Chapter- III:

**EVOLUTION OF BPO PROCESSES FOR FINANCIAL SECTOR**

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EVOLUTION OF BPO IN FINANCIAL SECTOR

Outsourcing or the use of third-party service providers is a business strategy that is being considered more frequently by financial institutions as they respond to an increasingly competitive market place. While not new, many of the activities currently being outsourced, such as information systems, business processes and internal audit are integral to the functioning of the organization, vital to supporting core businesses and create dependencies upon service providers. Given the scale and prevalence of these types of arrangements, outsourcing raises potential supervisory concerns.

Outsourcing is the transfer of direct managerial responsibility, but not accountability, to an unaffiliated, third party service provider who performs services previously delivered by internal staff and management. Business process outsourcing relationships take many forms. At one end of the spectrum are contractor like relationships where the choice among capable providers is large. In this case, contracts tend to be relatively short term and the cost and inconvenience of switching among vendors is relatively low. At the other end of the spectrum are long-term partnerships/strategic alliances/joint ventures where both parties share in the associated risks and revenues. The intention of these arrangements is for the financial institution and service provider to be fully integrated in seamless delivery of customized services.
Contractor-like relationships are relatively easy to setup and are best for commodity-like services such as procurement operations or mortgage servicing. The large mega deals, such as those involving full support of information technology efforts, are examples of outsourcing strategic, more complex activities that are not easily transferable. In these cases, staff, equipment and full responsibility for delivering an extensive group of services is outsourced to the service provider.

Although financial institution have outsourced activities such as payroll processing for years, outsourced activities have recently included information technology, accounting, audit, electronic funds transfer, investment management and human resources. In the financial service industry, outsourcing has been in use for quite some time. Essentially, financial institutions have used outside service providers for such clerical activities as printing customer financial statements and storing records since the 1970s. The financial services industry is conceptually structured in terms of front and back offices and outsourcing in that era mainly occurred in back-office business processes. Examples include cheque clearing and payment processing in retail banking, or clearing and settlement functions that are outsourced to central clearing houses within the trading industry. Similarly, credit rating within the lending industry and custody of assets functions within the investment management industry were frequently outsourced in the 1970’s. (1)

As a faltering global economy puts pressure on corporate results, executives are increasingly turning to outsourcing to reduce costs and boost productivity. Outsourcing providers pledge to perform back-office functions, including finance and accounting, more cheaply and efficiently than companies can do on their own, thanks to economies of scale, standardized processes and advanced technology. For many companies the Outsourcing allows them to focus on their core businesses. “In the boom market companies were much more focused on revenue growth”. With the development of efficient transportation, logistics systems and hubs on a global scale, routine manufacturing activities were outsourced to Asian countries such as Japan, South Korea, Taiwan and more recently India, China, Malaysia, Indonesia and Thailand. Now, with the worldwide IT, Internet and voice/data communications infrastructure, it has become possible to outsource routine service activities and processes to countries that can perform those tasks with equal quality but in a much more cost effective manner. In a global market place, managing a business is increasingly becoming complex. Competition is also compelling enterprises to respond quickly to changing market condition driven by customer focus. Companies have began to realize that it is essential to focus on some core competency rather than to get involved in activities and processes that are non-core to their businesses. The non-core processes are being increasingly outsourced to a specialized service provider or an outsourcing vendor who can perform these tasks more cost effectively. This is the crux behind the evolution of Business process outsourcing (BPO).  

**Exhibit 3.1: Evolution of outsourced processes:**

<table>
<thead>
<tr>
<th>Time</th>
<th>Process</th>
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<tbody>
<tr>
<td></td>
<td>Complex Banking transaction</td>
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<tr>
<td></td>
<td>Human Resources</td>
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<tr>
<td></td>
<td>Finance &amp; Accounting</td>
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<td></td>
<td>Claims Processing</td>
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<td></td>
<td>Technical support, collections</td>
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<tr>
<td></td>
<td>Data Entry, Call Centers</td>
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In the initial stages only basic, non-core processes were outsourced. The trend started with outsourcing of data entry kind of processes and other call centers for customer support. Gradual technical support and processes, like collections were also outsourced from companies with the expertise and specialization in that field. This was further extended to functions like claims processing. By 2003 many companies have started outsourcing functions like finance and Accounting. Outsourcing of human resources and complex banking transactions has also picked up in 2003 and by 2008 most of the companies realize the benefits and follow the trend.

Today outsourcing has become a more acceptable way of life and the focus has shifted to developing and adopting an outsourcing model that is best aligned to a company’s overall strategy and culture. Many of the activities currently being outsourced, such as information systems, business processes and internal audit, are integral to the functioning of the organization, vital to supporting core businesses and create dependencies upon service providers. In order to circumvent the disadvantages of outsourcing namely- Loosing strategic control and their ability to innovate and respond to changes in market conditions banks are turning to the practice of ‘in sourcing’. The practice of using offshore processing centers owned by the bank, is now gaining momentum, as it is also cost competitive. The most popular in sourcing model is that of global offshore processing centers, which have involved the banks setting up centralized processing hubs in Asian countries such as India, Malaysia, and China dedicated to fulfilling their back-office operations.
BPO – a survival need in the financial services industry:

BPO is one of the most important cost control weapons in the management armoury, says Raju Bhatnagar, CEO, of one of the outsourcing service provider. BPO providers are able to bring powers in areas of re-engineering, process improvements as well as technologies, thereby eliminating unnecessary operating costs.

