Enabling Banking Shared Services through Captive or Business Process Outsourcing

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Banks and other financial institutions are facing mounting regulatory requirements and reporting complexities urging investment in systems, resources and infrastructure. This spiraling complexity comes in the face of capital requirements which are becoming far more stringent, forcing banks to rethink their business models.¹
Not only has the change in the regulatory environment facilitated growth in internal processes and technology, the changes have impacted the manner in which banks can generate revenues. Avenues previously open have been changed or are restricted, forcing banks to rethink their business models as they face competitive pricing pressures in trying to drive profitable returns.

In this environment, the ability of an institution to manage costs becomes a premium. One of the primary methods used by banks to manage costs is the expansion of their shared services capability and leveraging their in-house Captive Centers (often offshore). The purpose of Shared Services models being to improve the delivery of cost-effective, flexible, and quality services.

A high-performance Shared Services model helps eliminate redundancy through process and technology standardization. It consolidates and redesigns non-core support functions into shared functions, operating like a business with high focus on client services and cost management.

In our view, banks would find that many of the core issues faced as result of the increasingly complex regulatory environment can be alleviated using a Shared Services model. These include:

- Complex, duplicate, costly and non-standard processes
- Multilayered, top-heavy organization
- Duplicate, siloed and regionalized infrastructure
- Excessive management time spent on transactional activities and not enough on revenue generation and value-add activities
- Disparate data, reporting and many versions of the “truth”
- Staffing to support peak demand periods

Through the implementation and operation of a mature and high-performance Shared Services operating model, banks would be able to:

- Lower location and resource costs
- Reduce working capital
- Reduce staff, processing expenses and systems infrastructure expenses and costs
- Invest in an organizational structure capable of supporting growth
- Standardize processes and systems
- Reduce cycle times for key processes, including daily and month-end close

Upon implementation of a new, strategically placed Shared Services Center in a lower cost location, financial institutions can expect to recognize labor arbitrage benefits within the first one to two years. Although these possible savings are usually realized up front, often many banks fail to reap further efficiencies and savings later in the lifecycle, as the Center is simply a centralized operation and not a fully functioning Shared Services Center. This inability to further increase efficiency and savings could inhibit the bank’s ongoing ability to support growth and control costs effectively.

Institutions should consider that a Shared Services Center is more than just a centralization of services. A shared services structure places great emphasis on “shared” responsibility for end-results and on “service” delivery for very high client satisfaction. Whereas a Captive Center, based on the centralization of services usually follows the parent management structure, with very limited independent control, and efficiencies linked more directly to parent goals.
Find below a summary of the differences between centralized services and shared services:

<table>
<thead>
<tr>
<th>Attribute</th>
<th>Traditional View of Centralized Services</th>
<th>Typical Shared Services</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customers treated as...</td>
<td>End users</td>
<td>Clients (including employees, end customers, vendors)</td>
</tr>
<tr>
<td>Governance</td>
<td>Headquarter (HQ) manager</td>
<td>Independent unit – Client board/Advisory group (organizational construct varies with geographic objectives)</td>
</tr>
<tr>
<td>Location</td>
<td>HQ (typically)</td>
<td>High skill, low cost area(s)</td>
</tr>
<tr>
<td>Primary Focus</td>
<td>Cost control</td>
<td>Service excellence, high performance, cost control, continuous improvement (service and costs)</td>
</tr>
<tr>
<td>Service Responsibility</td>
<td>HQ</td>
<td>Shared between Shared Services Center and clients as stated in service level agreements</td>
</tr>
<tr>
<td>Service Management</td>
<td>Optional</td>
<td>Service level agreements, key performance indicators, performance reporting</td>
</tr>
<tr>
<td>Typical Management Processes</td>
<td>Recruiting, workload and cost management</td>
<td>Performance measurement, continuous improvement, client relationship management, communication, people development</td>
</tr>
</tbody>
</table>

Source: Accenture, October 2015
The implementation of a high-performance Shared Services model can provide a bank with an opportunity to redesign its processes around preferred practices and the effective use of enabling technology, with the goal of helping to reduce ongoing costs over the long term.

