Financial Services Procurement: The Risk of Stagnation

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BACKGROUND

The Financial Sector's increasing desire to outsource, coupled with the complex convergence of operational and information technology, including the explosive growth of IoT devices in support of connected banking, are just some of the more recent factors driving the financial sector's appetite to upgrade its spend management practice.

For purchased services, while IT & telecom, marketing/advertising, and facilities management remain primary, the spend across HR, insurance, legal, customer service and real estate continues to grow and are increasingly outsourced, reflecting a well-established trend in other industries. In much the same way that transportation, healthcare, and energy industries have become third-party services integrators, financial service companies are also following suit.

Overall spend management practices in the financial services sector have seen solid improvements. But, purchased services spend management remains a challenge regardless of industry but particularly in the Financial Services sector. Managing performance-based spend, at scale, requires an integrated and upgraded set of capabilities. While the enablers may be relatively easy to identify, they remain difficult to translate.

MODERNIZING FINANCIAL SERVICES SPEND MANAGEMENT —THE STAKES

It's common knowledge that organizations waste millions every year by overpaying or undercharging service contracts. Regardless of how effectively the service agreement may have been negotiated, estimates indicate that the inability to properly manage the governing contracts costs the buyers' bottom lines 20% year-over-year.

Having the ability to drive internal compliance to contracted terms and conditions is a prerequisite to sourcing better contracts. Suppliers want and reward for certainty. Put another way, if the buy-side organization can't keep its promises, it becomes known (and part of the procurement organization's brand) and suppliers hedge against it.

Supplier selection has been traditionally driven by a combination of factors including price, diversity requirements, pre-existing agreements, and facility constraints. Of course, data sources tied to risk has entered the calculus, further complicating initial assessments and ongoing management. For example, when considering just one new dimension, GDPR compliance, the EU says that companies must provide a "reasonable" level of protection for personal data, but does not define what constitutes "reasonable," allowing the GDPR governing body all the leeway it needs to levy fines —and the financial services sector is a prime target.

On a practical level, only a cursory view of the changing domestic and international "risk landscape" reveals an urgency. Whether the reasons to modernize current procurement infrastructure are being driven by consumer omnipresence, social media, increasing regulation or a heightened sense of corporate social responsibility, does it make a difference? Notions of "visibility" can no longer be pursued as ideals but as a practical matter supporting specific risk management objectives.

IMPORTANT DISTINCTIONS

To be clear, financial services organizations are no strangers to indirect spend management. In terms of the sector's willingness to adopt technologies that help, the industry has been aggressive. In addition, banks and insurance companies have remained long-term and preferred targets of tech-enabled consultancies that bring industry-specialized, category sourcing expertise. But negotiating better supplier contracts and effectively managing supplier performance, from a compliance perspective, are rarely connected activities, post signature, and they need to be.

While various new point solutions have emerged that do, in fact, address one or more of these tasks individually, solution evaluators must remain wary of indirect spend management tools masquerading as integrated solutions. Although the cloud has enabled a new generation of procurement solutions, still, only a few even attempt to address contract management, supplier performance monitoring and compliance in an integrated fashion.

Selecting the right complement of technologies requires the ability to distinguish between data-level integration and application-level integration. Solution evaluators must also recognize that what a solution can do is often as much a function of their native capabilities as the environment in which they will be expected to perform.

MODERN PRACTICE: THE INTEGRATION OF SOURCING, CONTRACTING AND COMPLIANCE

Areas for short-term sourcing performance improvements can be obvious and revealed through tasks as simple as comparing supplier contract terms and prices across locations, departments and units, and then reevaluating conditional terms, such as demand-based discounts. However, the considerations that now drive supplier selection processes are driven by a complex mesh of stakeholder interests that often don't align.

There are several RFx platforms that are now capable of soliciting less prescriptive proposals from suppliers. But there are fewer capable of analyzing such proposals in a multi-location, multi-stakeholder constraint context (i.e. facility differences, pre-existing arrangements, diversity initiatives, etc.). The list grows even shorter when the buy-side's choice is limited to suppliers capable of meeting various stringent qualifying criteria (e.g. financial health, environmental/ sustainability requirements). Any credible, modern supplier assessment/risk management program recognizes the task as a multi-faceted, continuous process, not an episodic event when, for example, a "scorecard" is manually updated with supplier reported data.

At the same time, contracting processes still haven't appropriately evolved. Indeed, the anatomy of contracts hasn't changed all that much in decades. Regardless of the reasons, processes dedicated to negotiations, authoring, execution/enforcement, and renewal are generally not well-coordinated activities. Whether the recent introduction of risk-aware concepts proves to be the catalyst for change remains to be seen, but the inability to monitor simple service level agreements, let alone ensure compliance to regulated matters (where penalties can be assessed) is a particularly acute problem in financial services.

Static contracts are now being replaced by dynamic, smart agreements capable of tracking their own performance in near real-time. Intelligent contracts capable of "self-execution" reduce transaction costs, enable closer cooperation and enhance trust. As connected data sets, all members of what are quickly becoming "contracting blockchains" can and should be systematically engaged in performance verification.

Effective spend management requires clear visibility and monitoring of supplier contractual obligations and service levels. Among other things, that also means ready accessibility to the latest versions of contract documents and the ability to instantly resolve quality, delivery and payment issues via automated and transparent validation.

Good suppliers welcome additional performance challenges. They see it as a way to competitively distinguish themselves. Provided the performance data is regarded as a trusted, shared asset of the relationship(s), suppliers see intelligent contracts as their ally, as should buyers.

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Tom is a serial entrepreneur and reluctant expert in the myriad applications of optimization to strategic sourcing and supply chain management. He has been the first business executive hired by technology innovators from MIT, the University of Cambridge and CMU, so getting high-brow intellectuals and early commercial adopters on the same page is a battle-tested communication skill that Tom has had ample opportunity to hone over a 30-year career. Tom earned his undergraduate degree at Allegheny College and went on to the University of Taipei to continue his study of Mandarin. In his spare time, Tom is the principal editor of Healthcare Matters.

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