Financial service institutions generally seen as victims of historical thought process are witnessing cataclysmic changes. Everybody is on the lookout for improving their operations to become more efficient and focusing on customers by providing them with convenient, innovative and cutting edge services. But the sad part is that any effort in this direction directly increases pressure on bottom-line profitability. To compound the discomfiture, there is an exponential increase in competition, never and hitherto unknown players, entering the market and customers are becoming more mercenary and consequently less loyal.

The current global mantra to overcome this apparent impasse appears to be through the medium of Business Process Outsourcing (BPO). In some respects, BPO can be viewed as an amalgamation of Business Process Re-engineering (the great management obsession of the nineties) and outsourcing. The intent is to enable an organization to access best practices for a set of business process. E.g. accounting, customer management etc. by using a specialist provider who has acquired world class skills many companies, including a significant portion in the financial services sector, tried their hand at Business Process Re-engineering in the nineties. Only a few
emerged successfully, having achieved the objectives they had set for themselves. Most found that their initiatives floundered mid-way, possibly because they either lacked unwavering commitment at the board / senior management level or the essential leading-edge technical skills were inadequate or more often did not have the sheer management energy to push through intensive process-improvement projects. However, BPO offers business improvement without tears or, at least, it can do so if a sensible approach is adopted.

The BPO space is likely to witness an explosive growth in the medium-term. Quantitatively, Gartner estimates that BPO business aggregated $208 billion in 1999 would grow to $543 billion by 2004. However, if contract manufacturing were to be excluded, since it is not relevant for an analysis of financial services, the consolidated volume in 1999 was $106 billion and is expected to grow at nearly 23% annually to approximately $301 billion over the same period.

At present, most of the customers (84%) for BPO are in North America and Europe. This share of the pie is likely to remain unchanged in the foreseeable future by 2004, 54% of BPO contracts will be in the US and 31% in Europe, roughly the same proportion as today. These statistics, however, do not imply that the BPO work will actually be performed in the US and Europe. Current trends make it evident that one is likely to see a strong movement in BPO outsourcing Eastwards, notably to India, over the next couple of years. Estimates indicate that by 2004, although customers based in Asia / Pacific using BPO will account for less than 5% of global revenues, BPO
service providers in the region will be performing a much higher proportion of the work.\(^3\)

**Global scenario:**

According to a study by Ross Research, Financial services organizations made up approximately 25% of the year 2002 outsourcing contracts. Though most of the deals took place in the first half of 2002, financial services will continue to be a prime focus in the future among out sources – both large and small. Mid- sized financial services companies, like most organizations, are looking harder than ever for ways to reduce costs. There has also been much consolidation in this industry – not just among major corporations but also among mid sized enterprises – leading the new and much larger institutions to turn to outsourcing providers that wring out costs, eliminate redundancies, and make operations run more efficiently for their customers.

According to Ross Research, corporate governance and partner control are pivotal issues for Financial Service Institutions when considering BPO. The threat of post sign-up vendor problems is one that prevents many financial service institutions from considering BPO. Financial Service Institutions remain skeptical to yielding control, but attitudes are changing to BPO as cost pressures mount and vendor expertise becomes evident. In September 2002, Accenture surveyed 30 senior financial professionals at 30 of the 197 US Retail banks with more than $3 billion in assets and

