



# Market Changes Shine Bright Light on MSP Landscape

Services procurement has  
a new channel

By Michael Matherly

**N**ot all of us understand the vast intricacies of our economy and how all the moving parts impact each other, but one thing we all know with certainty is that "change begets more change."

Occasionally the aggregate of big economic changes shines such a bright light on structural weaknesses that an entire industry responds predictably (in hindsight only, of course), and evolution becomes visible, tangible. We are seeing this kind of evolutionary industry change before our eyes in how managed service providers

## ARTICLE HIGHLIGHTS

- Economic pressures drive enhanced outlook on Services Procurement opportunities
- Why SOW Services is so challenging to get under control
- MSPs are well positioned to provide "ready-made" solutions to existing clients
- The 'MSP vs Internal' business case should be updated with this new scope

(MSPs) are expanding their models to bring Services spend under management.

### **Buildup To The Tipping Point**

Prior to the current economic down turn, let's say Q2 of 2008 (I know, differing viewpoints on this), maturation and sophistication of most large company's procurement organizations was limited to direct spend and the easily commoditizable indirect spend. We already know why direct spend has received Procurement and Supply Chain attention: because market efficiency has always dealt swiftly and harshly with exposed weaknesses in core product and service offerings. Direct spend is under control at going concerns because it is the life blood of the business.

Do we know why indirect spend (ie everything else) has received only scattered Procurement attention prior to this economy?

To answer this question we first have to acknowledge that some really low hanging indirect fruit (ie office supplies, travel, etc - collectively in the 5-10% range) has already been controlled in most organizations (but not all!). Second, we acknowledge that the Services Procurement category, often the largest spend component within indirect is another story altogether - Forrester estimates 60-70% the last few years and it is growing (relatively any way).

At one end of the Services Procurement spectrum you have staffing or contingent labor. While this is not "easily" commoditizable, it has effectively been brought under control by most large companies, though only a relative few within the fortune 500 have invested enough internally to truly manage contingent labor in house. Other Fortune 500s, about 75% (+ or - given the changes underway as this article is being written), utilize some combination of staffing managed service provider (MSP) and vendor management system (VMS) to handle all the headaches of controlling typically large transactional volumes of temporary and contract workers for the organization and drive category savings.

For companies that have not yet invested in or matured internal capabilities to manage contingent workers, MSPs can be a very attractive option. They have everything big companies need to get the staffing process (or lack thereof) under control: a self-service tool that integrates with the client's purchase order / AP systems, skilled and experienced recruiting, strong vendor relationship management, and contingent labor management expertise. Effectively and efficiently developing these necessities in house is no small task. Even if the rare company can pull it off, it is debatable whether they are actually able to sustain margins as competitively as MSPs do. So it is no surprise that most business cases done ahead of internal investment and contingent labor maturity, provide compelling evidence (not to mention internal support) to go the MSP route.

On the other hand, business cases done post internal investment and after a certain, modest level of category maturation, tend to present a longer than acceptable payback period for bringing in an MSP. However, the final decision on whether to hire an MSP in this situation is rarely driven by the business case alone: Usually, the "stay the course" decision is driven by an existing technology and institutionalized process that would be so painful to unwind and replace that internal support never materializes. Thus, historically, second generation MSP/VMS models have been much more likely than "post internal MSP" solutions.

### **SOW Services - The Focus Narrows**

The other end of the Services spectrum is a different story, though. Most big companies have not invested in an internal solution to truly control Services such as consulting or other non-staffing related services requiring a unique SOW (statement of work). [Aptly referred to sometimes as "SOW work", but we will refer to it from here on out as "SOW Services", because the term SOW is what differentiates this kind of external service from contractors or staff augmentation: it typically requires a separate contract or statement of work to more clearly

define the deliverables or services being purchased.] If companies *have* made the investment in an internal solution, there is a good chance they have not figured out all of the political chess moves and the transactional servicing requirements to make it work well yet. A full transition from a meager amount of SOW Services controlled to 80%+ of Services under management can take years to fully implement (absent an internal mandate, of course). Often we hear of semi-mature internal solutions where the intent is good and a fair improvement has been made, but significant exceptions remain that cause the effort to fall short of *Strategic Sourcing for Services*. For instance, organizational or functional carve-outs, "pet suppliers", excessive rate exceptions, contractors in consultant's clothing, non-compliance, etc.