An effective Shared Services Center also provides a bank with access to a management team focused on building a high-performance workforce to provide service excellence, which can be a strategic asset for the bank. This should help the bank’s core management retain its focus on clients and key bank growth strategies, while helping to manage operations independently as an effective and streamlined business.

Once the decision is made to pursue a Shared Services model, the key question is:

Should the bank build an in-house “Captive” Shared Services Center or move the operation to a Business Process Outsourcing (BPO) Shared Services Center provider?

The factors to be considered include:

Is the bank properly assessing the impact of its decision with a focus on short or long-term goals?

If the Captive Center is pursued over the BPO Shared Services Center, is the bank pursuing a centralized captive center or the broader fully functioning captive version of a shared services center approach?

Does the financial institution understand all the tangible and intangible costs and benefits associated with the decision?

Experience indicates that over the last 20 years, most banks and financial services institutions have opted for a centralized captive center approach as part of their operating model.

While a direct comparison of Captive Center and BPO Shared Services Center models may lead banks focused on cost reduction to prefer the Captive model, banks are encouraged to take a broader perspective in their decision. It is important they gain a thorough understanding of the operation and long-term opportunities offered by both the Captive Center and BPO Shared Services Center models. Many banks may also be challenged in their knowledge of Shared Services Centers and the demands of running any offshore center entity. This is attributed to the fact that a bank’s core capabilities reside in the front office, and not in managing the daily operations of a Captive Center or a BPO Shared Services Center.

Once committed to a Captive Center model, we have often seen that the focus of the organization usually shifts to short-term cost reduction. This is often captured through immediate labor arbitrage savings obtained by centralizing activities such as accounts payable and record-to-report offshore. Again, banks are encouraged to evaluate if this is the right long-term decision for the bank.

To understand the driving forces behind the decision to use a Captive Center model, a comparison of the acquired experiences and knowledge of running Captive and BPO Shared Services Centers should be performed. To help deliver this, Accenture drew upon its experience with clients’ organizations and the input, insights and perspectives of client personnel from both Captive and BPO Shared Services Centers.

As referenced earlier, a key undercurrent to this comparison are the spiraling cost and stringent deadlines required to address the changing regulatory environment post the 2008 financial crisis. This has encouraged banks to review their operating models and overall cost drivers in order to help increase net revenues and return on equity (ROE). As a result, banks have been looking to Centralized models to help control costs and increase efficiencies and savings. In addition, Federal Reserve recovery and resolution plans are making the setup of service companies in Centralized or Shared Services models attractive to the support of core operational entities. The question remains, should the effort be managed in-house via a captive center or a BPO shared services center arrangement?
In analyzing client decisions to move to a Captive Center in a lower cost location vs. a BPO Shared Services Center, our discussions with clients would indicate that a shift to a Captive Center is often based upon moving to a company-controlled environment rather than a third-party controlled outsourcing center. These clients prefer setting up a company-controlled Captive Center as they perceive it to be a safer control environment and a less risky approach, as they are utilizing their own employees, organizational structure, technology and business processes.

The second factor that plays to clients’ perception of risk, are the types of activities moved to a Centralized or Shared Services model. The clients we spoke with indicated a greater level of comfort outsourcing more traditional, low skilled transaction services such as accounts payable. These types of processes are considered to have more standard practices and lower financial and reputational risk associated with them.

In addition, the criticality of these processes are considered low by regulators who are beginning to publish guidelines as to which functions should be outsourced and how to manage the third party risk associated with the use of vendors. The relative low risk of these activities compares favorably to the controller accounting environments where the risk of error is considered more ruinous. If an operation within a center fails to make a timely vendor payment, it is an issue with temporary repercussions and one more easily addressed than the impact of an accounting error on reported results.

