

# Sourcing for Survival: What Impact is the Credit Crunch Having on Sourcing in the Financial Services Sector?

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In today's turbulent and uncertain market conditions many of the business assumptions that have typically influenced make or buy decisions and shaped effective outsourcing contracts and service delivery arrangements are in a state of flux.

Financial Services institutions (FIs) are operating in the most challenging conditions since the 1930s and many will need to fundamentally reconsider their external and internal service delivery arrangements, recognizing that the prevailing market conditions will heavily influence their requirements and their spend on information technology (IT) and business support services.

After a period when the impact of the recession on outsourcing was somewhat uncertain, it's clear now that the economic conditions are both disrupting and driving outsourcing. On the one hand there's been some disruption in the shorter term, some impact on project budgets and a deferral of capital expenditure and non mission-critical initiatives. Conversely, many outsourced services are non-discretionary and there is a realization that the credit crunch means that outsourcing and off-shoring are ever more useful structural tools to re-size and optimize service requirements.

This goes both for new services being considered for outsourcing and those that are already outsourced. Indeed there will often be a need to restructure or refocus existing agreements to ensure that they are aligned with changing business needs and volume baselines may need to be re-set.

In short, a firm's approach to sourcing strategy and execution is set to be a key determinant of success in recessionary times, recognizing that there are several major trends which are now at work:

## Key Drivers for Re-Aligning Sourcing Plans

- Regulatory pressures are intensifying and look likely to herald increasing distrust of Financial Services and additional compliance requirements, in turn bringing additional costs and complexity and new control requirements and service responsibilities
- Changes in business volumes are creating a need for greater agility and flexibility of existing outsourcing contracts and resulting in a requirement to restructure contract pricing and service levels
- Divestment and acquisitions by institutions are bringing additional challenges around managed contract exit or aggregation and standardization of provider provisioning
- Risks are emerging which may not as yet have been fully quantified and rapid assessment of these risks is required to derive the optimum allocation of service provider responsibilities and define the most appropriate mitigation and contract re-negotiation strategy in each case

## Expected Outcomes and Imperatives

- New sourcing initiatives will continue to be considered where benefits realization is rapid and IT and operations costs can be re-

profiled with the attendant challenge of managing "bubbles" of investment passed to the market

- Timelines will be squeezed with a need to move at a faster pace to meet stakeholder agendas, intensifying the need to focus on what really matters rather than getting lost in the minutiae
- Strategies should be joined up across business units and geographies to maximize benefits accruing and avoid disconnected, non-standard service delivery, recognizing that careful prioritization of initiatives and a clear understanding of service boundaries and dependencies is necessary
- Lift and drop off-shoring with a FI retaining sufficient control over captive or third party operations is currently seen as a simpler model which often leads to a clearer business outcome than more complex transformational outsourcing
- Many outsourced activities are no longer just commodity type services and are core to the delivery of the FI's own service proposition yet capabilities are often more developed on the supply side – as a result there is no great likelihood of in-sourcing being a viable alternative in all but some specific circumstances and a calm and considered response to recession is required
- Some existing outsourcing deals may be exited or rebased via restructuring programmes - the degree of commercial leverage will depend on contract terms whilst the need for business continuity

will mean that most services will generally stay with incumbents. Successful restructuring will often be predicated on finding win-win approaches perhaps via scaling up a service provider's scope of supply or addressing systemic issues on the client side which can unlock additional value

- Leverage of already existing relationships via effective supplier management and demand management will be critical and there are signs of an increased uptake of outsourcing the governance or integration of service relationships to third party experts, enabling a more standardized approach across different providers and increasing the likelihood of outsourcing delivering the benefits projected in the initial business case
- Effective management of service volumes delivered by service providers is critical together with tight control of change management as margins are often higher for new and add-on services
- Creating a variable resource base in new contracts, as lower demand feeds through into the economy and FIs rein in new customers, will be as important as reductions in absolute costs (in this area outsourcing has already made a major contribution)

#### Market Trends and Expectations

- Against the increasingly recessionary backdrop there are undoubtedly see further opportunities to lower G&A spend levels and improve associated service levels through sourcing
- The service provider market is now much more mature across IT, HR, F&A and Financial Services Operations (FSO), with MNCs, European and Indian service providers increasingly competing on a global basis and B2B offers creating opportunities to access industry leading FSO delivery platforms and scale economies
- The era of off-shoring as a pure cost play is drawing to a close. Wage-price arbitrage continues to be important but the more mature buyers of outsourced services are accessing additional benefits such as increased capacity and capability in order to help differentiate themselves
- The growth of outsourcing of knowledge-based processes such as research and analytics is complementing traditional back office services, further increasing this trend towards capability acquisition
- FIs are adopting a multi-sourcing "no one size fits all" approach combining internal optimization, automation, shared services and outsourcing
- The number of captive operations is still growing but the pace of growth has slowed as outsourcing has become a viable alternative for a wider range of processes and FIs are increasingly looking to focus on their core businesses
- There are increasing number of FIs looking to monetize their IT and business process captives (e.g. Citi), this trend is being given greater emphasis by the need to inject capital given prevailing economic conditions but the window of opportunity to transfer captives to service providers will be short and providers will be increasingly selective with regard to asset acquisition
- A wider range of global service delivery locations is providing greater choice to FIs and increasing competition for India
- Provider propositions are being enhanced via a number of different strategies including service specialization and acquisition / market consolidation (e.g. HP and EDS)
- Several alternative multi-provider "end-to-end" models are now prevalent in FS with providers now developing their ability to work together with other providers and take on risk for the integration of third party services as an alternative to a client assured multi-provider delivery model
- There is an increase in providers'

ability and readiness to construct relationships and contracts to deliver increased productivity, transformation or innovation often via the use of outcome based or risk reward pricing

- Arguably sometimes the more traditional approaches to procurement and provider management still adopted by some FIs, allied with poor forecasting of future business requirements and worsening market conditions, are holding back full realization of benefits from such models

Failure of an outsourcing initiative is most commonly derived from decisions made at the front-end of the sourcing life-cycle, when a misconceived strategy means a Financial Services institution negotiates a good deal for the wrong requirement.

Equally prevalent is value leakage post-contract, when insufficient thought has been given to investing in the skills and structures required to govern the outsourced services, especially in multi-provider landscapes.

Firms that have an enterprise approach to outsourcing, selectively re-aligning their service models by making informed judgements of their own versus service provider capabilities, transferring appropriate risks to the supply side whilst paying proper attention to provider management, will differentiate themselves from peers with more inefficient and inflexible delivery arrangements.

At the same time, given that the recession will (hopefully) be temporary, successful sourcing strategies will also anticipate the subsequent upturn, ensuring that future potential increased requirements are priced appropriately and legislated for clearly in service contracts which will satisfy business needs later in the contract term.

EquaTerra helps Financial Services institutions with the full spectrum of sourcing and transformation advisory requirements covering all aspects of Information Technology, HR, F&A, Procurement and Financial Services Operations. ■