

Supplier Management for Complex Outsourced Services: A Strategic Framework

Chris O'D Malone, Director Shared Services
Expense Management Solutions, Inc.
508-460-7014; malone@expensemanagement.com

93rd Annual International Supply Management Conference, May 2008

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

In this paper, we will explore how the careful design and implementation of a supplier management strategy minimizes the risk of “leakage,” and maximizes the value of your supplier relationships. We will then outline a framework for development of a strategic supplier management program, which 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 Supplier Management?” (Please note that for our purposes, we use the terms “supplier,” “vendor,” “supply partner,” or “service provider,” interchangeably.) Strategic Supplier Management consists of a continuum of activities, the result of which is a relationship that satisfies the goals and objectives of both the client and supplier. In general terms, these goals and objectives will include:

- align performance to meet organizational objectives
- adapt the relationship to changing requirements, business strategies and economic realities
- facilitate strategic planning for the future
- ensure and increase value generation for the term of the relationship
- promote effective communication throughout the organization
- mitigate financial, operational and legal risks
- enhance transparency and visibility into cost structures and operations

By designing, and implementing a strategy to accomplish these goals, the supplier manager focuses the energy and attention of the various stakeholders and increases the odds of a successful outcome. Whether the desired results of the initiative were to obtain the best product, secure the cost effective delivery of a service, increase customer satisfaction, or enhance shareholder value – strategic supplier management provides the framework to ensure that the ongoing relationship with the service provider(s) accomplishes these results.

Why Should You Have A Supplier Management Strategy? Supplier managers are responsible for more complex supply chains and globally integrated service relationships than ever before. Improvements in sophistication of sourcing processes, performance measurement and compensation arrangements have heightened expectations for value generation through reduced costs and cycle times and increased quality and consistency. And

yet – *sourcing initiatives routinely fail to deliver the full value expected.* Reasons for this gap between expectations and performance include:

- inflated expectations of the capabilities of e-sourcing platforms
- inadequate attention to the complexities of transition, implementation and change management
- lack of a long-term strategy to manage the supplier relationship over time

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 factors associated with supplier relationship management. *Only eight percent* of failures were attributable to poor performance by the supplier.

In 2006 Expense Management Solutions conducted a survey on strategic supplier management practices in service contracts. In our survey, 52% of respondents indicated that 10% or more of contract value is lost through inconsistent or ineffective application of supplier management strategies in their organizations. Even by conservative estimates, these companies had hundreds of millions of dollars at risk in their outsourced services contracts alone!

Components of a Comprehensive Supplier Management Strategy. So, how do successful companies manage complex supplier relationships to meet their elevated expectations? We have found that effective supplier management consists of five critical elements, which include:

- * Supplier Relationship Management (SRM) Readiness Assessment
- * Supplier segmentation
- * Demand management
- * Market management
- * Performance management

It is crucial to understand that these activities are not performed at a single point in time. To do so is to assume that businesses, markets, technology, politics and dozens of additional factors that influence key business relationships are unchanging, when in reality they are in a constant state of change.

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.

SRM Readiness. A good SRM Readiness Assessment offers a systematic framework to address the strategy, planning and prerequisites for SRM. Characteristics of SRM readiness include close integration of relationship management with sourcing strategy, thorough relationship planning, an effective process to transfer control of the relationship and related knowledge from the sourcing team to the relationship management team, definition of roles and responsibilities and their subsequent assignment. The SRM Readiness Assessment should also address aspects of the corporate infrastructure that will facilitate relationship

management, including communication and technology platforms, and support at the executive management level.

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 supplier versus difficulty of switching to a new one. 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 supplier segmentation is to think that you only have to develop a supplier management strategy and perform supplier relationship management for relationships with the highest value at stake. The reality is, *you must have a strategy for all of your supplier relationships*. However, 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 trial 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, negotiation 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 suppliers, 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. Demand forecasts should be integrated into a comprehensive supplier communications program. This information will help suppliers to efficiently manage their resources, resulting in lower costs, which, given a well-designed contract, should also accrue as a benefit to the client.

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, supplier 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 structure your RFP and evaluate the proposals appropriately. To be effective at SRM, *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

Continuous market management will provide you with vital information necessary to understand the key drivers and success factors of your supplier. A major disruption in a market may provide you with an opportunity to renegotiate a contract, or it may endanger the supplier's viability and threaten your business continuity. Regulatory changes in your supplier's industry or a major technological advance can precipitate changes you must be in a position to anticipate.

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, effective management of outsourced services is often as much, if not *more* dependent on knowledge acquired through market management. 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 geopolitical 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 relationship management program, 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 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 supplier’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 supplier 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
- Development of a schedule for periodic meetings and reviews
- Measurement and reporting of performance metrics against targets defined in the contract
- Use of scorecards, customer satisfaction surveys, and other processes and instruments to assess supplier 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 supplier 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 supplier is greatly increased when dealing with complex outsourced services.

Conclusion. Effective strategic supplier management results in a fundamental shift in the way *in which we view our relationships with our outsourced service providers.* “Getting the supplier 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 supplier” 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 effective 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.

REFERENCES:

Flynn, Michele and Teplansky, Robert, “An Examination of Supplier Management Tools and Practices Today and Opportunities for Tomorrow,” *Expense Management Solutions, Inc.*, September 2006, pp 2-11

Flynn, Michele and Teplansky, Robert, “Developing a Supplier Management Strategy – Corporate Services,” *Expense Management Solutions, Inc.*, August 2006, pp 8-29

Madow, Eliot, “Strategic Sourcing – Problems, Solutions, and Approaches to Generating Shareholder Value,” February 2005, pp 3-14

Corbett, Michael F., “Leading Outsourcing Indicators,” *Michael F. Corbett & Associates, Ltd.*, Spring 2004, pp 7

Goolsby, Kathleen and Whitlow, F. Keaton, “What Causes Outsourcing Failures?” *Outsourcing Center Survey – Everest Partners L.P.*, 2004, pp 2

Procurement Strategy Council, “Capturing Value From Strategic Supplier Management,” *Corporate Executive Board*, 2006, pp 6

The Author. Chris Malone is director of the Shared Services group at Expense Management Solutions, Inc. Expense Management Solutions is the premier provider of sourcing advisory services specifically for corporate shared services such as print and graphics, mail, food service, travel, fleet management, reprographics and document management, and corporate real estate management. Chris has more than twenty-five years experience in administrative and shared services, working within Fortune 200 companies. Chris served as a second vice president of investment operations for a global financial services company; engagement manager for a national software and consulting firm, and director of administrative operations for an asset management company. Her outsourcing and supply management experience includes engagements for corporate and shared services departments of large multi-national organizations, as well as outsourcing initiatives for financial institutions.