Although comfort appears to be a key driver in a bank’s initial decision to move to a shared services using a Captive model, longer term our experience indicates other drivers outweigh this decision. In some cases, it appears that as a bank becomes more comfortable with a Captive Center and internal organizations accept the Center as an extension of their team, banks begin to transition the Captive Center operations to a BPO Shared Services Center provider.

What is the catalyst for banks to transition from a Captive Center to a BPO Shared Services Center? Does the trigger appear to be related to the financial institution’s inability to capture the ongoing operational benefits of running a Centralized Captive Center vs. a BPO Shared Services Center? Does the Centralized Captive Center provide the most effective method to help meet the institution’s ultimate goal in moving to a fully functioning shared services operation or would they be better served by going directly to a BPO Shared Services Center provider? Let’s assess the core components of such an operational decision.
The Operational Decision

Optimizing operational benefits

As referenced, feedback captured from our client discussions would indicate that they are more likely to build a Captive Center instead of engaging a third-party vendor.

These clients perceive moving to a Captive is a safer, less risky decision than moving to a BPO Shared Services Center.

In our view, one of the largest risks in setting up a Shared Services Center is the initial transition and specifically, the knowledge transfer to the offshore entity. In either a Captive Center or BPO Shared Services Center, both are often transitioning knowledge from onshore tenured resources to primarily new resources. The core issue for banks is identifying the preferred and less risky method to transfer knowledge. From the bank's perspective, it’s a standard move as the knowledge base being transitioned exists within the institution and it’s simply a matter of managing the transition. One cautionary area of concern, however, is the actual transition. Often the actual transition process and effort are underestimated, with banks failing to appreciate that to effectively transition work requires a sophisticated and structured process, which in and of itself, we believe could be considered a “skill.”

One of the first steps to any conversion is to secure desktop level documentation for the roles which will be transitioned. Although financial institutions are required to have process level documentation due to regulatory requirements, it is seldom at the level of detail required to execute a Center transition. To develop the documentation and training process required for a project of this magnitude, a clearly defined project plan and hands-on management of the process is required. This is necessary to identify all activities in scope, develop consistent documentation, certify all results and reach key milestones and the desired end state.

Typically when financial institutions are faced with the challenge of transitioning to a Captive Center, they will often engage a project team composed of bank resources to execute the documentation, training and transition plan. The bank project team often delegates the effort to create the documents to the operational departments whose roles are being transitioned. They leverage current employees to develop and provide the documentation and assist with the transition. This can present a challenge to these bank resources who are still responsible for performing their daily operational roles. This additional activity can lead to inconsistent process documentation and can challenge the target dates for completing the transition.

With respect to the BPO Shared Services Center, a bank is purchasing project managers trained and experienced to perform the transition. A seasoned BPO operation is expected to have established credentials and capabilities from which to draw. This additional activity can lead to inconsistent process documentation and can challenge the target dates for completing the transition.

As a bank pursues a Captive Center, there are other key operational issues which can impact its viability and success. These are resources, culture and organizational hierarchy. Each should be addressed and implemented differently for a Captive or BPO Shared Services Center model.

Resources

Similar to recruiting for any organization, hiring for Captive Center roles can be impacted by the size and reputation of the financial institution or BPO provider. In the offshore environment, BPOs tend to be larger entities, often benefiting from greater name recognition and perceived broader skill development potential for prospective job candidates. That said, the ability of an organization to acquire talented candidates is additionally impacted by the candidate’s priorities, financial situation or developmental goals.
Specifically:

1. **Compensation**

A Captive Center’s compensation, made up of base salary and bonus, tends to be higher than those offered by their BPO peers. This is attributable to the BPO Shared Services Center’s focus on hiring new college graduates and developing talent from within while Captive Centers tend to favor experienced hires. Captives tend to onboard higher ranking resources, creating the perception that their organization is staffed by more experienced people, with deeper skills, but at a higher cost. Captives perceive the higher salary as a means of retaining resources over the long term. This strategy appears to align with the perceived low risk comfort approach. However, this does not in our view necessarily result in a more effective organization than a BPO Shared Services Center team performing the same tasks.

