

The Hidden Costs and Complexity of Managing Multiple ADM Suppliers

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Executive Summary

As Application Development and Maintenance (ADM) outsourcing services have grown rapidly based on the power of the labor arbitrage value proposition, many organizations outsourcing ADM utilized multiple third-party suppliers. Motivations for using multiple suppliers are far ranging; common examples are variations in suppliers' capabilities, localized decision-making across an enterprise, and a desire to retain competitive tension.

The portfolio of suppliers serving a company is often complex and creates considerable challenges to manage and optimize. Consequently, leading companies rationalized the number of suppliers in their ADM portfolio and attained financial benefits plus a less complex sourcing environment. Other companies now pursue similar objectives.

The financial benefits of utilizing fewer suppliers can be as much as 22-28% on an annualized basis. The drivers of these benefits are:

- One-time costs can be reduced by 35-40% by using existing suppliers. Key drivers of this include avoidance of redundant internal set-up costs (e.g., MSA, telecom) and more time/cost efficient transitions of new work.
- Recurring costs can be reduced by 20-25% by using fewer suppliers. Key drivers of this include less effort by the buyer to manage supplier relationships and delivery plus better optimized resourcing from suppliers (e.g., offshore delivery mix, leverage of onsite relationship management).

To capture the benefits of supplier consolidation, companies need to adopt several "no regrets" approaches including limiting the number of suppliers, segmenting suppliers, and ensuring appropriate scale. Beyond these approaches, companies must work through three steps to achieve the desired benefits:

- Validate the internal scope of organizational entities to include (e.g., enterprise level versus business units)
- Select the preferred engagement model (e.g., focus on outcomes versus focus on seeking talent at the best price)
- Manage and optimize the model through carefully awarding scope and the adoption of governance models

In this whitepaper, we analyze the costs and complexity of managing multiple ADM suppliers and how buyers can benefit from limiting the number of suppliers in their portfolio. The whitepaper addresses three areas:

- Multiple supplier ADM portfolios: Evolution and context
- Costs associated with managing multiple ADM suppliers
- Approaches to manage complexities arising from multiple suppliers

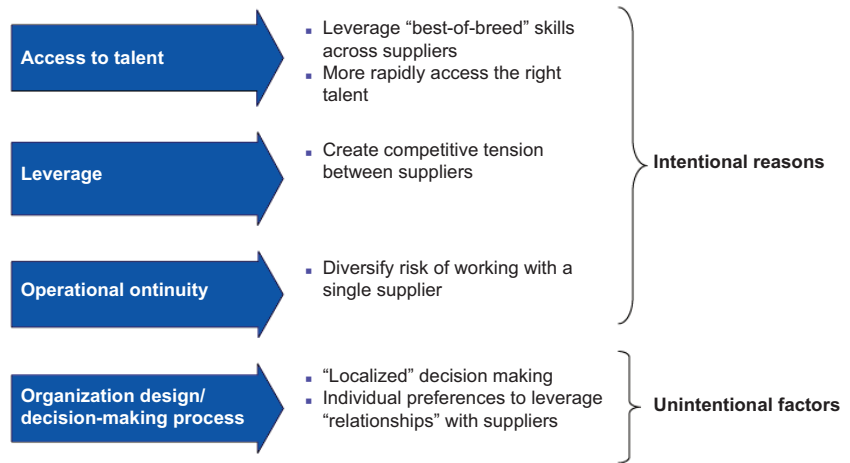
Multiple Supplier ADM Portfolios: Evolution and Context

Buyers aggressively outsourcing ADM typically use multiple suppliers for both intentional and unintentional reasons (see **Exhibit 1**). Many buyers are intentional about their rationale for using multiple suppliers. These motivations include gaining access to talent/skill, achieving financial leverage through competitive tension, and ensuring operational continuity by diversifying risk. However, in many cases, the extent to which multiple suppliers are utilized is a consequence of “localized” decision-making processes across the organization and individual preferences to leverage “relationships” with suppliers.

