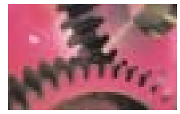
Economist Intelligence Unit

The Economist

Better, faster, cheaper?
Business process transformation in financial services

An Economist Intelligence Unit white paper sponsored by EDS



Preface

Better, faster, cheaper? is an Economist Intelligence Unit white paper, sponsored by EDS. The Economist Intelligence Unit bears sole responsibility for the content of this report. The main author was Aviva Freundman and the editor Simon Tilford. The findings and views expressed in this white paper do not necessarily reflect the views of EDS, which has sponsored the publication in the interests of informed debate. It is based on the following research activities.

- The Economist Intelligence Unit conducted a wide-ranging global survey of 300 senior executives of financial services companies about their organisations' plans for business processes.
- To supplement the survey results, the Economist Intelligence Unit conducted in-depth interviews with 34 senior executives of financial services companies worldwide. The executives include:

Ron Teerlink, chief operating officer, Shared Business Services, ABN AMRO

Neil Tointon, operations director, Abbey Life

Patricia Nugent, vice-president, Global Business Transformation, American Express

Tadd Spiegel, director, Global Business Transformation, American Express

Etienne Aubourg, group executive and vice-president for IT, Procurement and Operations, Axa

David Walker, group operations manager, Global Debt Derivative Operations, Bank of America

Lloyd Darlington, chief executive officer, Technology and Solutions Group, BMO Financial Group

Tiku Patel, managing director, Premier Banking, Barclays

Richard Straus, chief financial officer, Citigroup Private Bank Asia.

Manuel Loos, head of process and organisational development, Citigroup (Germany)

Tom Abraham, head of outsourcing, Global Transaction Services EMEA, Citigroup (US)

Tom Isaac, managing director, Global Transaction Services, Citigroup

Christine Larsen, managing director, Global Transaction Services, Citigroup

Graeme Hosking, global head of bulk payments operations, Deutsche Bank

Gerhard Kebbel, managing director, Retail Banking, Eurohypo

Luc Leclercq, director of operations, F&C Asset Management

Peter Fingar, executive director, Greystone Group

Rob Muth, head of global resourcing, HSBC

Dick Harryvan, general manager, ING Direct

Campbell Fleming, European head of operations, JP Morgan Fleming Asset Management

G. Murlidhar, chief financial officer and company secretary, Kotak Mahindra Old Mutual Life Insurance

Iain Saville, director and head of business process reform, Lloyd's of London

Richard Gibbs, chief economist, Macquarie Bank

Christopher Thom, chief risk officer, Mastercard

Steve Ferrari, service development director, Prudential Assurance

Tony Chaudhry, infrastructure director, Royal & Sun Alliance

Simon Bush, group head for banking operations, Standard Chartered Bank

Rick Leander, leader, Strategic Payments Forum, SVPCO

Philippe Menier, chief operating officer, Visa Europe

Jon Bradbury, chief financial officer, Winterthur Life Hong Kong

Brett Champlin, president, Association of Business Process Management Professionals

Frits Bussemaker, chairman, Business Process Management Forum

Derek Miers, co-chairman, Business Process Management Initiative

Andrew Spanyi, managing director, Spanyi International

Executive summary

Business process transformation aims to improve the efficiency of business operations by removing duplicate or unnecessary steps and automating as many processes as possible. It involves a radical rethink of what processes are and how they can best be executed. Financial services industries, which were protected for many years by regulatory barriers to the entry of new competitors, have been slow to streamline their operations along business process lines. Where they have done so, it has too often been on a piecemeal basis, improving the efficiency of isolated processes, but seldom re-engineering on a company-wide basis and rarely removing departmental barriers to ensure that business processing is as efficient as possible.

That is now changing as new technology is lowering barriers to entry across much of the financial services sector, which, along with regulation aimed at stimulating improvements in transparency and reporting standards, is forcing companies to think carefully about how they structure their operations. Many business process transformation strategies involve outsourcing, and the politically sensitive topic of offshoring to low-cost locations such as India or the Philippines. However, companies can and do conduct internal re-engineering programmes to achieve efficiency goals.

Based on a survey of 300 financial services companies worldwide and a programme of in-depth interviews with business leaders and industry analysts this white paper looks at the dynamics of successful reorganisation of financial services companies and draws a number of conclusions.

- The competitive landscape of the financial industry is changing rapidly, a trend symbolised by the arrival of nimble internet-based companies and the move by retailers to offer financial products. These new entrants can deliver services quickly and accurately from newly established processing centres, often unconstrained by high-cost branch networks. They leverage sophisticated information technology (IT) to link work across different internal departments and achieve greater economies of scale by outsourcing business processes to shared facilities and third-party providers.

