

# How Cisco IT Improved Strategic Vendor Management

Strategic sourcing for vendor management results in flexibility, simplicity, and reduced costs.

**Cisco IT Case Study / Business Management / Vendor Management:** This case study describes the creation of a global vendor management office (VMO) within Cisco. The VMO supports strategic vendor relationships across the IT organization. In the first three quarters of 2004, the VMO saved or recovered US\$33M in IT costs and improved several Cisco vendor relationships. Cisco customers can benefit from Cisco IT's real-world experience in this area to help support similar enterprise needs.

“Time has continuously redefined success for business. In the 1980s it was companies that had effective internal product development. In the 1990s it was companies who could mix internal development with the ability to effectively acquire and integrate. In the new millennium, it will be those companies that can do the above and effectively partner.”

— John Chambers, President and CEO, Cisco Systems

## CHALLENGE

With more than 35,000 employees and hundreds of locations, Cisco Systems® has an enormous IT infrastructure budget. Each Cisco® office has many complex IT requirements, including: high-speed connections; voice, data, and video networking equipment; computers, servers, and storage; and, security and support. Cisco uses its own products and services wherever possible, but still spends US\$500M a year globally on other IT products and services.

The Cisco global network is one of the most innovative enterprise environments in the world, and is an important contributor to the company's high productivity ratings. This can increase pressure to introduce new services or equip new offices quickly. In the past, Cisco had no consistent

process for new products and services. Every time Cisco opened a new location or implemented a new service in an existing location, one of several scenarios ensued:

- The fastest path involved local managers calling up local suppliers and ordering whatever was needed. This represented the most expensive solution for Cisco. A lack of formal contracts often led to disagreements over prices, warranties, and support.
- Another approach involved regional IT offices negotiating contracts with local suppliers. Each contract was negotiated individually, so past lessons and economies of scale were not referenced.
- Sometimes, the IT group would call for requests for proposals or quotes (RFPs or RFQs), and award the business based on responses. While this resulted in better prices, the proposal process was not consistent, resulting in little or no emphasis on establishing strategic vendors or planning for the future.

This lack of consistent process meant that Cisco could receive 20 different agreements for the same service with the same vendor. Agreements in different countries would have different prices, lengths, terms, and service levels. This was an inefficient and complex process for both the vendor and Cisco to manage. In addition, the number of vendors calling on Cisco was dramatically increasing in the last few years; without a standard and consistent method for dealing with these contacts, more Cisco employees were required to spend more time responding to these contacts.

In addition to the complexity of these agreements, the lack of strategic planning began to cost Cisco significant amounts of money. Cisco discovered that it had signed multiyear contracts for products or circuits that became

obsolete as they moved to larger offices or new technologies. Furthermore, with so many small agreements, Cisco missed the opportunity to negotiate for better terms or prices based on its total sales volume. This resulted in Cisco paying more than necessary for products or services. A benchmarking survey in EMEA showed that Cisco typically paid more than other enterprises for similar services.

This lack of consistency was negatively affecting the relationships between Cisco and its vendors. Informal contracts do not properly set expectations for either the seller or the buyer. It was also not always clear to vendors what Cisco deemed its criteria for awarding business. There was no standard process for weighting bids, vendor communication, and oversight. Disagreements escalated to both Cisco and vendor senior management. This was particularly serious because many Cisco vendors are also significant Cisco customers. Sales teams began to complain that the situation was affecting their customer relationships.

## SOLUTION

The impetus for change began in Europe, where the vast number of service providers made choosing suppliers for WAN infrastructure particularly complex. In 2001, the Europe, Middle East and Africa (EMEA) theater of Cisco IT Infrastructure formed a vendor management office (VMO). Its primary goal was to develop a strategic, consistent approach to selecting WAN infrastructure vendors in EMEA that would reduce both cost and risk for Cisco. It chose to work only with vendors strategic to the needs, marketplace, and business of Cisco. Within a short period of time they had successfully renegotiated contracts and repaired relationships, which attracted attention within Cisco.

The VMO became a global IT group in May 2002. Its mandate has expanded to include managing strategic vendors that supply hardware infrastructure, software, storage, telecom services, and outsourced infrastructure services. In addition, the VMO provides value and expertise in process and business development, asset management, and vendor engagement.