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determined that two-thirds are outsourcing one or more of their internal or external business functions. Specifically, Accenture determined that 75% of senior financial professionals at US Banks outsource credit card processing functions, while 55% outsource some aspect of their internal HR administration. According to a recent study by Accenture and the Economic Intelligence Unit (EIU), Outsourcing of finance and accounting functions is bound to grow over the next three years as companies are leveraging outsourcing for strategic benefits. About 30% of the companies surveyed reported that they outsource finance and accounting functions. Two – thirds of them said the arrangements were ‘successful’ or ‘very successful’. While cost saving and increased productivity are key motivators for outsourcing, the study found that finance and accounting outsourcing also is increasingly being used as a catalyst for business transformation. The study revealed that of the finance and accounting function, the most commonly outsourced is payroll, with 27% of the survey respondents reporting that they outsource this function. Budgeting and forecasting are the two finance and accounting functions least likely to be outsourced. The survey also indicated that executives are more inclined to outsource generic finance processes than core operations. Surprisingly 82% of survey respondents said they have no formal metrics in place to measure the success of the outsourcing arrangement. 66 percent of the respondents cited lower costs as the primary benefit of outsourcing. 21 of 39 fortune 500 banks, brokerages and insurance companies surveyed, said their top reason for outsourcing IT was to focus on core businesses. Other factors that were cited included increasing shareholder value, improving corporate efficiency and reducing operational risk management. Several high profile financial services firms have signed
outsourcing deals in the last few months, handing off control of data and systems in order to save money and focus on core business operations. E.g. J.P. Morgan Chase & Co. announced a 7 years, $5 billion agreement under which IBM will take over its data processing infrastructure. The contract includes a planned transfer of about 4000 J.P. Morgan IT workers and contractors to IBM during the first half of the year. The deal also provides for New York based J.P. Morgan to buy computing resources and other IT services from IBM under a utility model, meaning the bank will pay only for what it uses. Electronic data System Corporation has signed a 10 year, $4.5 billion contract to manage Charlotte, N.C. based bank of America Corporation’s domestic voice and data networks. In addition, Plano, Texas based EDS inked a 5 year outsourcing deal valued at $1.3 billion with Amsterdam-based ABN Amro Bank’s wholesale banking business unit. Deutsche Bank expects to save $1 billion over the next decade through its outsourcing deal with IBM. Deutsche Bank is transferring 900 of its IT employees to IBM as part of the agreement. Key to deal was IBM’s ability to update Deutsche Bank to state-of-the-art technology while offering it a utility model for purchasing IT resources. Deutsche Bank felt comfortable outsourcing its data processing operations because IBM and other IT services vendors have proven that they can provide sufficient uptime and security. 4

In America, some of the largest financial services companies are getting together to develop best practices for outsourcing live operations offshore. This sector has been at the forefront of the expanding off-shore market in the USA. Application development and maintenance of legacy systems have been moved offshore for a number of years,

but attention is now turning to the potential for offshore technical support for IT systems and infrastructures. Technical support staff and systems administrators based offshore work on real time IT applications remotely over a network connections to the operational system. Sever capacity management, network and firewall administration are all functions that could be handled offshore. The risks to be addressed include concerns about offshore access to live data and business critical systems, security management and the protection of intellectual property. Members of the New-York based Financial Services Technology Consortium (FSTC) – including J.P.Morgan Chase & Co., Bank of America, Citygroup, and Wells Fargo & Co.- met in August 2003 to discuss about the examining of offshore security, privacy, business continuity and contract cancellation issues linked to offshore management of onshore applications. The FSTC is looking at how to protect confidential data like trade secrets and customer information and prevent them being disclosed or stolen by competitors, the outsourcing supplier or its employees. 5

Competition is the most important issue facing top decision-makers in some of the World’s largest companies today, to meet this challenge; leading companies worldwide are focusing their resources on their core competencies as a business strategy to compete profitably in a global market business process outsourcing (BPO) is paving the way for leading companies to compete globally and increase profitability into the new millennium. Business Process Outsourcing (BPO) means delegating the ownership, administration and operation of a process to a third party. BPO is about

solving a business problem. BPO aims to raise a client company’s shareholder value because it is about delivering outcomes— that is, higher-performing business processes. In our surroundings—many items we own were manufactured in a different country. This is a business reality in most industrial and manufacturing sectors. Companies essentially have three kinds of processes, core processes (which give strategic advantage) critical, non-core processes (which are important but are not competitive differentiators), and non-core non-critical processes (which are needed to make the environment work). Non-core functions are the best candidates for outsourcing. The practice is going widespread acceptance throughout the United States, Europe, South America, and Asia Pacific as an important new management tool to improve performance and profitability, gain competitive advantage in the global marketplace, and ultimately build shareholder value. BPO usage and interest varies among different countries and regions. The practice is most prevalent in Canada (73%), United States (72%), and Australia (72%), where about three quarters of the executives reported BPO programs in place. More than half of the companies in Japan (60%), and Europe (55%) have BPO programs, but less than half (40%) of the companies in South America have BPO programs.

According to a recently released IDC and Financial Insights study, financial institutions are increasingly looking to third parties to manage entire payment functions, rather than the process alone.

IDC estimates that U.S. spending on payments BPO services reached $3.3 billion in 2005 and will grow at a five-year compound annual growth rate (CAGR) of 4.2% to reach $4 billion by 2010. This increasing trend of payments outsourcing presents new
opportunities and challenges for financial institutions and payments processing vendors.

"Financial services institutions have been pioneering adopters of the BPO model. Payments outsourcing, an increasingly visible and gaining segment of the global business process outsourcing market, is the latest reflection of this industry's comfort with outsourced business processes," said Shruti Yadav, analyst, BPO Services at IDC. "IDC observes healthy growth in deal activity and market spending accompanied by a shift from back-office to strategic objectives and deal drivers." According to Aaron McPherson, co-author of the report and research director for Payments at Financial Insights, an IDC Company, "The accelerating rate of change in the payments industry, particularly in checks and cards, has many financial institutions looking at outsourcing as a way to manage their technology and market risk. While the largest institutions have the scale too actually in source their payment processing, mid-tier institutions are going to want to band together to achieve similar economies of scale. This may take the form of payment utilities, which manage a particular payment method for multiple institutions." The study reveals that while cost and efficiency considerations remain central to payments outsourcing decisions, customers are increasingly looking to impact strategic areas such as customer service, compliance, process integration, and competitiveness. IDC and Financial Insights highlight the following key trends in the payments BPO market in 2006:

In sourcing among larger banks, as banks continue to move from large-scale contracts to more targeted initiatives. Small and medium-sized banks will drive outsourcing demand as they embrace outsourcing as a way to grow and compete with larger banks.
International expansion and global integration as banks focus on business development and emerging growth opportunities.