- The technological changes that are making this possible pose big challenges for established financial services providers. They are prompting them to reconfigure their operations along business process lines, eliminating waste and duplication in an effort to maximise efficiencies. Cost is citied by two-thirds of the survey respondents but is by no means the only driver of this process; by enabling a focus on core activities, business process transformation can also be a source of new revenue and improved customer service as well as enabling more effective risk management.

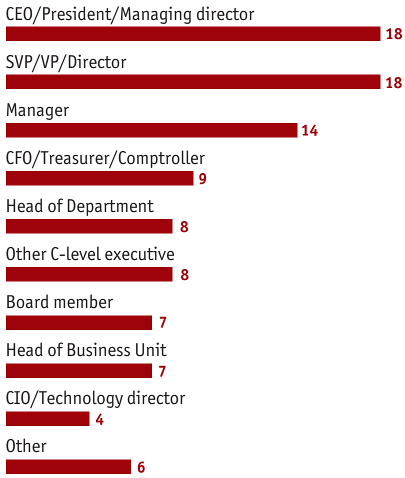
- More often than not, reconfiguring business processes involves centralising processing in a shared services centre, either internally or in a utility owned jointly with other financial companies. Over half of the respondents to the survey consider one of these to be the most effective strategy for improving the efficiency of their organisation’s business services. Indeed the need to retain control remains a key concern, with

Who took the survey?

A total of 300 senior executives participated in the Economist Intelligence Unit's survey. Just over one half of the respondents were C-level executives or board members; the remainder were senior managers.

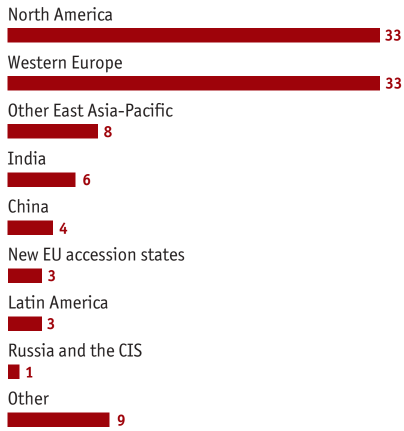
Over 40% of the companies surveyed have a market capitalisation in excess of US$1bn and one-third in excess of US$3bn. A broad spectrum of financial sectors were represented: retail banking accounted for 20% of the respondents; insurance companies for 17%; investment banking and asset management for 15% each; and wholesale banking for 11%. Responses were drawn from across the world, but western Europe and North America accounted for two-thirds.

Which of the following best describes your title?
(% respondents)



Source: Economist Intelligence Unit, 2005

Where is your company headquartered?
(% respondents)



Source: Economist Intelligence Unit, 2005

companies generally preferring to outsource work to third parties that are based locally rather than offshore. However, these concerns are far from insurmountable, with the proportion of companies relying on offshore third parties and foreign subsidiaries set to rise steadily.

- Whereas financial services companies have until now generally outsourced low-value-added activities that are not considered core to their business, they are now loosening their definition of what constitutes "core" and "non-core" activities. Moreover, many increasingly see outsourcing and offshoring as a way of boosting quality rather than simply as a route to lower costs. The survey suggests that the value of outsourcing contracts as a proportion of the total costs of financial services companies will rise sharply over the next three years. At present, in only 16% of companies does the value of business process outsourcing contracts exceed 15% of overall costs; this proportion is set to rise to 35% in three years' time.

- Although companies of all sizes are set to accelerate their reorganisation of business processes, there are significant differences across sub-sectors of the financial services industry. Retail banks are generally furthest along this path, reflecting the faster pace of change in this market. Nevertheless, pressure on others, such as the insurance industry (which as a whole has made least progress) is set to increase strongly as barriers to entry fall quickly.

Rethinking the way financial services companies manage business processes has the potential to increase their competitiveness, much as it has in the manufacturing sector. How quickly companies go about it and how well they manage this process will play a big part in determining whether they flourish in an increasingly competitive market place.

Driving change

Deregulation and advances in technology are exposing financial services companies to much greater competition. Low-cost providers, in the form of online banks, insurers and retailers, are applying new and more efficient business models to the provision of financial services. It is now possible to offer retail banking services without the expense of a physical presence and customers can access an increasingly broad range of financial services through their Internet browsers, and switch between providers much more quickly in the past.

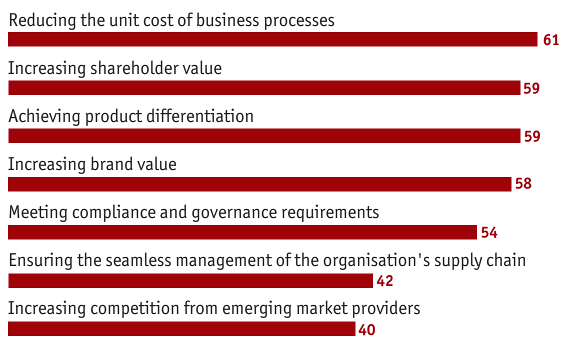
These trends are forcing established players to rethink how they do business and in particular how they execute their business processes. Indeed, according to a new global survey of 300 senior executives from the financial services industry undertaken by the Economist Intelligence Unit on behalf of EDS, reducing the cost of business processes will be the single biggest challenge facing financial services companies over the next five years, cited by over 60% of the respondents. Until recently process re-engineering was carried out on a piecemeal basis, leading to isolated efficiency improvements, but this no longer enough.

