COST CUTTING INITIATIVES:

Auditing and Re-Negotiating Vendor Contracts

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Executive Summary

Senior executives at financial institutions across the nation, and abroad, are missing key opportunities to cut costs and improve revenue optimization during this current recession. To this end, a progressive approach to auditing respective e-business and technology contracts is required.

The management consulting firm Booz & Company recently surveyed 155 senior executives at Fortune 500 companies. The report concluded that an overarching concern exists in that traditional cost-containment measures are falling short during this downturn. As a result, senior executives are seeking alternatives because traditional cost-cutting approaches are being applied to a non-traditional recession with little success.

The vast majority of respondents (92 percent) cited “constantly changing objectives due to unstable economic conditions” as a major challenge to achieving their cost-reduction goals. As a consequence, senior executives are left in a precarious position. With traditional cost-cutting measure missing the mark, there is no room for failure when attempting a new approach to enhancing the bottom line.
Students of history understood the economy had reached the recession level before it was officially recognized by the Bush Administration; a declaration that spurred investigation, debate and resulted in the largest federal bailout in history.

Economists looked to the Inverted Yield Curve, an early predictor of a recession. In short, it’s an interest rate model in which long-term debt instruments have a lower yield than short-term debt instruments of the same credit quality. For financial institutions, investment revenues dropped as a consequence of returns dropping. It began with the mortgage crisis and then filtered into auto loans and personal lines of credit.

Credit Unions, in increasing numbers, are closing branches, laying off employees and freezing scheduled projects. Unlike the banking industry, Credit Unions are trying hard to maintain respective employee rosters by moving positions around and placing a hiring freeze. Despite best intentions, however, these traditional approaches are not working as the economy continues to slow and regroup. A new approach is desperately needed.

While the current state of the economy is troubling, it isn’t without hope. Opportunity exists including an exhaustive auditing process of all existing technical applications and contracts. For Credit Unions this approach can be perceived as overwhelming; however, when experienced, progressive consultants are brought into the fold, *sense* turns into dollars saved.

Approaching Cost Cutting

As noted, an unconventional recession is being experienced. In years past, including the mild recession post September 11, 2001, companies would employ their Plan A approach: across-the-board cuts by investigating working capital management issues and focus on reducing marketing spending. Forty-percent of respondents from the aforementioned Booz & Company survey said they have focused on these cost cutting techniques recently and for good reason as historically these cuts can result in significant savings in six to eight months.

Normally, this amount of cutting coupled with the time frame provides enough proverbial coal to keep the engine running as the market rebounds. Today's recession, however, is not similar to post September 11th or that of the early 1980s; it's historic in proportion sharing similarities with The Great Depression. As a result, the aforementioned cuts aren't enough and companies are heading downhill fast without brakes.

One in five companies survey is making capital expenditure cuts of 25 percent or more. By relying primarily on a short-term cash-conservation view and cutting new investment to the bone, the report states that companies risk destroying their fundamental ability to compete once the economy rebounds (and it will). Perhaps more alarming is that this approach is not guaranteed to work in either the short or long run. Eighty-six percent said they have already implemented their cost-cutting toolbox and are running out of options for further action, and 72 percent acknowledge that the cost-cutting culture is negatively impacting morale.

While a snapshot of the overall market, this approach is significantly impacting various leading industries including automotive which remains on life support. Lessons can be learned from studying these surveys and business models.

Take for example Nissan which in 1999 was on the death's door after severe mismanagement during Japan's worst economic time period known as the lost decade. Renault CEO Louis Schweitzer made what was an unprecedented move by paying approximately $5 billion for effective control of Nissan. Schweitzer was dismissed as foolish by leading industry heads including Robert Lutz, then vice-chairman of General Motors Corp., who publicly stated that Renault might as well have dumped the billions in the Pacific Ocean. Schweitzer brought in Carlos Ghosn, a no nonsense cost-cutter with pedigree intelligence.

Among initiatives, Ghosn slashed purchasing costs by 20 percent. He did this in part by meeting directly with manufactures and vendors. In short, he said, "if I'm not making money, you're not making money and in order to succeed collectively we will have to work together on adjusting pricing." Nissan not only survived, today it remains viable as the Big Three automakers scramble for their respective lives. In the face of adversity, opportunity exists.

A Credit Union Perspective

Credit Unions are facing tremendous pressure financially and as such are required to reevaluate expenditures. When looking to cut costs, Credit Unions' senior executives, with the assistance of a third party consultant, should investigate respective third party relationships, especially vendor contracts.

It's no longer affordable or feasible for Credit Unions not to seek out current market pricing upon renewal of all third party contracts. Often this is a muddied practice. When successfully executed, an outside auditing approach can save a Credit Union hundreds of thousands of dollars over a period of one to five years.

The vast majority of existing contracts vendors have with financial institutions include an embedded renewal clause. The monetary increase is in step with the consumer price index. As a consequence, countless credit unions and banks are losing thousands of dollars every year! While an initial contract will last between three and five years, these contracts are renewed automatically on an annual basis; however, the terms are often not revisited.

Typically, a Credit Union is not equipped with the knowledge to understand the complexities of a renewal clause. This is for good reason as a Credit Union might deal with vendor contracts at best on a yearly basis while vendors negotiate these contracts daily. They have the upper hand. To provide a level playing field, technology and financial consultant are essential as they study contracts and renewals on a weekly or monthly basis. Put simply, this is not an area of strength for Credit Unions.

