

## White Paper



### Managing Supplier Transitions

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#### Abstract

As the outsourcing relationships get more value focused, supplier switches are becoming commonplace. Supplier transition assumes importance since the risks posed due to supplier switch can result in financial damages and business disruption if not managed properly. A risk mitigation strategy should guide and influence an effective supplier transition.

## Need For a Supplier Switch

The customer - IT supplier relationships are undergoing unprecedented transformation. As of September 2010, 500 outsourcing contracts worth 37.5 Billion USD were lined up for renewal according to research firm Ovum (1). Organizations are investing in re-articulating their outsourcing vision and gaining expertise in order to validate and evolve their decision making capabilities which enable them to successfully steer the mega outsourcing deals. Behind the big sound bytes of these multi-million dollar outsourcing deals, also lie complex supplier switch decisions that organizations have to make. The intense focus on value is a key driver for both the customer and the supplier to discontinue a particular relationship and the same driver is responsible for creation of a new one. The outsourcing experience of organizations has increased multi-fold that has led to a more evolved sourcing strategy which tends to align itself with a modular, best-of breed approach in choosing suppliers. There are local project level considerations and global organizational imperatives which tend to influence sourcing decisions. On the other hand, the suppliers bring innovations to their delivery and pricing mechanisms in order to derive maximum value from their transactions with the customer. In the absence of any incremental value, the supplier may take an informed decision of triggering a transition, either at project or at the complete engagement level.

Thus, the rationale behind supplier switch decisions can be looked at as an entire spectrum of reasons which need to be looked in detail.

**Performance:** More often than not the balance of performance vs. expectation sets the tone for the duration of a relationship.

Organizations take great pains to clearly delineate expectations and quantify and qualify supplier performance. Basic minimum performance is assured via meticulous service level agreements and contracts. However, tangible qualitative value-adds are also expected over and above the basic service delivery. Quality and capacity of delivery on time is an issue with relatively new engagements and is generally responsible for the maximum supplier switch decisions while the engagement is still in its infancy. Cost becomes a criterion over a medium term, when the IT management on the customer side starts to benchmark internally as well as externally. Cost expectations can be difficult to meet for the supplier as a year on year cost reduction is difficult to sustain and becomes untenable during troughs in the business cycle. A new supplier may be better equipped or innovate to meet the cost challenge or could try to out-price in a competitive context.

**Scalability:** Business imperatives could drive expansion in new markets or introduction of new processes which require fresh functionality implementation. Technological imperatives could lead to change in platforms, packages and architecture. The supplier could be found wanting in case it is unable to provide new functional, technical or program management skill sets. If a supplier is a local vendor who can provide skills only in the local language and market, in a changed context when more regions and languages are integrated, the supplier may not be able to scale up with the customer on a global stage. Hence, the IT sourcing strategy needs to be aligned with long term business needs and could trigger supplier switch.

**Sourcing strategy:** Purchasing policy could activate fresh sourcing especially when long running contracts come up for renewal.

The supplier could be out-bid and out-priced or could decide to opt-out especially if the terms and conditions and the financial aspects are not agreeable. A global sourcing initiative could mandate off-shoring and suppliers who cannot assure an offshore or near-shore delivery could be targets of switch. A modular sourcing initiative could trigger consolidation of supplier base by slicing the IT function into a few important chunks and awarding them to key suppliers based on a best-of-breed approach. This could trigger a mass supplier switch at various projects and engagements. In other cases, the supplier could have wielded immense bargaining power due to legacy contracts and volumes or was the only choice available due to the complexity of the work involved. This would have led to a loss of control over deliverables, inflexibility and high costs. However, over time the sourcing strategy would aim at regaining the balance of power by introducing a new supplier in some projects and gradually reducing the volume share.

**Supplier's incapacity:** Due to competitive pressures, business events like hostile take-over or acquisition or legal problems, the ability of the supplier to provide services on a long term basis could be severely impeded. This situation warrants a supplier switch.

Any supplier switch comes with a transition process which could involve hundreds of man-hours spent in preparing for an exit strategy from the current contract, activating and implementing the sourcing process and then negotiating with the new supplier. The costs are surmounted by risks which make the transition painful. The success of the transition is more dependent on how well the risks are managed since sourcing costs are but a fraction of the costs which are implied if the risks are not controlled effectively.

## Supplier switch risks

The business context of supplier switch and the key elements like involved suppliers and the IT organizations determine the type of risks which can arise before, during and after the transition.

**Type of engagement:** Typically transitions for steady state support projects are more structured than a transition of implementation projects which have to face supplier switches. In long duration implementation and global roll-outs, supplier transitions are driven mostly by unfulfilled realizations and gaps. If the desired functionality is effort intensive and is related to critical business functions, then there is a likelihood that already cost and time overruns have occurred. Business plans have already suffered a sizeable setback and there is a desperate attempt to salvage the situation. It is a challenging situation for a new supplier to walk in and continue from where work has stopped. Most likely, the implementation would have to be restarted if a suitable transition is not planned. On the other hand, in a steady state support which has been running for a long duration, the system appreciation documentation and subject knowledge is captured more comprehensively and would aid the new supplier more.