The emerging role of offshore, which is already pervading virtually all segments of the larger business outsourcing market. Banks have realized that outsourcing Banking and Financial Services is a strategic activity that streamlines and simplifies operational processes, reduces cost and complexity and maximizes revenue. The shift towards global multi-sourcing recognizes the need to select the vendor best qualified to provide outsourced banking services in specific locations. Understanding the specific needs of customers in different locations help banks to differentiating their product offerings and stay ahead in a highly competitive global marketplace. Outsourcing service providers can provide real-time, online, 24x7 processing, along with reliable, accurate and cost-effective Banking and Financial Services. This enables banks to maintain core focus and achieve organizational agility and flexibility and increase responsiveness to customers. The banking industry has been a leader in business process outsourcing. Many Institutions now view BPO as an integral part of their drive toward improved performance via raising return on assets or reducing their cost to income ratio, with its potential to reduce operational expenses and optimize processes. But attaining performance improvement and BPO successes requires financial institutions to master the structure and management of their business process sourcing deals as a core business competency. So before initiating a BPO transaction, financial institutions should develop an approach which includes the following seven essential elements-

**Essential Elements:**
a) **Articulated objectives**-
Institutions must decide upon and clearly articulate the business objectives that will define sourcing success. Such objectives typically include reduced costs, improved service levels and the freeing up of management resources to concentrate on core competencies.

b) **Clearly defined scope**-
Business Processes are most often ingrained into the underlying business, with their delivery requiring industry-specific expertise. Accordingly, BPO requires a more tailored solution. Providers of BPO services need to understand what performance is required from them in order to properly develop technical solution and price the deal.

c) **Flexibility**-
Flexibility is an effort to accommodate technological and business change; institutions should structure their BPO deals to allow for flexibility.

d) **Performance Measures**-
Institutions should accurately measure their current performance to provide a verifiable base from which to develop fair and objective service level requirements for the services provider.

e) **Cost Predictability**-
Although the pricing model may vary depending on each company’s preferences and the nature of the BPO transaction, it is essential that the pricing provisions of every BPO contract deliver specificity and cost predictability while giving financial institutions the flexibility to make adjustments to accommodate changing circumstances.
f) Process and control-

In negotiating any BPO transactions, institutions must endeavor to put in place a robust services agreement and not be distracted by ‘blue sky’ offerings in the form of partnerships or joint ventures.

g) Exit strategy -

Before entering any outsourcing relationship, institutions must ensure that the contract stipulates what will happen in the event of termination or expiration.

As a faltering global economy puts pressure on corporate results, executives are increasingly turning to outsourcing to reduce costs and boost productivity. Outsourcing providers pledge to perform back-office functions, including finance and accounting, more cheaply and efficiently than companies can do on their own, thanks to economies of scale, standardized processes and advanced technology. For many companies, the equation of high-quality service at lower prices is irresistible, particularly when outsourcing allows them to focus on their core businesses. “In the boom market companies were much more focused on revenue growth”. Outsourcing is the transfer or delegation to an external service provider the operation and day to day management of a business process. The customer receives a service that performs a distinct business function that fits into the customer’s overall business operations.

Outsourcing finance and accounting offers a range of benefits, with-

a) Lowering costs and maximizing efficiencies.

b) Enabling sharper focus on core competencies.

c) Increasing business productivity of CFO and other finance staff.

d) Accessing best-of-breed talent and technology.
e) Improving quality of service.

f) Delivering greater transparency and openness in the eyes of the market.

g) Improving quality of finance-related data and analysis.

h) Handling-off development and compliance risks.

i) Enhancing disaster recovery and continuity planning.

j) Catalyzing wider organizational change.

To be sure, outsourcing has been slow to come to the financial sector, but now even that is changing. In addition to payroll, which is outsourced by half of all companies, more than one third of companies currently outsource some or all of their tax work. Outsourcing is growing in other areas of the financial sector as well, such as accounting and reporting, receivables and payables, and expense processing. While this still reflects a piecemeal approach, it does show a growing trend.

The financial services sector accounts for the largest share of the worldwide offshore IT-BPO sector. Within the sector, segments involving high levels of retail exposure are by nature high on repetitive transaction volume that make them prime candidates for automation. The mortgages business is a key example. The process of acquiring and managing mortgages and loans requires financial services institutions to maintain massive middle and back-office capabilities, as well as the sales channels and marketing functions to support these products.

