of difficulties in gaining alignment among internal stakeholders (e.g., compliance, risk, audit, etc.); a tendency to underestimate the amount of effort required; and challenges convincing business units of the need for relationship managers to undertake additional risk-management activities. In many instances, budget constraints and data-access barriers (i.e., the availability of contractual documentation or poor system interoperability) also complicate the task.

Despite these obstacles, organizations can no longer ignore the risks to which they are subjected via their supplier relationships. For an unlucky few, costly high-profile incidents have been the triggers for implementing their supplier risk management and third party compliance programs. No longer can real or perceived internal barriers be allowed to thwart the development of what has become a core component of enterprise risk management.

Conclusion

Any one of the "five deadly sins of vendor management" can greatly harm the health of a company's outsourcing program. Avoiding them is important but so is keeping the big picture in mind. Those who are most intent on maximizing the benefits of their third-party relationships maintain a long-term view of building the VMPO. This includes putting forth the necessary time and effort to establish relationships with key internal stakeholders and critical service providers, investing in leading IT solutions with suitable tools and scalable capabilities, and designing an agile vendor-management operating model that can readily adapt to changes in enterprise strategy. Like any fitness program, building a strong and capable VMPO requires flexibility, determination, and ultimately, endurance.

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