How to Raise Your Contract Negotiation IQ

Uncovering the High-Performing Financial Opportunities in Your Vendor Contracts

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Contract Negotiation IQ

Community banks and credit unions can manage upwards of 200 different technology vendors with 30 high-dollar contracts representing 80% of all technology spend. The velocity of most contract renewals range between three and seven years. Some contracts even commit financial institutions to a 10-year obligation. Contract managers, technology managers and financial executives are faced with a never-ending cycle of contract renegotiations or a decision to end a vendor relationship and pursue greener pastures with a new vendor.

To achieve high-performing financial and operational outcomes, banks and credit unions require a strong "Contract Negotiation IQ." This form of intelligence is an organizational embodiment and not limited to a few key staff focused on contract renegotiations. A negotiator with a strong Contract Negotiation IQ knows how to:

- Effectively leverage time (often 12 months or more) in negotiations with vendors
- Obtain fair and competitive pricing
- Secure clear and measurable contract terms for service delivery
- Hold the line in a confident, firm, professional and fair manner

Obtaining competitive pricing may put a bank or credit union in a temporarily adversarial position with its vendors, so knowing when to trust a vendor to provide accurate pricing is a trait of an individual with a high Contract Negotiation IQ. However, aggressively negotiating the right contract terms, conditions and pricing is essential to ensuring the financial institution meets and exceeds its performance and financial goals.

At Cornerstone Advisors, we strive to always deliver "Cornerstone-Grade" pricing, which reflects the most competitive negotiated pricing results available—results based on Cornerstone Contract Vault proprietary data plus the cumulative experience of more than 2,000 vendor contract negotiations. Cornerstone-Grade pricing is a critical component of Contract Negotiation IQ.

There is substantial money at stake. Consider that a credit union with $5 billion in assets could spend more than $20 million annually on technology contracts. While the amount spent on technology varies by institution, financial institutions invest millions of dollars each year, and it is imperative that they make smart decisions to get the most from their technology spend (Table A).

Aggressively negotiating the right contract terms, conditions and pricing is essential to ensuring the financial institution meets and exceeds its performance and financial goals.

Table A: Technology Spend in Banks and Credit Unions

2023 Technology Spend as a % of Assets and Dollars

	Banks Median Assets: \$2.28B (\$240MM – \$26B)		**Credit Unions** Median Assets: \$1.74B (\$420MM – \$11B)	
	% of Assets	**Spend**	**% of Assets**	**Spend**
25th Percentile	0.163%	\$1,630,000	0.295%	\$2,950,000
Median	0.257%	\$2,570,000	0.419%	\$4,190,000
75th Percentile	0.321%	\$3,210,000	0.562%	\$5,620,000

Source: Cornerstone Advisors Performance Vault

Financial institutions that are well prepared for contract renegotiations employ best practices such as starting negotiations as early as feasible and using Cornerstone Contract-Grade pricing. This study will illustrate that far too many institutions are not paying enough attention to contract timing and pricing, needlessly ceding more money to the vendor community, and provide insights into leveling the vendor playing field by improving Contract Negotiation IQ.

To discover how FIs are managing their contract renegotiation process, in June and July 2023 Cornerstone Advisors conducted a national survey of executives and senior staff from 121 community banks and credit unions focused on contract negotiations. In this report we compare results with our previous survey in 2021 to identify trends. This year's report will highlight the attributes that contribute to a strong Contract Negotiation IQ and how FIs can take specific steps to optimize contract renegotiation opportunities with their vendors.

