Measuring Technology Vendor Business Value

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Getting better business value from technology vendors

Technology vendors are a high point of leverage for creating business value, but that value can be difficult to measure. The importance of a vendor may be obvious to everyone, though the exact return on that investment is unknown.

Quantifying business value helps technology leaders make good decisions about which investments to pursue, which vendors to hire, and how to measure their performance. Using even an informal and inexact arithmetic can help a company set governance objectives and tie those objectives to financial performance.

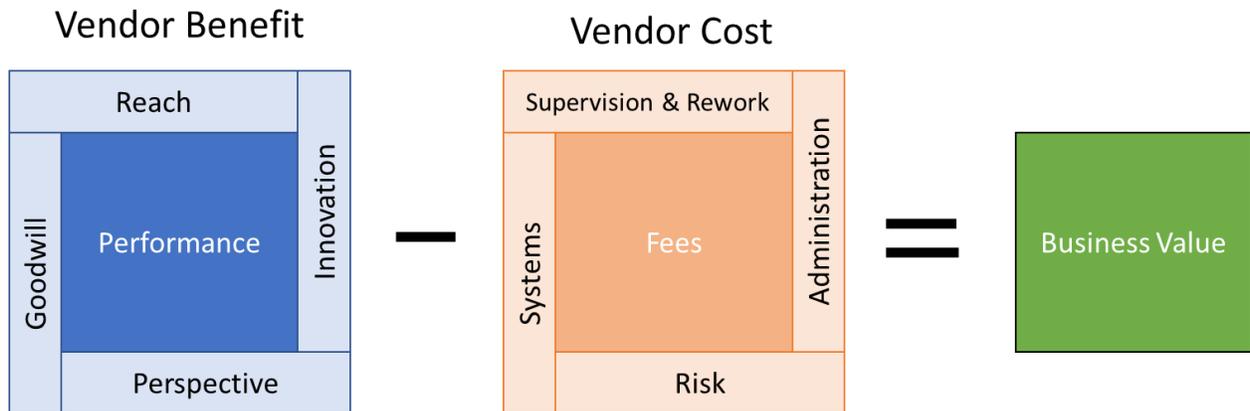The following methodology is intended to be used as:

- A frame of reference for understanding technology vendor business value;
- A process for quantifying business value delivered by a vendor, and;
- A way to anchor conversations about vendor performance improvement initiatives.

This methodology is most applicable to technology services firms, both managed services (operational) and project services. It is based in part on COBIT 2019, TOGAF V9.2, interviews with over 70 technology leaders, and my personal experience of working the industry.

Measuring business value

Business value is the difference between benefit to the business and the total cost of ownership (TCO) of that relationship. It's a comparison of what you get versus what you pay. Calculating the business value of a vendor, therefore is the act of subtracting the full cost of a vendor from the full benefit of that vendor.

Vendor performance and vendor fees are the core benefits and costs of the relationship, but a broader perspective, including second order benefits and fees, can be illuminating. These second order considerations often make the difference between a good vendor fulfilling the terms of the agreement, and a great vendor going above and beyond.

Vendor Benefit

Reach	
Goodwill	Performance	Innovation
	Perspective	

−

Vendor Cost

Supervision & Rework	
Systems	Fees	Administration
	Risk	

=

Business Value

Performance

Performance is the core of the value delivered by the vendor. It is a measure of the vendor's ability to meet contract terms and satisfy business needs.

Performance can be quantified by comparing a current vendor to its Next Best Alternative. A vendor's performance is worth exactly what the market charges for similar services. Testing the market periodically ensures the client is getting the best deal currently available for the right level of service.

If internalizing the service is the next best alternative, a complete analysis of all associated costs is needed to provide the right frame of reference. What is the cost of the people, systems, integrations, processes, management time, etc. required to deliver the service at the right capability level? Rarely, can a service be internalized by one for one hiring.

Some vendors fail to deliver at the contracted level. The cost of this failure should be accounted for in the costs phase of the analysis, not as a discount against performance. The value of performance is measured at the hypothetical level in the contract.

Calculating performance

Possible Metrics	Example
Cost of the next best alternative	3 systems administrators, 2 monitoring systems and 20% of a manager's time could deliver the service at a cost of $XX / year.

Reach

Vendor relationships can provide access to experienced resources at a large scale. Many vendors have deep benches of skilled senior consultants who can solve problems quickly even if those problems are outside of current agreement's scope.

In an emergency, a vendor's reach can be invaluable. The ability to pull in skilled resources who have familiarity and access to your systems without notice can be the difference between preventing a disaster and recovering from one.

