

Vendors May Cost You More than Your Project: How to Avoid Vendor Risks

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Introduction

Let's face it: we are all dependent on vendors, whether in our workplace or our personal lives, for the simple reason that none of us can "do it all on our own." What we can do, however, is ensure that we are managing those vendors in order to have our needs and expectations fulfilled.

If you look anywhere in the news today you will find a whole host of stories about financial problems that are caused at least in part, if not entirely, by poor vendor management and oversight.

One local headline reads "\$6 Million Later, County Scraps Computer System." The story goes on to discuss how over US \$6 million had been spent on a program meant to support the judicial and criminal justice systems---and how ultimately nothing was delivered (Levine, 2006). The program was finally cancelled.

A global manufacturer of home healthcare products made headlines when it announced to shareholders and the public that dividends would be reduced by US \$.25 to \$.30 per share, and projected a revenue shortfall of \$30 million due to "problems with the implementation of a new enterprise resource planning system" (Baron, 2005).

As evidenced by these news reports, vendor performance and its management impact *more* than just project success. Other areas that are impacted include shareholders, taxpayers, customers, careers, organizations' reputations, and, ultimately, the vendors themselves. These vendors may in fact have had very good intentions, but their performance may have missed the mark due to an absence of that vendor management component that solidifies a partnership.

Who is to Blame?

In today's world, when something goes wrong, everyone likes to put the blame on someone or something. People often blame all program and project management problems on one specific area---whether it be technology, vendor procurement, an organization's ability or inability to change, management, or leadership (and the list goes on).

I believe that the root cause of these problems is the poor execution of program and project management practices, of which vendor management is a component.

Vendors are not, and should not, be brought into a supporting role to be "scapegoats," but should be considered partners that help the organization to fill a void in expertise, staffing, and skills.

Why Engage a Vendor?

Typical considerations for seeking external vendor support include the following:

- The organization has never done "X" before and wants to be assured of success by someone who has.
- The organization may have credibility challenges and it is more palatable for an external vendor to do the work.
- The project timeline dictates speed to market, and the organization does not have the internal resources needed to shorten the timeline.
- The vendor has a broader perspective; they have experience with similar organizations and can effectively handle the complexities.
- The organization's staff does not have the capacity.
- The organization may have a culture that is more prone to outsourcing than in-sourcing.

If you look at Chapter 12 of *A Guide to the Project Management Body of Knowledge (PMBOK® Guide)*---Third edition on Project Procurement Management, there is a chart depicting the various steps from planning purchases

and acquisitions through contract closure (Project Management Institute [PMI], 2004). This is not a complex chart; the messaging is clear---plan for vendor procurement and management.

What Are We Purchasing?

In my experience, people make purchases without a real understanding of what they want to buy. Marketing is driven by this concept and reality.

For example, if you are buying a car and do not include an 8-CD Disc Changer as a requirement, you may end up driving down the road with only the radio.

Scope and requirements are essential inputs to vendor evaluations. These evaluations consist of what vendor, what services, and at what price. Requirements should be ranked in terms of importance in the event that choices and trade-offs need to be made. One thing to consider with any vendor evaluation is whether the product or service already exists (and can be demonstrated), or whether they are simply “promising” that it will exist.

How Not to Do It

An organization that decided to replace their aging HR/payroll system had a tight timeline in which to do it (because of some compliance issues), so they skipped providing the definition of requirements. They chose a best of breed product and signed a contract.

During a project kick-off meeting, it was discovered that the vendor’s product technical platform did not align with the organization’s IT architecture. A further review disclosed unanticipated costs for hosting. The contract was cancelled, with significant financial penalties to the organization. *Now the team was challenged even more with an even tighter timeline.*

Mitigating Risks

Although every vendor evaluation and selection has inherent risks, some to consider for mitigation are:

- **Technical, quality, and performance risks**---any one of these can be a serious show-stopper.
- **Schedule performance risks**---these can range from annoyance to catastrophe.
- **Cost risk**---this can be mitigated based on how you choose to accept or transfer the risk via the pricing (fixed vs. cost plus).