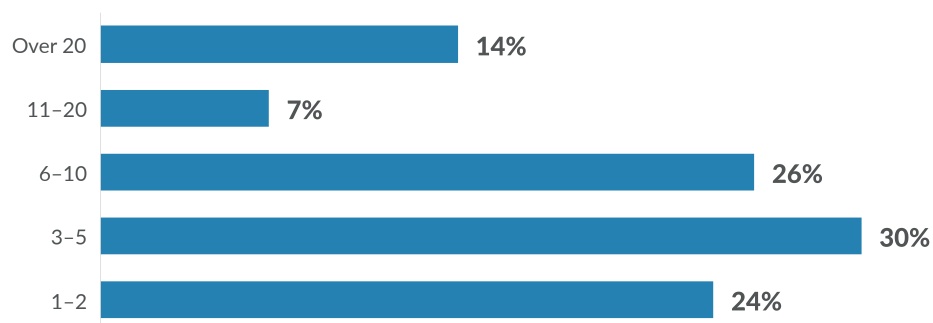
Time as a Negotiation Lever

Time is one of a negotiating financial institution's most powerful assets. One of the quickest and surest ways for a bank or credit union to boost its Contract Negotiation IQ is to start any negotiation far ahead of a contract's termination date. If the institution does not have time to find and convert to a competing system when negotiations with the incumbent vendor begin, it is ceding considerable leverage to the vendor.

Nearly one in five financial institutions negotiate 11 or more contracts each year. That's almost one contract per month! Because some contracts can significantly impact an institution's operations, an insightful review is needed to ensure optimal financial performance, regardless of the volume of contracts renewed. While the details of contracts vary, significant effort is required for institutions to ensure they are optimizing their contract renewals for the most beneficial pricing, service, roadmap commitments and capabilities. (Figure 1).

Figure 1: Volume of Annual Contract Renegotiations

In a typical year, how many vendor contracts does your bank or credit union renegotiate?



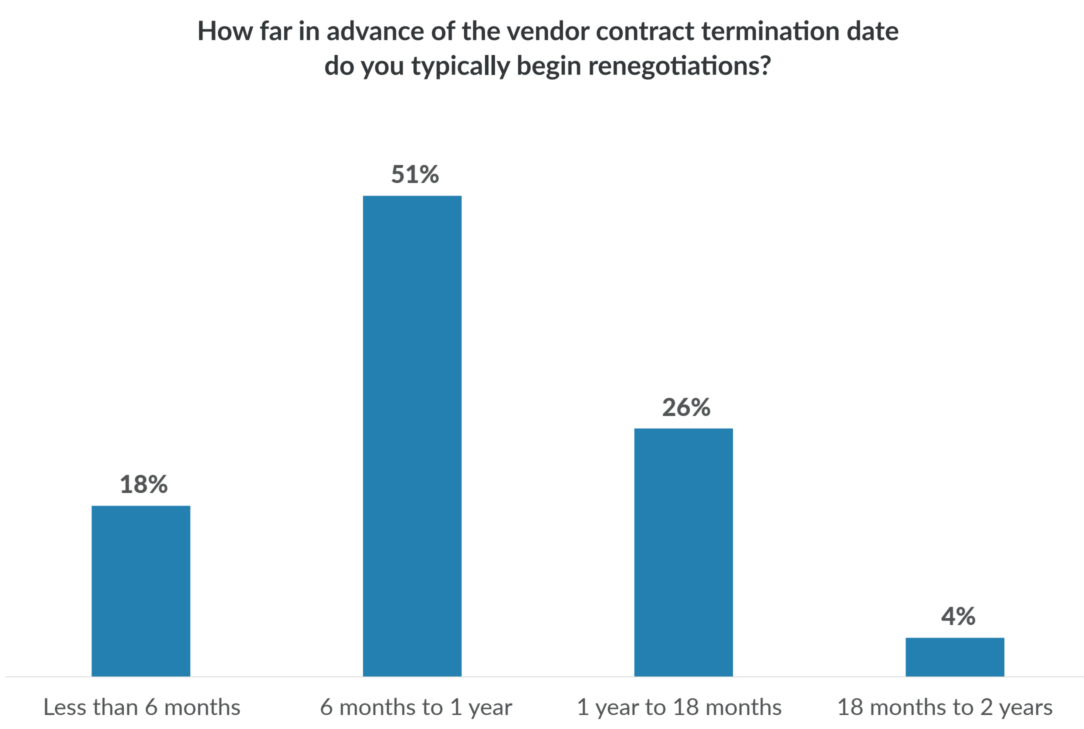
Source: Cornerstone Advisors survey of 121 bank and credit union executives and senior staff, June-July 2023

Since Cornerstone's last survey, contract negotiators at banks and credit unions have shown slight improvements in negotiation leverage by providing adequate time to renegotiate a contract. In 2021, 21% of contract negotiators started a renegotiation less than six months before termination. In 2023, this number improved to 18%, demonstrating a shift away from "emergency reaction mode" and into improved Contract Negotiation IQ.

