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The Art of Negotiation

CORE AND THIRD-PARTY AGREEMENTS MADE EASIER
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Executive Summary

When a financial institution engages a vendor in contract negotiations for a new or existing technology platform, the process often becomes muddied and terms of service become unclear. Expertly executing this process is critical, especially in the ongoing wake of COVID-19, as a wrong decision will adversely impact day-to-day operations ultimately diminishing customer/member experience and employee confidence.

Financial institutions pursuing new technology platforms often approach the negotiating table stripped of the necessary tools to succeed. This is not their fault. They are not experienced or well-versed in this otherwise cumbersome, but all-important process.

The point of no return is most often when the contract is signed. So to avoid pitfalls, it is prudent to engage an objective third party consultant. This consultant should be an unbiased advocate representing the financial institution's best interests. Unlike well-intended C-level executives, consultants have the experience and knowledge to successfully navigate the negotiation and adoption of a technological operating platform.

Does working with a consultant require an investment? The answer is yes. But would a smart homeowner purchase a home without first hiring experts to inspect the roof, the foundation, the HVAC system, et al.? Of course he or she would, but why? C-level executives should look at purchasing a new technology platform—from due diligence, to selection, to implementation, to training, to going live—in the same manner as buying a home. And building on this home buying analogy, financial institutions aren't in the business of handing out mortgages to unqualified customers/members. They have systems and metrics in place, such as credit scores, to determine if a customer/member is qualified. So why would a financial institution engage with vendors without the oversight of an experienced consultant who can negotiate sound contractual terms that not only save money, but ensure exemplary services?

The purpose of this white paper is to provide knowledge and insights gathered from consultants who have successfully negotiated hundreds of technology and service contracts. This white paper will lift the curtain and shine new light on how to handle contract negotiations—from soup to nuts—complete with a host of detailed questions and approaches. But perhaps more importantly, it will teach how not to handle negotiations. After all, there is but one true opportunity to master the art of negotiation.

Industry Overview

In order to stay viable, financial institutions are required to continually investigate whether they can operate more efficiently, offer competitive products and services and maintain customer/member satisfaction. And while this has long been a conventional approach, COVID-19 has served to underscore this winning practice. Therefore, the prime motivation for converting to a new core platform is usually the realization of an outdated, under-performing operating environment.

The decision to implement a new technology – whether it's a new core-processing system or ancillary products – is a significant undertaking. The resulting challenge is initiating a costly system revamp, which when mismanaged results in both short and long-term struggles.

To further complicate the issue, consolidation within the financial technology industry has resulted in less competition, reduced price advantages, forced conversions from "sunsetted" products, and overburdened conversion teams. So in today's market, there is considerable pressure on financial institutions to make the correct technological choice out of the gate. The wrong choice is costly and can sidetrack an organization’s projected growth for countless years.

Despite best intentions, many financial institutions will scramble to keep stride with competition and industry trends by moving forward without having a customized core system replacement plan in place. This is understandable as it is difficult to deal with the daily tribulations of operating a financial institution without coupling problems associated with deploying a new technology platform.

The reality, however, is that seeking new technology requires meticulous due diligence. This evaluation methodology takes, on average, approximately one year. The process officially starts when a financial institution begins the task of identifying existing operating issues and shortfalls. Next, the search and selection process of a vendor and operating environment commences, a multi-tiered process including discovery process, negotiation, agreement, implementation and conversion.

To be safe, a financial institution that is looking to implement a new technology platform should start the search process two to three years before desired implementation.

Vendor and System Selection Process

Once the aforementioned questions are researched, assessed and answered, a search-and-selection strategy is the next step. Initial questions, for example, should include:

- What are your vendor expectations?
- Do you want to improve your core system, contact center, ATMs, card portfolio, Internet banking, bill payment or other processes?