Recent trends of fluctuating interest rates, wavering consumer confidence, increasing origination volumes and increasing regulation are putting the squeeze on margins in the mortgage market. Since mortgages (being long term in nature) are viewed as the cornerstone of customer relationships, banks are seeking to differentiate themselves
not only on the product range but also the quality of services they offer- and take advantage of cross-sell opportunities that exist within this relationship. In such a scenario, outsourcing has emerged as a valuable tool in helping companies address the competitive pressures in the mortgage industry. Companies are very aggressively pursuing global options to run their operations which help them with better cost structures, reduced response time to market and offer better efficiencies.

The highly competitive and global nature of business dictates that senior managers constantly evaluate and investigate opportunities for competitive advantage for their companies. This involves continuous examination of processes and IT strategies, so that companies can optimise its resources and achieve the best outcome for its customers, shareholders and staff.

The financial services sector is perhaps the fastest moving, most heavily regulated, most competitive, dynamic and technologically innovative of all business sectors. To remain competitive in this industry, organizations are looking at each of their business functions and asking – does the way we do this differentiate us;

The lifeblood of the financial services sector is transactions. This is a core banking function; a bank which lost the ability to perform transactions would collapse within days, if not hours. While crucial to bank’s existence, this type of administrative function or process is not strategic. It doesn’t provide an opportunity for competitive advantage, revenue growth or new income streams. In fact, the administrative aspects of banking represent significant costs, which impact IT budgets and management resources without creating any differentiation or business benefit for the organization.

For years, banks have successfully sought approaches and solutions that minimize
these costs, but today’s CIOs are investigating a new approach to banking administration that could provide as yet unrecognised advantages by freeing resources, maximising productivity and delivering economies of scale.

Financial services companies have turned to outsourcing as a means of handling back-office processes for some time. Business process outsourcing deals have largely been transactional in nature, as functions were outsourced to drive out costs and human and financial capital redeployed to support other initiatives. Banks now look to service providers for vision and strategies that can help them achieve this.

Economies of scale are an ingrained concept in the banking industry. Banks have long depended on high volumes to sustain low unit costs for transactions, and this trend provides the driving force for a new kind of business process outsourcing. The latest model for BPO is based on the concept of the utility, whereby a single services company provides outsourcing options for multiple businesses in a single vertical market. The BPO utility recognises that an individual bank, acting alone, can respond to industry pressures and achieve improvements in efficiency but that optimum efficiency can only be gained through collaboration, particularly in the face of falling volumes. The characteristics of payments in banking make this an area well suited to collaboration, but the utility model applies to more than just payments. There are significant potential savings in the insurance, mortgage, publishing, manufacturing, communications and commercial sectors. The BPO utility approaches a common business challenge and aggregates volume by relocating the processes of similar organizations to a single business process infrastructure. The resulting economies of scale in IT, in business operations, in physical locations and staffing allow the
common business processes that exist in the banking sector to be shared and provide value by significantly reducing the cost of each individual transaction or process. Inevitably, two or more companies that are considering collaboration within a BPO utility will bring different business cases, strategies and technology infrastructure to the table. Technology assets are likely to be at a different stage of their respective lives and have different levels of value to each organization. A process of equalisation needs to take place in order to resolve these differences, a process with which the external service provider can assist.

There are different ways of structuring a BPO utility. The final outcome will be determined by the degree of openness and the level of trust between the partners involved. The service provider must inevitably play an important role in making this collaboration take place by providing a compelling platform for collaboration and by facilitating the transaction. The test case for collaboration lies in the following question: does the value of the combined plan exceed the returns, both fiscal and strategic, gained by each institution acting on its own?

A fundamental role for the external service provider is to manage change for the collaborating customers. This strategy frees the IT and strategic resources within a financial institution and enables these institutions to concentrate on the customer facing systems and new business methods, the true competitive battleground in business today.

The BPO utility lets businesses concentrate on improving service levels, reducing transaction and implementation costs, and introducing innovation. Gartner predicts that spending on BPO services in Asia-Pacific will rise to US$13.1bn in 2007.
According to Gartner, Australia is one of the leading growth markets in the region for BPO, because of flexible labour regulations, cost pressure on government and the continued growth in domestic services industries. BPO operations have traditionally been associated with horizontal business processes and functions and BPO is maturing and evolving to provide transformational capabilities, new value and competitive advantage. This ‘transformational nature’ allows the service provider to take advantage of the vertical expertise and resources it has to transform commoditised business processes into a competitive advantage. 6

The evolution of the BPO business case can be broken down into three key stages, from ‘make it cheaper’, through ‘make it better’, which is what most organizations strive for today, to ‘make me money’, which is the proposition for future BPO strategies and the utility. Today’s business case for outsourcing is about more than just cost reduction, it’s about aggregation of volume, strategic thinking and collaboration. More flexible in its terms and broader in scope, outsourcing can now be a key component of banks' strategy -

Financial services industry forces have altered the way banks view their business. Competition, customer demand, product innovation, regulatory concerns, and investment community opinions require responses on several fronts. For the last five years, banks have relied on strategic positioning, technology innovation, and reengineering to strengthen the organization's capital base. As a result, financial

6. BPO in Banking-Author: Rueben Khoo, Managing Partner Financial Services, Asia Pacific, UNISYS network.
institutions have significantly changed their business, technology, and organizational views.

