



## Purchasing management

for external IT service providers in the change  
of the third party management concept

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More and more companies are optimising their purchasing practices by outsourcing purchasing management of external IT service providers to a third party manager. This third party manager takes charge of the search for a suitable IT service provider, taking care of the entire procurement processing and contract management - right through to invoicing and reporting. Low outlay, reduced costs and greater transparency are just some of the advantages of bundling external IT service providers in a central contract partner.

### **1. Introduction**

Purchasing has been in the grip of change for some time. The previously mostly operational focus is now increasingly giving way to a strategic one. One of the reasons for this, says Kim Kuhlen, partner at HDP Management Consulting GmbH, is the rediscovery of purchasing and the identification of the associated cost-cutting potential. Costs can be reduced thanks to consolidation of external IT service providers. As a rule of thumb, if 20 per cent of the total procurement volume is provided by 80 percent of the external IT service providers, there is potential to cut costs. Moreover, further savings can also be achieved by increasing efficiency, standardising processes, reducing purchasing prices and avoiding shortfalls.

### **2. IT as the starting point**

Essentially, the procurement of external IT service providers entails risks in terms of costs, framework conditions and selection criteria. These become particularly problematic if internal capacity, experience and expertise shortfalls are covered through external know-how. This is mainly the case in the field of IT. Often, freelancers or small IT service providers who have a high degree of specialisation and low daily fees are engaged as suppliers on a time and material basis. Word-of-mouth recommendation is a common selection criterion for such suppliers. Yet the question is raised over whether the best quality is being delivered at the best price, since there is little in the way of transparency or opportunities for comparison. Orders have hitherto been mainly awarded by departments directly. Purchasing, as an executing body, remained largely unaffected by the decision. Today, the commissioning of an external IT service provider requires a precise cost/benefits analysis. This is the decision tool for purchasing and the department on which the approval of a project is based. The aim in such situations is to no longer define needs on a personal basis but rather on a performance basis. The department draws up a catalogue of services for a forthcoming task and this catalogue is used jointly by purchasing and the department to select suitable IT service providers and move forward to the tendering stage. Only if there are comparable quotes to hand can these be evaluated and subsequently negotiated before the order is finally awarded.

### **3. Consolidation – why and how?**

According to Kuhlen, the number of external IT service providers can be reduced by up to 75 percent through consolidation. Daily rates can be reduced by up to 20 per cent and expenditure on external service providers by up to 25 per cent. If there are shortfalls in internal capacity with regard to effecting such changes, collaboration with a third party manager (TPM) or managed service

provider (MSP) is one option. These centralise the purchasing management of non-strategic external IT service providers and take charge of the entire procurement process for customers. As well as taking over and renegotiating existing contracts via the TPM, their role also includes searching for and delivering new IT service providers, invoicing, reporting and quality management. It is through this comprehensive portfolio of services that the TPM sets itself not inconsiderably apart from the role of a simple recruitment agency whose focus lies in the pure project-related recruitment of trained personnel.

### **3.1 Outsourcing the purchasing management of IT service providers**

If a company's business partners number more than 50 external IT service providers, the commissioning of a third-party manager is a worthwhile venture. Essentially, banks, insurance firms and telecommunications companies request this service in order to optimise the costs and outlay associated with procuring and administering IT service providers. The TPM acts as a contract partner to the customer and to the IT service provider. The journey from the concept development and definition of contractual principles and processes to the definition of communication and ultimate implementation at the customer's premises takes around three months. Generally speaking, the procurement of non-strategic IT service providers is outsourced to the TPM, so that purchasing is relieved of this task and has more time to look after strategic IT service providers (strategic partners). Arguments for the engagement of a third-party manager:

- Refocussing of purchasing
- Unburdening of in-house resources
- Stepping-up of the competition
- Support for the consolidation process
- Provision of external IT service providers at market-standard conditions

## **4. How the collaboration works**

The customer signs a contract with the TPM that regulates the transfer of the existing pool of IT service providers. The TPM bundles these non-strategic IT service providers and becomes their contract partner. At the time of the transfer, the contracts and associated conditions are re-negotiated. In addition, the TPM can make use of its existing base of service providers or search specifically on the freelancer market for further IT service providers. Depending on the requirements, the TPM can request bids from any size of company – from small firms to international conglomerates. If a specific project is imminent, it issues clearly-structured procedures. First, the department formulates the requirements, determining what knowledge and experience an IT service provider needs to contribute in order to solve the task. On the basis of this catalogue, the TPM then provides a pre-defined number of qualified profiles from which the customer can choose. Criteria such as prices, services and market conditions are factored into the decision, one which is made by the department in collaboration with the customer's purchasing department.

### **4.1 Control and quality**

Performance monitoring is carried out by the customer. The responsible manager records proofs of performance and travel cost overviews, which the TPM checks as defined in the agreed contract

and reimburses these costs to the IT service provider. Accordingly, the TPM also invoices the services plus a processing fee to the customer. The invoice layout and content are agreed in advance with the customer. Detailed reports provide information on services, the duration of deployment and daily rates for the IT service providers, giving the customer transparency over his expenditure on external IT service providers. Quality is essential for satisfaction. Using a feedback questionnaire, the TPM finds out how satisfied the customer is, for example with his response time, solution orientation or reliability, and how he rates the external IT service provider who has been engaged. Feedback from the department to an IT service provider is taken into account for further requests.