The experience of another sector provides them with a blueprint. Manufacturers pioneered techniques of linking their IT platforms to those of suppliers and customers, so that information—and work—flows seamlessly from the beginning to the end of the value chain. With improvements in IT capabilities, companies were able to improve speed and the quality of performance without losing control of key processes. While the financial services industry was slow to learn these lessons, the survey results suggest that this is now changing. This chapter will discuss the factors driving this trend.

Cutting costs

Both the qualitative and quantitative research undertaken by the Economist Intelligence Unit strongly suggests that transforming major components of business processes can yield substantial cost savings. Eurohypo, one of Germany's largest mortgage banks, implemented a process reorganisation project, beginning in 2003. It re-engineered its work flow by streamlining computer systems and consolidating five service centres into two, and converted all its paper transactions into electronic ones. As a result, the bank was able to reduce the number of full-time staff working in its retail processing department from 438 to 300. "When you look at all these changes together, the savings achieved were in excess of 30%," says Gerhard Kebbel, Eurohypo's managing director of retail banking.

How significant do you think the following challenges will be to your organisation in five years' time?
(% respondents)



Source: Economist Intelligence Unit, 2005

It is a similar story at Prudential Assurance Co, a UK-based insurance company. "We achieved ongoing operational cost reductions of 40%-50% by setting up a captive back-office processing centre in India, recouping our investment within two years," says Steve Ferrari, the company's service development director. A further example is provided by Abbey Life, which in 2002 transferred processing of life insurance policy administration to a third party-provider. Neil Tointon, operations director of Abbey Life, said that the savings have been very significant: "our modelling points to a cost reduction of about 20%, with a lot of that saving due to the adoption of a single systems platform and from the re-engineering of processes, through cutting out waste and leveraging economies of scale."

Boosting revenue

Controlling costs is not the only aim of business process transformation. Boosting revenue is also a key objective—either by gaining market share through delivering improvements in customer service, or by offering business processing services to other organisations.

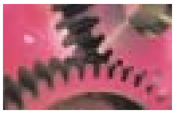
Citigroup's Global Transaction Services (GTS), for example, provides processing functions to other companies. Tom Abraham, head of outsourcing at GTS EMEA, says it is one of the fastest growing units in Citigroup and one of its most efficient users of capital. "We are trying to extend the range of services we offer. Right now, our main focus is on fund managers, but we are expanding by offering our services to other banks, to brokers and dealers, and to investment banks."

Processing business services for other financial institutions can sometimes raise data-security and competition issues, but these are far from insurmountable. Mr Abraham describes the situation as follows: "in instances where we provide services to companies with which Citigroup competes, we keep walls in place to respect the confidentiality of their data." In the case of ABN AMRO, which takes in back-office processing work for 30 other banks, its clients are generally banks that do not compete with ABN AMRO, or at least do not compete with it in the specific products for which it is doing the back-office processing.

Streamlining processes can also lead to substantial improvements in customer service by boosting the accuracy of customer transactions, reducing response times and freeing up capacity that can be deployed in customer-facing activities or in other parts of the organisation.

These advantages are illustrated by BMO Financial Group, a Canadian bank, which began transforming its retail banking processes in 2002. It streamlined and automated such processes as contact management with customers, workflow management of service requests, maintenance of key customer information and responses to mortgage inquiries. "We created common process models for use within different parts of the organisation, which allowed us to improve the customer experience", says Lloyd Darlington, the bank's president and chief executive officer (CEO) of Technology and Solutions. As a result, customers engaging the services of different divisions of the bank—corporate banking, retail banking or wealth management, for example—see familiar procedures, logos and service standards, and the various products can be reported to the customer together, thus improving cross-selling opportunities. According to Mr Darlington, "visibility of the entire process has improved. When a customer rings the call centre with a demand, a service request is created and routed to the back office. At any point in time all of our staff, including the relationship managers and tellers, have access to the information and status of the service request. This allows the staff to be more proactive in their interactions with the client."

Greater responsiveness—for example, by reducing the time it takes to respond to a customer application



for credit or to process an insurance policy—and improved accuracy, are seen as further benefits. Manuel Loos, head of process and organisational development at Citibank Germany, explains his firm's strategy for achieving this: "we start by looking at our customers' needs, and at what sequence of tasks might be involved in meeting those needs. We want to achieve an end-to-end view of all our processes, driven by customer expectations."