If the incumbent vendor knows the institution has no time to switch vendors before the current contract terminates, the institution has lost most of its renegotiation leverage before the game has even begun.

This year, more banks and credit unions chose to renegotiate contracts in the six-to-18-month range compared to 2021, when more than half of institutions selected that timeframe. This is suitable for some contracts, but when an institution is converting to a new vendor, it's much too short a timeframe to successfully explore and then implement critical systems such as core or digital delivery (Figure 2).

Figure 2: Advance Timeline for Contract Renegotiations



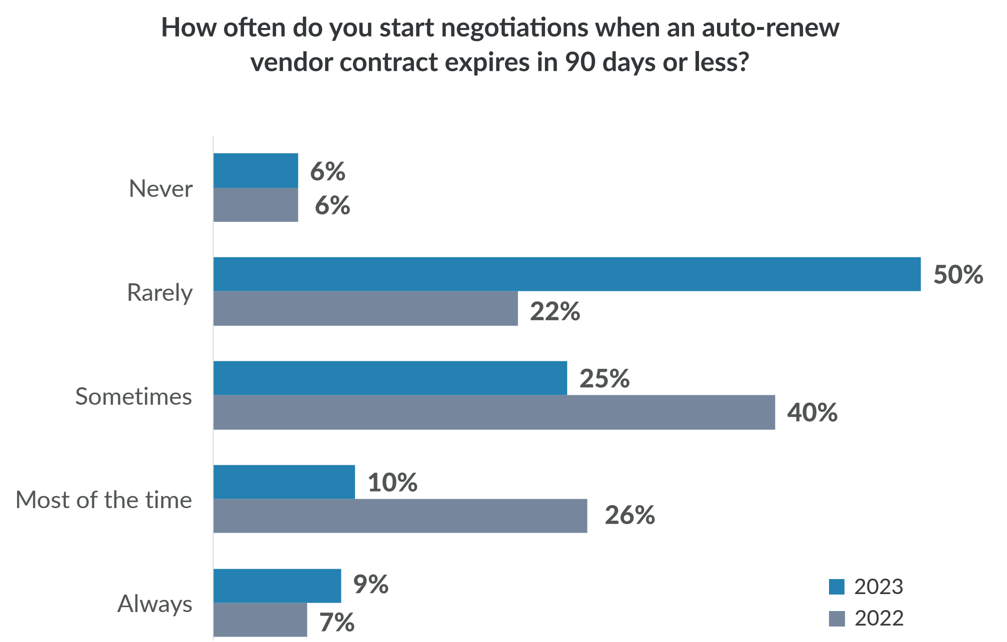
Source: Cornerstone Advisors survey of 121 bank and credit union executives and senior staff, June-July 2023

High Contract Negotiations IQ banks and credit unions recognize that time is their strongest asset during negotiations. Time is essential to provide the institution with the ability to consider and select a new technology partner. If the incumbent vendor knows the institution has no time to switch vendors before the current contract terminates, the institution has lost most of its renegotiation leverage before the game has even begun.

Additionally, financial institutions should not allow vendors to delay their efforts to begin negotiations. Vendors know why a bank or credit union wants to start renegotiations early, and many will do their best to thwart those efforts with foot-dragging, questionable "resource shortages" or even suspicious "renegotiation policies."

A noticeable, positive change in behavior is how fewer banks and credit unions are waiting until the last minute (90 days or less) to start contract negotiations with a vendor when an auto-renew is at play. In 2021, 33% of institutions were either "most of the time" or "always" waiting until 90 days or less. In 2023, this number dropped to 19%, with more than 50% of participants now in the "rarely" category (Figure 3).

