Procurement in the Financial Services Sector

Minimizing Risk, Improving Supplier Performance — and Giving Employees a Great Shopping Experience

JAGGAER

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Introduction

Over the past dozen or so years, procurement has moved up the agenda in financial services, as financial regulation has imposed restrictive capital requirements and stricter risk management obligations, together with new data privacy laws such as the European Union's General Data Protection Regulation (GDPR). Abiding by this broad regulation corpus is not a choice anymore and failing to do so jeopardizes the core business.

Against this background, procurement teams in this sector face some unique challenges. For example, the regulatory compliance environment sets limits on how procurement can achieve goals such as cutting costs and selecting vendors. The fact that a bank's (or other financial services institution's) suppliers are, in many if not most cases, also its customers, provides enormous scope for conflicts of interest for individual employees, for departments, and for the bank as a whole.

Let's say, for example, a supplier of facility management services fails to meet its contractual obligations, causing the bank to make substantial losses. The bank's Chief Procurement Officer may want to change vendor and is likely to come under pressure to do so. But if the vendor is also a customer, and perhaps even one that recently received finance to invest in new infrastructure or business development, the CPO may meet resistance from customer relationship managers and senior management.

The bank may also be exposed to accusations of bribery and corruption, even when there is none.

The nature of banking and financial services has also changed fundamentally for other reasons. With the rise of

internet banking and online services, retail banks have closed many branches, while the competitive landscape, with new market entrants, in particular digital banks operating with fewer fixed costs, has compelled them to look for additional savings.

However, suppliers are (of course) not just a source of risk or a target for savings. As more and more services are outsourced, they play an important role in supporting company success, in financial services as elsewhere. Procurement professionals need to nurture these relationships while ensuring they stay on the right side of the regulatory framework.

In this white paper we explore some of these issues in depth and consider the future of procurement in financial the sector.

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The Risk and Compliance Environment

Strategic suppliers – by which we mean suppliers who are critical to the company's continuing business, both day-to-day and long-term – all present various kinds of risk to the bank. These include operational risk, should they fail to perform as expected, and credit risk should they encounter financial difficulties, such as default on loans, as well as compliance risk if the buyer-vendor relationship is not transparent and compliant with regulations.

This is a matter not just for the financial institution itself, but for the economy and very social fabric of society. To address such risks, in America the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 strengthened the Federal Reserve's ability to maintain financial stability. Each bank with over $50 billion in assets had to submit a "living will" to the Fed, outlining how the bank would safely wind down if facing a financial crisis. This was to prevent another bankruptcy on the scale of Lehman Brothers.

In Europe, the Bank Recovery and Resolution Directive (BRRD), introduced in the spring of 2014, gives central banks the power to intervene if a failing bank poses a public risk; this has been adopted into the national law of European Union member states. These developments set the backdrop for the tougher regulatory environment in which financial services now operates. Procurement teams

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have a vital role to play in this. They need to be able to work in close collaboration with internal and external auditors, as well as the compliance and risk teams. To do this effectively, procurement teams must take steps to ensure governance and transparency within their organizations.

The challenge has been complicated by the trend towards the outsourcing of services by banks in order to reduce costs and improve their efficiency and flexibility. Outsourcing makes it possible to take advantage of economies of scale and is a form of easy access to new technologies and to tools and services not available in the institution itself. However, it can also have serious drawbacks. Managing outsourcing risk has become a major priority for many businesses.

As per the Office Journal of the European Union Commission Delegated Regulation (EU) 2017/565 outsourcing is defined as "an arrangement of any form between an investment firm and a service provider by which that service provider performs a process, a service or an activity which would otherwise be undertaken by the investment firm itself." Services may be outsourced, but the responsibility is not. Financial institutions still have a duty of care. Consumer banking in particular has a long history of serious financial and reputational crises that were the result of mistakes made by vendors, for example disruptions to services caused by an IT failure, which lead to market panic. Or breaches of privacy resulting from human error or the theft or sale of customer data.