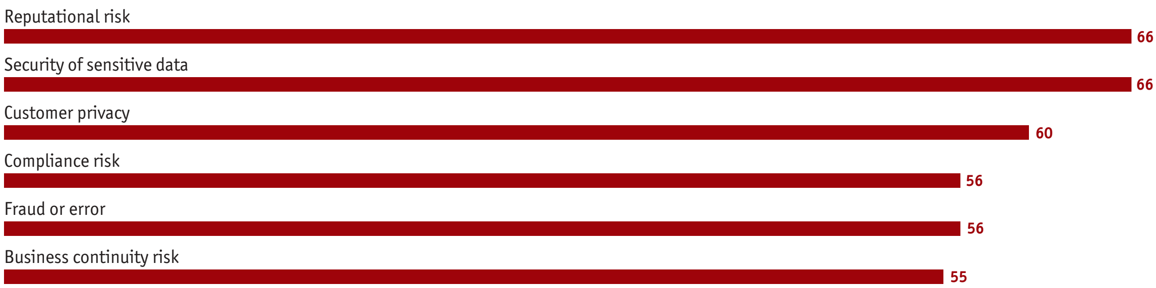
Business process transformation can also help financial services companies segment their customer bases more effectively, which in turn improves their ability to enter new market segments and expand their presence in existing ones. Suppliers of credit or other banking services cannot control the terms as they once did. "I want to know how improving business process management will help me to enter new markets," says David Walker, principal and group operations manager, Global Debt Derivative Operations, Bank of America, "because we can no longer take customers for granted."

Managing risks

Finally, financial services companies point to a wave of new laws and regulations as drivers of business process transformation projects. Basel II requirements to reduce operational risks along with Sarbanes-Oxley demands concerning data quality and the soundness of financial controls and provisions under the US Patriot Act aimed at preventing money laundering, are all part of a more stringent regulatory environment. These rules, taken together, make tighter control of all business functions essential, encouraging companies to devise an electronic "paper trail" for everything they do. For example, Mastercard has formally integrated risk management into its business process transformation, says Christopher Thom, the company's chief risk officer. "We have taken our external auditors' risk assessments, and put them together with our internal auditor's business risk assessments, and mapped them into the various risk categories, and into the key risks that the business itself has identified. Hopefully, with these tracking mechanisms in place, nothing will escape attention."

Of course, outsourcing business processes raises regulatory compliance risks if a third-party provider fails to follow all the necessary documentation and reporting steps and nearly 60% of the respondents to the Economists Intelligence Units' survey see compliance issues as a key risk of outsourcing business processes. However, it can also improve risk management by adding an extra layer of management control. Neil Tointon, operations director of Abbey Life, puts it this way: "in addition to controlling costs, we felt that outsourcing would help us to improve

How important are the following factors to your organisation in determining where to locate outsourced activities?
(% respondents)



Source: Economist Intelligence Unit, 2005

control of the business. With outsourcing, not only do we apply our own governance and control structure, but so does the outsourcing company, which applies its own management and control."

Re-engineering and automating business processes can also have a broader impact on containing risk by exposing problems within the organisation. "There is always a tendency for an organisation to become siloed," says Mr Thom, of Mastercard. "The problem is that you might have an instance of employee fraud in one business unit, which is seen as a local problem. However, if fraud is also occurring in other business units, you will benefit from having a more holistic view of how to manage it."

Rethinking business processes

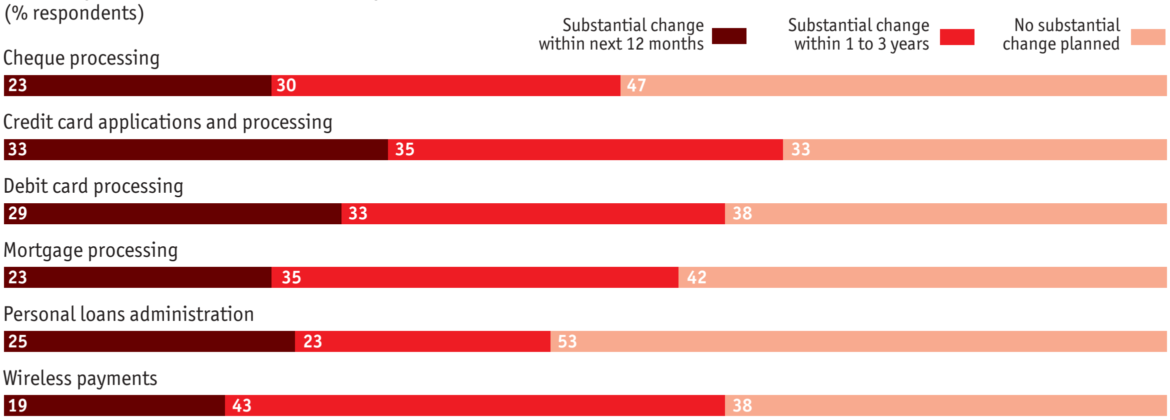
Financial services companies certainly intend to step up their efforts to re-engineer business processes, according to the survey. Perhaps unsurprisingly given the rising competitive pressures facing the sector, retail banks look set to be particularly aggressive in reconfiguring their operations, in particular credit card applications and debit card processing. However, change will by no means be confined to mass processes carried out by retail banks; investment banks and asset managers are also planning big changes, as are insurance companies, traditionally laggards among financial services companies in the take-up of new technology. How are they going about implementing these changes?

