Building stronger IT vendor relationships

Low costs aren't everything—particularly for critical systems.

Baljit S. Dail and Andrew S. West

The McKinsey Quarterly, Web exclusive, June 2005

Companies in a wide range of industries have successfully worked out when and how to develop stronger partnerships with vendors; automakers and other manufacturers, for instance, have long cut costs and spurred innovation by partnering with key suppliers. Yet few companies have taken this approach with IT vendors. What's holding the rest back?

Our research indicates that although a majority of technology executives want to have stronger relationships with their IT suppliers, they often act in ways that undermine that goal. In fact, many corporate customers lose out on the potential benefit of a closer relationship by engaging in value-destroying or inconsistent behavior—too much emphasis on costs, say—when they interact with vendors.

McKinsey interviewed IT executives at 23 companies representing a wide range of industries to learn about technology-purchasing patterns, criteria, and priorities over the next 12 to 36 months. We found not only a number of factors that subvert effective buyer-vendor relationships but also ways for both parties to increase the value they deliver and receive.

The benefits of partnership

Although 20 percent of the executives we interviewed regard costs—not added value—as the top priority, 70 percent said that they want to move away from purely transactional relationships by establishing stronger partnerships with a smaller number of preferred IT suppliers. These relationship-seeking customers want vendors that better understand their specific technical environment, offer ongoing advice, help them manage aggressive technology upgrade-and-innovation cycles, and provide solutions for their most pressing business problems. As one buyer explained, "We're looking for a vendor that can bring real insight to our business by tying together industry knowledge, technical knowledge, and knowledge of us as a customer—vendors get to see what my peers are doing and should be able to use this information to help me make better decisions." Another noted, "I want my supplier to approach my account like a good financial planner—to review my status and recent transactions, then engage me in a rich discussion around my emerging needs, market trends, and relevant new-product offerings."

Buyers and vendors alike stand to gain from a smaller number of more committed relationships. Consider the case of a telecommunications company that used tough tactics with one of its vendors when it negotiated the contract for a customer-relationship-management system. Despite the size and clout of the company, the resulting arm's-length relationship meant that when it wanted additional features, it had to invest a great deal of time and money to customize the software in house. After the company committed itself to a higher-value relationship, however, it began meeting with the vendor's CEO, sharing its development plans, and suggesting features that could minimize the need for customization—suggestions the vendor started to take.

Another case: a travel company was launching a new online system, which required a significant infrastructure upgrade involving a number of vendors. At first, the company took a very tough stance with each of them on price, but it became clear that cutting the project's implementation time was a priority and that protracted negotiations were putting it at risk. A new CIO therefore decided to enter into more open and relationship-based negotiations with a set of core vendors. This approach not only enabled the joint team to meet the project's schedule at minimal additional cost but also created the right environment for these vendors to become strategic partners over the long term, bringing new ideas and insights to the CIO. Since relationship-based

negotiations with all vendors would not have been practical, it was essential to identify those that were crucial to the project's success and could be of value on a longer-run basis.

Such companies are in the minority, however. Of the 70 percent of respondents who say that they want to have close relationships with vendors, only 30 percent actually do. The rest continue to think and act in a transactional way, and many blindly seek the lowest total cost of ownership (TCO) from their vendors in all circumstances—typically by negotiating hard at the bargaining table. When an IT product is vital, however, TCO analysis is often too narrow. The cost of downtime when a hotel's reservation system crashes or when a store can't meet its inventory requirements because of IT snafus surely outweighs any incremental IT savings from tough negotiations.

Companies aspiring to better relationships with their vendors should approach the challenge on two fronts. First they must analyze their portfolios of IT vendors to determine which ones are the best candidates for closer partnerships. Then they must change their behavior to close the gap between themselves and their vendors.

Analyzing the vendor portfolio

If only because resources are limited, no company can afford to have strong relationships with all of its IT vendors. To decide which of them are most important, the company should begin by breaking down its portfolio into critical and noncritical vendors and focus its efforts accordingly.

A critical vendor provides the integral products that support crucial technology needs or the noncommodity products that eat up a large part of a company's IT budget. These are the vendors for tight relationships. Storage products, for example, are a big-ticket purchase for telecom companies, which must log data on every call placed or received, for both legal and operational (billing) reasons. Thus, storage vendors would be on the critical list. A hotel's most critical vendor might provide and support the mainframe that runs the core reservation system.