Figure 3: Financial Institutions Negotiating with 90 Days or Less (2021 vs. 2023)



Source: Cornerstone Advisors survey of 121 bank and credit union executives and senior staff, June-July 2023

An improved awareness of how time is a key contributor to a financial institution's leverage occurred from 2021 with 23% fewer institutions "rarely" starting a renegotiation with 90 days or less until termination. Though the trend is in the right direction, 44% of banks and credit unions "sometimes" and "always" waiting until the last 90 days to negotiate is still far too high. These institutions are in emergency reaction mode and have very little leverage to negotiate. Allocating time to negotiations is a choice to keep or give away opportunity cost. Financial institutions that allocate sufficient time gain leverage. Without leverage, a FI loses the opportunity to optimize its contract pricing.

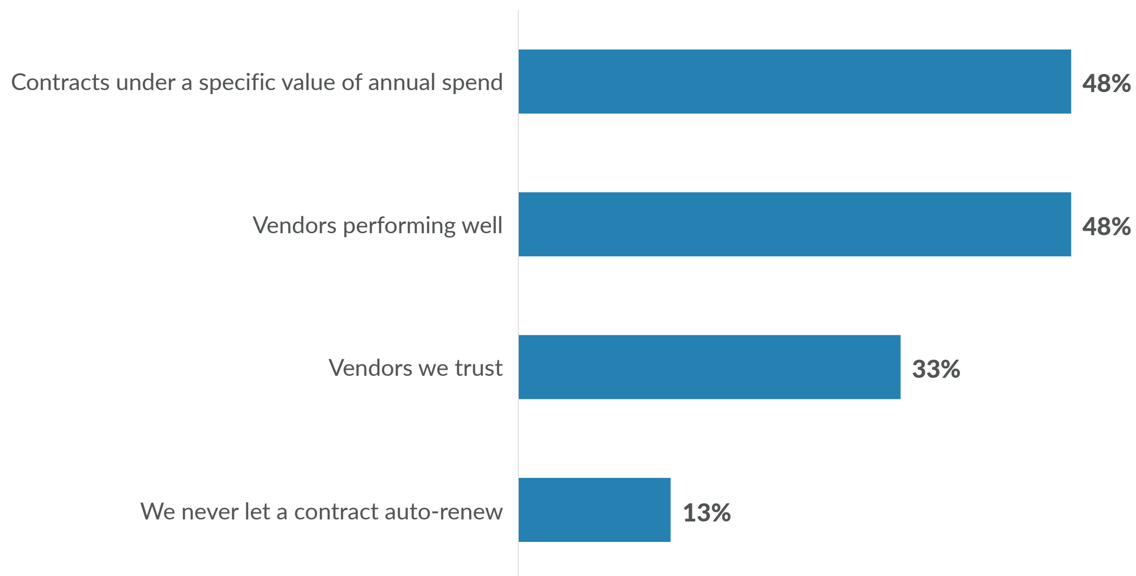
Financial institutions with a strong Contract Negotiation IQ utilize this leverage to select another system or obtain better pricing with their current vendors. An institution that wants to make strategic changes to support its digital transformation strategy, for example, will need to ensure sufficient time is allocated to the negotiation process. Institutions with a high Contract Negotiation IQ ensure they have a longer runway for vendor selection and negotiations.

Vendor Trust and Price Awareness

Many banks and credit unions consider the quality of the relationship a critical factor when renegotiating contracts with a vendor. An attribute of a healthy vendor relationship is the perception of trust that the vendor is delivering on its commitments. A third of institutions surveyed allow a contract to auto-renew when they trust the vendor, and nearly half allow an auto-renewal when the vendor is performing well. The same percentage applies to auto-renewals when the contract is under a specific dollar size (Figure 4).

Figure 4: Conditions to Allow a Contract to Auto-Renew

Which of the following conditions do you typically allow to auto-renew?



