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Outsourcing is Need of Market: Banking Services

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ABSTRACT

Financial services businesses throughout the world are increasingly using third parties to carry out activities that the businesses themselves would normally have undertaken. Today outsourcing is increasingly used as a means of both reducing costs and achieving strategic aims. It's potential impact can be seen across the many business activities including information technology – applications development, programming and coding (specific operations – some aspects of finance and accounting, back office activities, processing and administration) and contract functions – call centres done by outside experts at a fraction of existing cost.

Introduction:

The technological innovation followed by revolutionary improvements in communication network is responsible for marked change in way banks re-engineer their business models to offer cutting-edge serviced to their customers. Competition in the market intensified and profit margins started declining rapidly. Banks started looking at new business models to reduce their operational costs and at the same time maintain their service levels to their customers. More and more back office operations hitherto conducted in-house are gradually becoming potential scope for outsourcing.

Outsourcing has emerged as a separate rapidly growing industry. Due to fast developments in information technology, the Indian banking sector is outsourcing a good portion of their routine activities. Fully automated banking transactions are the out come of the outsourcing initiatives in banking. In the run for more profits and productivity, banks try to reduce cost through outsourcing. Right from mobilizing deposits to the disbursal of loans, banks engage outsourcing agencies in different degrees. Of the available models of outsourcing, bank will have to choose like joint venture, off-shore, on-shore, near-shore etc.

The factors that influence banks to outsource are primarily the cost savings, access to cutting-edge technology infrastructure and skilled, efficient labour resources.

Financial Inclusion

What is financial inclusion? By financial inclusion we mean the provision by the financial system of financial products and services at an affordable price to those who have been financially excluded. Growing prosperity in the rural areas is an indication of the potential for growth. However, the pre-reqisite to this would be initiatives that would bring the rural population into the fold of the Banking system. Inspite of the promising numbers as seen in changing demographics of the rural area, the fact remains that only 31 out of 100 of the adult population of this country have bank accounts.

What is outsourcing ?

"Outsourcing means Contracting with a vendor to provide a service rather than providing it yourself"

Outsourcing means "an investment strategy of delegation some of the business processes to an outsider, without doing it in-house". It aims to reduce staff & to cut-off expenses on unwanted work and to focus on productive business / earnings.

It is thus, shifting of some responsibilities to a service provider, who performs the services for the outsourcer. This responsibility makes take the form of manufacturing, accounting, compiling, marketing, advertising technical know-how, inspection, audit etc. Eventually, the concept spread to the territory sector like information technology, telecom, banking, insurance, management and consultancy etc.

Outsourcing is entering into contract with another organization / Agency to operate and manage one or more of its business processes. In brief, outsourcing is defined as the "act of transferring bank's activities to another firm or organisations, an activity that way formerly conducted in house and by extension, the resulting state of not conducting that activity in house any more."

Concept Emerged

The concept of outsourcing emerged from the economic theory of "division of labour and specialization", which professed economies of scale, innovation and more productivity, which form the basic objectives of outsourcing. In today's global platform, running a business is more complex than yester years. To refrain from stress or strain, outsourcing is adopted for sharing their burden.

Why outsourcing ?

The major trigger for outsourcing is identified as cost reduction by various surveys. Besides, cost reduction, access to new technology, focus on core competency, scale of economies emerge as valid motives for outsourcing decisions by banks across the world.

In other words we can say, by strategic outsourcing the bank will be in a position to improve customer, service, reduce costs, improve the bottom line and on the top of it have a competitive advantage.

Need for Outsourcing in Financial services

The financial services sector is well suited to outsourcing for the following reasons

Financial Services are information based. These services are easier to source externally than materials products because there is no physical goods flow to be co-ordinated with the information flow.

The process of outsourcing generally encompasses four stages :

1. **Strategic thinking,** to develop the organization's philosophy about the role of outsourcing in its activities.
2. **Evaluated and selection,** to decide on the appropriate outsourcing projects and potential locations for the work to be done and service providers to do it.
3. **Contract development,** to work out the legal, pricing and service level agreement (SLA) terms and
4. **Outsourcing management or governance** to refine the ongoing working relationship between the client and outsourcing service providers.

Principal of Outsourcing

1. Take the outsourcing as a strategic issue
2. Take it as a part of change management
3. The concept should be cleared
4. Take all the stake holders into confidence.
5. Enter into a clear service contract with the outsourcing agency and have a regular follow-up, supervision and control.

Types of outsourcing

Off-shore : When a outsourcing agency is in a neighboring country of the company outsourcing, it is termed near – shore outsourcing.
On-shore : When a outsourcing agency is within a company's own country, it is called on-shore outsourcing.
Near-shore : When a outsourcing agency is in a neighboring country of the company outsourcing, it is termed near – shore outsourcing.

Areas of outsourcing in banking sector

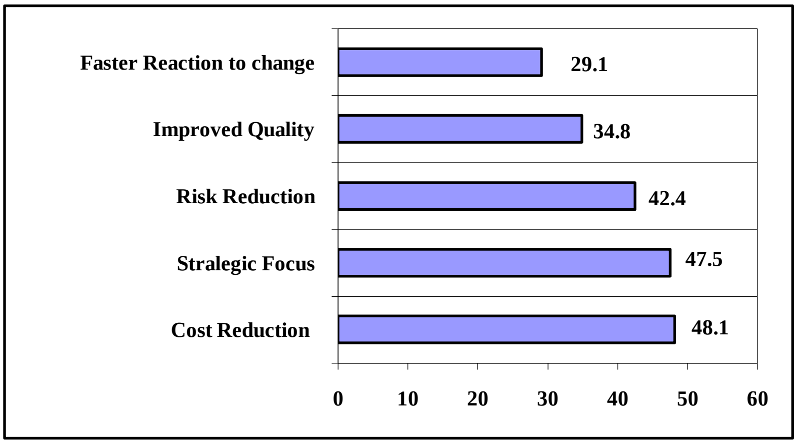
- Automation of banking activities.
- Distribution of loans Products.
- Loan documentation.
- Cross-selling of para-banking products
- Innovation of new deposit & loan products.
- Management of plastic money.
- Maintenance of ATM's
- Risk Management.
- Process of cheque books
- Customer query management (Cell Centres)
- Selection, Recruitment and training of personnel.