Strategic considerations

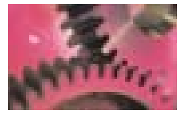
Typically, a business process transformation project begins by defining the major processes to be re-engineered and then systematically maps out the steps involved in completing each process from inception to completion. The strategy relies on inspecting each of the business processes, end-to-end, and removing duplication. At present, many financial services providers continue to perform processes on a stop-and-go basis, with one department doing a piece of the process, putting it down and waiting for it to be picked up by the next department. The objective is to ensure that the work is dealt with in a smooth flow. "We focused mainly on simplifying processes, to achieve operational cost savings and improved quality," says Dick Harryvan, general manager of ING Direct.

Most of the companies surveyed re-engineered processes first, as a prelude to deciding whether to outsource or send them offshore in whole or in part. Iain Saville, director and head of business process reform at Lloyd's of London, argues that "computerising a mess is a lousy idea, as is outsourcing a mess." This is supported by the results of our quantitative survey, which reveals that nearly

Which payment and credit processes does your organisation plan to re-engineer over the following time periods?
(% respondents)



Source: Economist Intelligence Unit, 2005

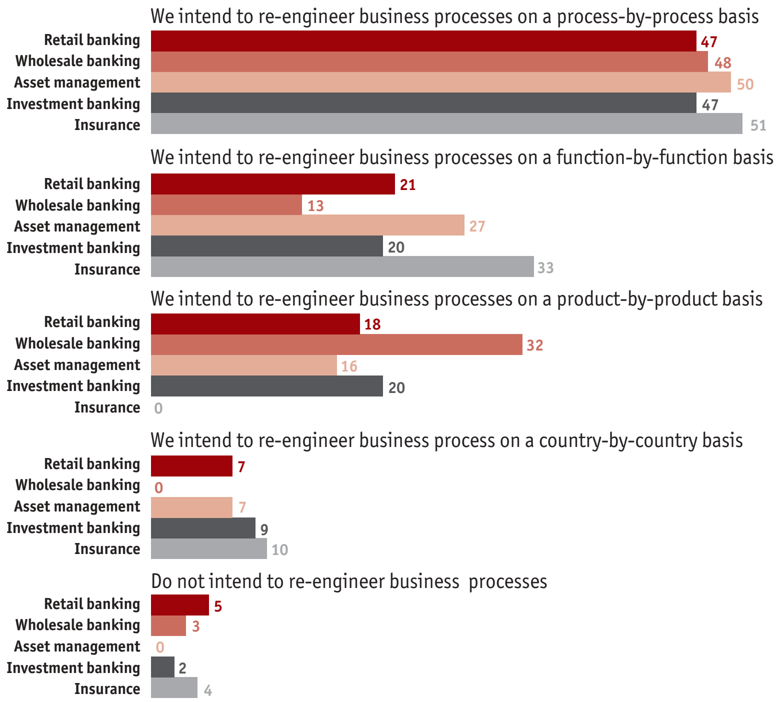


half of respondents intend to re-engineer business processes on a process-by-process basis, something that is mirrored across the financial sector as a whole.

Once business processes have been streamlined and, where appropriate, automated, companies face the next decision: whether to keep process management in-house, or to outsource it in whole or in part to third-party providers. Furthermore, if processes are to be outsourced, which ones can be outsourced and which kept in-house? Some financial executives feel strongly that core functions should remain in-house. "There are certain skill sets that you have to keep within the control of your own company," says Jon Bradbury, chief financial officer of Winterthur Life Hong Kong. "That's based on concern over quality of the sales process, quality of the post-sales administration, and control over the risk management system." G. Murlidhar, chief financial officer of Kotak Mahindra Old Mutual Life Insurance, concurs: "in a business such as insurance, core functions like underwriting and essential elements of customer care have to be handled and controlled by us internally, and cannot be outsourced."