Source: Cornerstone Advisors survey of 121 bank and credit union executives and senior staff, June-July 2023

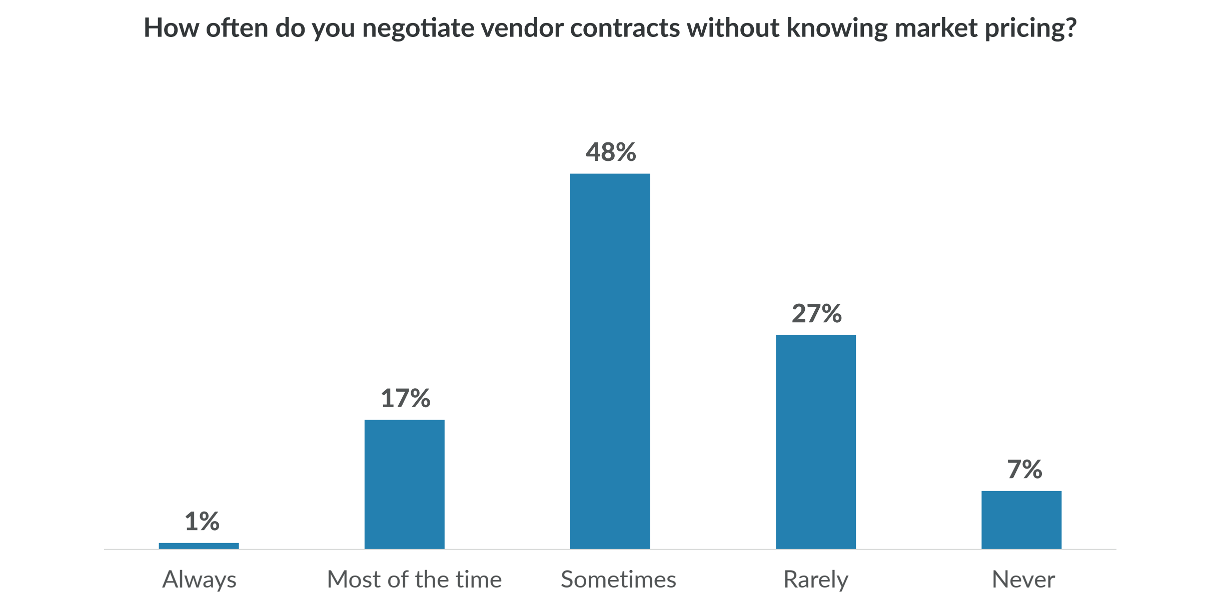
At Cornerstone Advisors, we see too many financial institutions allowing emotion to guide the decision-making process regarding auto-renewals. An institution that has limited resources to devote to every contract renewal leaves money on the table or misses opportunities to achieve the best service levels and business terms. Trust and vendor performance play a role in the overall FI/vendor relationship, but too much is at stake to let those factors override common sense in ensuring the next several years' experience with the vendor are structured in the institution's favor.

The Power to Know

The confidence to face off with a vendor and secure the best pricing requires a high Contract Negotiation IQ. Vendors are counting on clients' lack of knowledge of competitive pricing. In most cases, the account manager and everyone up the vendor management chain are compensated to maximize the contract revenue value. That comes at the financial institution's expense.

Unfortunately, few institutions have the Contract Negotiation IQ to know Cornerstone-Grade pricing. In 2021, 26% of institutions said they got fair pricing for a contract renegotiation "always" or "most of the time." But this number is on the decline. In 2023, this level of confidence dropped to 18%, and nearly half claimed to know the market price only "sometimes" (Figure 5). Good news for vendors, bad news for financial institutions! Considering that 83% of credit unions and community banks have little to no knowledge regarding the current state of pricing for a contract renewal, it can lead to a slow and steady drain on earnings.