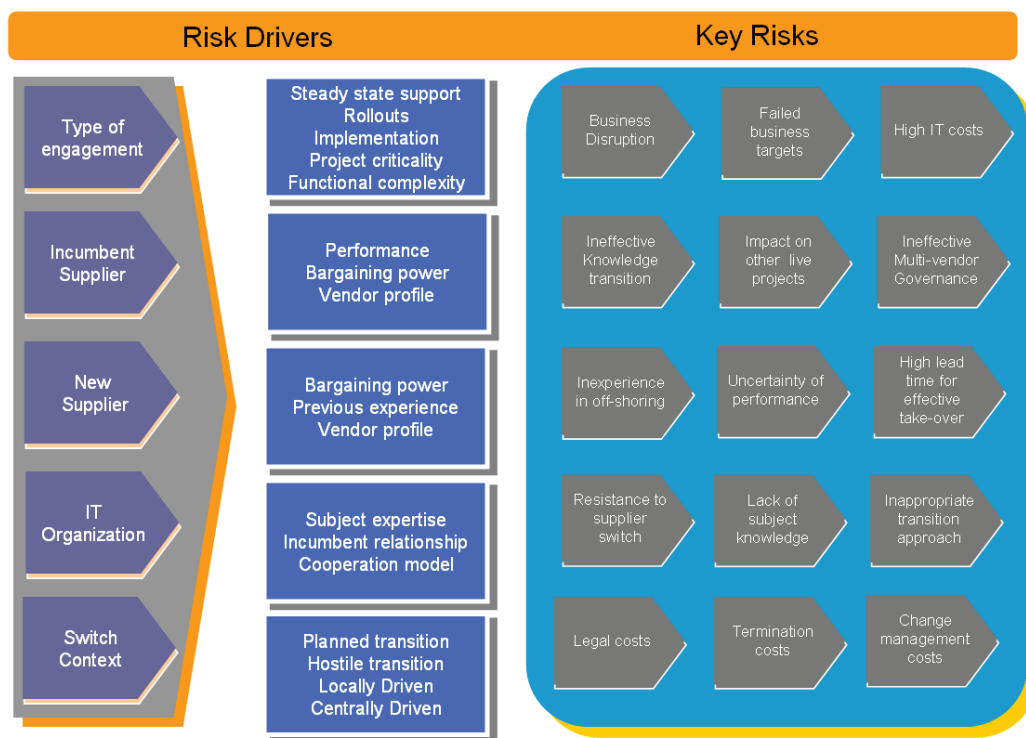


Figure 1

**Incumbent supplier:** The balance of power between the incumbent supplier and the customer decides how well the transition takes place. The incumbent could be well entrenched as a service provider in multiple regions, business functions and would have established enduring relationships with the internal IT teams through the length and breadth of the customer's organization. In such a scenario, it needs to be seen, whether the supplier will retain a sizeable chunk of business going forward, whether the supplier switch is part of a planned strategy across the organization or is locally centered and if a switch in one critical project can alter or affect relationships in other projects significantly. It is relatively easy to secure cooperation from the incumbent in case a long term relationship is protected with the supplier on an overall organizational basis. However, the situation could easily deteriorate with legal and exit clauses being invoked in case the supplier does not see a long term benefit or the supplier switch is hostile.

**New supplier:** The new supplier entering the stage to pick up the strands faces enormous challenges. Even if the supplier has an existing relationship, if a switch has taken place in a critical project or if the circumstances have led to a hostile switch, there will always be a skepticism attached in the initial phase. The supplier has to undertake the knowledge transfer successfully and start performing from Day 1 apart from reassuring the IT organization. In spite of comprehensive exit agreements and knowledge transfer clauses with the incumbent, there is a real risk that the new supplier may not be able to hit the ground running on Day 1 when the transition ends. Transitions could be delayed and business disruption stands a real chance. In case, the supplier has to start off-shoring and previously the project did not have an experience in realizing a complete cycle of deliverables, then the situation presents a big challenge as to how cost benefits from off-shoring can be derived from Day 1 without an impact on quality and service levels.