Without a sound starting strategy, some vendors will try to dominate the process by determining rules and setting expectations. As a consequence, financial institutions are removed from the decision-making process and are too often forced to react rather than initiate. To realize a successful negotiation, a financial institution must be specific in its goals and stay true to its strategy throughout the varied process. As such, the strength of a negotiation platform is comprised of the elements of an organization's business model. A financial institution should know the variables and constructs of its business better than a vendor. To this end, it is the financial institution's responsibility to become an active participant providing the required variables for sound solutions.

Before a successful negotiation can commence, participants must have a clear understanding of the variables comprising their goals – the sticking points. Adherence to these three necessary steps is critical:

1. Listen to your customers/members: One of the decisive advantages financial institutions have over big banks is the ability to listen to customers/members and quickly implement suggestions and address concerns. Therefore, incorporate customer/member "wants and needs" into the strategy. In order to understand the needs of a customer/member base, a financial institution must have a system in place that tracks customers'/members' activity in relation to products and services.

2. Maintain a watchful eye: A thorough selection process goes beyond a simple request for proposal (RFP), sitting down with vendors and negotiating a contract. In many cases, consultants send out generic RFPs and simply assist in a cursory overview of the operating environment. While unacceptable, this is a common approach. A financial institution that is aware

of perils involving conversion, operations and after-conversion support will have a distinct advantage while negotiating.

3. <u>Search for the right system solution</u>: Evaluate the positives and negatives associated with your existing technology. Before entering into a new technology platform, financial institutions should identify the existence of the following system characteristics: seamlessness, openness, ease of use, stability, flexibility, functionality, price/performance, vendor implementation and service quality strength.

While there are host of common issues seasoned consultants confront during a negotiation process, the following three examples are easily avoidable mistakes:

- <u>Financial institutions do not follow an interview process</u>: Executives must avoid the natural inclination to follow a demonstration process as this approach only indicates what a specific vendor's system does well. It does not indicate how it will impact a financial institution's unique situation.
- <u>Financial institutions must conduct interviews:</u> Executives should approach vendors as if they are interviewing them for a senior level

position. Leave no stone unturned. Questions should center on the vendor’s ability to meet unique operational needs. When executed properly, financial institutions set the rules and control the selection process allowing a holistic view of the vendor product offerings to emerge.

- Financial institutions are often too trustworthy: A vendor’s history might offer insight into a product; however, it does not assure that a system will work well with respective platforms. Every financial institution is unique and one size does not fit all when it comes to technology.

Without the aforementioned due diligence, the search-and-selection process will be flawed leading to costly issues after conversion. When executed properly, the process will underscore specific and measurable reasons as to respective needs weighed against the agreed upon offer presented by the vendor. Therefore, the vendor is forced to commit, in writing, to be an honorable, long-term partner with shared goals of collective success.

Interviews Instead of Demonstrations

A technology selection process is comprehensive. Financial institutions are encouraged to proactively conduct interactive meetings, be it virtual or in-person, with vendors. It is the role of a third party consultant to synchronize participating parties, a process that allows a financial institution to discover the best-fit system that will meet all requirements. The problem is that without the oversight of a consultant, C-level executives unwillingly overlook, underestimate or miss important contract clauses.

Financial institutions should abandon the typical vendor "demo process" and rather opt for exhaustive, exploratory interviews. More often than not, this approach results in the selection of a progressive vendor team that will be in place from inception to conversion, and hopefully for years to come.

The goal of the interview process is to understand the vendors' product interface and user-ability. Depending on the services used, or outsourced, and the level of in-house proficiency, financial institutions often hire or confer with qualified independent consultants to ensure proper oversight and execution.

During this interview screening process, financial institutions should:

- Make requests for information (RFI) for potential vendors as part of a pre-selection process. RFIs determine the financial technology suppliers required for the interview phase.
- Understand the vendor's major supporting agents (i.e., subcontractors, support vendors and other parties).
- Analyze the vendors' most recent audited financial statements and annual reports as well as other indicators (i.e., publicly traded bond ratings). This process alerts financial institutions to mergers or takeovers that often lead to a second, costly future conversion.
- Invite vendors to engage in an interview process. This eliminates the "dog and pony/demo" show providing for an interactive, progressive discussion on specific services.