Vendor reach creates agility and resiliency. Vendors with an ability to scale can quickly execute projects and support continuous improvement cycles. Especially for dynamic businesses with quickly changing needs, vendor reach is highly valuable.

Calculating Reach

Possible Metrics	Example
Cost to identify and contract with additional suppliers.	We would need retainers with 3 more suppliers at an annual cost of $XX
Cost of delay resolving emergencies	We anticipate 2 more outages per year for a total of 16 hours resulting in $XX in unrecoverable revenue and reputation damage.

Innovation

Vendors can be a great source of innovation. The right relationships with the right vendors can help drive digital transformation and creative problem solving. Innovations can be exclusive to the client or general for the market. They can be coordinated or uncoordinated. They can be collaboratively developed or built by the vendor independently.

Vendor innovation is typically incremental in value, but it can also be unbounded. The right vendor-driven innovation can rewrite a business plan or revolutionize an industry.

Calculating Innovation

Possible Metrics	Example
Cost to drive similar innovation internally	We would need additional managerial resources at 20% FTE.

Perspective

Technology vendors have visibility into the industry, new product releases, and cybersecurity threats. They also often support multiple clients who have complimentary use cases and relevant challenges. Vendors can be a valuable source of information and ideas to help a company adopt new technologies and avoid emerging risks.

Calculating Perspective

Possible Metrics	Example
Cost to develop a similar perspective internally	We would need to send a team to 3 additional conferences per year and devote 5% of employee time to professional development.

Goodwill

There is an intangible value to a great vendor relationship. Vendors often become personal friends and confidants who are committed to their clients' successes. Long-standing vendor relationships return value in unanticipated and often intangible ways.

Vendors often build goodwill by giving away products or services. The realized value of these give-aways should be included in the analysis.

Calculating Goodwill

Possible Metrics	Example
Value of free products and services	Vendor gave 100 licenses and 50 hours of project work outside of the agreement at a value of $XX.
Time savings in resolving conflict	Our relationship helps us avoid XX hours of hassle at a cost of $XX.

Vendor Costs

The Total Cost of Ownership (TCO) of working with a vendor is a broad analysis, inclusive of managerial time, risk, and required systems and licensing. Including these secondary costs in the analysis is more accurate and fair. It also highlights ways in which vendor value can be quickly improved.

Vendor Fees

Vendors fees include all the hard costs paid to the vendor, inclusive of any annual fees, one-time fees, hidden fees, etc. Vendor fee should be straightforward and easy to anticipate. They are simply the total vendor spend over a 12 month period.

Calculating Fees

Possible Metrics	Example
Total Fees paid over a 12 month period	We anticipate paying the vendor $XX in annual fees and one time charges over the next 12 months.

Supervision & Rework

Vendors providing ongoing support through managed services agreements or delivering projects against a statement of work (SOW) often require weekly status meetings, monthly reports, and quarterly business reviews, emails, text message, phone calls, etc. While usually valuable, these meetings represent a soft cost to the business in terms of internal team members' time and business hard costs if requiring attendance from other vendors.

Internal resource time may be required to help rework or fix problems created by the vendor. Poorly performing vendors especially require frequent and costly intervention. Failure to meet deliver standards set in the contract and accounted for under "performance" of the agreement should be quantified under this category.

Calculating Rework & Supervision

Possible Metrics	Example
Time spent meeting and communicating with the vendor	50 weekly meetings, 12 monthly meetings, 4 quarterly meetings for 100 hours @ rate = $XX
Time spent fixing vendor problems	50 project hours @ rate = $XX

Systems

Vendor agreements often require usage of systems and licensing that would otherwise not be needed. Vendors may need CRM licenses, workstations, M365 licenses, etc. These costs should be included.

Calculating Systems Costs

Possible Metrics	Example
Costs required to support vendors and provide access.	Vendor requires 3 CRM licenses and 2 workstations.

Administration

Vendors may create additional work for other departments like accounts payable, legal, and facilities. Vendors who frequently send incorrect invoices, or refuse to integrate with vendor management systems may create additional costs for their clients.

Calculating Administration

Possible Metrics	Example
Time related to resolving invoicing, legal, and other administrative issues	1/3 of vendor monthly invoices are incorrect, requiring x hours per year to resolve.

Risk

Vendors create operational and security risks for their customers beyond simply failing to deliver contracted services. This risk can be incremental, limited to the total fees paid to the vendor and some inconvenience. It can also be unbounded, or many times the cost of vendor fees. A vendor, for example, who disrupts operations at an oil drilling rig can cost a company hundreds of thousands of dollars a day.

