



INDUSTRY DEVELOPMENTS AND MODELS

Vendor Sourcing and Management: Sourcing in 3 Dimensions

Aaron Polikaitis

IDC OPINION

A client executive recently renewed an agreement for a legacy on-premise human capital management (HCM) solution. In return for a five-year commitment, the vendor reduced the maintenance fee, saving the enterprise 25% annually. Based on IDC's benchmark data, indeed, the pricing was best in class. Unfortunately, several months later, another executive at the same enterprise (in the Digital Transformation Office) requested help on a transformation strategy for replacing its outdated and problematic on-premise HCM system with a SaaS-based solution. *Should the contract renewal be classified as savings or a costly mistake?*

IDC observes that such a scenario repeated frequently throughout different industry segments, primarily within enterprises having separate highly siloed organizations responsible for maintaining legacy spend categories and digital transformation (DX). Just how much such fragmented initiatives are costing enterprises is not known at this point. However, based on recent IDC observations, siloed sourcing is causing enterprises to spend far more than they would have if their legacy and innovation sourcing initiatives were integrated. Much has been written about negotiation strategies and procurement tactics to maximize savings. After all, IT budgets represent, on average, 4.9% of enterprise revenue. A modest reduction in IT spend can significantly enhance the bottom-line profit of an enterprise. Typically, cost savings initiatives begin their journey with a historical assessment of purchases as well as a thorough review of existing inventory.

A vendor sourcing and management (VSM) organization will embark on the journey asking key questions, including: Are the existing assets under maintenance being fully utilized? Is the enterprise leveraging its purchasing power by consolidating requirements and negotiating wisely? When were competitive price assessments conducted in the various spend categories? These are all good questions, and in the process of answering them, enterprises may be able to identify potential sources of savings, the "low-hanging fruit." Nevertheless, this traditional historical perspective of comparing prior spend with new spend and inventory often ignores the tremendous changes occurring in technology, especially the shift from the 2nd Platform to the 3rd Platform. In addition:

- Negotiating optimized discounts for legacy platform technology that will or should be replaced in the near future can be a pointless and futile exercise. Furthermore, it may be a counterproductive one as well.
- Instead of looking in the rear-view mirror for savings in spend categories, enterprises should integrate VSM practices with digital transformation initiatives and optimize the entire technology portfolio for digital transformation.

IN THIS STUDY

This IDC study provides guidance to CFOs, CIOs, CPOs, and VSM practitioners looking for strategic guidance on how to optimize their vendor and technology portfolio for digital transformation. If your enterprise has not yet experienced one or more digital transformation initiatives, chances are good that a digital transformation initiative is in its infancy or will be initiated in the near term. Based on a recent IDC study, 66% of CIOs assert their enterprise is dealing with disruptive technologies or new business models. Digital transformation is changing enterprise business models and operations. This study explores how traditional legacy platform sourcing cost savings initiatives are transforming into technology portfolio management and governance practices in preparation for digital transformation. More specifically, this study identifies and explores the following key steps to accomplish the optimization:

- Embrace innovation: Identify digital transformation drivers and owners, establish cross-functional dialog between owners and VSM executives, and share a common vision.
- Integrate VSM: Assess, document, and communicate legacy vendor relationships; establish digital transformation road maps; and develop business cases.
- Infuse the enterprise with the appropriate skill sets necessary to source 3rd Platform solutions and manage digital transformations.

SITUATION OVERVIEW

IDC often consults with clients that have established a renewed focus on IT sourcing governance. Our clients want to know what are the most effective strategies for maximizing savings within their vast portfolio of technology asset categories. Often, these assets have been neglected for years: some are under maintenance but not being utilized; others are not under maintenance but should be. Years of unstructured and unplanned spend have led to a poorly optimized portfolio of technology assets. Unfortunately, the total spend for these assets is often hard to quantify due to decentralized procurement practices through a variety of financial processes and systems. Nevertheless, enterprises that find themselves in these situations are confident that there are great savings opportunities to be mined in the vast tangle of technology assets and related maintenance streams. A team is assembled and chartered with a savings initiative related to legacy asset rationalization.

Inflated Savings Expectations

It is not uncommon, especially during the initial stages after embarking on a savings strategy, to uncover an asset – most often a poorly managed collection of software licenses that yields savings for the team. In many cases, the assets are underutilized, yet maintenance continues to be paid on the entire inventory. Nevertheless, after the "low-hanging fruit" is found, the savings opportunities become more elusive. In fact, it is not uncommon to uncover situations in which assets are not licensed or maintained appropriately, leading to additional expenditures rather than savings. Furthermore, upon closer inspection of vendor terms and conditions, clients are often disappointed to find that they are obligated to maintain assets whether they are utilized or not. Vendor terms often stipulate that the entire inventory must be maintained to benefit from the specified negotiated discounts. It's at this stage of the savings journey that most teams are faced with resetting savings expectations upon which the teams were chartered.

