Financial Services INSIGHT
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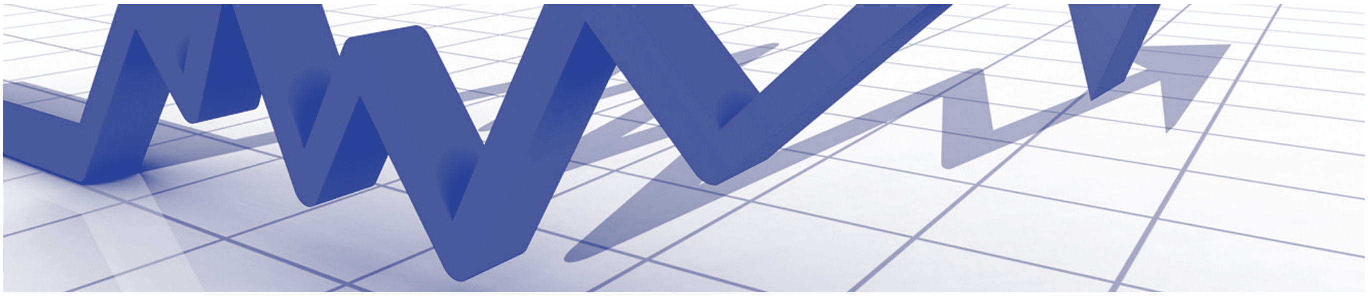
Money's not all banks buy

Strategic Supplier Management for Financial Services Organizations



Purchasing, as a rule, is not part of a bank or insurance company’s core business. As a result, financial services organizations often underestimate both the risks associated with purchasing and the advantages of managing suppliers and product groups in a systematic way. However, strategic management of suppliers can deliver considerable benefits, including a significant reduction in purchasing costs for the organization, support for the development of sustainable procurement, as well as an enhanced role for the purchasing department.

Financial services providers purchase many products and services nationally and internationally, including catering, outside consultancy services, the Reuters and Bloomberg information services, office supplies and services critical to the organization’s core business.

The group of suppliers can be as diverse as the pro-ducts and services themselves, and this applies as much for small, one-person financial consultancies as for global full-service providers, for volumes small or large. However, an unsystematic approach to purcha-sing can result in:

- Too many suppliers
- Insufficient supplier concentration (e.g. 90 per cent of suppliers accounting for a mere 5 per cent of turnover)
- Unknown risks (for example, mission-critical pro-ducts and services with a direct impact on the core business might be from questionable suppliers)

Another factor adding to the intractability of the problem is that those who can assess the quality of goods and services purchased are scattered throughout the organization. This makes coordination difficult and can lead to duplication of effort. For example, the same products may be sourced from several suppliers and lack of communication among those ordering can put any possible synergies out of reach.

Why manage suppliers strategically?

Adopting an organization-wide, strategic approach to supplier management can help to:

- Identify, control, reduce or eliminate strategic risks associated with a given supplier
- Manage and improve the quality of purchased products and services
- Ensure that diversity among suppliers and products is kept within bounds
- Reduce the number of products and services within a (commodity) product group
- Standardize processes whenever possible
- Reduce the number of suppliers whenever possible
- Help favor the best suppliers without jeopardizing healthy competition, and ensure that actual market prices are paid
- Anticipate and recognize supplier market developments relevant to financial service providers
- Adapt processes and organizations within both the supplier company and the purchasing organization to allow organization-wide supplier management
- Reliably identify potential for improvement and take immediate advantage of it

Quantifiable cost savings

Strategic Supplier Management can also deliver quantifiable cost savings. These fall into 3 categories:

- Real purchasing costs: Strategies such as order bundling, reducing the number of suppliers, reducing the variety of products, and cooperation agreements with the best suppliers can deliver quantifiable benefits for each supplier and product category. In fact, Arthur D. Little's experience among financial services providers has shown measures such as these can reduce real purcha-sing costs by 12 – 15 per cent or more.

- Cost of risk: Diligent purchasing risk control ap-plied to suppliers and products that have a direct impact on an organization's core business is yet another, albeit more difficult to quantify, benefit.
- Efficiency costs: Efficiency savings are often lower and more difficult to quantify than savings in purchasing costs and cost of risk, yet they do exist. However, because purchasing activity is spread across the organization, the opportunity to reduce the number of jobs is unlikely to arise.

In most cases, quantifiable savings from reductions in real costs justify Strategic Supplier Management. A return on investment often materializes within a year.

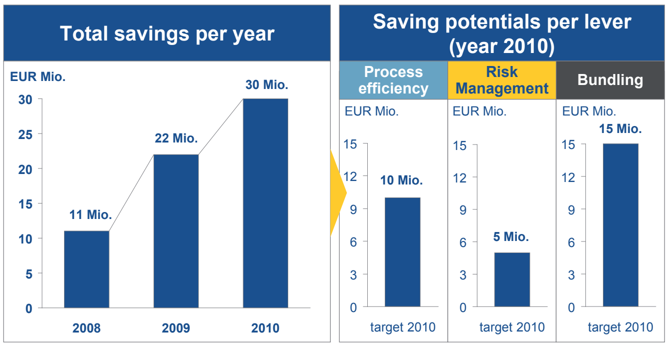


Figure 1: Realizing savings potentials through the use of prioritized cost levers.