03 |

Managing Risk: Know your Supplier

Effective supplier risk management involves proactively assessing and tracking supplier and contract risk with qualitative and quantitative risk analytics.

First, you need to set out your risk profile, asking questions such as: What happens if ...

- A strategic supplier declares bankruptcy
- There is a major security breach by a supplier
- A supplier is the target for cybercrime attacks e.g., through phishing
- A supplier or employee of a supplier turns up on a sanctions list or a watch list
- A supplier or employee of a supplier contravenes anti-bribery legislation
- A natural disaster or pandemic puts a supplier temporarily out of action

These risks are not exhaustive. They were increased by the Covid-19 pandemic, and new risks emerged. As a recent report by the European Banking Authority (EBA) noted, "Outsourcing of ICT functions and services has gained further attention in the crisis. It allows banks relatively easy access to new technologies and to achieve economies of scale. However, outsourcing can pose challenges related to third-party risk management as well as consumer data confidentiality and protection, among other challenges. A potential concentration on a limited number of outsourcing providers can additionally pose a systemic risk, especially when the services provided relate to banks' critical or important functions."[1]

[1] Risk Assessment of the European Banking System, EBA, December 2020.

In response to these risks, the EBA updated its guidelines on outsourcing arrangements, which are aimed at ensuring that banks can apply a single framework on outsourcing. The essential elements of this framework are:

Process Management

Banks must have a robust and properly implemented policy, processes and control elements surrounding outsourcing. The bank's management committee and board of directors should have continuous oversight and supervision of the entities involved, and ensure that their responsibilities are not delegated.

Governance

The first step to assessing risks associated with an outsourced service is to conduct a thorough analysis of the activity to be outsourced. Depending on the results, certain requirements will be applied in the selection phase. Good governance also implies evaluating the capacity of suppliers and analyzing various potential risks.

Defining Obligations and Monitoring Performance

After selection, in the contractual phase, the obligations of each of the parties must be properly established and financial services organizations need to collect information relating to subcontracting, information security and the rights of audit and resolution.

Once the contract is in force, companies must monitor the supplier's performance, and strategies should be established for the possible early termination of contracts and/or supplier development plans to ensure business continuity. Where appropriate, the risk assessments carried out in the first instance are to be updated.

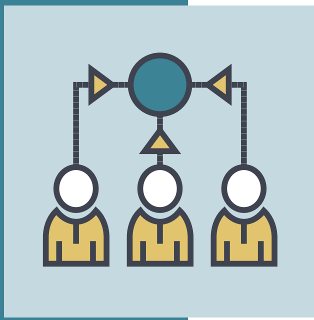
Supervision of Hiring

Recent trends have seen a blurring of the division between a financial services firm's human resources and procurement functions. Increasingly, they make use of various indirect outsourced staffing services (project contracts, statement of work, freelances, independent contractors etc.) with agencies as well as the third-party service providers. The possible permutations are endless, and the procedures that are in place for vetting full-time employees may not be in place for contractors, creating further exposure to risk.

The EBA guidelines state that the hiring process for outsourced services needs to be supervised by competent authorities, and a reporting process needs to be put in place. To ensure that this is done effectively, they recommend having a structured record of all outsourcing arrangements, including the suppliers involved and all the information associated with the outsourcing process.

Onboarding

Banks and other financial institutions are by now very familiar with onboarding best practices from a know-your-customer (KYC) perspective. They similarly need highly robust best practices for onboarding third parties, conducting risk assessments and due diligence, and managing the entire life cycle of the third-party relationship.



One Step Ahead

Whether or not your bank operates within the European Union, you need to stay on top of these risks, and ideally one step ahead. To do so, you should maintain a central repository of all your third-party relationships, their company data, and their risk profiles. Spreadsheets, emails and manual records are inadequate to the task of managing risk, not least because the provisioning of many services, especially in the ICT category, increasingly relies on interdependent relationships and multi-tier supply networks, which may involve a huge number of individual vendors.