2. **Resource Promotion and Advancement**

The promotion and advancement of resources within a Captive Center organization is often aligned to the bank’s annual performance review period. In comparison, most BPO organizations “we are familiar with” use a quarterly promotion cycle. The impact to the bank is that a Captive may operate with higher salaries, but fewer opportunities and levers to promote staff. If the resource’s priority is financial in nature, this may initially suffice; if the focus is on developing skills, expanding knowledge base, or looking for rapid advancement, potentially not.

Additionally, due to the more frequent opportunity for advancement in a BPO Shared Services Center model long term, there is the potential that salary levels between the BPO and Captive may move closer as the BPO associates advance more rapidly.

3. **Resource Turnover**

One would expect a Captive Center’s higher salary structure would result in lower average attrition rates, and lower turnover and retraining costs than their BPO peers. In our experience that isn’t necessarily the case, as variances occur across locations and industries supported. Generally, in our experience with clients, regardless of model, the situation appears to follow normal resource employment patterns where attrition is not driven entirely by salary, but also by factors such as the competitiveness and potential of the labor market and the career development aspirations of the employees.

It is also our view, even as Captive Center resources become more tenured than BPO Shared Services Center resources, the actual resource skillset gap between the two models is narrower than perceived. We believe this is driven by the Captive’s siloed organizational approach, with its limited number of processes and scope. In comparison, larger offshore BPO Shared Services Centers offer their resources broader, multiclient, multiprocess exposure, allowing for a more expansive and robust skill and career development opportunity.

It is commonly recognized, in the offshore environment, that global BPO Shared Services Center’s provide a known avenue for resources to broaden their skill sets and become more marketable “talent.” This also provides the BPO with a more expansive opportunity to drive preferred practices and improvements in comparison to the Captive model, whose resources may be more unlikely to make improvement recommendations given their siloed focus and reduced exposure to multiple approaches.

From this perspective, the BPO Shared Services Center’s operational structure is more conducive to retaining and expanding resources’ breadth of experience. It is common for experienced BPO personnel to transition from one client assignment to another, within the same provider in an effort to further develop their skill set. Also a BPO Shared Services Center’s structure can facilitate the timely transition of resources until replacement resources are available, reducing the risk of knowledge loss due to employee transition. This is often much harder to manage and plan for in a Captive Center when a resource decides to depart or move into a different role. A Captive often has limited size, limited career growth opportunity for its resources, and smaller resource pools that can be leveraged for transition.
**Culture**

Our experience also indicates that the culture of a Captive Center is more closely tied to that of the supported financial institution and is often viewed as an extension of the existing organizational structure.

A Captive Center is viewed as having very little influence within a bank’s operations, with core policy setting and controls retained onshore and beyond the Captive’s control. Additionally, Captives supporting back office bank operations can often be viewed as third class operations. In a banking environment, resources without front office banking experience or exposure are very often perceived as less experienced and knowledgeable, thus commanding less respect within the organization.

For a Captive Center the objective is to provide a centralized center of operations consistent with the existing operating model. With labor arbitrage savings secured, the Captive’s management team can then focus its efforts on delivering quality outputs on budget, on time, using the Captive’s resources. As process change or improvement is not a priority for the Centralized Captive, the opportunity to secure additional cost savings is very limited. In addition, the drive to implement continuous improvements to gain further cost reductions is not typically seen as being a driving force within a Captive Center.

Captive Centers operating under limited governance or service management frameworks naturally inhibit their ability to effectively identify and implement changes and improvements that could drive additional cost savings.