You must define what you need in order to get what you want!

Vendor Pricing Scenarios: What is Best for the Buyer?

Let’s first define “best for the buyer;” this is where we have to understand the buyer’s goals in engaging an external vendor:

- Cost risk mitigation
- Schedule risk mitigation
- Deliverable risk mitigation
- Quality risk mitigation
- Don’t want to manage the vendor resource(s)

Without understanding some of these goals, you cannot effectively begin to consider fixed vs. cost plus pricing. Now, let’s look at a typical matrix (Exhibit 1) that depicts what might be best for the buyer once we have understood the buyer’s goals.

Fixed	Cost Plus
o Cost risks to vendor	o Cost risks to buyer
o Obligated to finish the job o Higher profits?	o Best efforts only o Lower profits?
o Typically minimal buyer oversight	o Requires much buyer oversight
o Progress payments generally linked to performance	o Payments may not be based on progress and performance
o Can include incentives	o Can be cost plus an incentive
o Can include economic price adjustments	o Can include cost plus percentage cost fee increase
o Subjective award fees	o Subjective award fees

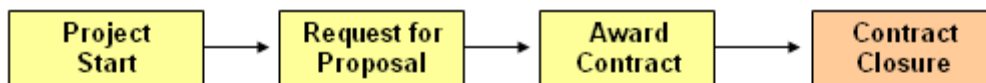
Exhibit 1---Fixed vs. Cost Plus

Many project managers do not understand the drivers when seeking external vendor support and therefore cannot take this chart and ask the most important questions to help them understand the pricing options. When these drivers are understood, however, the vendor selection and negotiation can be further streamlined.

How to Procure a Vendor

Specific steps with inputs and outputs that support the procurement process are taken. Many organizations have formalized the approach and leveraged vendor relationships by establishing a supply chain or procurement group.

Next, let's look at the inputs, outputs, and steps that are a part of the procurement process (Exhibit 2). One of the main reasons we are having this "look-see" is to remind ourselves that this process is a part of every project work plan. If it is overlooked, you and your project will be impacted.



Procurement Definition	Vendor Selection	Vendor Performance
o Specifications	o Proposals in Evaluation	o Monitoring/Managing
o Models	o Evaluation	o Reporting
o SOW	o Source Selection	o Changes
o Sample Contract	o Management Approval	o Delivery
o Known Requirements	o Negotiations	o Assessment & Closure
o Evaluation Criteria	o Review Contract with Legal	o Performance Archiving

Exhibit 2--What to Procure

Now we know what we want to buy; the requirements are solid, and using Exhibit 2, we ought to be able to negotiate that contract, right? Not quite! Everyone should understand where there may be vendor "gaps" in meeting the stated requirements and the responsibility (in terms of time and cost, and who accepts responsibility) of closing those gaps.

Typical Case Study Reflecting a Real Scenario

Two organizations agreed on a contract for demonstration of proof of concept only. The vendor was to provide a viable proof of concept to the client, using the client-generated requirements.

What was unclear from the start were the gaps. The vendor had a product that had significant gaps that needed to be closed to generate the agreed upon proof of concept. The buyer was unaware that the vendor was intending to build something to bridge those gaps, and the contract was not clear.

The vendor was unable to demonstrate a viable proof of concept and intended to invoice the client for the work to bridge the gaps. Renegotiation was quickly needed. Lessons learned from this scenario are that one needs to understand the agreement with the vendor and to state clearly the understanding in the legal contract. This understanding will benefit both the vendor and buyer.