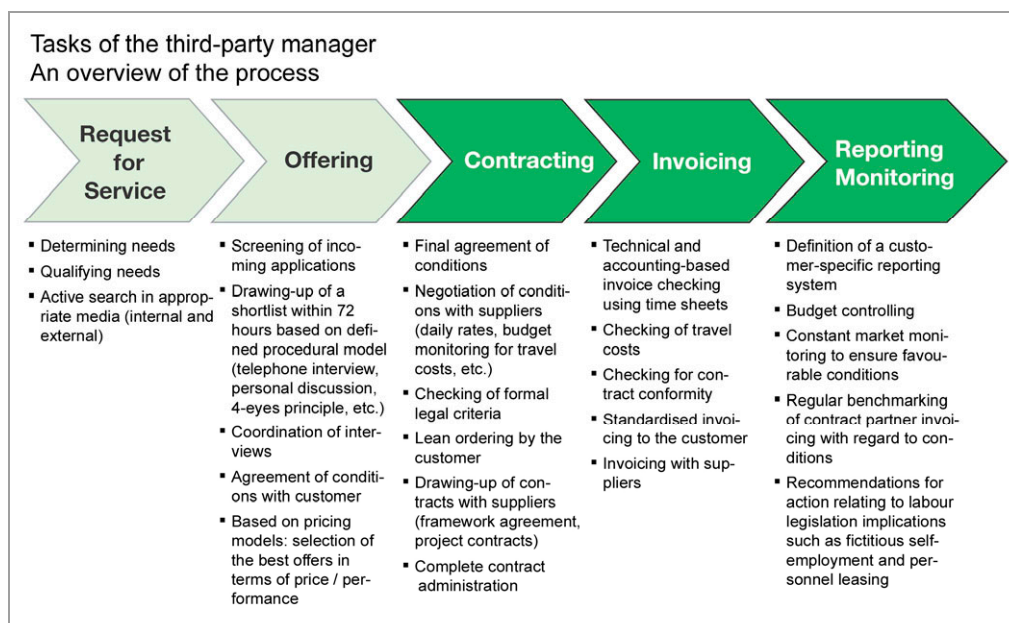


Figure 1: Tasks of the third-party manager

## 5. Advantages of a third-party manager

A company that engages a TPM bundles the defined, non-strategic IT service providers into just one contract partner. Outsourcing of the procurement process means a significant reduction in outlay. Numerous individual contracts are old hat. On the customer's side, there is just one contract with the TPM, which facilitates a high degree of standardisation. Instead of a range of contracts, only one contract has to be adapted and updated as time goes by. Standard contracts and seamless controlling create transparency and easier comparability as well as offering greater legal security. A further positive effect is that the risk of apparent self-employment and personnel leasing is reduced. The TPM preventatively analyses the relevant criteria, such as the period of engagement of external consultants, the number of customers or the type and nature of the deployment of external IT service providers within the customer's business organisation and provides recommendations for action for day-to-day cooperation.

In terms of procurement, the customer benefits from the TPM's market knowledge and experience which will enable him to critically query the daily rates for certain services, for example, and possibly

re-negotiate them whilst also carrying out extensive benchmark analyses. Ideally, the price level drops in this situation, although in any case there is controlled adaptation to the market conditions. The TPM's neutral stance is the result of the lack of emotional connection to one particular IT service provider, thereby facilitating a more objective perspective.

## 6. Framework conditions for good collaboration

Essential for the success of such a project is the communication of project goals and the associated customer benefits by the customer's management board to its own staff and IT service providers. These also include measures that are used if the goal-achievement process is not given adequate support. IT service providers must primarily be made aware that commissioning is performed solely via the TPM. Transferring the contractual conditions to the TPM could give the customer a feeling of being dependent. This can be counteracted from the very start by not introducing an exclusivity clause into the agreement, for example. The customer then has the option to restore the direct contractual relationship with IT service providers.

## 7. Trend

The frequency of TPM commissioning has increased markedly in the last year, not least due to process outsourcing, which is growing in importance in the fields of human resources, procurement and finance and thus defining the framework for TPM services in the long term. In future too, says Kuhlen, further growth can be expected in this industry, since there is still considerable cost-cutting potential in the majority of companies in the elevated SME sector. In Germany, the concept of TPM is still in its infancy. In the USA, on the other hand, it has already been in use since the 1990s with a much broader spectrum of services. It is anticipated that the concept will expand across Germany in future too. The first step has already been taken, in that TPMs no longer recruit resources solely from freelancers but instead are increasingly also sourcing from major SME-sector and global companies. The practice of 'onboarding' will also grow in importance in Europe. In this situation, the TPM, for example, will take charge of the entire process linked to the commencement and termination of a working relationship. The performance of security checks and the provision of access cards and hardware would then also become the responsibility of the TPM.

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### Literature

Source of quotations by Kuhlen: Interview on the subject of third-party management, Daniela Conrady, freelance journalist, July 2006

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