Siloed Sunsetting and Innovation

Meanwhile, as the legacy cost savings initiatives are in full swing, several organization layers apart from the legacy savings team, groups chartered with ushering in innovative technologies, have been busy evaluating 3rd Platform technologies and contemplating digital transformations. Often, these technologies and transformations may facilitate the replacement of legacy technologies (e.g., the expensive-to-maintain assets accumulated over many years). Nevertheless, because these groups (legacy and innovation) are separated by organization layers and, in many cases, large geographic distances, the potential synergies of combining the initiatives are often lost. Instead of combining business cases for sunsetting existing expensive technologies and replacing with leading-edge 3rd Platform solutions, each group works independently and struggles to make a solid business case its own initiative. Worse yet, long-term relationships for legacy technology are formed with vendors offering improved discounts. Legacy teams eager to find savings may claim "quick win" victories while undermining the strategic direction set by teams chartered to innovate.

A recent, highly publicized move by the world's largest retailer Walmart emphasizes the need for tight integration between innovation and legacy teams. In 2011, Walmart formed @WalmartLabs, a technology research division located in the heart of Silicon Valley. After a significant expansion and numerous acquisitions of various high-tech start-ups, earlier this year, Walmart merged its tech group at its headquarters in Bentonville, Arkansas, with @WalmartLabs to create a new division called "Walmart Technology." Enhanced collaboration between the two teams was cited as the reason for the merger.

Sourcing in 3 Dimensions

- As a trusted advisor to many Fortune 500 enterprises, IDC has a unique opportunity to provide advice to different organizations within the same enterprise. From this vantage point, we have observed counterproductive sourcing behaviors, similar to those described in this study, at numerous enterprises. In some cases, we have been specifically requested not to share information regarding strategic technology sourcing plans with other groups. Clearly, there is either a lack of trust, capability, and maturity or a combination of the foregoing in such situations. Whatever the cause, IDC predicts that over 70% of such siloed sourcing practices will lead to failed digital transformations. Of course, none of these organizations would ever consider allowing IDC to highlight their siloed approaches to sourcing in our research. Conversely, successful strategies are much easier to highlight (see *IDC PeerScope: Leading in 3D - Practices for Integrating Digital Innovation Groups with Traditional IT Operations*, IDC #US41039016, March 2016).
- IDC's Leading in 3 Dimensions (L3D) framework addresses an often adopted but misguided strategy of creating and leading two separate organizations - one for innovation and the other for operations - each with its own structure, processes, governance, metrics, and organization (see *Leading in 3 Dimensions (L3D): Critical Issues*, IDC #US40706315, December 2015). IDC's Leading in 3D framework involves:
 - Partnering with the business to *embrace innovation*
 - *Integrating* and scaling new innovations within existing operations of the enterprise
 - Changing the culture or DNA of an organization by *incorporating* and infusing new skills, techniques, and culture

As observed in the broader context of a bifurcated IT leadership model, VSM operations are often separated from centers of innovation where 3rd Platform technologies are evaluated and business relationships are created and managed. Applying IDC's L3D framework within the context of VSM, CFOs, CIOs, CPOs, and VSM practitioners should optimize technology portfolios for maximized savings.

Embrace Innovation: Identify Digital Transformation Drivers and Owners, Establish Cross-Functional Dialog Between Owners and VSM Executives, and Share a Common Vision

Without understanding business drivers for DX within the enterprise or knowing the key owners that will be promoting the transformation activity, VSM operations are destined to continue seeking savings within legacy technology spend categories in a silo. Weekly cross-functional DX team meetings are a critical prerequisite (see *IDC PeerScope: Leading in 3D – Practices for Integrating Digital Innovation Groups with Traditional IT Operations*, IDC #US41039016, March 2016). It's important to note, however, that earning a seat at the table in such meetings will, in many enterprises, require VSM executives to refine organizational structures and upgrade talent. Enterprises are recruiting executives with outstanding resumes and impeccable track records to lead digital transformation initiatives. Similarly, many IT organizations have upgraded their talent pools to drive DX more effectively and efficiently. Although there are many VSMs that have retained the appropriate talent to provide thought leadership at a high-level strategic context, many VSM operations are still considered back-office administrative operations with limited ability to contribute at a strategic level. To change this perception, at the very least, VSM practitioners should become current on 3rd Platform technology vendor landscapes and overall market trends. This could be accomplished through more formal processes (RFIs) or through less formal meetings, demos, and peer interactions.