Figure 5: Frequency of Knowing Market Pricing



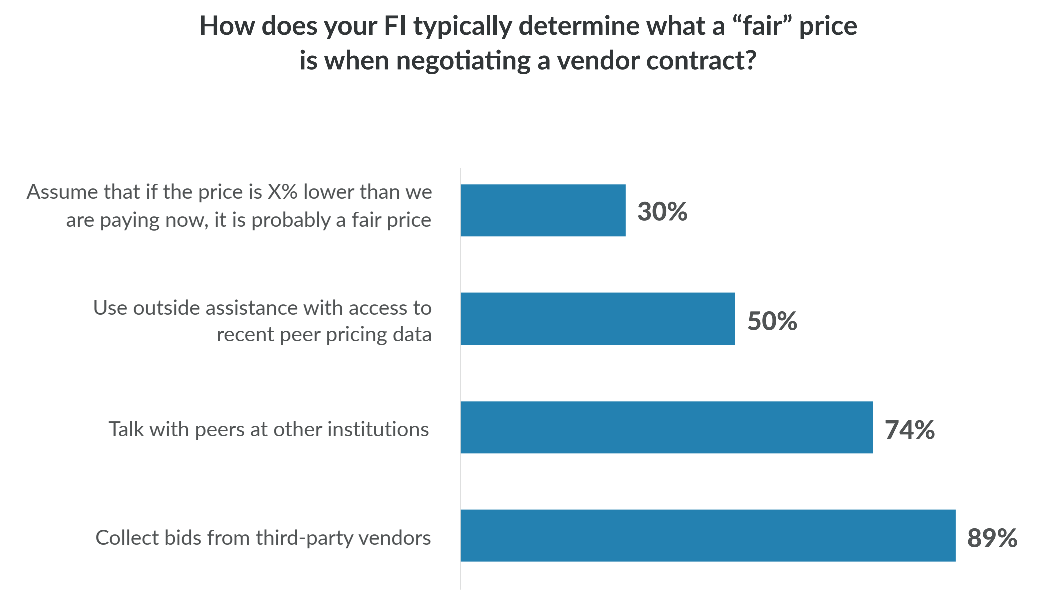
Source: Cornerstone Advisors survey of 121 bank and credit union executives and senior staff, June-July 2023

It is troubling but not surprising that the knowledge of market pricing has slipped as it is a challenging and time-consuming process to obtain reliable pricing data. Plus, the number of active vendors is growing daily, particularly in the digital arena, making it increasingly difficult to find sources of recent, proven pricing information. Many financial institutions put out bids to multiple vendors to troll for prices. While infinitely more effective than guessing what the discount should be, the risk of this approach is that all vendors can easily see it coming and provide a list price proposal that is not reflective of competitive conditions. This approach weakens an institution's Contract Negotiation IQ.

The practice of fishing for bids ("kicking the tires") is a simple but flawed method of obtaining competitive pricing for services. This approach leads to inflated pricing from vendors. In 2023, 89% of institutions used this pricing strategy, a 21% increase over 2021.

Asking a peer at another institution has seen a 19% growth since 2021 with 74% of respondents using this technique to ascertain market pricing. The "phone a friend" model comes with challenges as most contract pricing is protected by nondisclosure agreements, and contract details such as asset size, account and transaction volumes and bundled pricing vary greatly among firms, making it a less than ideal model for assessing a fair contract price (Figure 6).

Figure 6: Knowing You Got a Fair Contract Price



Source: Cornerstone Advisors survey of 121 bank and credit union executives and senior staff, June-July 2023

At Cornerstone we witness few organizations negotiating the volume and variety of vendor contracts to obtain fair pricing on their own. Financial institutions with the highest Contract Negotiation IQ use outside assistance to gauge the true market price of a vendor's product or service. For major contracts, failing to take advantage of Cornerstone resources typically results in inferior pricing and contract terms.

Nearly 60% of bank and credit union executives are not confident in their ability to obtain the best service delivery and price reductions.

Confidence

Financial institutions with a high Contract Negotiation IQ know their strengths and weaknesses. Executives surveyed for this report shared their level of confidence about negotiating with vendors on two key attributes: obtaining price reductions, and improved service delivery in the negotiation process. Many institutions lack knowledge of the correct requirements for service level agreements or for the appropriate penalty to ensure vendor accountability. Nearly 60% of bank and credit union executives are not confident in their ability to obtain the best service delivery and price reductions (Figure 7).