With these critical steps taken, two or three vendor finalists will emerge. After pre-selecting a finalist and a runner-up, the entire process should repeat including a second-round testing respective products, services and support. At this stage, a financial institution should identify pricing points from three tier-one competitors.

Core Vendor Selection Check List:

- Ask the remaining vendors to set up a laboratory system onsite to evaluate – operations, front office, back-office, lending, delivery channels, et al.
- Use the hands-on interview and laboratory sessions to ask the vendor hard-hitting questions that impact day-to-day operations.
- Assess the vendor personnel assigned to support the institution, especially during conversion and post-conversion.

If financial institutions enter into an agreement on blind faith with a vendor, they are doomed to fail. Therefore, evaluate the service provider's experience and ability to provide the necessary services and supporting technology for both current and anticipated needs.

From Contract to Conversion

Once a system is selected, take the necessary time to methodically prepare for the negotiation process. Like the proverbial turtle, pace indeed wins the race. This approach will not be easy as sales people are encouraged to expedite the process. Vendors will sometimes try to coerce a financial institution into making a quick decision by placing a deadline on time sensitive prices. Here’s a familiar pitch: “If you sign by a specific date, you will receive huge savings.” Therefore, it is critical that the financial institution sets the timeframe for the negotiation. But again, this is only possible if the financial institution proactively starts the process in advance of existing expiring contract terms.

Employing a balanced understanding of project management, contract negotiation and systems integration will present a level playing field, while providing the financial institution with the upper hand. While some vendors are often quick to close a deal, financial institutions, too, are often faced with time constraints. In this circumstance, financial institutions will negotiate what they believe are good terms only to overlook key elements, such as vendors who cannot commit necessary resources for a seamless and painless conversion, which is common as some vendors use the least amount of company resources whenever possible.

Slowing down the process provides a financial institution valuable time to effectively assess the system they are about to purchase. Critical support components are often overlooked during the negotiation process. To this end, a financial institution is encouraged to build conversion assistance into the deal.

Negotiating Tips:

- Identify your leverage early on.
- Determine who has the most to gain and lose from the deal?
- Determine a timeframe.
- Set time limitations and stick to them.
- Avoid committing to positions that restrict further movement in the negotiation process.
- Regardless of approach, maintain emotional distance.
- Despite discouraging feelings, remain patient and collected.
- Listening is as important as arguing.
- Construct concise and specific questions.
- Never interrupt when someone is responding to your question as they may provide valuable information.
- Above all else, the best negotiating tool is the ability to walk away from a deal that doesn't serve your organization or its customers/members.

Once terms are agreed upon and an operating environment is selected, perhaps the most critical phase begins: Introducing respective legal teams. Despite an attorney's merits, he or she is not normally versed in technical aspects of the project and, thus, cannot appreciate the related terms and conditions comprising a sound agreement. Attorneys, however, are excellent at determining the legal elements of an agreement and should work in concert with the financial institution and its preferred consultant.

Without knowledge of technology, methodology, and best practices, unwilling and costly mistakes will be made with repercussions rippling far past the negotiation table. Therefore, experienced consultants provide a distinct advantage in the negotiating process.

Each contract "ripple" has a dollar value that increases with distance. Therefore, agreements between the financial institution and vendor should contain specific time requirements as well as key issues identified during the interview and negotiation phases.

Financial institutions should require well-defined performance standards indicators, including minimum service level requirements and cures for performance failures in the contract. The contract should allow for modifications in the financial institutions' operation system; otherwise, it is a subscription and not an agreement.