For noncritical vendors, which supply more standard products (such as ordinary desktop systems), transactional relationships are fine. Companies can treat these products as commodities, shop for the best price, seek bids from more than one supplier, and use a standard TCO approach to purchasing.

Once a company has ranked its vendors, it should compare the skills of the critical ones with those of its internal IT organization to see how well the two complement each other and which capabilities of which vendors it might further leverage to meet its needs. Ask yourself what you hope to achieve through each critical vendor. Many companies, for instance, want insights into the way competitors use the products of a certain vendor; others may want a larger say in its R&D or engineering function to ensure that its products better suit their needs.

Next, explore which vendors have the skills and commitment to exert the greatest impact on your company. Consider, for example, the value that a vendor now delivers as reflected in the quality of its products, its responsiveness, its knowledge, and its expertise. How well does the vendor understand your business and how do its offerings fit your needs? Is the vendor willing to commit extra resources to ensure your company's success? Since a critical vendor may fall short on one or more of these dimensions, it's important to consider vendors you don't currently use.

The next step is to identify the gaps between your current and desired vendor relationships. Since a mix of transactional and high-impact ones is usually the goal, this analysis will show where your company is over- or underinvesting in its vendors; thus it may choose to pull away from some and move closer to others (exhibit). Focus time and resources on undercapitalized yet critical relationships.

Close the gaps

Our research shows that to achieve higher-value relationships, most companies must change their behavior and the way they communicate with vendors. Certain kinds of behavior on the customer's part—focusing conversations on TCO, for instance, or using a vendor's openness about potential product defects as a negotiating weapon—promote transactional relationships, and vendors may respond by committing fewer resources and engaging less fully. Other companies sabotage their relationships with vendors by withholding information and regular feedback and by behaving inconsistently—in effect, sending mixed messages about the type of relationship they desire. The following forms of behavior promote closer relationships.

- **Be explicit about expectations.** A good portfolio analysis helps companies identify what, specifically, they want from their key vendor relationships. A company's needs—tactical knowledge about competitors, influence over a vendor's R&D, a high degree of responsiveness or expertise in specific areas—must be communicated clearly, and the vendor must explicitly agree to meet them. Be clear, too, about what your company is willing to pay for added services; although higher value doesn't necessarily come at a higher cost, trade-offs are often necessary. Finally, make sure that the vendor shares your desire for a closer relationship.
- **Involve senior management.** Assigning an executive sponsor (such as the CIO or the chief marketing officer) to build, monitor, and sustain ties with a vendor tells it that its relationship with your company is important. Yet even when sponsors are on board, they may not spend enough time with key vendors. An executive sponsor should hold quarterly meetings with their top managers.
- **Share information.** When a company shares details about its IT infrastructure, business plans, priorities, or technology road map, its vendors can provide more effective solutions and insights. Moreover, the sharing of information often allows companies to leverage their vendors' R&D and can thereby prevent major customization expenses. Clearly, withholding information is counterproductive.
- **Provide regular feedback**. Constructive, systematic feedback demonstrates a high level of commitment and provides a forum for resolving issues. Companies should stick to fact-based evaluations and avoid off-the-cuff or anecdotal criticism.

Building higher-value relationships is a two-way street, of course, and the actions of vendors are equally important. Those that are open about product issues build trust and provide insights that can guide the purchasing decisions of buyers; sharing information about a forthcoming product can, for example, help buyers better plan their own IT architectures. Moreover, vendors that listen to what key customers need and then respond accordingly may spare them the high costs of correction and customization—and make them less likely to stray.

To get more from IT investments, companies must understand the types of relationships they seek from their vendors, decide which vendors can offer those relationships, and then act on this evaluation. By avoiding value-destroying behavior, companies and their vendors can build a foundation of trust—and closer relationships that deliver a far greater impact than mere transactional ones.

About the Authors

Baljit Dail is a principal in McKinsey's IT practice and specializes in applications strategy, IT architecture, and the telecommunications industry. He is based in New Jersey. **Andy West** is a consultant in McKinsey's high-tech practice and specializes in sales and marketing and in merger-related issues. He is based in Boston.

This article was first published in the Spring 2005 issue of *McKinsey on IT*. An abridged version of it also appears in *The McKinsey Quarterly*, 2005 Number 2.