Figure 7: Confidence in Your Organization's Negotiation Abilities

Source: Cornerstone Advisors survey of 121 bank and credit union executives and senior staff, June-July 2023

Vendors can smell a lack of confidence in a negotiator a mile away, and they will use that knowledge to their advantage. Community banks are 5% more likely to be confident in this category than credit unions, and perspectives differ based on leadership position. CEOs, CFOs and COOs were less confident in their staff's ability to obtain price reductions. Executives should keep the traits of confident negotiators in mind when assessing their negotiations team. Confident negotiators:

- Know exactly what price to request from a vendor because they have done the research
- Are not afraid to get into a temporarily confrontational negotiation with a trusted or beloved vendor
- Control their emotions and undergo fact- and data-based negotiations
- Do not let contracts auto-renew because they know they can gain improvements even with small-dollar contracts
- Are firm but fair, bolstered by up-to-date market research

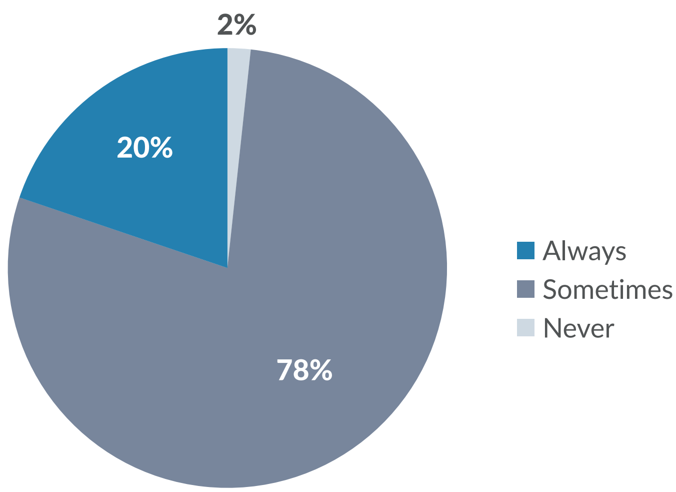
Roles aligned with vendor management and technology management were more optimistic in their capabilities to confidently obtain the best possible pricing from a vendor. To raise the Contract Intelligence IQ of an institution's team, better access to timely market pricing information is critical. This underscores the value of using an outside expert with knowledge of the market for each vendor.

Seeking Clarity in Contracts

At Cornerstone Advisors, we believe in the power of knowledge to drive efficiency in banking, and we salute the 98% of institutions surveyed for this report that said they sometimes or always use a third party to negotiate various contracts. Only 2% choose to never engage an expert (Figure 8).

Figure 8: Engaging External Assistance with Contract Negotiations

When negotiating a vendor contract, do you engage a third party or expert to assist you?

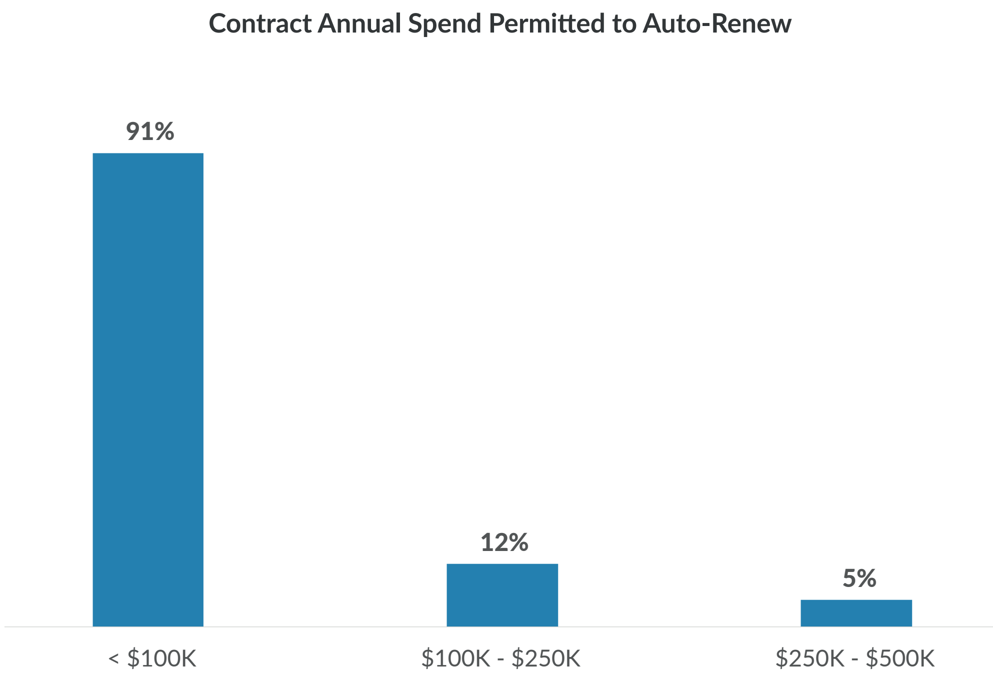


Source: Cornerstone Advisors survey of 121 bank and credit union executives and senior staff, June-July 2023