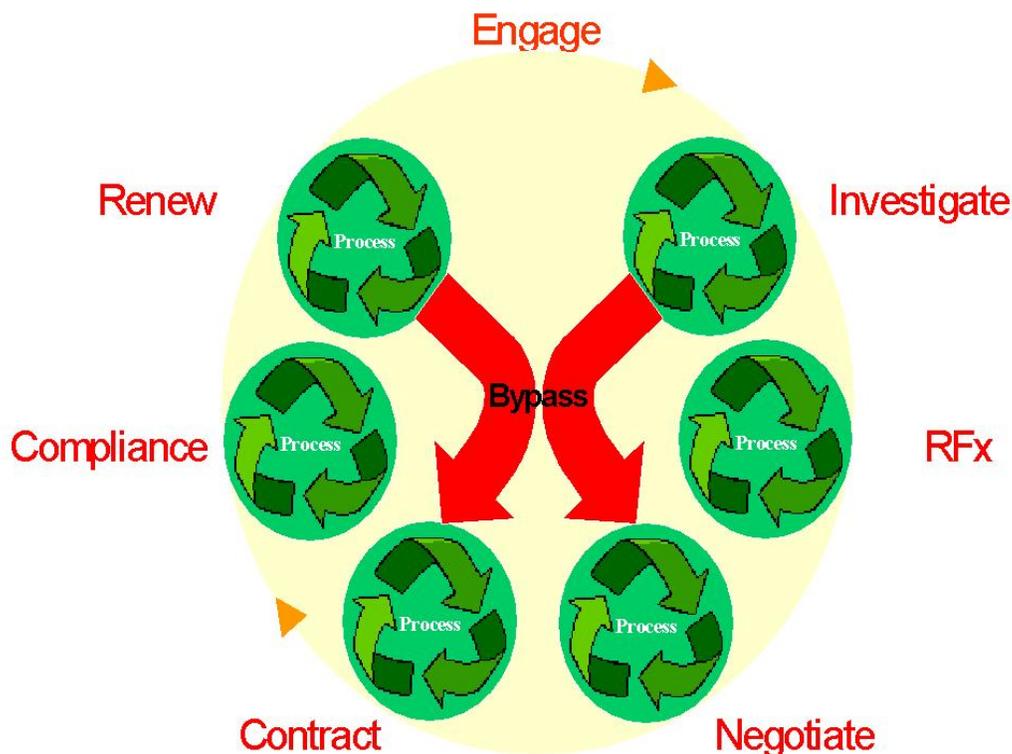
### VMO Overview

The VMO has defined seven phases of Cisco vendor management that result in successful outcomes for all parties (see Figure 1). This process helps organize and standardize the various functions of the VMO, while encouraging change and continuous improvement.

- **Engage**—When changing business climates or technologies generate the need for products or services within Cisco, the VMO leads the engagement of vendors to help ensure consistency and fairness of communications. New vendors might call Cisco hoping for new business opportunities, or Cisco might receive sales referrals from other business partners or from Cisco sales groups. At other times the VMO might actively seek out a vendor, when internal Cisco client groups require new service, or bankruptcies or other business problems affect a current vendor's ability to deliver service, or when new technologies emerge that the VMO would like to explore to help improve client services.
- **Investigate**—To evaluate competing products and services, the VMO works with client groups within Cisco IT Infrastructure Operations to investigate industry trends in technology, pricing, and standards. The VMO also works with sales, marketing, development, business units, finance, and procurement to identify potential vendors, and investigate possible solutions. This requires the VMO staff to be familiar with a wide variety of industry technologies and trends, and select VMO staff are organized into technology sector specialization. These sector specialists monitor the technology trends and pricing trends, and engage external technology consultants to learn more. The VMO also meets with vendor management groups in other companies and participates in customer forums and panels to share and gain information.
- **Evaluate**—If warranted, the VMO initiates a bid process, which results in a shortlist of quality candidates that meet all Cisco client and IT criteria. "We try and communicate all of the business issues that exist and make business decisions that are strategic to Cisco accordingly," says Wallace Chan, IT program manager, VMO. This process helps to educate vendors about Cisco needs and expectations, and to engage in clear

communication about what the vendor can deliver, in a consistent, open, and fair manner. The VMO will issue a Request for Information (RFI) to gain more information from vendors if needed; or a more detailed RFP if a firm and competitive bid from multiple vendors is desired. The primary goal of the VMO is to avoid competitive RFPs whenever possible, and to select and develop the best strategic vendor to meet each new client's need.