The banks are presently outsourcing the following functions :-

1. Opening and closing of accounts.
2. Issue of cheque books and statement of accounts.
3. Processing of cheques
4. Call Center
5. Administration of Pay-roll and TDS
6. Services of cash collectors
7. Services of Recovery agents for recovery of bad loans
8. Valuation and mutation of property
9. Training of personnel
10. Marketing of Banks' products
11. Maintenance of various equipment including computer etc.
12. Cross selling of Bank's products such as insurance life and non life and mutual funds.
13. Credit cards and Debts cards.
14. Security and Maintenance of ATMs.

Reasons for outsourcing (%)

Source : Cap Gemini Ernest & Young, 2004



Benefits of Outsourcing

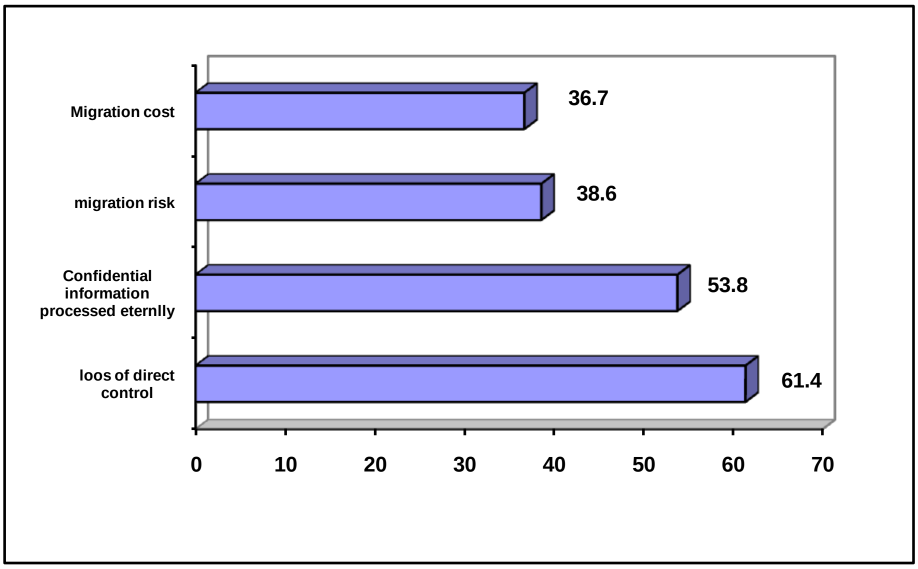
1. Improved customer service
2. Ample time for focusing on Core function.
3. Lesser Capital requirements.
4. Helps banks to concentrate on brand building
5. To gain a competitive advantage
6. Helps in effective recycling of founds.
7. Saving of resources – Profitability increases.

Outsourcing is a two-edged sword, through, it harbours particular risks. Firms mainly hesitate to outsource because they fear to lose direct control. Moreover, there is the fact that confidential information is processed outside the firm as well as the risk and cost related to the migration process.

Activities that should not be outsourced

Banks which choose to outsource financial services should however not outsource core management functions including Internal Audit, Compliance function and decision-making functions like determining compliance with KYC norms for opening deposit accounts, according sanction for loans (including retail loans) and management of investment portfolio.

The banks are presently outsourcing the following functions :-



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Latest Trends in Financial Outsourcing

- Cloud Services and Automation. ...
- Consistent Increase in Demand. ...
- Increased Complexity. ...
- Variable Cost Structure. ...
- Customer Process Analysis. ...
- Gain Sharing. ...
- Business Process Utility (BPU)

Conclusion

Banks now have a platform to stand on and outsource. To achieve this end, they should outsource to an agency of world class standard and maintain the high level quality and precision. But the success of outsourcing decision primarily rests on the edifice of three pillars, viz. The proper identification of activities to be outsourced, selection and monitoring of a service provider to ensure that there is no disruption in the timely delivery of quality service as per the agreed terms and most importantly structuring a service level agreement that is flexible enough to make amendments, review at regular intervals in the event of any unforeseen situation. It is to be well ingrained in the minds of people who are party to the bank's outsourcing decision that changes in banking are taking place with rapid speed and are unprecedented many times.

Outsourcing also allows better alignment between cost structure and revenues, greater flexibility to introduce new products, more innovative investment structures, access to new technology, rapid integration of the same into the company's systems and greater ability to keep pace with changing regulations and markets. The core activities presently being outsourced by Indian Banks includes hardware and software maintenance, hosting, management of data centers, outsourcing of data center operations, application support, disaster recovery facilities management, comprising network management and monitoring, maintenance of websites and maintenance and management of ATM's. While these are the more popular activities, some of the emerging opportunities exist in areas of e banking initiatives, e commerce outsourcing, complete outsourcing of the IT function and outsourcing the entire ATM set up and operation to a third party.

Outsourcing can take place at individual, process and functional levels. But its important to note that if managed properly, outsourcing can be an efficient risk mitigation tool. Outsourcing in Banks and financial services may finally be coming of the age. Financial services organizations continue to struggle with capital adequacy, operational costs and need to improve shareholder return and to meet all these challenges by continuing focus on their main business and organization's vision – **outsourcing is one such solution.**

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