Integrate VSM: Assess, Document, and Communicate Legacy Vendor Relationships; Establish Digital Transformation Road Maps; and Develop Business Cases

In an unfamiliar foreign country, most travelers are lost without a map (or a smartphone with GPS). Now, what about those travelers that don't even know where they are going? Even GPS can't help in that case. Likewise, without understanding the current legacy vendor and technology landscape, it is impossible to make sound technology and financial decisions and prioritize digital transformation initiatives. Furthermore, without a comprehensive shared future-state vision, organizations are destined to continue to make costly mistakes. All too often, digital transformations are initiated without a complete understanding of the existing vendor landscape, resulting in significant negative financial implications and in some cases derailing the digital transformation initiatives themselves. One Fortune 500 client launched a DX initiative to implement a cloud-hosted human resource management (HRM) solution. The initiative was a great success – that is until it became apparent that the maintenance revenue stream paid to the on-premise legacy HRM solution provider was inseparable from the total maintenance revenue stream paid for a complete suite of products, most of which were still in use. At the end of the day, the enterprise was obligated to pay maintenance on products it was no longer using. With some additional planning and review of existing agreements, the HRM DX initiative could have been timed more carefully to avoid having to pay maintenance on a legacy solution that was no longer in use. Alternatively, the price for the cloud-hosted HRM solution could have been negotiated downward to compensate for the overlapping payment for the legacy solution. Furthermore, the enterprise could have made a well-informed decision to implement the cloud-hosted HRM solution despite having to pay maintenance on an unused solution – provided, of course, that a business case could be made to support such an additional cost.

Accordingly, VSM organizations (VSMOs) must be able to clearly communicate relevant information regarding existing relationships to avoid such consequences. At a minimum, the VSMO must be able to communicate answers to key questions such as:

- When do existing legacy technology agreements expire?
- What is the estimated cost of extending such agreements? Short term? Long term?
- What are the financial implications of termination? Entire agreement? Partial termination?
- For how long are the legacy capital assets on the financial books? When will they be fully depreciated?

Only after the extended executive team shares a common DX vision, and existing legacy technology relationships are well understood, it is possible to develop comprehensive and fiscally responsible road maps for sunseting existing legacy platforms and introducing 3rd Platform technologies.

Finally, and probably the most important from a fiscal responsibility perspective, VSM executives must provide the necessary leadership to drive the development of business cases supporting the digital transformation. Having firsthand knowledge of existing vendor relationships as well as front-line responsibility for negotiations with 3rd Platform vendors, VSMOs are uniquely positioned to provide key data points necessary to develop business cases supporting digital transformations (see *IDC PlanScape: Building the Business Case for the Cloud Transition Strategy*, IDC #US41154516, April 2016). Nevertheless, if VSM executives are not integrated into the organizational fabric driving digital transformation, such key data points will be lost or overlooked, leading to poor financial decisions.

Infuse the Enterprise with the Appropriate Skill Sets Necessary to Source 3rd Platform Solutions and Manage Digital Transformations

As technology delivery models change, so do the sourcing practices used to acquire them. The focus shifts from the sourcing of commodities assembled by IT into solutions used to provide services to the sourcing of business services directly on behalf on the lines of business (LOBs). In fact, IDC estimates that the lines of business fund at least 61% of all technology projects. Forces behind the economy of scale have moved the heavy lifting of commodities into the cloud. It is now the SaaS and cloud vendors that assemble commodities to provide business services directly to the LOB.

Along with this shift in sourcing practice comes a change in competencies required to effectively execute the sourcing strategies. In 2015, IDC conducted a skills competency survey within the IT ecosystem. The goal of the survey was to determine how important certain competencies were to IT organizations for the successful support of broader enterprise strategies, based on their importance in today's environment as well as their importance anticipated in the future (three to five years). VSM-related competencies (business relationship management, IT procurement, and contracts and IT vendor management) were both of current and future importance to the IT executives polled.

Now, enterprises that have been successful in infusing the appropriate skill sets have done so in different ways (see *IDC PeerScape: Leading in 3D – Practices for Integrating Digital Innovation Groups with Traditional IT Operations*, IDC #US41039016, March 2016). Organizations should seek out specific best practices adopted by enterprises for infusing additional skills and domain expertise through vendor partnerships, start-up acquisitions, and new talent hires. In addition, specifically as it relates to VSM skills, enterprises have successfully infused the appropriate skill sets by creating cross-functional teams with individuals from traditionally siloed organizations: finance, legal, procurement, marketing, R&D, IT, and so forth. This not only infuses teams with the appropriate skill sets but also allows the individual team members to learn from each other and establishes a more hospitable climate for organizational collaboration. Less successful enterprises are characterized by strict hierarchical reporting structures and commonly observed turf battles.