Getting all SOW Services spend under control internally is not nearly as "doable" as contingent labor for three primary and related reasons:

*First, the spend is spread across the organization*, in nearly all cost centers, making for a large number of internal customers that need to be brought on board. Why is this any different than the contingent labor spend that we said earlier was easily commoditizable? Because staffing and headcount spend (contingent labor) is viewed differently by HR and the rest of the organization. They are more focused on on-boarding, security, and other staff-related issues. External service providers of non-contingent labor tend to fly under the radar of most HR and Legal issues. (Whether this is right or wrong is a risk tolerance matter for each organization.) Also, the average purchase order (PO) amounts for SOW spend is considerably more than the PO needed to bring a contractor on: the higher the PO amount the greater scrutiny and approval authority required.

*Second, the owners of that spend are typically business or staff executives* that are personally on the hook for delivering the underlying projects or deliverables that the spend is being used to accomplish. They are generally much more

concerned with the constraints of timing and quality than they are with cost (at least historically). This, too, is changing, but probably not as fast as some CPO/CFOs or some of you would like.

*Third, the requirements for the underlying projects and deliverables are unique*, thus "not commoditizable." More explicitly, SOW Services spend differs from contractor spend in the following ways:

- There is no single (manageable) set of vendors that will be able to meet all Services / project needs;
- there is no predictable, common means of delivery on which to base standard pricing/rates. For instance, the common resource levels and skill sets that are present in temporary, contractor spend; and,
- the preference is (should be) for fixed fee pricing of SOW Services so as to transfer delivery accountability to the service provider. This is why there is either a contract or uniquely worded purchase order used for these Services.

## **The Evolution We See**

The evolution we are seeing in the management of SOW Services spend is twofold:

*The Call To Action* - This economy is forcing all companies to seek non-margin reducing alternatives to improve the bottom line. In most industries and for most companies (maybe not Wal-Mart), margins have been hit hard recently and most cannot afford to go down that road any more, and survive. So they have to find other ways to sustain themselves. After all the tolerable layoffs, the divestitures and all the cutbacks have run their course, companies are desperately scouring the company landscape looking for savings. Now, at last (say the Procurement professionals who have known this all along) companies are realizing that there is

an incremental 10-30% + savings opportunity waiting for them in their indirect spend (predominantly the virtually untapped, uncontrolled SOW Services spend).

The recent activity in this space, both on the client side and the MSP side, gives the appearance that we are actually seeing a surge in Services Procurement activity. The difference between a "call to action" and a "surge" is that a surge will eventually subside. If MSPs and Procurement organizations are smart, they will leverage this opportunity to institutionalize whatever improvements are made so going back is never an option.

*The Ready-made Solution* - How to quickly tap into SOW Services savings is where we are seeing the biggest changes. The fact that times are tough does lower the internal influencing (ie political) hurdles to develop an internal solution, but lower hurdles still mean challenges herding all the SOW Services spend owners to a consensus. Even when that eventually happens, an effective infrastructure to really control SOW spend can still take 9-18 months to put in place and ramp up to targeted savings capacity. As such, companies are looking for "ready-made solutions" for their SOW sourcing needs. The MSP model is well suited to deliver such a solution to their clients because they already have one of the two most critical parts required to control SOW spend already in place: a self-service tool that integrates with the client's purchase order / AP systems. This is a huge head start for MSP clients to take advantage of, but the mere presence of a VMS will not alone tap into the full savings potential. Services Procurement professionals already know this, VMSs and MSPs are learning.

To effectively drive Strategic Sourcing benefits and savings into the SOW Services space requires human-driven sourcing expertise and expert spend management practices. This is a concept MSPs already understand - it is the exact combination of expertise and tool that they have already successfully leveraged to

overwhelmingly penetrate Fortune 500 contingent labor spend.

This type of MSP expansion into SOW Services spend warrants a business case update for all the Fortune 500's who may have thought they were stuck on their internal solution when it was just contingent labor they were trying to solve for. Additionally, MSPs should be targeting The Fortune 1000 and beyond because now they have a much more comprehensive solution to offer those firms on the brink of investing in a procurement organization.

### **Our Response To Change**

Those MSPs that get out in front of their client's SOW Services spend needs with this one-two punch of tool functionality and experienced sourcing service stand to significantly expand their footprint into their clients' procurable spend. And there is no reason to doubt, that when this economy turns and things settle down, that this new "Services Procurement MSP" model will be any less sticky than its predecessor the staffing only MSP model.

Change begets *opportunity*.

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