**IT Organization:** The IT organization is the pivot around which the supplier transition takes place. It has to provide insurance against all possible risks during the switch. However, the IT organization may itself present resistance to the new supplier in case the relationship with the incumbent was comfortable and there is not sufficient buy-in for the supplier switch. Business disruption is an unintentional side-effect. In case of a hostile switch, if the IT organization lacks subject matter expertise itself or has not ensured sufficient working knowledge with the business and First level support, then things could come pretty much to a standstill even before a new supplier takes charge. In planned transitions, the IT organization has the responsibility to ensure that an appropriate knowledge transfer approach is followed and in case there is a failure in coordination with the new supplier and the incumbent, there could be a loss of control. In situations, when only a single track within the project is transitioned while the incumbent still provides services in other tracks, then an appropriate framework is a mandatory to manage a multi-vendor scenario. A spate of responsibility and hand-over issues between the suppliers could cripple the project functioning. Ultimately, the IT organization is seen as the driver for change even in supplier switch situations and the business will only target the IT organization in case the risks are not managed properly and there is a drop in quality and service levels. The balance of power between the IT and business could be affected with such events.

**Switch context:** The context in which the supplier switch happens provides the undercurrent which leads to specific risks in specific situations. Hostile transitions or centrally driven transitions without proper local buy-in are difficult to salvage from the beginning and could be mired in legal and exit costs. On the other hand, a not so successful planned transition could raise question marks over whether sourcing initiatives deliver the promised benefits.

## Risk mitigation approach

An approach to supplier switch takes into consideration all elements of risk mitigation essential to manage supplier risks inherent in the switch context and the transition process. When mass switch decisions are triggered, only a comprehensive approach can withstand the enormity of the task involved.

**Evaluating risk profile:** For every supplier switch situation, it is important to evaluate the risk profile of the proposed plan.

The various elements of the risk explained in the above sections can be evaluated with a scoring matrix and then used to classify the various supplier switch situations based on the risk profile. In addition, based on this scoring matrix, possible risky situations in future can be identified e.g. in case of hostile transitions.

**Timing supplier switch:** The risk profile will reveal hot spots in the IT portfolio. Though, a big-bang switch if successful provides immediate windfall gains on sourcing strategy, however, the risk of simultaneous business disruptions across critical applications is very real and should be managed. The supplier switch decisions can be rolled out and timed in a phased manner so that the hot-spots are not impacted at the same time.

**Focused risk reduction:** A series of activities are required to cool the hot-spots. Knowledge issues within the IT organizations need to be sorted out on a war footing before the switch situations arise. In general business continuity plans are a must, however, for critical applications which directly impact sales, revenues, payables and financial reporting need to have contingency measures including manual offline workarounds for core processes. For in-flight transition of implementation projects, baseline documentation milestones also need to be planned from the incumbent.

**Phased off-shoring:** For off-shoring benefits to accrue it is essential that stakeholders get accustomed with the general concept and are able to see the benefits, transparency and a real interface with the off-shore team. This can be done first in pilot processes and once the gains are established, a rapid off-shoring can take root, process by process. This approach would enable a balance between cost gains, quality and service level adherence.

**Robust knowledge transfer approach:** The new supplier can take the onus of pulling and culling information from the incumbent, rather than the incumbent deciding what to push as knowledge topics. Any tools which can analyze processes, system configuration and developments via reverse engineering could be an important support when lack of documentation is preventing a comprehensive knowledge transfer. The new supplier could have some of these proprietary tools which should be allowed then to be used. An appropriate governance procedure for transition should be established which allows for timely escalations and focused resolution. For off-shore vendors, connectivity and infrastructure set up are critical for a timely start of transition activities. This should be done ensured at the earliest.

**Contract reviews and contractual protection:** The contracts, service agreements etc should be reviewed on the basis of the risk profile and safeguards should be built in by the purchasing and the IT organization against unfavorable exit clauses. Effective participation from the incumbent should be ensured in the contract in all types of engagements.

**Improving sourcing and supplier selection:** Supplier switches especially when they are hostile, gives a learning opportunity to improve supplier selection and sourcing processes. The end result should be that the hot-spots in the risk profile created due to incumbent and new suppliers should be reduced to a minimum.



## Conclusion

It would be an understatement to describe that smart organizations find it challenging to deal with supplier transitions. The customer – supplier relationship is subject to many pulls and pressures ranging from sourcing strategy and business imperatives. If organizations look forward to maximize sourcing related gains and become even more value focused, the suppliers on the other hand also play strategically for long term relationships and gaining an increasing share of the IT budget. In such an environmental context, the organization should aim at dealing with the reality of supplier switches, evaluating the risks involved and pre-empting them with a comprehensive mitigation approach.

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## About the Author

Prateek S. Mitter is a Lead Consultant with the Infosys SAP Practice and has 11 years of extensive experience in Automotive domain across areas like direct and indirect purchasing, sales management, product management, after sales and parts management. His focus areas are improving automation in business processes, enabling cutting edge After Sales concepts and working on new paradigms in change management. Prateek is a management graduate from IIT Delhi

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## References

- 1) IT Services Contracts Quarterly Analysis; Ovum Research, Nov. 2010



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