The future vision of many financial organizations is drastically different from the capabilities of their system infrastructure. Realizing that the existing technology environment may not be supportive of the business in addressing the industry's competitive forces; financial institutions are examining their strategic direction. They are now concentrating on core competencies (activities or services which provide a strategic advantage or competitive edge) and outsourcing other activities to the best or most efficient provider of a product or service. To be sure, adopting an outsourcing approach impacts an organization dramatically. Prior to analyzing this impact, it is important to understand the trends within outsourcing.

**Beyond data processing**

Although the term itself is fairly new, outsourcing has been around for several decades with many of the major players dating back to the 1960s. However, today's emphasis has been removed from the traditional definition of outsourcing, which consisted of computer service support, data center management, and operations. Organizations are continuing to disaggregate production functions and are looking to have them performed by whoever is best able to provide the service at a competitive price. This encompasses a redefinition of the functions so that other sub-components can be performed.\(^7\)

Chase Manhattan Bank's recent agreement to outsource its check processing operations to Fiserv supports the disaggregation concept. While the size of the check

processing operation is unique, the recent phenomenon of outsourcing the human resource area (Chase and Citibank are examples) is further evidence that financial institutions are unbundling their business and system operational functions and concentrating on core competencies. There are three trends in outsourcing that suggest a continuation of the expansion of the outsourcing model beyond traditional areas.

1. While financial considerations remain a factor in deciding to outsource a function, many companies are looking more to gain competitive advantage or to receive value-added services. Outsourcing is no longer used simply to alter the balance sheet. Kodak and Xerox, for example, have outsourced components of their information technology operations in order to focus on business strategy and core competencies. Republic National Bank is another example of a bank that outsourced its check processing operations. Its purpose was to realize the benefits of imaging faster than they could have on their own. Their decision was based on a desire to foster a sophisticated and cutting-edge perception with their customers, not simply to realign their balance sheets. Looking at outsourcing to gain a competitive advantage or attain value-added service is a cultural change that will continue to grow.

2. Information technology application maintenance and development are viewed as one of the fastest growing components of outsourcing. As reported in the 1995 Ernst & Young /ABA Special Report on Technology in Banking, this area is projected to double in contract size in the next two years. Continental Bank outsourced components of application development several years ago. A more recent development is a concept referred to as "just-in-time staffing" or "flex sourcing."
The information technology development cycle involves personnel experienced in the latest architectural framework and technology skills. After the initial planning, a two or three year build-up of personnel is created to initiate major projects and maintain existing technology infrastructure. As the business hits a down cycle, or as the major projects are implemented, the workload shifts from development to maintenance. Since developers rarely perceive maintenance work as fulfilling, an exodus begins when the cycle begins again the future. The organization wastes its investment in developing personnel who fit its culture.

3. Flex sourcing (or just-in-time staffing) is a concept in which an organization partners with a third-party service provider to bring personnel with the latest IT skills to supplement a basic core of the financial institution's maintenance and development personnel. As the demand for a specialty is required, technicians educated in effective methodologies and tools are deployed to provide value immediately. As the need for the skill declines, the personnel are redeployed to another organization without wasting the financial institution's capital.  

After years of outsourcing technology support and other back-office operations to countries like India and China, financial institutions are increasingly looking to move large portions of their investment banking operations abroad, according to a recent report by Deloitte Touche Tohmatsu.

Faced with a dearth of skilled workers and shrinking profit margins, banks that want to remain competitive in the global marketplace can't afford to miss out on high-quality and cheaper foreign talent, the report said. As a result, what began as technology support is now morphing into more analytic operations.

"Most of the large financial institutions were in the IT side of outsourcing but as they leveraged that experience, they got more interested" in moving more of their investment banking and research activities abroad, said Niket Patankar, chief executive of outsourcing firm Adventity Inc.⁹

Among the leaders in outsourcing and offshoring are the big investment banks: Citigroup (Research), Morgan Stanley (Research), Lehman Brothers (Research) and JPMorgan Chase (Research). Typically, those banks have moved their research analysis operations offshore in order to take advantage of the time difference between the U.S. and Asia as well as the cheaper labor.

"Investment banking has a lot of number crunching that to a large degree can be done anywhere," said Alenka Grealish, manager of the banking group at Celent LLC. "By taking press releases and data feeds and digesting them offshore, the components can be made into basic analyst reports" that are available to clients early in the morning.

**Going one step further**

JPMorgan Chase, however, is taking its investment banking activities abroad a step

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Evolution of BPO in Financial Sector

further. The company was one of the first investment banks to not only transfer the company's back-office and call-center operations but to also hire research analysts in India, Hong Kong and Singapore to complement its U.S.-based research team.

