

The Eight Levels of Vendor Management

American Banker, Friday, July 9, 2010

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Vendor management can be a perfunctory exercise to satisfy FDIC and OCC compliance checklists. Or it can be a richly rewarding discipline that furthers a bank's most strategic goals.

Since you must have a function in place, why not climb what we call the "vendor management value curve"? After all, there are good reasons why it is important:

- Regulators have made it a priority. OCC guidelines couldn't be clearer: "Many third-party relationships should be subject to the same risk management, security, privacy and other consumer protection policies that would be expected if a national bank were conducting the activities directly."
- Cost pressures have increased outsourcing, with more vendors playing more critical roles. From the mundane (document shredding) to the customer-facing (contact centers), to the innovative (mobile), it is not unusual for a midsize bank to have a hundred vital vendor relationships and large banks many more.
- Outsourcing brings uncertainty. Studies suggest a third of outsourcing projects fall short or fail. Implementations are prone to delays and overruns. In today's fast-changing, tight-margin environment, that translates to higher risk.
- Vendors' own situations can have serious implications, potentially involving security or customer privacy breaches, fraud or the collapse of the vendor. Bank profits and reputation can be at stake in vendor relations.

How to build an effective vendor management function? There are eight levels for escalating vendor value: availability, reference checks, unit cost comparison, basic spend analytics, advanced spend analytics, balance scorecard/strategic alignment, advanced selection/engagement and strategic vendor alliances.

At the first levels vendor management is narrowly focused. Is the vendor available for the job? Do the vendor's references and capabilities meet the business requirements of the project? At this stage integrated vendor management does not deliver appreciably more value than separate buyers of vendor solutions would on their own. But a consistent approach creates a stepping stone to greater value.

Next strive to ensure that the bank is getting the most for its vendor spend. It helps the buyer compare vendors on cost and provides basic spend analytics: With which vendors are we doing business? What internal groups are driving that business?

Additional value is generated when vendor management categorizes and consolidates spend data, performs decision-support analytics and compares actual spend to forecast. Is our spending focused on revenue opportunities or day-to-day operations? Which vendors regularly meet or exceed budget and why?

Then strong vendor management asks not just how do we manage our vendor spend, but what is the overall return

on our vendor spend? What indirect costs should be included — what is the "total cost of ownership"? Have we quantified the benefit and risk of engaging one vendor versus another, of multisourcing versus single sourcing? Have we quantified vendors' comparative strategic value to us?

At this level best practices include uniform vendor selection criteria, standard vendor engagement procedures, routine audits of vendors and regular review of vendors' delivery performance and compliance.

Finally top-level vendor management establishes alliances with selected vendors to create value beyond the ordinary. Such vendors seek mutual success and create an environment of shared risk/reward with the bank. At this level, vendor management capitalizes on the alignment of bank/vendor strategies and engages vendors on the basis of the enterprise value they can deliver over the longer term.

Management can determine where a bank's vendor capability is today by looking at four attributes.

View of vendors. Not entirely tangible but highly telling is how the bank views and values its vendors. At fledgling levels, vendors are viewed as commodity suppliers and are valued on a transactional basis. At best-practice levels, the broader components of vendor value are clearly understood, appreciated and communicated across the enterprise.

Visibility of vendor activity. If it takes extensive manual effort to learn about a bank's vendor activity, that's early stage. If vendor management can access this information in real time and apply industry-standard analytics, it is well into mature territory. Many are somewhere between, gathering basic information from vendors after the fact and then performing basic analysis and reporting.

Control of MSAs and SOWs. Best practice calls for central control and oversight of master service agreements and statements of work. If a bank leaves this control at the business unit level there is potential for inconsistencies in how MSAs and SOWs are structured, executed and managed.

Vendor performance metrics. A mature vendor management function produces, analyzes and reports standard performance metrics tailored to the product or service being purchased, applies them consistently across the enterprise and across vendors, and makes recommendations from analysis of the metrics.

At the other end, few if any metrics are reported, or they are ad hoc by department and prone to inconsistency in measurement and interpretation.

As banks seek more value from their vendor spend, vendor management can be that path to value. A high-value function can serve strategic goals, not only in holding down costs but reducing the risks inherent in vendor relationships while creating an environment hospitable to innovation.

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