In contrast, initially clients often respond to a BPO Shared Services Center as a vendor and not as a partner. The relationship is dictated by a defined contract with transition and performance measures contractually bound. BPO management usually relies heavily on its experience and discipline around process transition and change management to help meet contracted performance levels and client expectations. This is often reinforced as the contractual focus placed on a BPO is to drive efficiencies and the resulting productivity improvement. This further enhances client satisfaction and benefits the BPO through improved profitability.

It is this pursuit of efficiency and process improvement that helps differentiate a BPO Shared Services Center from a Captive Center. Once a BPO Shared Services Center meets its objectives, efficiency targets and key metrics, its service level agreement (SLA)-driven culture tends to evolve with a focus on performing additional analysis, creating a need for different competencies within its staff. Expanding the scope of activities that can be performed helps elevate BPO resources and the entity’s status among onshore client peers and management. This helps evolve the relationship into one that is eventually partner-based, with the BPO Shared Services Center considered a part of the client team.

**Organizational Span of Control**

Another operational area which impacts the success or failure of a Shared Services Center is the organizational structure and management of the operation.

Although the management hierarchy structure of a Captive Center and BPO Shared Services Center are similar, there is one significant difference impacting the efficiency and cost effectiveness of the operation and that is span of control. Captive Centers characteristically have a narrower span of control than BPO Shared Services Centers’ organizations, leaving Captive Centers with a more hierarchical and expensive overhead structure. In the Captive model, the organizational structure leads to a more tenured resource pool with narrow process-specific knowledge. This does not lend itself to providing the organization with a pool of broadly skilled resources with the knowledge to manage numerous process areas. Instead, it creates a structure which inhibits resource mobility. In addition, when knowledge gaps occur, it requires management knowledge and skills to cover the gaps. This creates an inflexible workforce which is not easily open to change.
The Economic Decision

The preferred long-term investment

The drive to lower costs and increase ROE is critical to implementing a Shared Services model.

The following section explores additional economic issues around which model to choose.

Initial Asset Investment

In addition to the previously discussed intangible and tangible costs associated with the decision (e.g. transition, resources) to set up a Captive Center, there are also “base costs” to setting up and operating an effective Shared Services Center (e.g. facility, technology). This is an area where there are stark differences in the cost effectiveness of a BPO model over a Captive model.

The crux of the issue in our view is a BPO model facilitates the ability to spread the asset investment costs across numerous global clients, far beyond the extent to which a Captive model could leverage those assets. For example, Captives are rarely able to help drive full seat occupancy as do BPOs. Indeed the need to maintain the seat occupancy can become a burden for management over a 3-5 year investment period. Whereas BPO’s can strive to improve seat occupancy, utilizing multiple global clients to cover the 24 hour seat availability.

As an example, in one client situation reviewed, the financial institution had invested in the setup of two separate Captive Center locations. When faced with an economic downturn in business, the institution was unable to quickly reduce its investment in real estate and was left with sunk costs in building assets and Center set up.

Impact of Downturns

As previously referenced, Captive Centers are often viewed by the bank as another budgeted organization or cost center. As such, they face the same cost reduction pressures as the bank’s headquarters, lines of business and other cost center organizations. This can lead a Captive’s management to react in a manner consistent with standard corporate onshore cost reduction actions. This includes reducing expenditures on items considered non-essential to core operations, pulling back on technology/tools expenditures, reduced training, and other perceived non-essential costs associated with process improvements. Generally, resource reductions are considered an avenue of last resort. The perception is that they will be needed to address potential work volume increases in the absence of process automation which has not been a captive center focus. Resources are also protected as Captives attempt to strengthen their footprint and influence within the bank.

The BPO Shared Services Center model varies distinctly from a Captive Center model. From the bank’s perspective, a BPO Shared Services Center is contractually bound to a price and often an annual productivity improvement price reduction. For the bank, this means that price reduction savings are already identified and normally included in the annual budgeting exercise and likely excluded from additional cost reductions.

