

FINANCIAL SERVICES – THE CASE FOR IT OUTSOURCING

MARK RYAN outlines the case for financial institutions to outsource

Over the past fifteen to twenty years, fashions in business strategy have come and gone – upsizing, downsizing, rightsizing, optimising, economising. In particular, IT outsourcing has been in and out of favour. While feasibility studies have regularly made compelling financial arguments in favour of outsourcing, the ‘intangibles’ often swayed the decision against proceeding. Indeed in the past, the decision to outsource was often regarded as a sign of weakness – an indication that the organisation lacked the capabilities – rather than a strategic move forward.

In the financial services sector, security and apparent loss of control were typically the main reasons behind the negative thinking. In addition, the argument was made that outsourcing IT was effectively giving up a key competitive advantage. Transferring resources or key information that was regarded as the soul of the bank’s business to a third party was unthinkable. These, along with a number of hidden agendas and fears that Chinese or paper walls would allow a third party access to competitive information, have been the arguments against outsourcing traditional back office or support activities. In the board room, these concerns and to some extent the associated scaremongering almost invariably won the day over the more quantifiable arguments.

Added to these concerns, many of the early IT outsourcing examples were very focused around a simple cost-reduction agenda. As a result, they had limited success and some negative experiences. The disappointments were mainly due to the almost singular focus on cost, and the impact that this had on the underlying relationship between the financial institution and the third party. The contracts tended to be structured and measured in ways that strained the relationship and resulted in adversarial customer-vendor dealings, instead of creating a true business partnership. These types of early examples and the associated problems continued to bolster the arguments against outsourcing.

THE CHANGE IN THINKING

However, over the past couple of years, financial services organisations have again been evaluating their existing operating models, their underlying cost bases, and more importantly, their real core competencies. Some fundamental questions are now being asked about support areas such as IT, HR, finance, and back office administration, that are not core competencies, but that have continued to absorb very significant resources and ongoing management attention over the years.

In addition IT departments themselves continue to face huge challenges: the need to manage costs in a difficult economy, to increase IT efficiency and effectiveness, to align processes better with business priorities, to choose between competing emerging and new technologies, to enable greater enterprise integration, and to launch new IT initiatives that deliver demonstrable business value quickly.

Many financial services organisations are now asking some very hard questions around their IT capability and their current sourcing approach. These include :



Mark Ryan:
Accenture have put rigorous systems in place to ensure data security and confidentiality

- Is there any validity to the 'loss of competitive advantage' argument? Where are the actual examples?
- Is it appropriate to devote significant amounts of management time to non-core decisions (new technologies, selecting solutions, IT delivery, sourcing options, etc.)?
- Will management by contract (that is, partnership with a third party) actually give far better accountability and control than the current management by command (that is, responding to in-house requests), in terms of service levels, delivery, and certainty around costs?
- Are there organisations with whom we can partner who can deliver these services more effectively, provide greater certainty on costs, and remove the management time overhead?

The traditional arguments against outsourcing no longer carry the same weight and emotional significance that they did in the past. In an increasingly competitive and cost-focused world, organisations are now forced to concentrate more and more on their core competencies, such as product innovation, distribution, and credit and relationship management.

A recent British Bankers Association (BBA) survey on the outsourcing practices of over one hundred institutions revealed that 'concentrating management on core activities' was the number one factor (followed by 'greater levels of service standards') in terms of the decision to outsource.

Organisations are realising more and more that if they focus exclusively on the core activities that have made them successful and the things that are clearly good at, and outsource the activities that are more generic or that they are perhaps not so good at, then there is no question but that they will improve their overall business performance.

A Morgan Chambers study (Outsourcing in the FTSE100: The Definitive Study)¹, summarises the outsourcing deals and approaches adopted by every FTSE100 company over the past five years. The aim of this study was to discover exactly what effect outsourcing has on a listed organisation's performance. The study revealed that 56 per cent of the FTSE100 companies outsource in a significant way, and that one third of these contracts were in the area of Business Process Outsourcing (BPO). Financial Services was the biggest sector for this particular form of outsourcing, with approximately a third of all BPO contracts in banking.

The study also revealed a considerable increase in innovative commercial arrangements, with risk/reward agreements up by 71 per cent in the past three years. Most significantly, the study showed that strategic outsourcing increases an organisation's share price by an average of 5.3 per cent. It is results and experiences such as these which have led an increasing number of Irish financial services organisations to revisit the question of outsourcing.

OUTSOURCING HAS COME OF AGE

Outsourcing is no longer viewed simply as a blunt instrument for cost reduction. Today many organisations see it as another important mechanism for improving not just their underlying cost base, but their overall business performance, and thus their shareholder value. Many are now moving to a much more sophisticated outsourcing

approach that involves partnering with third parties in order to create high-performance support operations that equal the best in the industry. This move to a more collaborative relationship has had a significant impact on the value and therefore on the success of these new outsourcing arrangements.

The benefits to the organisations are obvious: reduced management overhead, greater certainty on IT cost base, removal of issues around reskilling staff and upgrading technologies, accountability moved to a trusted partner, and service levels and delivery underwritten by contract in a controlled and secure environment. In short, financial institutions can focus all their energies on making decisions that relate to their core competencies, and allow the third party partner to manage the areas that have been outsourced.

The increased understanding of these relationships is leading researchers such as Gartner to forecast that the only area of significant (double digit) growth in the IT Services sector in the coming years will lie in outsourcing, and that the largest share of this growth will be in Business Process Outsourcing. Gartner forecasts that, between 2002 and 2007, key processes such as IT, HR, finance and administration, and payment services will be increasingly outsourced, with growth in payment services largely due to financial services outsourcing in order to realise cost savings from centralised transaction processing.

At the heart of these new outsourcing relationships is trust. The partnerships tend to be based on sharing both the risks (i.e. standard payments linked to achieving agreed business benefits) and the rewards (i.e. bonuses linked to exceeding targeted business benefits). Results are now measured in improved business performance (e.g. reduced cost/income ratio) and the benefits of this success are shared.

What makes these new outsourcing partnerships different? We can identify six characteristics:

- C-Level leadership and vision (driven from the top)
- A real recognition of what the organisation's core competencies are
- Broader strategic agenda around improving business performance
- Innovative deal structures that motivate both sides to succeed
- Collaboration and trust between the parties
- Clear focus on business outcomes

The old fear of outsourcing is disappearing, as more and more organisations ask searching questions about their business model, their underlying cost base, and their approach to the sourcing of non-core activities.

Outsourcing offers a real alternative. By converting the unpredictable, variable and high costs of many non-core back office activities into a more predictable, fixed (and lower) outsourcing cost, the business proposition has now become compelling. With outsourcing now an industry in its own right, delivering real, measurable bottom-line benefits, the former intangible objections are fading away. Credible outsourcing organisations such as Accenture have put rigorous and auditable systems in place to ensure that the security and confidentiality of data is no longer a concern. Many IT staff in financial institutions now see their transfer to a technology services company as a career opportunity, rather than as a threat to their job. IT Outsourcing has definitely come of age.

¹CW360.com and Morgan Chambers plc, 2001