After piloting the program in 2003 with about 1,200 employees in India, the company announced late last year that it plans to have a total of 9,000 employees in India by the end of 2007, with one-third of those employees working for the company's investment banking unit. Not only will the Indian workers handle research and analysis for the bank but will also be responsible for its foreign exchange trades and its highly complicated credit derivatives contracts. 10

Some experts expect that as banks become more comfortable with their offshore operations and foreign talent becomes more attuned to the companies' way of doing business, financial institutions may even shift some deal-making responsibility onto its foreign employees.

The Deloitte Touche Tohmatsu report indicated that offshore operations give financial services companies a foothold in new and emerging markets such as China, where there are more revenue opportunites than mature markets like the U.S. The report also predicts that driven by the need to take aggressive cost-cutting measures, the financial services industry will move 20 percent of its total costs base offshore by the end of 2010, compared to the current average of 3.5 percent. Although no numbers are yet

available, Peter Lowes, principle and head of outsourcing advisory services at Deloitte Consulting LLP, said in a few years, banks may increasingly rely on offshore talent to conduct due diligence and to screen prospective clients for investment banking business. And while there is no single, authoritative source on the specific number of U.S. investment banking jobs that could be lost to offshoring, Forrester Research predicts that within 10 years, at least 3.3 million U.S. jobs across industries will be shipped to lower-cost and developing countries such India, China and the Philippines.

HSBC Holdings, the world’s second-largest bank, has over 9,500 offices in 80 countries in Europe, Asia Pacific, the Americas, the Middle East, and Africa. HSBC is under increasing pressure from Citigroup to remain competitive on cost. HSBC already runs a number of global processing hubs in India and Malaysia. Recently, it announced plans to migrate certain business tasks — mainly processing work and call center inquiries — to India, Malaysia, and China. Accompanying the migration of these tasks is the relocation of 4,000 jobs, considered one of the largest overseas transfers of British jobs. HSBC’s decision mirrors similar offshore outsourcing moves by other British companies such as British Telecom, Aviva, and Prudential. In the world of financial services, offshore outsourcing was once regarded as a short-term solution for problems such as sharp or unexpected rises in demand or shortages in programmers. ¹¹ Today, financial services companies ranging from retail and

Investment banking, life, auto, and mortgage insurance businesses, to credit card processors and brokerage companies view offshore outsourcing as a key element of their overall corporate strategies.

**A competitive necessity**

"I believe the industry has reached such a level of globalization that it matters less and less where the actual (research) is generated and matters more what the cost of generating those products are" said Richard Bove, analyst at Punk Ziegel & Co. "Banks can't afford not to do (outsourcing) anymore."

It takes about three years for banks to see full benefits from an offshoring program, said Deloitte's Lowes, as companies overcome the initial learning curve of doing business abroad and gradually build their scale. Firms that aggressively expand their scope and scale will deliver much higher returns on the foreign investments than those that simply dabble in the practice, he said. Top performers can see cost savings of up to 60 percent while bottom performers report savings of less than 20 percent, Lowes said. Lowes added that those companies that reinvest some of their cost savings towards continuing to expand their operations offshore are going to be the true long-term winners. 12

"The economics (of offshoring in banking) are strong and the risks are being successfully mitigated" he said. "Today it's a competitive necessity."

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12. CNN Money.com – The Outsourcing wave hits investment bankers.
There are a number of trends evolving in modern banking, the most important of which relate to (a) technology and (b) outsourcing of services.

(a) Technology:

Banks in India have started using technology in a proactive manner. The huge number of Bank customers and their myriad needs are being met in increasingly sophisticated ways. In a number of areas, the foreign banks and the new private sector banks have been the first movers in the application of technology, but public sector banks are also catching up. One major advantage that Indian banks have is the availability of major IT companies in India who are the world leaders in IT applications.

Internet Banking:

Through its website, a bank may offer its customers online access to account information and payment and fund transfer facilities. The range of services offered differs from bank to bank depending mainly on the type and size of the bank. Internet banking is changing the banking industry and affecting banking relationships in a major way.

Examples of Online Payment Services offered by some banks- Shopping Online: One can shop securely online with the existing debit/credit card. This can also be done without revealing the customer's card number.

Prepaid Mobile Refill: A bank's account holder can recharge his prepaid mobile phone with this service.

Bill Pay: A customer can pay his telephone, electricity and mobile phone bills through the Internet, ATMs, mobile phone and telephone.
Register & Pay: One can view and pay various mobile, telephones, electricity bills and insurance premiums on-line. After registering, customers can get sms and e-mail alerts every time a bill is received.

RTGS Fund Transfer: RTGS is an inter-bank funds transfer system, where funds are transferred as and when the transactions are triggered (i.e. real time).

Online Payment of Taxes: A customer can pay various taxes online including Excise and Service Tax, Direct Tax etc.

Mobile Banking Transactions:

Some banks have started offering mobile banking and telebanking to customers. The expansion in the use and geographical reach of mobile phones has created new opportunities for banks to use this mode for banking transactions and also provide an opportunity to extend banking facilities to the hitherto excluded sections of the society. The RBI has adopted Bank Led Model in which mobile phone banking is promoted through business correspondents of banks. The operative guidelines for banks on Mobile Banking Transactions in India were issued on October 8, 2008. Only banks who have received one-time approval from the RBI are permitted to provide this facility to customers.