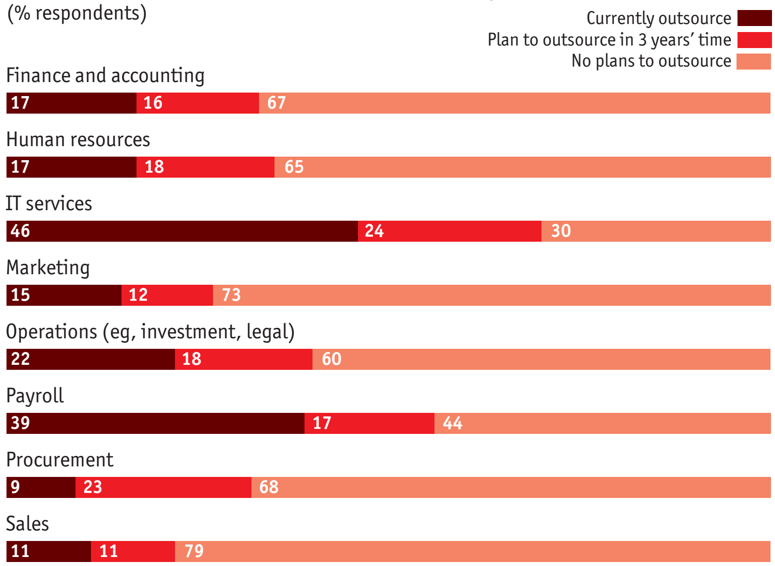
Others are much more open to new solutions. "I think outsourcing (including to offshore providers) will really take off," says Mr Teerlink of ABN AMRO. "We have already found that equity research can be outsourced to India, and so can product development for certain derivative products. We think anything that doesn't involve direct interaction with clients can be outsourced." Indeed, many financial services companies certainly seem to be loosening their definition of what functions must remain in-house, with enterprise services increasingly being seen as appropriate for outsourcing. Executives report that the range of outsourced processes is broadening, to include financial analysis, human resources administration, credit analysis and product development.

Which of the following statements best describes your organisation's plans to re-engineer business processes?
(% respondents)



Source: Economist Intelligence Unit, 2005

Which of the following enterprise business services does your organisation currently outsource and which does it plan to outsource in three years' time?
(% respondents)



Source: Economist Intelligence Unit, 2005

ABN AMRO—Driving economies of scale

ABM AMRO is a universal bank with substantial retail, wholesale and investment banking operations. According to Ron Teerlink, the organisation's head of shared business services, ABN AMRO rebuilt its entire organisation in the summer of 2000. "We moved from a structure based purely on geography to one with three main divisions that are essentially product-based: wholesale, consumer and small-business, and wealth management products for private clients. Each of those three main divisions has several product units."

Before the restructuring, each division had its own product functions—each product was handled separately by each division, from the client interface to product management, operations, IT, etc. In short, each product was a complete vertical silo. The transformation involved shifting from a focus on products to a focus on processes. "We looked at our value chains and decided that we could achieve substantial savings by creating shared service centres between silos," says Teerlink.

As it turned out, there were a lot of services that could be performed centrally, so in 2004 a division was created with responsibility for all the shared services. Although it cost €870m to set up, the projected savings are substantial. According to Mr Teerlink, "we estimate savings will be €100m in 2005, €300m in 2006, and €600m in 2007 and in each subsequent year. Those savings come mainly from avoiding duplication between the product units, but also from outsourcing some of the work to India." The bank has 2,000 people working at its subsidiary in India, with the Indian workforce expanding by 100 people a month.

The increasing readiness to outsource business processes is also illustrated by the results of the quantitative survey, which show that around half of the respondents are comfortable with outsourcing or placing in shared utilities functions such as credit card applications and the processing of debit cards and mortgages. Moreover, over 40% of the respondents are willing to outsource administration of the pension programme, and one-third would outsource investment management.

Indeed, the respondents to the survey expect the value of their business process outsourcing contracts

What do you estimate the cost of your organisation's business process outsourcing contracts to be as a proportion of overall costs at present, and what proportion do you expect them to comprise in three years' time?
(% respondents)

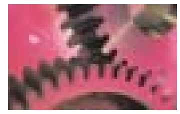
At present

	Under 10%	10-20%	20-30%	30% plus	Don't know
Retail banks	60%	15%	11%	2%	12%
Wholesale banks	47%	30%	0%	0%	23%
Asset management	56%	21%	9%	7%	7%
Investment banking	46%	30%	5%	2%	17%
Insurance	53%	16%	8%	4%	19%
All companies	52%	20%	6%	4%	18%