Sustainable procurement

Strategic management of suppliers can also support the development of sustainable procurement, a concept that is becoming increasingly relevant for businesses of all kinds. Sustainable procurement takes into account the economic, environmental and social impact of buying choices and can simultaneously deliver benefits for business. These include:

Reduced costs – resulting from enhanced compliance with regulation, lower consumption of energy and resources as well as reduced volume of purchase

Lower risks – thanks to a strengthened brand, enhanced reputation, improved community relationships and reduced grounds for litigation

More options – resulting from greater scope for innovation, additional opportunities for premium pricing and new sources of revenue

What does Strategic Supplier Management involve?

The main building blocks of Strategic Supplier Management are shown in figure 2 below:

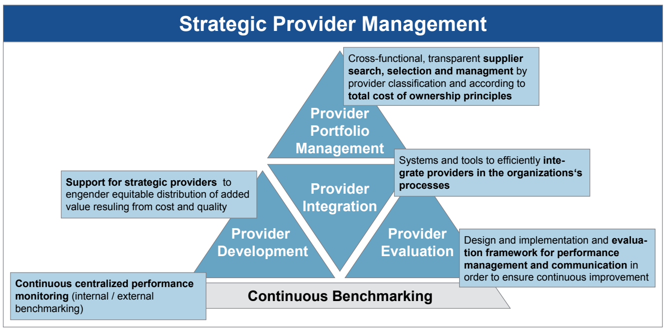


Figure 2: Strategic Supplier Management helps to shape the supplier portfolio and performance.

The main components of Strategic Supplier Management are:

- A classification system that assigns relative importance to products and suppliers
- A supplier and risk portfolio managed according to clear rules and enabling proactive contract management
- Processes and structures for organization-wide management
- An early risk and trend warning system that provides purchasing management with the data needed for decision-making

Repositioning the purchasing organization entails a culture change and is a long-term process that needs to be part of the corporate management agenda. As a result, the Chief Operating Officer (COO) is the most appropriate initiator of Strategic Supplier Management.

Employees who are not part of the purchasing department, but who are responsible for initiating purchasing activity, also need to be involved in any moves to develop Strategic Supplier Management – and this will require the approval of department heads. Employees responsible for initiating purchasing can contribute important expertise to purchasing decisions, including the grading of suppliers and the quality of products and services.

Building a purchasing strategy

A classification system for purchased products and services (product groups) and their suppliers is the basis of any effective Strategic Supplier Management. The data provided by classification helps to ensure that planned measures are effective by identifying:

- Which important product groups justify greater control

- Which product groups lend themselves to standardized ordering (e.g. with an e-procurement system)
- Which suppliers justify special cooperation agreements
- Which suppliers should be cut off
- Which product groups can do with fewer suppliers

Taken as a whole, the objectives and strategies for specific product groups and suppliers represent an organization's purchasing strategy.

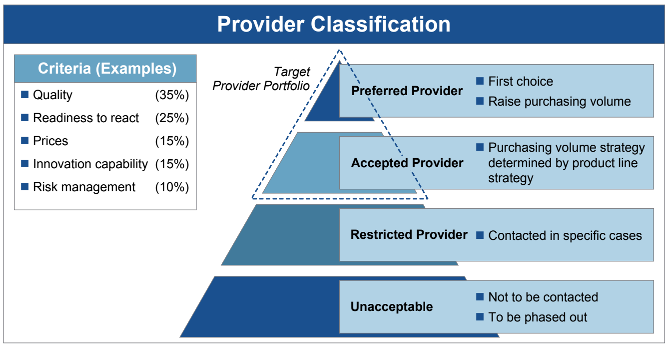


Figure 3: Systematic, unified and organization-wide supplier categorization is an essential aspect of effective supplier management.

Developing new processes and structures

Strategic Supplier Management supplements existing purchasing management. Suppliers and related risks are monitored organization-wide throughout the business relationship. Systematic control, starting with an analysis of the supplier market and continuing through to the evaluation and rating of the quality of suppliers, products and services (supplier portfolio management) is launched in coordination with the organization's management systems and scorecards. This ensures that suppliers continue to meet the conditions set for them. Satisfactory suppliers with the potential to improve further are encouraged by appropriate means; bad suppliers are cut off.

Investment in purchased products and services is managed within a portfolio as shown in figure 4 below. The portfolio manager or head of procurement monitors the performance of the portfolio and its continued match with the investment profile. The portfolio is developed to reflect budgets (investments), goals and expectations regarding risks and returns.