FUTURE OUTLOOK

Based on the most recent IDC MaturityScape Benchmark on VSM (see *IDC MaturityScape Benchmark: Vendor and Sourcing Management in the United States*, IDC #251186, September 2014), over 40% of all VSM operations are back-office operations and are viewed more as an obstacle than a valuable enabler to digital transformation. For the foreseeable future, these VSM operations will continue to seek savings within legacy technologies and vendor relationships, without incorporating broader 3rd Platform technology portfolio considerations in their savings strategies. The enterprises supported by such VSM operations will continue to innovate in isolation and will be hobbled by the lack of pertinent information regarding their existing legacy vendors and technologies. As a result of such siloed and bifurcated approaches, enterprises will incur avoidable financial expenditures. Enterprises with VSM operations, which embrace digital transformation and integrate their practices within teams supporting digital transformations, will optimize their overall technology portfolios and avoid making costly and unnecessary expenditures.

ESSENTIAL GUIDANCE

In summary, sourcing strategies that are intentional are more effective than strategies that are reactive and situational.

Fractured sourcing strategies, which consider a portion of a technology portfolio (legacy or 3rd Platform), are destined to fail. To avoid the negative consequences of such fractured strategies, IDC provides the following essential guidance:

- **In the short term (0-3 months):**
 - Establish frequent and regular executive team meetings for open communications related to digital transformation initiatives.
 - Incorporate VSM leadership into the team.
 - Establish and communicate business drivers of DX in all functional areas.
 - Become current on overall market trends and technology delivery models.
 - Conduct formal RFIs or informal meetings/demos with leading innovators in their fields.
- **In the medium term (3-6 months):**
 - Review and document legacy technology agreements:
 - When do existing legacy technology agreements expire?
 - What is the estimated cost of extending such agreements? Short term? Long term?
 - What are the financial implications of termination? Entire agreement? Partial termination?
 - For how long are the legacy capital assets on the financial books? When will they be fully depreciated?
 - Communicate the previously mentioned information to a broader audience that includes digital transformation driver owners.
 - Leverage this information as part of 3rd Platform technology sourcing strategies.
- **In the long term (6+ months):**
 - Enhance VSM skill sets by creating cross-functional teams from traditionally siloed organizations.

LEARN MORE

Related Research

- *IDC PlanScope: Building the Business Case for the Cloud Transition Strategy* (IDC #US41154516, April 2016)
- *Service Innovation: U.S. IT Budget Allocation by Industry Sector, 2015* (IDC #US41063816, March 2016)
- *IDC PeerScope: Leading in 3D – Practices for Integrating Digital Innovation Groups with Traditional IT Operations* (IDC #US41039016, March 2016)
- *IDC MaturityScope Benchmark: Leading in 3D in the United States* (IDC #US40995716, February 2016)
- *Organizing for Digital Transformation: Emerging Structures and Approaches* (IDC #US41034516, February 2016)
- *Leading in 3 Dimensions (L3D): Critical Issues* (IDC #US40706315, December 2015)
- *The Changing Role of IT Leadership: CIO Perspectives for 2016* (IDC #US40662915, December 2015)
- *IDC PeerScope: Practices for Creating a Compelling Digital Transformation Vision* (IDC #US40546715, November 2015)
- *2016 IDC FutureScope CIO Agenda Prediction 4: 70% Failure Rate of Siloed Digital Transformation Initiatives in 2018* (IDC #US40550115, November 2015)
- *Services Innovation: Future of IT Spending* (IDC #256556, June 2015)
- *IDC MaturityScope Benchmark: Vendor and Sourcing Management in the United States* (IDC #251186, September 2014)

Synopsis

This IDC study provides VSMO leaders, CPOs, CIOs, and LOB executives advice on optimizing investments in technology portfolios (legacy as well as 3rd Platform). Managing legacy technology assets in isolation of investments being made in 3rd Platform technologies presents opportunities for waste and mismanagement. Isolated efforts to cut spend on legacy technology may end up creating unforeseen financial liabilities. By applying fundamental concepts from IDC's Leading in 3 Dimensions framework within the context of vendor sourcing and management, this study details specific actions organizations can take that will enhance their ability to more effectively manage their technology investments.

This study focuses on IT strategy and governance, vendor sourcing and management, and IT talent and skills management.

According to Aaron Polikaitis, research vice president, IDC's IT Executive Programs (IEP) Vendor Sourcing and Management practice, "Unfortunately, the savings game within many enterprises has become an overly complex bureaucratic and isolated process – promoting fractured portfolio management practices – which may ultimately create greater financial liabilities than savings."

About IDC

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Global Headquarters

5 Speen Street
Framingham, MA 01701
USA
508.872.8200
Twitter: @IDC
idc-community.com
www.idc.com

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