- **Negotiate**—Once a vendor has been selected, the VMO manages the negotiation. This negotiation includes balancing the internal client needs for reliable and high-performance service (articulated in clear service-level agreements [SLAs]), low prices, and strong strategic partnerships, and the vendor's needs for clear deliverables and a fair price for the services delivered. This negotiation process is the most successful when both Cisco and the strategic vendor act as partners that desire a winning relationship for both parties.
- **Contract**—Following the negotiation phase, the Cisco purchasing group confirms the contract, working closely with the Cisco legal department to resolve any contract issues. The VMO remains engaged through this process, but allows the purchasing group to manage the contracting process. To help streamline this process, the VMO has established several guidelines—for example, keeping the contract length to no more than 24 to 36 months, and avoiding any minimum annual revenue commitments (MARC) or minimum term revenue commitments (MTRC) that are more than 50 percent of the total expected cost over the year (for the MARC) or over the life of the contract (for the MTRC). Lengthy contracts and contract revenue commitments can result in lost flexibility or additional costs for Cisco when unexpected technology, service, or client changes take place. Making use of current master sales agreements with each strategic vendor can also help to simplify the contracting process.
- **Compliance**—Once the contract is signed, the VMO generates quarterly reviews that compare commitments and performance with established criteria. This process continues to set expectations between Cisco and the strategic vendor, and improves communications, while still holding the vendor accountable for the quality of their service. Within the VMO, Cisco assigns a primary contact for each strategic vendor. This VMO contact manages the overall relationship, serves as the primary vendor contact, and helps ensure vendor information is communicated to appropriate stakeholders globally within Cisco. Throughout the life of the contract, the VMO manages all aspects of the vendor relationship. This continual performance monitoring requires support from the Cisco IT operations groups, and also improves IT operations' insight into the vendor relationship.
- **Renew**—When it is time to renew the contract, the VMO proactively reengages with vendors and Cisco client groups to restart the process. It is important to begin this process with ample time before the contract expires, to help ensure that there is time to investigate options. The VMO must determine if it is best to renew the contract (while renegotiating terms based on the current situation) or repeat the 7-step process. This decision process should include a discussion of the implications of the end of the contract with the appropriate internal Cisco clients, and obtaining their new requirements. The VMO will also investigate the general technology and vendor landscape again, possibly by issuing another RFI to the vendor and to other industry leaders, to benchmark the current technology and pricing directions.

**Figure 1.** The Seven Phases of Cisco Vendor Management

Partnering with other groups within Cisco is critical for the success of the vendor management process. “We’ve learned that the way to succeed is to work closely with other Cisco groups,” says Chuck Trent, director of information systems, VMO. “Without the shared ownership and commitment to success from procurement, legal, purchasing, and operations groups, the VMO could not achieve its goals.”

#### The Making of a Strategic Vendor

Creating a strategic vendor is complex process for both Cisco and for the selected strategic vendor. Because this process requires extra effort and attention, it is important to reduce the number of total vendors, and to distinguish between normal vendors and strategic vendors, or partners. The VMO defines strategic vendors as those vendors critical to Cisco IT or the position of Cisco in the marketplace. Ideally, Cisco strategic vendors are industry-leading in their sectors and are members of the Cisco Powered Network Program. In addition to selecting vendors based on their product or service, the VMO also evaluates the company’s financial health and level of customer service and satisfaction. Once selected, strategic vendors share the risks and rewards of a mutually beneficial business partnership with Cisco. Many strategic vendors are granted master service agreements that facilitate purchases from client groups within Cisco. Cisco also works with its strategic vendors to help them develop skills and relationships that can help them improve their value and their position in the marketplace, and expects the same support from them.

## RESULTS

Two years after its formation, the VMO’s success can be measured in many ways:

**Increased Flexibility and Simplicity**—With standard contracts in place worldwide, Cisco can manage existing contracts and negotiate new ones more easily. Also, with standard, simplified contracts and a consistent vendor engagement process, legal and procurement organizations and internal client groups within Cisco spend less time managing vendor relationships. The VMO measures its success through process consistency, contract simplification,

consistent contract terms and conditions, and contracts with lower cost commitments,

**Lower Costs to Cisco**—Cisco now enjoys better pricing based on the higher volume of goods and services it purchases from strategic vendors. The small VMO has more than paid for itself during its short time in operation. Thanks to VMO efforts, IT cost avoidance, cost savings, and cost recovery totaled \$33M through the first three quarters of FY04, and \$64M over the life of the contracts. This achievement was recognized in August 2004, when the VMO received a quarterly IT team award for excellent business partnership. Brad Boston, CIO and senior vice president, of Cisco Systems, presented the award. Cisco views the VMO's success as providing vendor services at lower costs.