From the BPO perspective, however, the productivity improvements force a BPO to focus on tools and process improvements that could drive higher efficiencies. In contrast to the Captive model, often the BPO response to a downturn is to continue to drive down direct costs by reducing headcount through investment in technology and tools.
As an additional note with respect to an impact on the bank’s budgeting exercise, outsourcing can also favorably impact the bank’s externally reported management headcount statistics. A BPO Shared Services Center model headcount may not be considered direct banking resources, enabling the bank to project lower headcount when reporting banking management headcount.

Furthermore, the BPO Shared Services Center’s multiclient support structure also provides an inherent scalability and flexibility that Captive Centers do not have as a single client operation. In a BPO operation, as a client requires more or less resources, even outside the previously referenced automation advantage, the BPO has the ability to re-allocate resources and associated costs to other client operations which may have complementary resource demands. In some BPO contracts, substantial downward shifts in volumes may result in “shared” cost savings between the BPO model and client if the BPO has the ability to drive further efficiencies and cost reductions.

Selling of Captives

In our view banks have come to understand the significant investment and skills required to build and operate an offshore or nearshore Captive Center. Usually, when a bank has captured the labor arbitrage savings, there isn’t an interest or commitment to invest in tools to drive further efficiencies. This creates a situation where the Captive is no longer part of the bank’s strategic business focus for future investment. Under such a scenario, the ongoing inability to provide increasing cost savings due to lack of automation feeds upon itself and in our view encourages banks to sell their Captives to BPO Shared Services Center providers.
Conclusion

Financial institutions operate in a fluid regulatory environment which is putting ever increasing pressure on their business model, revenues and costs.

They have responded in various ways, including evolving their operating model and pursuing the use of shared services in off and near shore captive centers to lower costs.

Historically, financial institutions have preferred to transition services to a Captive Center over a BPO Shared Services Center model as they believe it offers them greater control and less risk. In analyzing the factors involved, that does not always prove to be true.

When assessing the operational requirements of running a Shared Services Center, there are differences in the individual components and cost to the operation (e.g. offshore resource salaries, career development, spans of control). When approaching this decision, banks often fail to understand the full operational cost to the institution of making the decision to operate a fully functioning Captive Center long term. As this isn’t their core business, operationally, banks are not necessarily structured to effectively run onshore or offshore Captive Centers.

Ultimately, if the long-term goal of the financial institution is to create a sustainable and successful service operation that continues to drive cost efficiency, the bank could explore two possible options:

1) Implement a Captive Center, but only if the bank can commit to a fully functioning shared services center approach, not just a centralized center approach.

This is likely the more difficult of the two options proposed. For this option, the bank’s top management should commit to driving the decision and then support it throughout the institution. The bank would have to invest for the long term and commit to implementing a full service management approach which would continue to drive the necessary ongoing management and monitoring of performance and improvements. The bank would also have to make the technology and tool investments to help drive the long-term efficiencies and strategic savings to make the operation effective and sustainable.

2) Directly pursue a BPO Shared Services Center model without first setting up a Captive Center.

This option is supported by recent examples where some financial institutions have begun to divest their Captive Centers. As referenced, financial institutions initially transition to a Captive model because it provides them with cost savings from labor arbitrage. However, after seeking these initial cost savings, the Captives may find it difficult to advance efficiencies and savings as they are operating under a Centralized, not Shared Services Center model. Lacking the commitment to the full Shared Services Center model, banks are instead beginning to sell their Captives to Shared Services Center providers to help capture additional long-term cost savings, as the BPO Shared Services Center is better structured to deliver these benefits. Prior to banks making their initial investment in a Captive, they should evaluate their long-term commitment. If the commitment is lacking, they should explore moving their operations directly into a BPO Shared Services Center, as it appears to be the more financially astute long-term decision.
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