EXHIBIT 1

Factors that drive usage of multiple suppliers

Sources: Everest Research Institute; interviews with companies



The use of multiple suppliers often results in complex ADM supplier portfolios, which creates challenges for buyers to manage and optimize. These types of challenges include:

- Higher costs in setting up and managing multiple suppliers and diminished ability to access scale benefits of larger relationships
- Increased operational complexities in managing inter-linkages in project management, testing, change control, etc.
- Governance challenges in managing moving pieces across multiple areas (e.g., performance monitoring, reporting, ensuring accountability)
- Increased risk of project overruns or downtime created by complexities in managing interfaces across suppliers

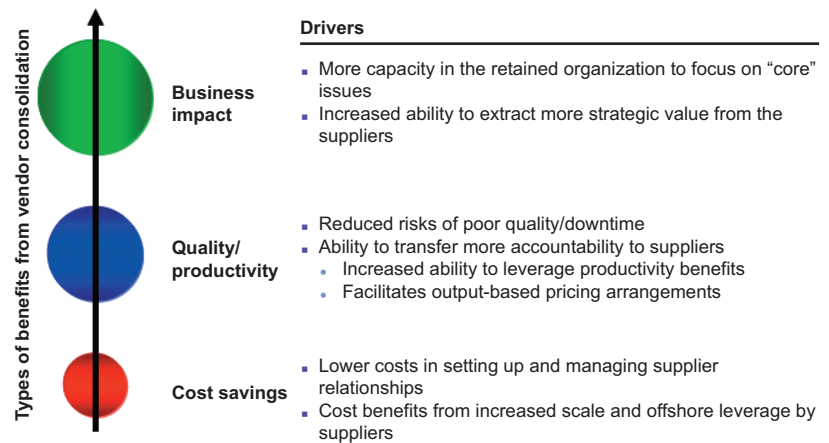
In response to these challenges, leading buyers rationalized the number of suppliers in their ADM portfolio and attained financial benefits plus a less complex sourcing environment. In doing so, these companies balanced the degree of consolidation against access to key skills and retention of sourcing options. Other companies now pursue similar objectives.

Buyers realize multiple types of benefits beyond cost savings by reducing the number of suppliers in their portfolio. Given the benefits of larger scale and deeper relationships, buyers working with fewer suppliers increase their ability to leverage productivity benefits and strategic value from suppliers (e.g., through increased ability to focus the relationship on pursuing strategic initiatives). This in turn facilitates output-based pricing arrangements and the ability to transfer more accountability to suppliers. Also, the retained organization in such companies has more capacity to focus on “core” issues (e.g., align applications with business needs). **Exhibit 2** below outlines the different types of benefits that buyers have realized by working with fewer suppliers.

EXHIBIT 2

Types of benefits for buyers from vendor consolidation

Source: Everest Research Institute



The financial benefits from using fewer suppliers are detailed in the next section.

Costs Associated with Managing Multiple Suppliers

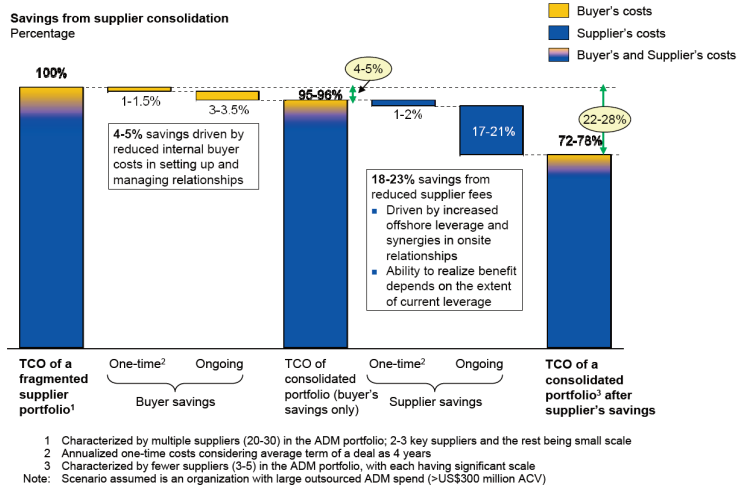
We utilized a total cost of ownership (TCO) view for the buyer to assess the financial impact of using fewer suppliers. This view incorporates buyers’ internal costs in managing suppliers and suppliers’ fees for providing services – including both one-time and ongoing costs.

Our analysis indicates that on a TCO basis, buyers can achieve financial benefits up to 22-28% by utilizing fewer suppliers. **Exhibit 3** illustrates the drivers of these financial benefits.