Calculating Risk

Quantifying the cost of risk is very difficult as the actual costs can't be anticipated. A full Business Impact Analysis can provide the needed perspective.

Possible Metrics	Example
Cost of additional cybersecurity insurance	Additional insurance covering systems users
Cost of an operational outage x the likelihood of the vendor causing that outage.	5% chance of an outage that would cost $XX in unrecoverable revenue.

Putting it all together

An example evaluation of a managed services partner in good standing may look something like this.
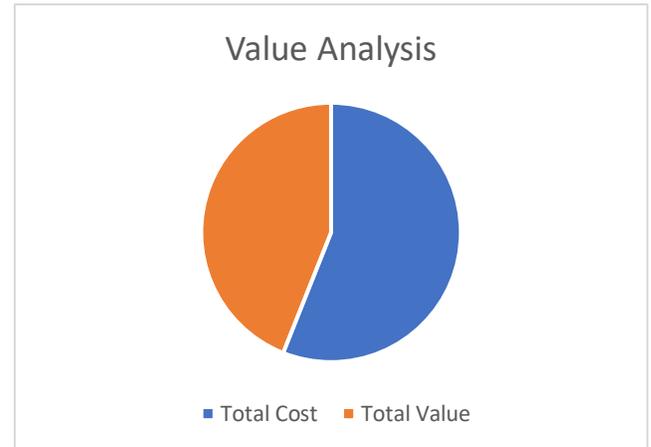
Vendor: AAA Technology Managed Services
Agreement expiration: 10/1/2022;
RFI Due: 4/1/2022: 90 day notice not to renew, 3 month selection process
Date of Analysis 4/1/2022

Estimated Benefit	$521,000
Estimated Cost	$291,900
Estimated Value	$229,100

Value Analysis

■ Total Cost ■ Total Value

Category	Possible Metrics	Example Notes	Estimated Cost
Performance	Cost of the next best alternative	3 systems administrators, 2 monitoring systems and 20% of a manager's time could deliver the service at a cost of $XX / year.	$ 350,000
Reach	Cost to identify and contract with additional suppliers.	We would need retainers with 3 more suppliers at an annual cost of $XX	$ 30,000
Reach	Cost of delay resolving emergencies	We anticipate .5 more outages per year for a total of 16 hours resulting in $XX in unrecoverable revenue and reputation damage.	$ 40,000
Innovation	Cost to drive similar innovation internally	We would need additional managerial resources at 20% FTE	$ 26,000
Perspective	Cost to develop a similar perspective internally	We would need to send a team to 3 additional conferences per year and devote 5% of employee time to professional development.	$ 30,000
Goodwill	Value of free products and services	Vendor gave 100 licenses and 50 hours of project work outside of the agreement at a value of $XX.	$ 35,000
Goodwill	Time savings in resolving conflict	Our relationship helps us avoid XX hours of hassle at a cost of $XX.	$ 10,000
Fees	Total Fees paid over a 12 month period	We anticipate paying the vendor $XX in annual fees and one time charges over the next 12 months.	$ 250,000
Rework & Supervision	Time spent meeting and communicating with the vendor	50 weekly meetings, 12 monthly meetings, 4 quarterly meetings for 100 hours @ rate = $XX	$ 15,000

Rework & Supervision	Time spent fixing vendor problems	50 project hours @ rate = $XX	$ 10,000
Systems	Costs required to support vendors and provide access.	Vendor requires 3 CRM licenses and 2 workstations.	$ 3,900
Administration	Time related to resolving invoicing, legal, and other administrative issues	1/3 of vendor monthly invoices are incorrect, requiring x hours per year to resolve.	$ 3,000
Risk	Cost of additional cybersecurity insurance	1/3 of vendor monthly invoices are incorrect, requiring x hours per year to resolve.	$ 5,000
Risk	Cost of an operational outage x the likelihood of the vendor causing that outage.	5% change of an outage that would cost $XX in unrecoverable revenue.	$ 5,000

Download this spreadsheet to calculate your vendor business value.

Model Limitations

The real world, as ever, is more complex than a financial model can represent. Like other financial models, this accounting is limited in its applicability. It should be used as a data point for decision making and thinking about vendor value. There are diminishing returns for making the model perfectly accurate.

The model is limited in these ways:

- Many of the costs are estimates and subject to error
- Many of the probabilities are estimated and subject to error
- Soft costs may not be realized by the business.
- Business value is often delivered by multiple internal and external teams. Assigning what value was delivered by which team can be a political and subjective exercise.
- Secondary vendor costs may relate to multiple initiatives or new initiatives. It may not have been required by the vendor, or for some other reason it may not be fair to charge it against the value of the relationship.