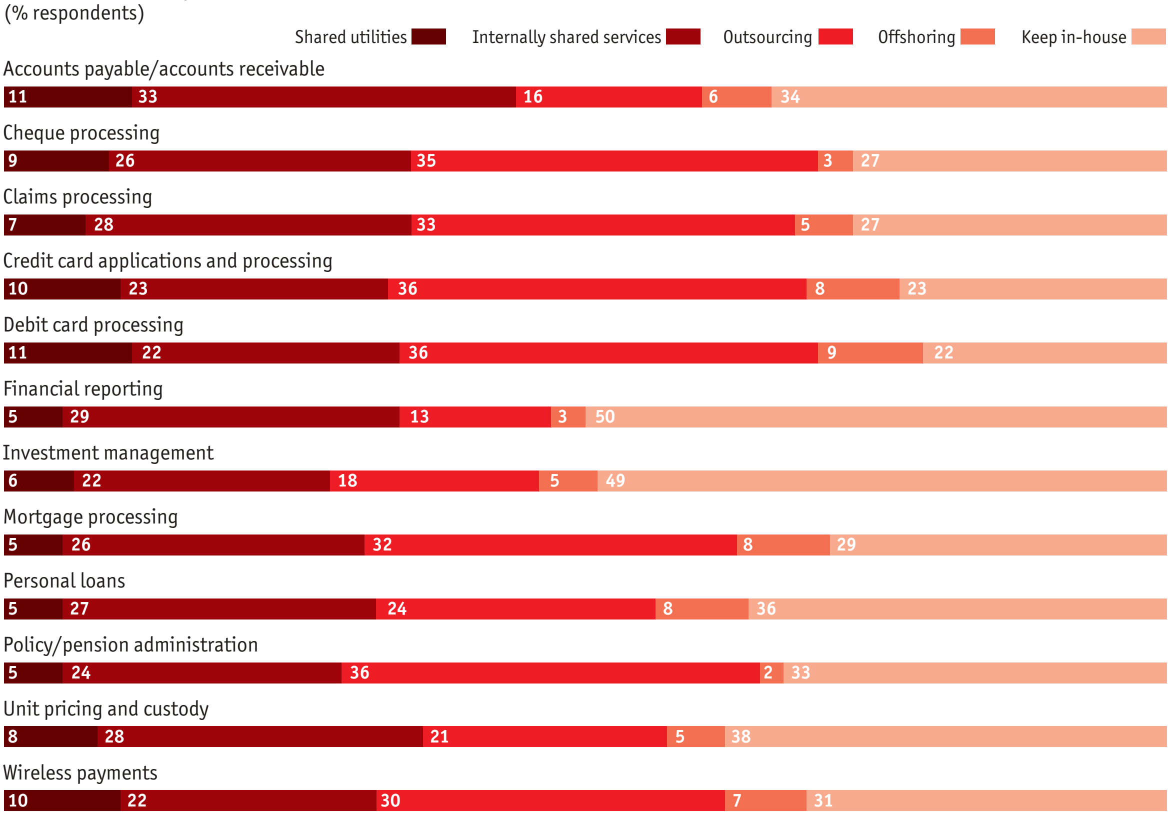
In three years' time

	Under 10%	10-20%	20-30%	30% plus	Don't know
Retail banks	27%	34%	15%	5%	19%
Wholesale banks	12%	37%	25%	0%	26%
Asset management	30%	28%	21%	9%	12%
Investment banking	11%	42%	16%	9%	22%
Insurance	32%	21%	20%	6%	21%
All companies	24%	30%	17%	6%	23%

Source: Economist Intelligence Unit, 2005



Which strategies do you consider most appropriate for each of the following processes?
(% respondents)



Source: Economist Intelligence Unit, 2005

to rise steadily over the next three years. At present, in just 16% of companies the value of business process outsourcing contracts exceeds 15% of overall costs, but 35% expect this to be the case in three years' time. The biggest change is set to take place in the asset management industry, where 45% of respondents expect the value of their outsourcing contracts to exceed 15% of total costs in three years.

Internally shared utilities

Although financial companies are becoming more prepared to outsource higher-value-added activities, the first step after re-engineering—and in some cases, even before re-engineering—is to centralise IT infrastructure and business processing in an internally shared service centre. This emerges as the preferred strategy for business process transformation among respondents to the survey; 66% said they currently use an internally shared service centre and a further 27% said they would do so within three years. Just 4% of the organisations with turnover in excess of US$1bn have no plans to use shared services, and the proportion among organisations with turnover of less then US$1bn is also very low, at 12%.

Citibank Germany, for example, has centralised back-office and other business processing in a single large facility. Until 2003 the bank had three different locations for administrative and back-office work: one

Do you currently employ internally shared services and do you plan to over the following time periods?
(% respondents)

	Currently employ	Plan to employ within 12 months	Plan to employ in one to three years	No plans to employ
Companies with global revenue of up to US$1bn	55	22	11	12
Companies with global revenue in excess of US$1bn	77	15	5	3
All companies	66	19	8	7

Source: Economist Intelligence Unit, 2005

for the call centre, one for credit cards, and a third for general administrative and back-office processing. According to Mr Loos, head of process and organisational development "in early 2003 we combined all those activities into a single location in Duisburg. We experienced strong growth and now have almost 2,000 Duisburg-based employees dealing with all back-office processes. Branches turned over many of their administrative processes to this central location, so they could concentrate on advising our customers."