Contracts are not getting simpler, and conditions in the fine print like annual price increases tied to measures such as the Consumer Price Index caught many financial institutions off guard this past year on the heels of historic high inflation. More than half of institutions in this year's study reported annual price increases ranging from 3% to 7%. The adage, "What you don't know won't hurt you" does not work in contract negotiations. Many banks and credit unions are unaware of how annual price increases are applied and the compounding, negative effect they have on the bottom line. The right knowledge is power, and only with this knowledge can financial institutions hope to raise their Contract Negotiation IQ.

The auto-renewal of contracts is a vendor's preferred outcome. While vendors pass on their preferred pricing, buried beneath the pricing proposal may be terms and conditions that are less than favorable for the institution. There is an inflection price point that matters when it comes to auto-renewals. More than 90% of credit unions and community banks in this survey will allow a contract under $100,000 in annual spend to automatically renew. Between 5% and 12% of institutions consider contracts between $100,000 and $500,000 an option to automatically renew (Figure 9). No institution in our survey allows a contract over $500,000 to auto-renew.

Figure 9: Allowing Auto-Renewals by Annual Contract Dollar Value



Source: Cornerstone Advisors survey of 121 bank and credit union executives and senior staff, June-July 2023

Allowing a contract to auto-renew allows a vendor's often-complicated, one-sided contract language to promote less than ideal business terms and conditions into the future. Institutions with a higher Contract Negotiation IQ will be on the lookout for terms and conditions such as these:

- Annual cost of living increases
- Limitations of liability
- Timing of payments to the vendor
- Early termination penalties
- Cost of deconversion
- Ability to contest an invoiced amount

Even small contracts can be wildly overpriced. Renegotiating several low-dollar but overpriced contracts can generate measurable improvements to the financial institution's efficiency and overall returns.

Conclusion

The vendor community is counting on financial institutions to be lax about raising their Contract Negotiation IQ. The preparation and approach to renegotiations of vendor contracts makes a significant difference in what FIs pay and the services they receive.

"The measure of intelligence is the ability to change" was a quote by Albert Einstein who, if he ran a bank or credit union, would likely urge his employees to seek change to deliver improvement. An institution that is not changing is not growing. And if it is not growing, it is not being intelligent.

Change can be difficult, but the investment to improve contract renegotiations will deliver returns for years to come. High Contract Negotiation IQ financial institutions will:

- 100% insist on **never** entering a contract negotiation with **dated** or otherwise poor pricing knowledge
- Start negotiations early enough to **maximize leverage** and put pressure on the vendor
- Build trusting, mutually beneficial vendor relationships but **use hardnosed negotiations** to provide the guardrails to protect the institution and separate roles and responsibilities
- **Prioritize resource allocation** to the biggest contracts but not lose track of the fact that small-dollar contracts can become large-dollar contracts over time without proper planning and negotiations
- Know their strengths and **utilize Cornerstone Advisors** to bolster their weaknesses
- Identify the appropriate responsibilities of internal negotiators along with the right balance of external expertise to **obtain optimal efficiency**

Institutions with a high Contract Negotiation IQ know how to 1) obtain **accurate Cornerstone-Grade pricing**, 2) time negotiations to **maximize negotiation leverage**, and 3) ensure the **vendor is accountable** for service delivery.

About Cornerstone Advisors

After more than 20 years in this business, Cornerstone Advisors knows the financial services industry inside and out. We know that when banks and credit unions improve their strategies, technologies and operations, improved financial performance naturally follows. Because we live by the philosophy that you can't improve what you don't measure, we help financial institutions use laser-focused measurement to develop more meaningful business strategies, make smarter technology decisions and strategically reengineer critical processes.

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Have questions regarding this report?

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