By Debbie Shatz

Maintaining a **Vendor Relationship**

You've selected your product, negotiated the contract with the vendor, implemented the system within your organization to rave reviews and are sitting back thinking it's all over. Instead, it is really just the beginning.

The relationship between an organization and its vendors adjusts once the implementation is complete—but it should never disappear. If anything, the relationship is more important post-implementation, once the constant contact during the implementation process is no longer needed. This phase of the relationship needs to be active and ongoing. It is the responsibility of the lender/client to ensure it doesn't become too passive.

With the increasing transformation of many information technology (IT) departments from being development-focused to being increasingly focused on vendor management with a related dependence on the vendor's services, the relationship between these entities takes on growing importance and influence over the organization's success. This column identifies some recommended best practices for maintaining this key relationship. The practices listed here are not only intended to retain an open line of communication between entities, but to enable a lender to stay attuned to any potential changes in the respective vendor, its products or position within the industry.

Having such a relationship to rely on is critical during the current credit crisis, as it is not only lenders that are going bankrupt, merging or changing their focus. There is a similar impact being felt throughout the vendor community.

At the end of 2007, Austin, Texas–based ARC Systems announced it was closing its doors after unsuccessfully searching for a buyer, and earlier in the year Irvine, California–based Portellus Inc. announced its exit from the mortgage industry.

Other vendors, such as Livonia, Michigan–based Dynatek Inc. and components of Minneapolis-based Fair Isaac Corporation's mortgage division, have been sold over the past year to be integrated into their purchasers' operation. These departures and the noted consolidation are just a small part of the changing landscape in the vendor community.

The end result of all this transformation and the operational changes and/or products to be introduced/retired/modified is unknown. This uncertainty adds a level of risk to any organization with dependence on its vendors, the vendor's products or its performance. An added awareness is needed to mitigate these risks.

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The dependence any organization has on a particular vendor will influence the extent to which the following practices are relevant or should be followed. The greater your dependence on a vendor, the greater your need for awareness about that vendor, its marketplace position, your relationship, the respective product and any related industry developments.

1. Identify your vendors. Maintaining a consolidated list of your vendors and service providers is always a valuable exercise, as many relationships are scattered throughout the organization among various business and technology units. Understanding the relationships you support may provide a previously unseen opportunity to consolidate relationships or provide additional leverage in negotiating new services with your provider.

2. Know the contractual highlights. Many organizations will file the contract once negotiations are completed, without taking note of the highlights and key parameters of the agreement. These key contractual parameters should be extracted and kept for easy reference on an ongoing basis, including the location of electronic and paper versions of the agreements, should they be needed in the future. The easy reference guide for the contract terms should include parameters such as:

- specified service levels and the related penalties;
- minimum purchase requirements;
- contractual terms, renewals and any guidelines for either party to exit the agreement, including the relevant required notification periods;
- no-compete agreements/sole-provisioning parameters; and
- information regarding escrowing of the source code—where the vendor stores a copy of the source code with a trusted third party for safekeeping. Parameters include the storage location, contact information, verification guidelines and terms of access.

3. Maintain open communication. While there might be communication among your organizations with the regular use of the product/services, it is important that those responsible for the vendor relationship have regularly scheduled discussions—and not just when an issue comes up that requires that level of involvement. Obviously, the frequency of these discussions should increase for vendors providing critical services or products, and occur less frequently for services around which there is less organizational dependency.

This ongoing communication provides an opportunity to discuss the status of the relationship, performance against any service levels, any issues that have arisen and additional needs that may arise. It provides an opportunity to talk about new products, changes in the industry, your organization's focus and the like. This foundational relationship provides for a stronger perspective from which to note changes in a vendor's status, business direction and/or financial well being, either from the open communication that's forthcoming as a result of the deeper relationship or from noting changes in the tenor, content or direction of these discussions.