Outsourcing of Services:

Mobile Banking in India - Till June 30, 2009, 32 banks had been granted permission to operate Mobile Banking in India, of which 7 belonged to the State Bank Group, 12 to nationalised banks and 13 to private/ foreign banks. 13

13. Report on Trends and Progress of Banking in India 2008-09, RBI.
Point of Sale (PoS) Terminals:

To use smart cards/debit cards/credit cards for the purchase of an item or for payment of a service at a merchant's store, the card has to be swiped in a terminal (known as Point of Sale or POS terminal) kept at the merchant's store. As soon as the card is put on the terminal, the details of the card are transmitted through dial-up or leased lines to a host computer. On verification of the genuineness of the card, the transaction is authorised and concluded. It is thus a means to 'check out' whether the cardholder is authorized to make a transaction using the card. POS terminal is a relatively new concept. A Point of Sale (PoS) terminal is an integrated PC-based device, with a monitor (CRT), PoS keyboard, PoS printer, Customer Display, Magnetic Swipe Reader and an electronic cash drawer all rolled into one. More generally, the POS terminal refers to the hardware and software used for checkouts. In recent years, banks are making efforts to acquire Point of Sale (PoS) terminals at the premises of merchants across the country as a relatively new source of income. 'Acquiring' a POS terminal means installing a POS terminal at the merchant premises. The installer of the PoS terminals is the acquirer of the terminal and the merchants are required to hold an account (merchant account) with the acquirer bank. The acquirer bank levies each transaction with a charge, say 1% of the transaction value. 14 This amount is payable by the merchant. Most merchants do not mind absorbing this cost, because such facilities expand their sales. Some merchants, however, pass on the cost to the customer. This business is known as merchant acquisition business. Banks

are varying with one another for PoS machine acquisition, since it offers a huge opportunity to generate additional income by increasing the card base and encouraging card holders to use them for their merchant transactions. Leading banks--both in the public and private sectors-- are planning to install hundreds of thousands of these terminals across the country. Some banks are planning joint ventures with global companies who have experience and expertise in this area. PoS terminals are predominantly used for sale and purchase transactions. The PoS terminals have proved to be very effective in combating fraudulent transaction by on-line verification of cards. Also, the RBI is expected to permit cash withdrawal transactions to cardholders from PoS terminals installed with shopkeepers, mall stores, etc.

PoS terminals, having gained significant acceptance in metros, need to become more popular in tier-2 and tier-3 cities. Public sector banks appear to be more interested in targeting the smaller towns and cities where they have strong branch presence. The challenges of setting up a widespread PoS network will be primarily (a) operational costs and (b) viability in smaller towns and cities. Experts feel that once the technology stabilises and costs per unit comes down, PoS terminals will become popular all over India.

**Outsourcing of Non-core Activities:**

Outsourcing can enable banks to stay ahead of competition. Growing competition in the banking sector has forced banks to outsource some of their activities to maintain their competitive edge. Decision to outsource could be on cost considerations as well as lack of expertise in banks in delivering certain services. Banks typically outsource their non-core functions so that they can concentrate on their core functions.
However, there are risks involved in the process of outsourcing to a third party. These risks include non-compliance with regulations, loss of control over business, leakage of customer data, lack of expertise of the third party, poor service from third party, etc. The key driving force behind outsourcing activities by any firm, irrespective of the nature of its business, is cost saving. Initially, foreign banks were involved in outsourcing their activities in order to leverage India's significant cost advantages. Organisations such as American Express, Citibank, Standard Chartered Bank, ANZ Grindlays, HSBC, and ABN Amro have been outsourcing their Information Technology Outsourcing (ITO)/Business Process Outsourcing (BPO) requirements to leading Indian IT companies.  

Developing best practices in the financial services Industry

In India, some of the largest financial companies are getting together to develop best practices for outsourcing live operations offshore. This sector has been at the forefront of the expanding offshore market. Application development and maintaining of legacy system has been moved offshore for a number of years, but attention is now turning to the potential for offshore technical support for IT Systems and Infrastructure. Technical support staff an systems Administrators based offshore work in real- time. IT application remotely over a network connection to the operational system. Server capacity management, network and firewall administration

are all function that could be handled offshore. The risks to be addressed include concerns about offshore access to live data and business critical system, security management and the protection of intellectual property.

Members of the New-York based Financial Services Technology Consortium (FSTC) – Including J.P.Morgan Chase & Co., Bank of America, and Citi Group and Wells Fargo & Co.- met in August 2003 to discuss how they could reduce offshore risk.\textsuperscript{16} Work is now under way to examine the offshore security, privacy, business continuity and contract cancellation issues linked to offshore management of onshore application. The FSTC is looking at how to protect confidential data like Trade secrets and customer information and prevent them being disclosed or stolen by competitors, the outsourcing supplier or is employees.

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