Tail Spend Management in Financial Services

Executive Summary

For procurement departments in financial services, risk mitigation is as important as cost control. Given that tail spend—another name for low-value, unmanaged spend—constitutes up to 90% of an organization's spend by volume, it represents a significant source of risk. For this reason, procurement in financial services stands to gain from adopting a robust tail spend management strategy. Further, the trend toward large-scale digitization in financial services provides incentive for procurement to be early adopters of digital solutions.

Introduction

In many respects, procurement departments in banking, insurance and asset management perform the same function as their counterparts in other industries. They are tasked with delivering value to their organization by strategically managing supplier relationships. At their best, they are beacons of innovation for the entire enterprise.

But all industries have unique procurement needs, and financial services is no exception. Few industries handle such a high volume of sensitive consumer information. Few industries must contend to the same extent with fraud, money laundering and malware attacks. And few other industries face regulatory structures as exacting and malleable as those that govern finance (e.g. Basel III, GDPR, NY DFS). Thus, the stakes for failing to strategically manage the entirety of a financial organization's suppliers, not just the 20% that represent the core of their annual spend, are high.

For these reasons Fairmarkit reviewed the challenges facing procurement departments in financial services, and found that financial services institutions, in particular, should strategically manage their spend from head to tail.

Where Financial Services Stands

Proxima's annual procurement report provides a good view of the landscape. It helps to situate a rapidly changing industry within a field of trends and developments.

According to the survey, procurement in financial services is, and will remain, most concerned with mitigating risk. This is in large part due to unstable markets, the worsening trade war with China and the rapid adoption of new, untested technologies. The survey respondents anticipate risk mitigation will only increase in importance in the following years (more on this later). As a result, compliance was rated as more important than innovation.

As it stands, procurement in financial services has the lowest degree of automated processes. This may change in the coming years, as procurement professionals were the most likely to believe that automation will prove a source of stable, long-term cost savings.

Many anticipated procurement developments hinge on the adoption of new digital technologies. More than other industries, professionals in financial services answered that technology is important to their future plans. As many as 88% of respondents answered that digital technologies are a central part of their five and ten year strategies.

The success of these initiatives, however, will depend on the level of support procurement can garner throughout the rest of the organization. This support—or the perception of support—is particularly low in financial services. Proxima found that only 35% of respondents believed that their initiatives were helpful to company-wide strategy, and financial services reported the lowest level of executive support among all surveyed industries.

Further, financial services reported the lowest level of satisfaction with supplier relationships at 35%. It should be no surprise, then, that financial services was more likely than any other industry to prioritize supplier visibility. This means that more employee hours will be spent negotiating with vendors, vetting proposals and assessing risk than devising a tenable long-term strategy.

These numbers should be taken with a grain of salt. They are projections and assessments, not prophecy. But these numbers provide a sketch of where procurement in financial services is, and where it is likely to go. The report suggests financial services is an industry that sees the benefits of a digital strategy but unable to gain support for a full-bore transformation. It suggests that many hours are going to be spent building a map of tier-n supply chains in order to assure compliance and mitigate peripheral risk. And it suggests that risk management will take a place alongside cost control as procurements most important task.

How Procurement Distributes Its Spend

In order to understand how a sound tail spend management strategy will benefit financial services, it's important to understand industry wide trends in spend distribution. Knowing these patterns can help you spot anomalies in your own spreadsheets and hone long-term strategies.

Although much has changed in the years since the 2007 financial crisis, financial institutions' spend breakdown has remained relatively consistent. Information Technology and Telecommunications are still the largest single area of spend, roughly equal to their pre-crisis levels at 30% of an organization's annual spend. Industry specific spends such as ATM equipment and maintenance, armored cars, transfer and clearance services, record keeping, market research and other banking services represent another 20-30%. And real estate, facilities, sales and marketing and other miscellaneous expenses represent the final 35-50%, with variation depending on the size and niche of the organization.

For a medium sized company, any one of these spend areas could include transactions with several thousand suppliers.

