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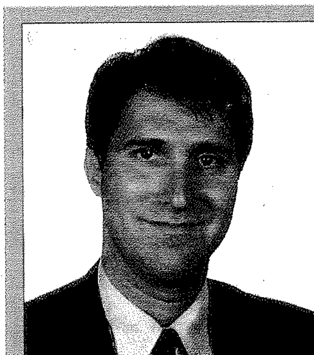
PERSPECTIVE

A New Model for Vendor Relations

As has been well chronicled, the banking industry has undergone dramatic transformation. Mergers, acquisitions and consolidations have changed the face of banking. True interstate banking, the proliferation of remote ATMs, and online and Internet banking have forever altered the ways financial institutions conduct business.

However, some practices have changed very little over the years. One is the process by which banks typically buy products and services. While other industries have moved forward in developing successful vendor relationship strategies, by and large banks have retained the Request for Proposal (RFP) method of choosing vendors. The RFP process, embraced today primarily by governmental bodies, focuses on price, often overlooking such factors as level of experience, specialty services and historical success. This contrasts sharply with the practice of many other industries that have aggressively created strategic alliances with their vendors. Banks must understand the goals they want to achieve in selecting vendors, and determine the best method for meeting those goals: the RFP process or a comprehensive vendor relations program.

Vendor relations entails day-to-day dealings with suppliers of both products and services. Maintaining effective relationships with key vendors may be vital to the bank's operations, yet many institutions select and maintain their key vendors by pricing alone. While that's acceptable for more generic products and services like office supplies, furniture and cleaning, certain vendor functions are an integral part of the bank, and affect the customers' impression of the institution. Indeed, customers associate these services with the overall effectiveness of the bank.



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When customers visit a remote ATM, for example, they expect to be able to make cash withdrawals, and assume that deposits will be picked up and processed in a timely manner. They associate the replenishment and maintenance of the unit as a bank function, unaware that these services are generally provided by an armored transport company and, in the case of technical maintenance, with the manufacturer of the ATM itself. Service failures may reflect directly on the bank, reducing customer satisfaction and ultimately customer retention. A bank could lose customers simply because it awards its ATM service contract on the basis of price rather than assessing the total cost implications of choosing a less-than-qualified vendor.

Some RFPs do not contain sections that enable vendors to differentiate themselves from their competition; some institutions do not even include formal meetings with vendors in the selection process, which would allow for personal interaction. Even in cases where the RFP presents an opportunity for the vendor to answer relevant questions at length, the vendor rarely gets the chance to suggest new business solutions that may create efficiencies and reduce costs. Often, key decision makers at the bank simply go directly to the "back of the book" to review pricing.

Ironically, the RFP process can be quite costly and time consuming. Numerous parties within the institutions get involved in vendor selections: legal, procurement and possibly field operations. The comprehensive questionnaire may be incredibly difficult to design and exhausting to review. And, in the end, pricing is almost always the key decision factor.

Of course, this mindset is easy to understand. Many institutions have centralized their purchasing function to achieve volume discounts and better control over the entire process. Vendors, accustomed to dealing with numerous local and regional managers within the same institution, now often establish a lead person who oversees the relationship. Some bank managers have pay incentives based on operating within their budgets—if they can run their departments at or below projected costs, they earn additional bonuses.

There are two essential drawbacks with this method. First, the lowest *priced* vendor does not necessarily equal the lowest *cost* approach. If, for example, an air freight company has the highest overall rates among its competitors, but provides solutions for reducing total cost (such as bundling deliveries to same locations), the bank may actually realize significant savings with this vendor. Similarly, if an armored car carrier charges the most per route-hour, but helps develop systems to reduce the total number of route-hours while maintaining a high level of service, the actual total cost of cash distribution may decrease significantly.

Equally important, the lowest priced vendor may not be able to provide consistently good service, creating dissatisfied bank customers who may choose to take their business elsewhere. Customers don't care about the bank's armored transport or air freight. They are interested in whether the bank is meeting their needs.

There are alternatives to the RFP process. Bank of America, for example, has instituted a vendor relationship program to promote a team approach, with the bank and its vendors working together to encourage a true partnership. Ultimately, the customer is the true beneficiary in terms of better service.

Its comprehensive training program includes mandatory classes for vendor managers to learn how to develop and maintain effective relationships. Vendor relations managers become arbiters, communicators, educators and diplomats to ensure that the two companies work together toward common goals and understanding. They communicate realistic expectations to their respective vendors on an ongoing basis. Bankers should not have to micromanage their vendors; they have their own responsibilities and should not be forced to worry about every tedious detail. Instead, all communications related to such issues are directed to the on-site company representatives, who can handle all situations in a more efficient manner, and merely report the results to the bank vendor relations manager.

Bank of America has identified four distinct vendor relationships: supplier, preferred supplier, alliance and strategic alliance. Among suppliers, there is very little differentiation in products and services and, thus, relationships are primarily based on pricing. On the other hand, strategic alliances are formed with vendors who provide products and services that are crucial to the bank's operations. Such relationships depend on mutual trust, ability to enhance business opportunities, and delivery of more effective customer service. Vendor qualifications and experience matter far more than pricing in establishing strategic alliances.

As part of the selection process, prospective vendors who have met minimum standards are given the opportunity to communicate their areas of expertise and the specific ideas they have to improve customer service. Current vendors must maintain performance up to the bank's expectations. They are monitored for timeliness, accuracy, responsiveness, completeness and problem resolution. Those vendors who continue to meet or exceed such performance expectations are typically rewarded with additional business.

Banks should learn that, while an RFP may be included as one aspect of the vendor selection process, pricing is not the primary factor, particularly for strategic alliances. The "cheapest" vendor may not necessarily be the "least expensive" one. Institutions that constantly change vendors to save money may find themselves dissatisfied with the level of service.

Hard dollars up front must be measured against the potential long-term impact should business be lost because of poor execution. By and large, as long as strategic alliance vendors continue performing in efficient and effective manners, they will not be replaced as a result of a bidding war. Thus, quality incumbent vendors definitely maintain a certain home-court advantage. It simply costs too much in the long run to constantly hire and train new ones.

This team approach becomes readily apparent in the ongoing interaction between the bank and many of its strategic alliances. These vendors are treated as though they were associates of the bank. Many actually work at the bank's facilities. They participate in planning meetings and quarterly reviews, and participate in brainstorming about improving customer service and reducing costs.

Many banks enjoy stronger customer relationships because of their ability to change with the times. While the RFP undoubtedly has a place in the vendor process, pricing should not be the sole yardstick for measuring prospective vendors. Perhaps it's time to consider a new paradigm in relationships with their strategic vendors. ●