Metrics

Finally, to optimize supplier performance and minimize risk, you need to have a robust set of metrics and feedback mechanisms in place. These can include:

- First and n-tier supplier risk scorecards
- KPIs e.g., performance against SLAs, on-time delivery
- Scorecards to capture stakeholder feedback
- Campaign management
- Integration with third-party data feeds to update supplier risk data
- Automatic updates of risk data
- Timely risk alerts

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Category Management is Key to your Success

Let us now turn to some of the positive steps that financial institutions can take to manage risk and at the same time get better performance from vendors. Category management is a discipline that emerged in retail and was extended to other sectors such as manufacturing. In financial services it means keeping your strategic suppliers close through an active, mutually respectful relationship while keeping all options open based on deep knowledge of the market. In other words, it helps eliminate the "systemic risk" identified above while also achieving economies of scale and other benefits.

Strategic suppliers play a critically important role in improving a financial institution's business performance and in particular its ability to innovate and therefore remain competitive. They also contribute to broader non-financial objectives such as ethical business, sustainability and diversity. Financial services institutions need to leverage their strengths to supplement core business activities, and in certain instances, even to help them reinvent their business model, meeting customer expectations which are constantly changing, and to win against new market entrants and global competition.

Category management has therefore come to play an increasingly valuable role in financial services. In fact, it is fair to say that the evolution of procurement from a purely transactional

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Category management is the assignment of specialists to manage and control spend for the institution's major categories, such as IT hardware, IT security, facility services, legal services, advertising and various categories of contract staff. All of these are very demanding and complex categories and fundamental to a bank's success.

Deep knowledge of one or more of these marketplaces is the key element of category management. The person who is the category lead should develop a thorough understanding of their categories and stay up to date on the latest developments so that the procurement approach can be optimized to the market's offerings. This insight can be gained through external market research, professional associations, industry newsletters and internet news searches. Something as simple as setting up a desktop alert based on certain keywords can help you stay informed of changing dynamics in a particular industry or supplier group.

Only with a clear category strategy can a financial institution maintain healthy competition between incumbent and potential vendors and put itself in a position where it can bring in new suppliers, should the situation demand it, with minimal or no disruption to day-to-day operations. Today, technological developments, such as the growth of secure cloud-based IT services, have reduced the dangers of being "locked in" by suppliers.

A category manager typically reports to the CPO, but must above all be able to work with a variety of clients within the business to develop and agree the category strategy and then execute it, creating and managing the operational metrics to measure success. The category strategy in turn depends on where the category sits in terms of its impact on the business and external factors such as the supply market and the regulatory environment. Strategic supplier and tail supplier management strategies being the extreme ends of an otherwise complex landscape.

A key challenge here is to aggregate the spend of disaggregated stakeholders within the organization – a category manager must often wear the mask of Janus! But the point is that category management should create a holistic view of an area of spend, not just a segmented view of your organization, while also looking outwards to develop excellent supplier relationships with a view not just toward achieving savings, but for achieving value.

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Strategic Sourcing

Whereas category management is focused on long-term relationships, strategic sourcing is largely focused on getting a good deal through one-off bidding events such as reverse auctions. That said, in order to execute such events effectively, you rely on the same market insights that are needed for category management.

The role of strategic sourcing in the financial services was given greater profile as institutions responded to the Covid-19 crisis in 2020, navigating the pandemic's disruptions. Sourcing played a vital role in securing the means to ensure business continuity and staff health and safety while containing costs and resetting some supplier relationships.

However, strategic sourcing can yield business impact in the longer term as well, especially as banks and financial services firms seek to restructure their business models in the post-Covid world and recast their supplier networks and service providers accordingly. Many of the services that firms need to source are "complex categories". With the sourcing of complex categories there are many variables and many moving parts: it has often been likened to a chessboard. There is no "perfect" sourcing strategy, but through sourcing optimization you can approach perfection by analyzing various scenarios using advanced software such as JAGGAER Sourcing Optimizer.