4. Leverage the partnership. Having a partnership—not just a generic vendor-client relationship—is something that should be leveraged by both parties. These deeper relationships should provide for more open communication between the parties as well as the shared focus on creating win-win solutions to most issues.

The partnership provides the foundation for both parties to tap the other for industry perspectives and to learn more about the other's business functions. For a vendor, increased understanding of how its product is being used can help the vendor with better marketing, system enhancements and so forth. For the lender, understanding more about the product, how it was created and the intention of particular functionality could enrich the lender's use of the product.

In addition, the lender can gain insights into the vendor market, its competition, and alternative products and solutions that may be available or will be introduced to the market shortly that could better support some aspect of the lender's business activities.

Such a partnership also provides a foundation for discussing financial instability issues for either party. If the lender is having difficulties, renegotiation of specific terms of the agreement for a period of time may be beneficial to the lender in reducing costs while retaining the client for the vendor. If the vendor is the one having difficulties, the lender may consider purchasing the organization (given deep-enough pockets of its own), or purchasing additional services contingent on particular service levels to help the vendor gain stability within a given time period.

5. Maintain documentation. In the rush of daily activity, we often allow ourselves to fall behind on activities such as updating documentation or keeping files up-to-date. Documentation related to all critical systems and the respective vendors should be maintained and updated on a regular basis; this includes legal, functional and technical documentation. In addition, the contractual highlights should be referenced to ensure the documentation received is consistent and timely per the agreement.

6. Validate escrow. In select situations, the contractual agreement may include terms requiring the vendor to escrow or store a copy of the application's source code with a third party. This protects the client in case the vendor fails or encounters other difficulties, providing the client with a basis from which to continue to utilize and support its production system. When escrow terms are included in the contractual agreement, it behooves the organization to verify that the source code stored is not only up-to-date, but is complete and can be used to successfully re-create the application (via compilation and other instructions usually included with the code).

To verify the contents of the escrow in detail, a third party is often tapped to provide a "clean" environment within which to load the software and compile the source code. The vendor should be available to address any issues, but not be directly involved with the exercise, as its purpose is to ensure the client can recover should the vendor not be available at some future point in time.

It is important to note that the compiled product may not completely match the current production version due to infrastructure differences, parameters not being set, and the like, but it does need to successfully create a usable application. The possible differences are significantly reduced or even non-existent if the agreement with the vendor includes the escrow of all client modifications or customizations completed for the organization by the vendor.

7. Increase internal resources. More frequently, support is outsourced to vendors, with only limited technical knowledge being retained in-house. There are risks associated with this approach should there be performance or other stability issues with the respective vendor. These risks can be mitigated somewhat by increasing the internal technical knowledge regarding the application, and/or by balancing the use of internal and external resources to share the support responsibility. With budgets as tight as they are and technical training costs on the rise, this is an area that will require careful consideration and balancing to determine if the organization deems the investment worth the risk mitigation that would result.

Should the worst occur and a key vendor fails or ceases support of a particular product, the lending organization may position itself to pick up selected key resources previously residing with the vendor. It is important to consider the skill set of these resources individually, and not as part of the vendor organization being supported by that infrastructure, when determining the level of support being gained with any hiring decision.

8. Do market research. An ongoing yet important task for all organizations is building an understanding of the products, features and functionality available in the marketplace. This knowledge allows the organization an awareness of available alternatives, and permits the lender to examine and compare available technology options, and to maintain a pulse on the vendor community and the product buzz within the industry. Identification of solutions that can be implemented quickly and easily (potentially as interim measures) should be noted during any market review—particularly if there is concern about the stability or viability of one of the organization's existing vendor relationships.

It is important to note that relationships differ based on prior relationships, experiences, personalities and objectives of the participants. The healthier relationships are those that include honesty, respect and an open exchange of information. Regardless of the type of relationship, it is important that each entity has practices in place to provide protection for its organization by following these best practices, or other similar steps, to ensure continuity and availability of service and functions to support its critical business activities.

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