What this means is that any financial institution's spend is distributed across an unwieldy array of suppliers and vendors, many of which don't have analogues in other industries. To make matters more complicated, a single spend category, such as IT, can fracture into many sub-categories (e.g. cloud computing, data storage, privacy compliance, security, app and online service development). This supplier sprawl can be the source of headaches. It can drain valuable internal resources and introduce risk.

Reducing Risk

The complexity of procurement in financial services has demanded a time-intensive management style. One solution to maximizing value and oversight in these areas—a potentially herculean effort for departments already facing a talent shortage - has been to outsource procurement to third-party agencies. But every intermediary introduces risk, and as the Consumer Financial Protection Bureau has made clear, work may be outsourced, but liability may not. **Supplier risk is your risk.**

Procurement departments in financial services are therefore tasked with producing short-term value through strategic sourcing, as well as hedging against long-term losses incurred by compliance violations or haphazard supply chain management. Emphasis in financial services procurement has shifted accordingly from cost control and value production to risk mitigation. According to a 2018 Deloitte study, 81% of financial services CPOs surveyed believed that reducing risk is now procurement's greatest responsibility. There's no reason, however, why value production and risk reduction need be mutually exclusive. With new technologies available, the most successful procurement departments will continue to deliver cost savings while minimizing risk, all with less effort than their competitors.

Using Data to Tame the Tail

Data is essential to all aspects of financial services. It informs whether or not loans are granted, how insurance is priced and which assets are purchased and sold. If data ensures competitive advantage in a financial institution's core area of business, there's no reason not to treat procurement data with the same degree of respect.

Yet, according to an ATKearney study of procurement in the financial services industry, "The more remote a sourcing category is with regard to the core business, the less attention is given to capturing quality procurement information." Deloitte's annual CPO survey confirmed this observation. The firm found that 65% of procurement leaders hav[e] limited or no visibility beyond their tier 1 suppliers." To use a metaphor, it can be easy to lose sight of the tail as it recedes from the body.

These sourcing categories may be remote, but they are by no means insignificant. According to McKinsey, the tail can represent over 90% of a financial institution's total supplier base. Organizations minimize the value of this 90% at their own discretion. A strategically managed tail can result in savings of 7-12% and improved operational efficiency of up to 30%. An unmanaged tail can erase gains and invite unwanted intervention.

Accurate data on this 90% of suppliers is the key to creating value through competitive bidding, vendor consolidation and other best practices. For financial institutions, specifically, this data offers an opportunity to identify risks at an early stage, to optimize work flows and cultivate agility in an area of the business prone to sprawl.

In short, finding sources of value requires visibility throughout the procurement cycle. It requires the right data to grant sourcing departments insight into their supply chains and guide management strategies.

Harnessing the Digital Revolution

Actionable data has traditionally taken time and effort to collect and organize. It was the result of diligent, patient work. The good news is that data collection doesn't have to paralyze procurement departments any longer. New, digital tools exist to automate the collection of procurement data.

From fintech disruptors to end-to-end sourcing platforms, procurement departments now have a range of tools at their disposal. But digital adoption in financial services procurement remains low. According to SAP Ariba's 2018 procurement survey, 83% of respondents across industries agreed that transformations in the digital landscape will affect procurement in the coming years. However, only 5% of respondents had highly automated processes. In contrast, Deloitte found that, within financial services, procurement leaders were twice as likely to declare the importance of data protection and cyber security, and the industry has emerged as a leader in automated solutions for digital procurement and supply chain transparency.

In financial services, if your organization isn't leveraging digital tools to drive procurement, you competitors likely are.

If you're interested in more information about how Fairmarkit's Tail Spend Management Platform can help organizations in financial services, we'd love to speak with you. Contact emma@fairmarkit.com.

About Fairmarkit

Founded in 2017, Fairmarkit is a Boston-based, tail spend management software. Fairmarkit's SaaS platform is tail spend centric, allowing business to strategically manage their small to medium sized purchases. Fairmarkit automates the control and optimization of tail spend purchases by streamlining and simplifying processes, yielding greater efficiencies and savings of 7-12%.