These tools enable sourcing teams to go beyond award decisions that are driven solely by cost, building scenarios based on a wide range of price and non-price bid information from suppliers, as well as constraints to reflect business objectives. In financial services, sourcing optimization is especially relevant for sourcing complex categories such as ICT, management consulting services, creative agencies and marketing, legal, market research and business intelligence.

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Contract Management

Contract management remains a largely manual process for the procurement function in many financial services companies, making it a time-consuming, laborious task and one that can have a huge negative impact if done badly. Most large banks deal with thousands of vendor contracts, each one with its own unique set of stipulations, deadlines and other hidden risks that can lead to non-compliance or cost overruns.

Contract management software applications help organizations deal with the increasing volume and complexity of contracts, and the costs and risks these present. It digitizes and stores all contracts in a central repository, enabling all stakeholders (procurement, obviously, but in financial services these also include legal and compliance departments, among others) to search for and review contracts, eliminating the need to rummage through stacks of paper manually. Not every person in an organization needs to be aware of every contract detail, but it is also important to make contracting accessible and transparent where necessary. Contract management solutions allow organizations to ensure that the correct people in their organization have visibility into contracts, providing a secure central repository.

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Procure-to-Pay: Making your Strategy Work

Up until now we have focused on “upstream” processes: sourcing, category management, risk management, supplier relationship management and contracts. But execution takes place downstream, and it is here that an organization needs to apply strict processes supported by robust technology. This is especially true in banks and financial services institutions, which are focused on indirect procurement (i.e., goods and services that are essential to maintain and develop operations, but not part of a final product). And all the more so because of the possible conflicts of interest that arise.

JAGGAER has identified six main challenges that you face in indirect procurement if you do not have the right tools and processes in place. These are explored in more depth in our white paper, Indirect Spend Management: Six Challenges Caused by Lack of Transparency and How to Overcome Them. In short, these are:

1. Maverick spend (or off-contract spend): You lose the benefits of hard-won contracts, e.g., with preferred suppliers. This means lost savings opportunities but, especially in financial services, it may expose you to legal risks and raise suspicions of fraud, even when no dishonesty is involved.
2. Non-compliance: If spend is not automatically monitored with agreed and standardized workflows, approvals, catalogues, expiration and renewal deadlines etc., and there is no notification of users in the event of non-compliance, you are likely to get into difficulties with internal and external auditors and financial regulators.
3. Missed opportunities to bundle purchases: To get the best deals your sourcing teams and category managers work to aggregate the requirements of multiple stakeholders. If any of these stakeholders then make purchases "under the radar" the bank is almost certain to pay higher prices.
4. Increased risk: Not just the risk of non-compliance but, for example, operational or credit risk. What happens if a supplier goes bust? Or defaults on loans, perhaps from the bank itself? Or underperforms on a specific digital banking project, and you have no visibility, or it is off-contract? Your upstream activity should have identified such risks, but they could reoccur if spending takes place off-system.
5. Ease of auditing: When spending is executed through a P2P system, you automatically have an audit trail. Otherwise responding to auditors' requests becomes an inefficient paperchase.
6. Spend optimization: If you capture data through a P2P system, you can analyze it and look for ways to optimize your spend. You have a feedback loop to upstream procurement processes. Without it, you miss opportunities for optimization.

A P2P software suite integrates and automates the entire back-office lifecycle of requisitioning, purchasing, receiving, paying invoices, and accounting for indirect goods and services. By creating standard workflows between buyers, procurement and accounting departments, a P2P solution should provide more transparency into, and control over, indirect spend, and should create a more congenial relationships between all stakeholders.

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Obstacles that you may need to overcome

So, why have banks and financial services often been slow to implement P2P systems? Some of the obstacles are greater than in many other sectors. The first of these is the number of disparate systems in a bank or insurance company. They typically consist of large business units within the organization, each of which has its own processes and tools to manage procurement, which makes data consolidation challenging and cumbersome. Banks also typically use multiple legacy ERP systems making it difficult to have a single and integrated source of truth for supplier and business data. In fact, P2P solutions were originally marketed as expensive bolt-ons to ERP systems, hosted on premise and inflexible, so may have fallen into disuse or else present further challenges of siloed information. These technological and departmental silos create inefficient processes that are mostly manual and error prone.