EXHIBIT 3

Financial benefits from using fewer suppliers

Source: Everest analysis



The differential between the annualized TCO of the two types of supplier portfolios (fragmented versus consolidated) represents potential benefits on a steady-state basis. This does not include costs involved in actually migrating work to fewer suppliers (e.g., contract terminations).

Given the larger scale and scope of work, suppliers can better optimize their sourcing through greater leverage of offshore and onsite relationship managers. The resulting reduction in supplier fees is typically the largest savings driver for the buyer from using fewer suppliers. However, the ability to realize these benefits largely depends on the extent of current offshore leverage even within a fragmented portfolio.

Key drivers of the financial benefits from using fewer suppliers differ between one-time and recurring costs.

1. Savings in one-time costs.

One-time costs can be reduced by 35-40% by using existing suppliers instead of new suppliers. Using existing suppliers helps buyers avoid redundant internal set-up costs such as MSA negotiations and dedicated telecom infrastructure. Also, given their knowledge of buyers' businesses and systems, existing suppliers can typically implement transitions faster. In addition, existing suppliers can cross-leverage their current client resources (e.g., onshore relationship managers), potentially resulting in lower transition costs.

2. Savings in recurring costs.

Recurring costs can be reduced by 20-25% by using fewer suppliers. Buyers incur lesser effort in managing fewer supplier relationships (includes governance aspects such as managing contracts, invoicing, compliance) and delivery (includes project management, testing, quality assurance). Also, given the larger scale and scope of work, suppliers can better optimize their onshore/offshore mix. This is often the most important lever for reduction in supplier fees. Specifically, as a supplier gains greater

critical mass, more senior roles can be moved offshore. This helps drive savings to a “zone of disproportionate return” as described in **Exhibit 4**. Further, the larger scale provides greater opportunity for the supplier to drive productivity improvements.

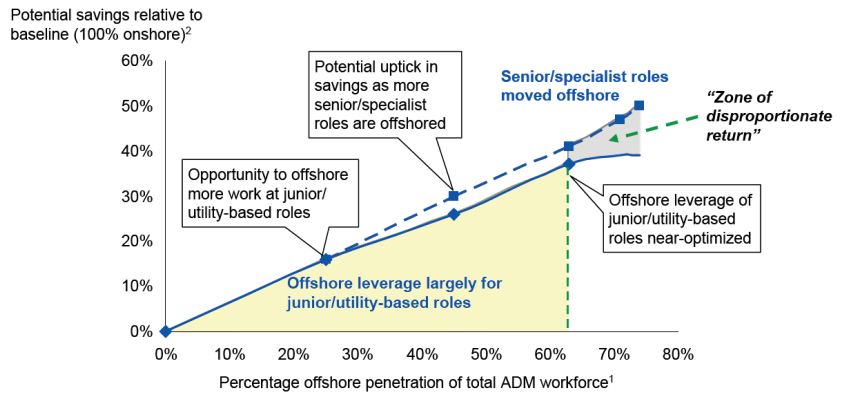
EXHIBIT 4

Potential savings from increasing offshore leverage

Source: Everest analysis

Offshore leverage of junior roles is capped

Uptick on savings can be attained only by moving more senior roles offshore



¹ Total ADM workforce includes retained IT organization, captives and outsourced FTEs of third-party suppliers
² Refers to organizations having a large ADM portfolio of >US\$300 million in ACV as a baseline of 100%
 Note: In calculating offshore leverage, typical staffing pyramid and corresponding billing rates for such ADM roles have been considered for analysis

While there are significant potential benefits from working with fewer suppliers, companies need to adopt multiple best practices and approaches to effectively capture these benefits. The next section describes these approaches.

Approach to Manage Complexity Arising from Multiple Suppliers

As a starting point, buyers need to adopt several “no regrets” approaches for building their ADM supplier portfolio. These include:

- Limiting the number of suppliers, by achieving organizational consensus on the principle that “fewer suppliers is almost always better”
- Segmenting suppliers into strategic or specialists
- Ensuring appropriate scale necessary to build mutually beneficial relationships with suppliers

While these approaches for designing a supplier portfolio are applicable across most types of buyer organizations, how to organize and operate the portfolio can take multiple forms. Buyers must work through three steps to appropriately manage complexity and cost in their organization-specific situations. These include:

1. Validating the internal scope of organizational entities (e.g., enterprise level versus specific business units, geographies)
2. Determining the appropriate engagement model with suppliers (e.g., focus on outcomes versus focus on getting talent at the right price)
3. Managing and optimizing day-to-day operations through carefully awarding scope and adopting governance models

A more detailed description of each of these three steps is as follows.