An enhanced role for the purchasing department

Important to the lasting success of Strategic Supplier Management is a new awareness on the part of the purchasing department of its role as an in-house service provider. Its role is no longer simply to process orders received from other departments quickly and accurately, but to advise other departments as they select and evaluate suppliers and write and execute supplier contracts. This new set-up requires supplementary management processes, embedded within the strategy for provider management.

For members of the purchasing department, the implementation of Strategic Supplier Management invariably gives rise to new opportunities for advancement and job enrichment. By playing an active role in helping the organization to get the best from its purchasing spend, the purchasing department can bring about lasting improvements to its reputation within the organization.

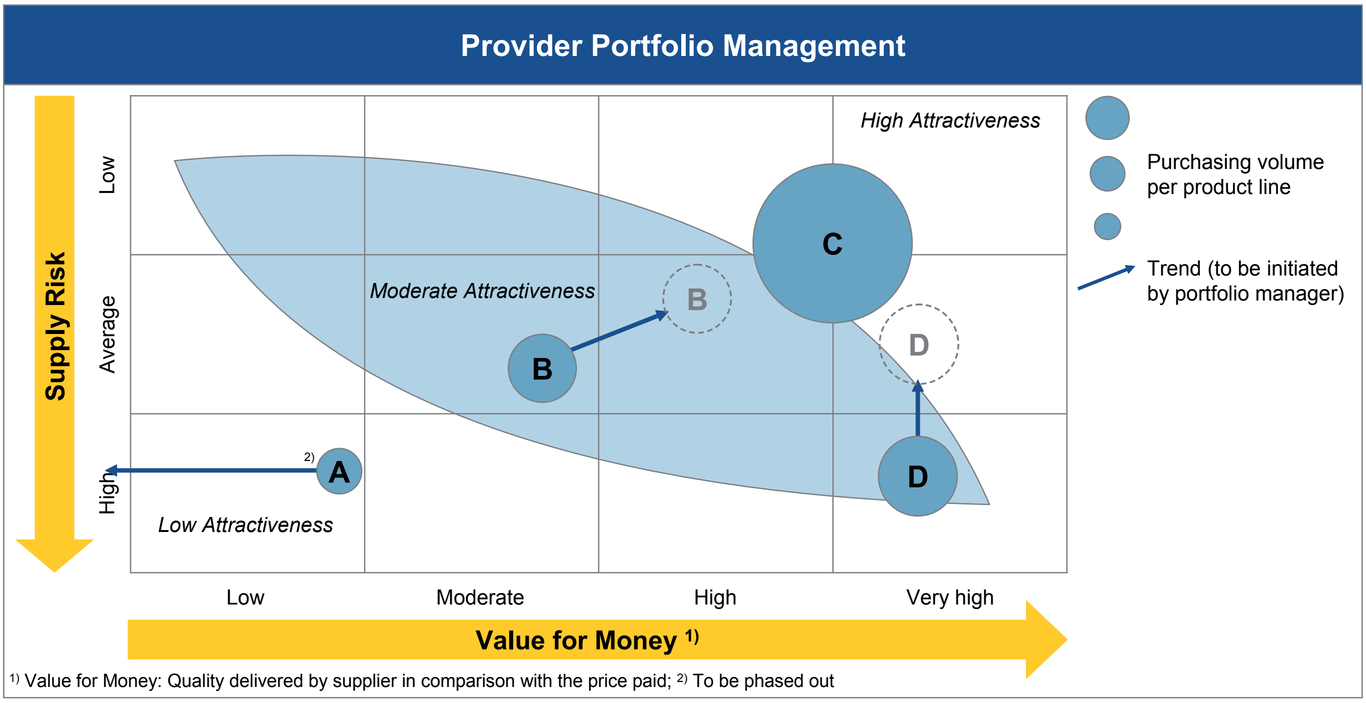


Figure 4: Procurement Portfolio Management follows the same principles adopted within other areas of financial services organizations.

As a consequence of the trend to outsource complete business areas and business processes, the importance of a strong risk management within procurement has been steadily increasing. Poorly managed risks have a direct impact on DekaBank's core business and, as a consequence, on the bank's performance. The implementation of the Strategic Provider Management initiative will enable us to keep up with this development."

Christian Thöne, Head of Procurement, DekaBank

Benchmarking Study: Measuring excellence in purchasing performance

Frankfurt, January 21st 2008 – The management consulting company Arthur D. Little together with a financial services taskforce of the "Bundesverband Materialwirtschaft, Einkauf und Logistik e.V. (BME)" has benchmarked the procurement departments of 20 well-known banks and insurances. The so-called Purchasing Value Excellence (PVE) Benchmarking for "Financial Services Organizations" is analyzing the following key questions: What characterizes an innovative procurement organization? Under which circumstances can high performance be achieved? In which areas can performance improvements be achieved with a substancial positive impact on the company's operating profit.

The Benchmark of Financial Services Organizations has been accomplished within the context of the Purchasing Value Excellence (PVE)-Study, where during the last few years, more than 500 leading companies have participated.

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