Credit Unions often have contract renewals on their to-do list. Senior executives and consultants work in the same capacity by and large. While the goal is the same: reduce cost while increasing revenue optimization, the approach is different. The benefit of using a third party consultant is for the same reason a third a party vendor is hired to handle technology applications.

Last year, over a period of a few months, Samaha Associates was able to save a small Credit Union upwards of $800,000 by thoroughly reviewing and analyzing its existing contracts. This included an inventory of all vendors services (past and present) and an audit of fees against current market pricing, which as we all know has suffered greatly.

This is but one example of a success story. In order to collectively thrive, vendors need financial institutions and financial institutions need vendor services. Too often what is missing from this all-important equation is an insightful, progressive financial consultant who has the Credit Unions' best interests in mind.

Like Ghosn, third party consultants can meet with the vendors for a progressive review of existing contracts. Vendors can't be blamed for not pointing out areas of weakness in a contract negotiation. It's their job to secure their bottom line as it is a Credit Union's CFO to secure its bottom line – Business 101. This is a symbiotic relationship, however, and one needs the other in order to survive especially during time of economic stress.

Recently J. Willard Marriott, Chairman and Chief Executive of Marriott International was quoted as saying "Real growth comes from the marketplace, not the workplace." While this can be interpreted a number of ways, for Credit Unions, the marketplace is where vendors operate. To this end, a Credit Union has to be proactive and progressive and not wait until a contract renewal, but bring the vendors to the bargaining table with a list of reasonable demands. With the right guidance, this approach can save a credit union between 10 and 50 percent on contract renewals.

The Booze & Company study recommends senior managers to remain flexible and open to new opportunities. Organizations revamping their internal structure will look different on the other side of this recession. Steps should include:

- Attack costs in a strategic, coordinated manner to reduce break-even to its lowest possible level without losing market advantage.
- Adopt a long-term view of how the industry should and will restructure, including possible government intervention.
- Develop a long-term game plan that includes a defined industry vision and where the organization fits within it. Plan capital expenditures based on that plan.
- Prepare to take intelligent risks, including preparation for the upturn, planning for price increases, and possibly recapitalizing debt.

Cost Cutting Increases Revenue Generation

All coaches are familiar with the following phrase: *the best offensive is good defense*. As the global financial crisis plays out, it has perhaps never been more crucial to have defensive measures in place. When times are grand, certain expenditures are written off as permissible; however unsound. What organizations, and individual for that matter, have realized as a result of this market downturn is necessary costs versus unnecessary costs. The immediate reaction, as noted above, to economic woes is to employ Plan A: lay offs and cross department cuts. In short, a tourniquet is applied to stop the bleeding. Once this is accomplished, senior executives have to determine whether they are going to save appendages and limbs—i.e employees and branches.

When successfully executed, auditing can be an organizations' saving grace. The process which is applied sporadically during the year, perhaps quarterly, examines nearly all aspects of operational costs from salaries to the amount of money spend on office supplies. One stone, however, is often unturned: vendor contracts.

Third party consultants are paid a percentage of the savings they secure. While this metric fluctuates, it is in a Credit Unions' best interest to explore this process for they can be assured that a consultant will not attempt a thorough contract auditing process without the confidence of securing savings for its client. The process is exhaustive and can take between two and four months to complete.
Since the vendor, and its legal team, develop the contracts, Credit Unions must realize that it is less a tailored contract and more so a subscription with minor alterations. Consultants understand that a vendors' objective is different that the inherent best interest of a credit union. It's not unlike a gym membership. A client accept the terms of service and cannot alter services specific to respective needs before signing on the dotted line. Experienced consultants understand pricing scheduling methods and can correct in Credit Unions favor during an auditing process.

Take for example a vendor contract for a Credit Unions Internet Banking provider. Without proper oversight, how can a Credit Union determine a user fee structure? Should be per use fee, or per active user fee? The answer gives light to another question: how is an active user defined?

Let's take a hypothetical scenario. On average, an audit conducted by an experienced consultant can reduce a per user fee from $10 to $5. The reason vendors will drop the price by 50 percent without issue in that the market value is $3.95 per user. When this model is applied to 100,000 users, savings begin to add up quickly.

There is also deliberately vague language in contracts when defining active user. Vendors will build into the contract that an active user is a member that logs in every six months. This time frame can be reduced to 30 days. Here again the Credit Union realizes significant savings.

Answers to the aforementioned scenarios are arrived at using an exhaustive Request for Proposal (RFP) application. During the renewal process the current vendor is audited with this document. In addition, two competition vendors are identified and provided with the RFP which can contain upwards of three hundred questions. In most cases, the engaged vendor seeking renewal will come down on pricing but not to market level. It is with the bids from the competing vendors that the true market value emerges. Thus, if the existing vendor wishes to remain engaged, the negotiating process, overseen by the same consultant that conducted the audit, commences with favorable outcomes for Credit Unions.

Another example is with fees associated with credit card accounts. In many cases, a renewal audit can significantly drop prices. In one case, per fee transaction went from 14 cents to four cents.

The contract renewal date, which many Credit Unions are unaware of, is not the only time to enter into a negotiation of existing terms. Contracts can (and should) be reviewed well before expiration date, which as noted above, will renew automatically. Credit Unions living fear of a decommission cost related to early termination of contract can be rest assured that in the hands of an experienced consultant, this fee would be waived.

Conclusion

Credit Unions must remove their blinders and focus on saving valuable money and resources today. Under the guidance of an independent, unbiased third party consultant, Credit Unions can approach vendors with reasonable requests that support respective long and short terms goals. In this volatile market, there is opportunity to negotiate and arrive at favorable terms - perhaps better rates than before the recession took the economy hostage.

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