The Contract

Let's be clear about what elements should be considered in a contractual agreement with a vendor (most of these should be considered required vs. optional):

- **Statement of Work (SOW)**---this protects both buyer and vendor
- **Technical specifications**---these prevent late mis-fits
- **Terms and conditions** such as:
 - Warranties
 - Locations of where the work is to be performed
 - SOW change process
 - Nonperformance
 - Term or duration
 - Pricing
 - Payments
 - Specific skills/experience/talents
- **Data reporting**---to build clarity around the vendor's reporting requirements such as cost reporting, quality metrics, and subcontracting utilization
- **Progress/status reporting**---to identify:
 - Process
 - Content
 - Frequency
 - Medium
 - Escalation procedures
 - Attendees (required) if meeting
- **Management requirements**---with baseline expectations regarding the following:
 - What tools are to be utilized
 - What methodology is to be used
 - What expectations one has about training
 - What the process is and the expectations are about knowledge transfer
- **Confidentiality**---this should be ensured to protect your organization, your data, your ideas, and your information, and to help provide clarity around the use of the data, the destruction of confidential materials, and where the confidential materials reside (and remain)
- **Pricing**---to ensure that there are no hidden fees and/or expenses
- **Invoicing**---to clarify the payment structure (when and how you pay), the invoicing periods and terms, and applicable taxes
- **Insurance**---your organization may have requirements for specific insurance coverage that a vendor must have, such as Errors and Omissions, Commercial Business, Workers Compensation, and so on.
- **Rights**---to ensure that there is a clear understanding of *who* owns the products when they are complete, including the rights of use by whom, when, and for how long

- **Miscellaneous legal**---this is where the mediation, arbitration, governing law, liability limitations, and auditability of the vendor should be included

The Infamous Statement of Work

Why should you have a statement of work (SOW)? The SOW is a key component, as it details and clarifies the work to be performed as well as under what conditions it should be performed. The SOW generally contains verbiage pertaining to:

- **Buyer’s objectives**
- **Deliverables**---clear statements about what these are
- **Performance objectives**---defining these standards will drive the checkpoints that will begin to measure the probability of success (it is recommended that these be jointly developed between buyer and vendor)
- **Personnel commitments**---identification of specific levels of people, talents and skills, can also include the names of individuals
- **Terms and conditions**---these can include “pay for performance,” the alignment of payment with the performance objectives in the SOW
- **Communication**---the stated expectations regarding how the vendor and buyer will communicate specifically regarding the SOW

We’re Ready to Go With Our Vendor: Now What?

Unfortunately, we focus too much on when and where we engage the vendor and then forget that we have to *manage the vendor*. Managing vendors is not considered an indication of distrust; rather it is a process for solidifying the vendor relationships and partnerships. As a project manager, this is your responsibility, and not that of the procurement folks, the legal team, or your manager.

Some key action items to support managing and partnering with your vendors include:

- **Setting up and conducting progress reviews**---you set the agenda and engage the participants who need to attend
- **Verifying invoices**---anyone can make a mistake, so ensure that you are getting what you are paying for
- **Resolving issues**---how long you permit vendor issues to remain in an “open status” can impact your success, so know when, how, and whom to escalate to
- **Using earned value management**---to track progress against the spending

The Vendor Was Not Managed: A Case Study

Everyone agrees that vendors can incur additional costs if they not managed properly. What most people do not realize is the extent of these costs.

A local government agency engaged a vendor to run and implement an ERP. The vendor was not managed, there was no documentation regarding expected performance, and there were no checkpoints with the vendor. The local government realized that they had paid the estimated costs to the vendor and had nothing to show for it.

The vendor was fired. The vendor took the local government agency to court and won the lawsuit. Because this was a local government contract, the fact that the taxpayers had to shell out \$3 million dollars to an incompetent and unmanaged vendor was shared on the front page of the newspaper. The local government agency could not demonstrate any documentation that represented any oversight of the vendor.