1. Validating the scope of organizational entities.

The scope of organizational entities included in the optimization is a critical foundation that shapes many other decisions and activities. Buyers need to make choices between a truly enterprise-driven approach towards optimization versus starting off in a few major groups (e.g., business units, functions, technologies) and then expanding scope.

These choices are closely linked to the buyer’s organizational structure, decision-making processes, and culture. Most large buyers are unlikely to start optimizing their ADM portfolios by increasing the scope of entities to include but, rather, deploy a new model in one area and then seek to increase scope to include other business units/geographies.

2. Determining the appropriate engagement model.

Companies should evaluate and choose between two broad engagement models:

- “Harmonized” model. The primary philosophy is acquiring talent at the best price. The buyer defines the primary tools and processes for service delivery.
- “Orchestrated” model. The primary philosophy is on attaining results from suppliers through defined objectives while requiring the supplier to determine how to attain the desired results. The buyer integrates the approaches followed by different suppliers (e.g., tools, processes).

These two models involve different economic structures, benefits, and limitations. **Exhibit 5** illustrates these differences that buyers need to consider while making choices.

Beliefs that lead to choosing the models:

Harmonized: Value comes from definition and predictability coupled with easy access to talent

Orchestrated: Value comes from actively managing incentives and challenging the status quo

EXHIBIT 5

Comparison of harmonized and orchestrated models

	Harmonized model	Orchestrated model
Economic model	<ul style="list-style-type: none"> ■ Pay for resources that perform work at specified level of quality 	<ul style="list-style-type: none"> ■ Pay defined fee for a service at a specified level of performance
Benefits	<ul style="list-style-type: none"> ■ Greater sense of control and definition ■ More easily comparable to captive operations ■ Easier to remove/add suppliers 	<ul style="list-style-type: none"> ■ Supplier can be held accountable for more holistic outcomes ■ Can create stronger supplier incentives for innovation and productivity
Typical limitations	<ul style="list-style-type: none"> ■ Supplier must mesh their approaches with the buyer-defined model ■ Requires buyers to retain expertise to choose standards, tools etc. 	<ul style="list-style-type: none"> ■ Greater dependence upon the quality of how the relationship is managed ■ Requires robust definition of required results

3. Managing and optimizing day-to-day operations.

After selecting the engagement model, buyers must manage and optimize three key areas to attain the benefits of fewer suppliers and the new model.

These include:

- Division of work. Highly interdependent delivery increases the requirement of coordination, thus impacting productivity.
- Scope and scale. The scope of work outsourced has implications on the complexity associated with managing the work (e.g., managed services versus staff augmentation). Also, the extent to which the buyer provides the supplier scale benefits determines the potential cost savings.
- Governance model. Deployment of efficient, common governance processes enables a more predictive environment through re-use of IP/frameworks. This lowers both one-time costs (e.g., legal) and recurring costs (e.g., performance, financial) associated with managing performance of multiple suppliers.

Conclusion

Limiting the number of supplier relationships is a key step for controlling complexity. Few buyers complain about having too few suppliers, but many struggle with too many suppliers. Additionally, the step of starting to control the number of suppliers is a forcing mechanism to initiate broader coordination and strategy within the buyer's organization.

Buyers can achieve significant benefits by reducing or limiting the number of suppliers in their outsourced ADM portfolios. These include both financial benefits (to the tune of 22-28%) and the ability to extract more strategic value from suppliers.

However, in order to fully capture these benefits, buyers will need to adopt multiple best practices and "no-regrets" approaches. Also, buyers will need to achieve clarity on the strategy for the engagement models with suppliers. In doing so, taking a longer term view instead of considering each new piece of ADM scope independently is critical to implementing the preferred strategy.

Study methodology

The basis for this whitepaper comes from three primary sources:

- Interviews with 10 leading buyers that reduced the number of suppliers with which they work or are in the process of doing so
- Everest's experience working with buyers seeking to reduce the number of ADM suppliers
- Interviews with leading suppliers that observed the impact of supplier consolidation across their customer base

The scope of the analysis includes large companies (typically correlated to annual IT budgets in excess of US\$300 million).

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