**Lower Costs to the Vendor**—While vendors are providing the same services at lower costs, their own costs are also reduced. Cisco has reduced its number of vendors, and has consolidating contracts with a smaller number of strategic vendors, so these strategic vendors receive more business and less paperwork. Instead of having dozens of contracts with Cisco, with different billing approaches and terms and conditions, each vendor has a single contract, reducing contract management costs. Because Cisco is now spending significantly less on its contracts, it has more to spend with its strategic vendors.

**Better Communication with Vendors**—Well-communicated, and consistent fair terms and conditions and SLAs reduce risk from both sides, and the creation of a global bidding process provides consistent criteria and communication with all vendors. "In the bidding process, we have created an environment where we communicate with one voice to all vendors," says Chan. "At the end of the bidding process, we offer to sit down with each vendor and show them their 'score'—where they did well and where they didn't." This consistent feedback helps all vendors understand their strengths and weaknesses with respect to Cisco needs and expectations.

For strategic vendors that have contractual relationships with Cisco, the VMO has introduced a quarterly "vendor scorecard" that monitors the vendor's performance, against written expectations. If a problem arises, all parties are alerted in a timely fashion using clear escalation paths, opening up further lines of communication between Cisco and its vendors. "Previously, we'd get into situations where there would be no well-defined exit strategy," says Abdul Mumin, IT program manager, VMO. "For example, Cisco outsourced an activity based on a minimum 12-month commitment, and a vendor assumed the contract based on a cost-benefit analysis of 3 to 5 years. After 2 years, Cisco found another way of accomplishing this activity, and the vendor imposed penalties that were left indeterminate in the original contract." These situations can result in embittered and negative relationships. Now, Cisco and strategic vendors set all terms and conditions at the beginning of their relationship, including details on successor or cancellation costs, technology migration, acquisition clauses, and mutual account team expectations. This close communication helps ensure a flexible and open relationship between Cisco and its vendors, allowing both to learn from mistakes and to adapt to changing vendor and Cisco circumstances. The VMO and the vendor measure their success through quarterly reviews and scorecards based on the meeting of contract SLAs.

**More Productive Partnerships with Vendors**—For any business relationship to be successful, it must be mutually advantageous. Cisco and its strategic vendors have evolved their relationships. "We are making contracts more fair," says Chan. "Some contracts have business downturn clauses, so if a vendor's business slumps, Cisco will renegotiate the contract. We also conduct annual industry benchmarking, so if the price for this product or service is going down, Cisco pays a price reflecting current market conditions. By sharing the risk, we are trying to create 'win-win' scenarios."

Cisco and its strategic vendors are using their improved relationships to lead industry discourse on new technologies and services. In the service provider market, Cisco is both a significant customer and vendor, as well as a leader in adopting new technology. "Service providers perceive us to be 18 to 24 months ahead of other enterprises," says Chan. "Service Providers showcase Cisco as the way of the future to other enterprises, and we try to take advantage of this position as buyers to advise and help business. We are members of service provider advisory boards and

councils across the globe.”

Cisco customers see the VMO as an attractive model. Since many Cisco customers are large, multinational enterprises, they share Cisco’s interest in establishing and maintaining strategic vendor relationships. VMO managers are often invited to participate in executive briefing center (EBC) meetings with customers to share their experiences, performance, and decision-making processes. The VMO measures its success by improved vendor performance during the contract, and improved vendor capabilities.

Industry Recognition: The Infrastructure Executive Council (IEC) is a community of senior executives with a shared commitment to improving performance through the provision of technology infrastructure and services across the enterprise. IEC provides best-practices research and executive education to IT infrastructure executives at leading global corporations. In June 2004, the VMO was named by the IEC as “best in class” for strategic sourcing. According to the IEC, “We believe Cisco’s vendor management processes represent an exemplar practice that other companies can learn from—the Cisco practice effectively addresses questions regarding how to remain responsive to changes in the vendor landscape and how to collaborate with internal constituencies for effective vendor management.” The IEC is now using the Cisco VMO as a model for how other companies should build their strategic sourcing strategy.

## **NEXT STEPS**

Currently, the VMO numbers approximately 20 people worldwide, each working with numerous strategic vendors on a daily basis. Its organization has recently been added to the Cisco IT global shared services, which further expands its mandate.

“Our organization is still maturing, so we are currently focusing on where we can add the most value,” says Micheal Bollen, senior IT manager, VMO. “In the future, we want to automate more things, such as contract management, e-procurement, and how to keep internal clients and stakeholders up-to-date on vendor management.”

## FOR MORE INFORMATION

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