Vendor Performance Measurements

You are measured for your performance, so why not measure your vendor’s? In order to measure your vendor’s progress throughout the project, you will need to take the following steps:

- **Require the vendor's schedule** ---this is needed also to integrate into your work plan
- **Conduct status meetings**---this will help minimize your own surprise by probing on status and “inspecting what you expect”
- **Address performance issues immediately**---don't provide a third or fourth chance for vendor performance recovery
- **Document, document, document**---ensure that all documentation is fact-based and shared with the vendor; engage other partners (e.g., legal, procurement) where appropriate in addressing vendor issues

Changes Are a Fact of Life

You can bet that changes are bound to occur and that they will impact the original SOW. The process for addressing these types of changes should be articulated in the contractual agreement---namely, concerning *how* changes will be handled. This presupposes that the process has been discussed with the vendor and agreed upon by both parties.

If these change controls were not established as part of the contract, the risk of schedule and budget impacts increases. Depending on the type of pricing of the vendor contract (fixed vs. cost plus), the vendor may even *welcome changes to the SOW!*

Depending on the magnitude of the change, the type of contract, and the change to the SOW, you and the vendor may need to reengage legal review and oversight..

Vendors Are Risky Business

Let's consider the many types of risks that a vendor brings to our projects and some potential mitigation strategies.

- **Performance risk.** (This is generally at the top of the list.)
 - Does the vendor have a track record with similar SOWs?
 - What are the vendor's prior customer experiences (e.g., same work done for others that may or may not be similar to us)?
 - What are other sources of reference (Gartner/Forrester, other customers, publications)?
- **Culture risk.** Often this is missed; the vendor may have done the same work before, but in a very different culture climate. Every organization's culture is unique; the challenge is to determine just "*how* unique."
 - Does the vendor have the ability to adapt and blend in?
- **Competency Risk.** This is similar to performance risk. Questions about competency should be addressed with vendor and vendor clients. Some of these risks can be addressed in the legal contract with the vendor.
 - Does the vendor have the right folks on the vendor's "bus"? (If you want particular people on the project, it needs to be clear to the vendor.)
 - Will the right skills be available at the right time?
- **Capacity risk.** This is often overlooked in the excitement of finding the right vendor to partner with on your project.
 - Is the vendor viable in terms of resources and the timing of their availability to support your schedule?
 - Is the vendor large enough to be a long-term supplier (support and implementation consideration)?
- **Reputation risk.** This is a consideration when you are searching for a vendor that may be specialized (non-Big 5) and this vendor will have visibility within your organization.

- Does the vendor have a credible reputation that can impact your organization and project team?
- **Alignment.** (This may or may not come to mind when you are in the process of choosing a vendor.)
 - Does the vendor share the same core values, have a similar methodology and standards? (An early disconnect may be an indicator of the relationship's success or failure.)

Because today's program/project initiatives are so complex and dispersed, the reality is you and your organization may have *multiple vendors* having to work together effectively and cohesively. This requires that some other considerations be taken in account:

- What is the risk of multiple vendors independently succeeding or collectively failing?
- Can you identify, very early, a method for resolving interrelated vendor issues and achieve agreement on this method with all vendors?
- Should you consider an external, unbiased oversight that fosters the multiple vendor engagement partners?

Termination of Vendor Contracts

Typically, termination of a vendor contract is due to one of the following four reasons:

- **Failure to perform against the SOW**---this is a vendor failure and points out the importance of (1) the clarity of the SOW (this assists not just you but the vendor in assessing performance) and (2) the need to manage the vendor to ensure that they are performing against the SOW.
- **Breach of contract**---the contractual agreement is not executed by the vendor or you (the buyer).
- **Anticipatory breach of contract**---the vendor does not intend to complete the work; significant associated costs have been incurred by the vendor.
- **Termination by you (the buyer)**---this is generally executed within the Terms and Conditions clause of the contract and can be executed with a legitimate basis for termination (e.g., a project cancellation).

Rating the Vendor Performance

The End of the Engagement

Great experiences are worth repeating, but not disasters! At the end of the engagement, you should determine if you would invite this vendor to support you again. First, "document, document, document": both the vendor and procurement need to know how you would rate the vendor's performance. Remember, feedback is helpful, so make it constructive where needed.

Also include and recognize your vendor for meeting/exceeding expectations; inclusion makes the team "whole."

What does the entire process provide? Mutual success!

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