Despite this, many banks and financial institutions held onto their outdated ERP bolt-ons largely due to security concerns, which for many years were the main impediment to the adoption of modern P2P systems.

These technological challenges may in turn lead to poor adoption. If users do not get the kind of shopping experience that they have grown used to with online consumer shopping, they are unlikely to use a P2P system. Sometimes, the situation arises that adoption is high for spend that is directly controlled by procurement professionals, who soon find their way around the system, but

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low for stakeholder departments, for whom procurement is not a core activity. This can lead to friction between teams.

Until recently this was less of a priority for senior and business unit management in any case, as they have traditionally tended to perceive procurement as a non-critical function. However, this perception has changed over recent years as a result of increased competition and the more general trend towards digital transformation, a process that was accelerated by the Covid-19 pandemic as banks and financial services companies had to adjust to remote and online working.

Procure to pay via the cloud

SaaS technology accessed in the cloud such as the JAGGAER ONE suite has made P2P more affordable, flexible and technically versatile. The benefits include increased uptake of the procurement system, streamlined processes and reduced cost of operations. Crucially, it gives end users a shopping experience similar to the one they have grown accustomed to as consumers, ensuring levels of adoption approaching 100%.

Since cloud technology has matured and become even more secure than on-premise implementations, as well as relieving organizations of an operational IT overhead, they are becoming more open to its adoption. A P2P solution such as JAGGAER ONE results in process standardization, improved efficiency and reduced operational costs, right across the organization's business units and international locations. Change management is also simplified as changes and support packs can be applied quickly and efficiently.

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enforcing a strict "no PO, no pay" policy. This will also reduce payment admin costs.

Organizations that implement P2P also succeed in reducing the turnaround time on approvals for purchases, as all documentation can be shared electronically, especially if DocuSign functionality is included.

Furthermore, by routing all spend through a centralized P2P system, a bank or financial services institution can, for the first time, gain global visibility over actual spend. Without a P2P solution this is a cumbersome process as data needs to be downloaded from multiple back-end tables and collated manually. A P2P solution with reporting functionality enables automatic no-touch report generation, and reports can be customized to meet specific needs according to function, department, organizational level etc.

Upstream and downstream

The full benefits of a cloud-based deployment are experienced when implementing a full solution, both upstream and downstream, or "source to pay". Not least, this provides spend visibility so that you can quickly identify value creation opportunities, uncover areas for optimization, identify spend not under management etc.

However, this can be achieved step-by-step. JAGGAER ONE is a comprehensive suite of software provided in modular form, allowing organizations to automate processes and extend the solution to new categories as their growth requires and their budgets allow. Even if introduced gradually, organizations experience maximum benefit with eventual full adoption of JAGGAER ONE for all spend categories and the entire source-to-pay lifecycle.

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Conclusion

In the financial services industry, procurement organizations face many challenges, and some of these are unique or peculiar to the sector. But the technology and the experience are available to overcome these challenges and increasing levels of automation will relieve CPOs and their procurement teams of much of the routine, manual effort.

As the financial services sector becomes increasingly competitive and burdened by new regulatory and compliance requirements, the digital transformation of procurement becomes even more of a business imperative. It will enable procurement professionals to focus more on true value-adding activities such as category management and strategic supplier relationship management, thereby delivering tremendous quantifiable and intangible benefits to the organization.

A source-to-pay cloud-based technology solution can enable financial services companies to:

- Increase transparency with KYS (know your supplier)
- Comply with EBA and other regulations on outsourcing
- Eliminate and/or mitigate operational, credit, compliance and reputational risk
- Respond with greater agility to external shocks such as the Covid-19 pandemic
- Improve supplier relationships
- Optimize sourcing, based on price and non-price factors to reduce costs and capture value
- Improve category management to create lasting value
- Increase spend under management and eliminate maverick spend
- Automate routine processes in procurement and accounts payable
- Gain visibility and insight to optimize future spend

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