



"turning data into dollars"

Tom's Ten Data Tips – September 2007

Vendor Selection

Vendor selection is a crucial skill in the recent trend towards outsourcing and offshoring. Outsourcing has been growing from 1% in 2003 to 9% in 2007 (Meta Group). Offshoring was used by 26% of all institutions in 2003, and has grown to over 70% (Deloitte). This has included both a move to low-wage countries, as well as divesting non-core activities.

Vendor selection may be seen as "just another choir", yet few other business processes have such a direct impact on aligning the value stream with the outside business world. For some choices, like Data Warehouse technology, Analytics platform, or CRM systems, the long-term commitment can be huge. Yet few companies engage in a clearly structured search of the market place. What's worse, many companies don't even have a reproducible process in place, making this process not only irregular, but unnecessarily laborious as well.

1. There Are 3 Structured Approaches To Vendor Selection

The literature shows three separate approaches to vendor selection:

- Categorical method; each potential supplier's performance is rated in specific areas defined by a list of relevant performance variables. A subjective rating (e.g.: good, average, poor) leads to a composite ranking.
- Cost-ratio method; the total cost of each purchase is calculated as its acquisition price plus the buyer's internal operating costs associated with the quality (or lack thereof) and delivery.
- Linear average (or weighted point) method; in this method the subjective nature of the categorical approach is improved by providing numerical weights to the evaluation criteria and individual vendor's performance. Then a composite performance index is calculated to determine "the winner".

The cost-ratio method is most involved (time consuming), but works best for highly structured decisions. The linear average is more generic and versatile.

2. Vendor Selection Is A Multi-Objective Decision

There are always several criteria on which vendors can be compared. Except for very rare cases, some vendors will score best on one criterion, and other vendors will come out first on the next criterion, etc.

The vendor selection model is therefore an inherent simplification of the problem. When a linear combination of feature scores is calculated, it is evident how all features are mapped and weighted on one dimension. Even when linear programming is used to solve this problem, the loss function that is minimized still implies some transformation to a unifying dimension.

3. A Transparent Selection Process Will Enhance Pan-Company Buy-In

Besides leading to better decisions per se, the major benefit of a structured decision making process is that the course of events leading to a vendor being chosen eventually, can be reproduced. The reasoning that was followed to arrive at the decision can be deconstructed and analyzed.

This is important, because the choice is rarely unanimous. Some people will have had preferences for one supplier over another. They are entitled to a sound and impartial answer as to why *their* preference wasn't chosen. Political "games playing" is thus eliminated. Also, suppliers (that might be invited again in the future for RFP's) invariably are curious why their offering wasn't chosen. They merit a candid response, in the interest of maintaining good relations.

4. Choose Resources In Accordance With Risk/Reward Sharing

You need to distinguish between high-value consulting and low-level commodity services you can safely select on the basis of price. The best arrangement for a buyer is where the project risks are transferred to the consultancy, by virtue of an agreement that is contingent on results. If the risk remains with the buyer, do personnel selection yourself when feasible. Only when the consultancy will take (a large) part of the risk, is it OK for them to appoint personnel on the project.

Jim Shepner, AMR Research says: "Small consulting companies and individual freelancers can offer highly skilled IT specialists at much more economic rates than large international IT Groups and system integrators."

5. Avoid Layers Of Sub-Contracting

In a complex and large scale project, it is quite common to have multiple parties involved who are working towards a common goal. In particular for highly specialized work, it is quite conceivable that disparate competencies are to be found in more than one company.

It is preferable to *directly* employ all parties, rather than to have one supplier sub-contract out to several independent parties. This has nothing to do with a financial margin they may factor in. Rather, the subcontractors don't have the same level of freedom to speak and act, and therefore can add much less value to the process – in particular when the going gets rough.

Outsourcing consulting recruitment itself is the silliest example of violating this tip. At first sight it looks appealing to cut this non-core activity out of the value chain. But the additional layer of command and responsibility is dysfunctional when activities grow out of sync with corporate strategy.

6. Substantiate Compelling Claims

When a vendor makes a truly compelling claim, always aim to see this substantiated. This can be done by demos, client visits, online forum discussions, or by discussing concerns with peers. Pre-sales staff from vendors can sometimes be overly optimistic, and their experience tends to be far less “grounded” in practice.

On the upside, an appealing claim may play a crucial role in supporting a business case for a particular tool or system. A firm reality check will solidify the business case, as this is bound to be subject to severe internal scrutiny as well.

7. Purchasing Is A Strategic Function

Because the impact on value creation is tremendous, selecting vendors for both software, as well as hardware, supplies, and even more importantly consulting should not be taken lightly. In today's networked economy, companies will increasingly rely on outside parties for the fulfillment of their mission.

This implies that management of vendor and/or partner relations should not be considered an operational or tactical responsibility, but rather a strategic function. This holds even more so in Just-In-Time or Lean operations.

8. Begin By Defining *Measurable* Selection Criteria

The very first step in vendor selection should be a solid assessment of which *measurable* criteria will be used to compare vendors by. More than 50 criteria for selection have been identified in the literature, which can be condensed to 20-25. Most often, some linear combination of these will provide the optimal choice.

Once a preferred solution has been determined, a transparent model will allow the buyer to easily assess the sensitivity of the choice to variations in criterion scores. This should provide ample “ammunition” in negotiations with vendors.

9. Address Functional As Well As Non-Functional Requirements

Functional requirements have to do with what the service or application attempts to accomplish. Non-functional requirements have to do with how user-friendly an application is, performance, availability, reliability, the service level, the number of user platforms supported, or how ‘easy’ it is to deal with a particular vendor, among others.

Many of the “second thoughts” from outsourcing to low-wage countries seem to revolve around cultural differences, non-matching value systems, communication challenges, etc. Note that these reasons don’t necessarily stem from not fulfilling functional requirements, but rather the non-functional ones.

10. Time-Contingent Payment Misaligns Client And Supplier

By far most consulting agreements are based on some kind of time-contingent payment scheme. This appears the default kind of agreement, and “time and materials” has become a standard expression.

The problem with this arrangement is that it fundamentally misaligns consultant and client. When the client is best served by keeping the assignment as small and short as possible, even the most ethical consultant may be tempted to expand the assignment, and make it last longer than strictly necessary.