A properly constructed contract will state in transparent language the rights and responsibilities of parties including:

- Timelines and implementation activities and responsibilities – consider existing systems or interconnected systems that may need development.
- Services performed by the technology provider. These include items such as, software support and maintenance and training.
- Obligations of the financial institution – the contracting parties' rights in modifying existing services performed under the contract.
- Cost Accountability – the cost associated with obtaining and maintaining of hardware and software needs. The agreement should list any conditions under which the cost structure changes, including limits on any cost increases.
- Ancillary issues – are there guidelines for adding new or different services and for contract re-negotiation?

The contract must also clearly state:

- Fees and costs for all services, including any development, conversion and recurring services.
- Charges based upon volume of activity and for special requests.

A typical vendor contract includes obscure legalese, which holds some vendors less accountable. In other cases, some vendors will sell a substantial block of consulting hours, but a weak service level agreement. Thus, money is wasted if the financial institution uses those service hours to fix problems. During negotiating, a financial institution must have foresight and consider these types of variables that may arise after conversion.

Aside from securing favorable pricing, financial institutions must negotiate vendor performance standards, a critical component to any agreement. Often this is done in the form of a codicil to the contract. A critical provision is the provision limiting liability. Some vendors commonly seek to limit its liability for the products and services offered. Frequently, a vendor disclaims special, indirect, incidental or consequential damages.

In certain cases, some vendors will negotiate aggressive contracts designed to limit direct or realized damages. If vendors will not be held accountable for direct or realized damages, a financial institution should walk away from the negotiation process.

The contract review process should be exhaustive. Financial institutions should avoid contracts where:

- The vendor can change terms unilaterally.
- The vendor can change fees without consent.
- The vendor can disclaim liability.
- The vendor has not shared third party documents.

When a conversion team, led by an unbiased consultant, is in place, outlined issues and concerns are most-often avoided making the selection process launch seamless. This approach mitigates surprises and saves organizations money. When a financial institution identifies weaknesses during the sales cycle instead of the conversion cycle, it will save customers/members, management and staff from operational turmoil.

A reputable consultant's duty is to ensure that specific technical/legal language underscores the contracts terms and conditions. Negotiation is not a subscription process; it is an agreement reaching process.

Conclusion

The financial technology market is dynamic and subject to shifting regulations, especially in the age of COVID-19. Transactions in such environments can be both complex and time consuming. Therefore, it is beneficial that a financial institution's negotiating team understands the financial-services industry and how related technologies develop.

The role of the consultant is that of the Sherpa—to expertly guide the financial institution to the top of the mountain. A good consultant will first try to work with existing vendors and contracts in the hopes of negotiating the best terms of behalf of its client. If the vendor is unwilling to budge or is otherwise deemed an obstructionist, it is the consultant who devises a contract exit strategy and then secures a better-suited technology service provider for the financial institution.

When moving through the selection process for a major project, the ultimate objective is to negotiate the best deal. This requires a financial institution to remain focused on its strategic goals, which, in turn, maintains a competitive edge. When a financial institution is searching for the right technology partner, it should render the process predictable. A fair agreement in line with an outlined strategy will preserve expectations.

While there are a number of essential variables to consider, managing the negotiating process properly ultimately saves time and money. The realized savings will eventually benefit customers/members by enhancing the financial institution’s value and quality of service. In the final analysis, negotiation is indeed an art form; a process rewarding the party dedicated to researching and investigating sound solutions. And whereas art appreciation is subjective, the result of a successful negotiation is binary: You either win or you lose.

Sabeh F. Samaha is president and CEO of Samaha & Associates Inc., a consulting group that works collaboratively with Financial Institutions to help improve business processes by optimizing efficiency and increasing revenue opportunities. Whether it is vendor contract negotiations, system conversions, or mergers, Samaha Associates understands what gets the job done from beginning to end. Sabeh can be reached toll-free at (855) 772-6242 x2020, sabeh.samaha@ssamaha.com or www.ssamaha.com.