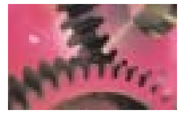
Axa, the French-based insurance giant, has approached business re-engineering in a similar way. It focused on pulling together the IT infrastructure used by its far-flung operations. Etienne Aubourg, group executive and vice-president for IT, Procurement and Operations, says: "most of our country subsidiaries had IT infrastructure taken out of their budget. We put all the infrastructure under Axa Tech, a separate subsidiary, and this allowed us to do a lot of rationalisation, cutting the number of mainframes and servers, and substantially reducing IT costs."

There are, of course, a few disadvantages to consolidating IT in a shared services centre. Typically there are high upfront investments associated with standardising systems throughout a company, and having a centralised IT function for a large number of subsidiaries can limit the scope for local solutions. A shared service centre that provides direct processing services to business units can also raise organisational issues. This is especially the case where shared service centres adhere to the letter of the service agreement rather than being flexible and willing to make changes as the need arises. "Shared service centres need to adopt a customer-supplier attitude within the organisation," says Graeme Hosking, global head of bulk banking and cash operations at Deutsche Bank.

Externally shared utilities

The use of externally shared services (where several organisations share a service provider) is currently considerably less popular than internally shared services, although they are gaining in popularity. Less than 40% of respondents to the survey currently use an externally shared services provider, but two-thirds expect to be doing so within three years. A good example of an external shared service is SWIFT, an electronic messaging system that enables banks quickly and accurately to process inter-bank payments. Crest, a UK clearance and settlement system for securities, is another example, as are the cheque-clearing systems owned and operated by several banks, such as Symcor (Canada).

What all these ventures have in common is that participants have to link their own IT systems into a shared platform, to send and receive messages that constitute exchanges of funds, transfers of ownership of securities, or contractual agreements. This makes these ventures resemble a shared back office. They have proved to be a good way of boosting customer service, according to Lloyd Darlington, of Bank of Montreal, one of the owners of Symcor. "We increased the amount of time branch personnel have to interact



Lloyd's of London—abandoning paper at last

In an attempt to abandon paper and move to electronic messaging, Lloyd's of London, the insurance market, is streamlining the process of underwriting and selling insurance —including standardisation of the data that are transferred during the process, the lack of which has held back computerisation.

According to Iain Saville, head of business process reform, "We are doing this through the lifecycle of the insurance transaction, including both the front office and the back office." The front office refers to the exchange of information between a broker and actual and potential underwriters, and the back office to accounting and settlement processes, as well as to ensuring that claims information is shared in an efficient way between everyone who needs to know that information. He says, "Insurance policies have to be processed quicker than at present."

As of mid-April 2005, a total of 15 customers had signed up for Kinnect, the name given to the platform, which now accounts for more than 60% of capacity at Lloyd's. Leading insurance brokerages Marsh and Willis have been at the forefront of efforts to sell Kinnect membership to other brokerages and to underwriters.

with customers by fully automating the balancing of incoming and outgoing payment clearing processes between the branches and Symcor."

According to the survey results, it is currently the bigger organisations that employ external shared utilities, with just 29% of the organisations with turnover less than US$1bn relying on them, compared with 47% of companies with turnover in excess of US$1bn. However, the survey does point to rapid growth by smaller companies, with the proportion expected to rise to over 60% in three years' time.

Breaking the survey results down by sector reveals that retail banks are currently the biggest users of externally shared services, which is supported by our qualitative research. However, the results also point to a strong rise in the proportion of asset-management companies and investment banks prepared to transfer business processes to externally shared utilities, with nearly three-quarters of both expecting to be doing so within three years.

Outsourcing to a local third-party provider

The chief advantage of outsourcing is cost control—as well as an improved ability to track costs. "It is easier to monitor activities outsourced to a third party provider than those kept in-house, which might be lumped together with general overheads and other activities," says Campbell Fleming, European head of operations, JP Morgan Fleming Asset Management. Companies' chief concern, when deciding whether, how and to whom to outsource, is whether the quality of the work done externally will impair service levels

Do you currently employ externally shared services or do you plan to over the following time periods?
(% respondents)

	Currently employ	Plan to employ within 12 months	Plan to employ in one to three years	No plans to employ
Companies with global revenues of up to US$1bn	29	17	16	38
Companies with global revenue in excess of US$1bn	47	11	9	33
All companies	39	15	13	33

Source: Economist Intelligence Unit, 2005

Insert survey chart: Do you currently employ external shared services and do you plan to over the following time periods?
(% respondents)

	Currently employ	Plan to employ within 12 months	Plan to employ in one to three years	No plans to employ
Retail banking	43	13	9	35
Wholesale banking	32	14	11	43
Asset management	35	28	12	25
Investment banking	40	19	12	29
Insurance	39	9	15	37
All companies	39	15	13	33

Source: Economist Intelligence Unit, 2005

and damage their reputation. Reputational risk emerged as one of the key perceived risks of outsourcing, cited by 66% of the survey respondents. The same proportion are concerned about the security of sensitive data. "We had quality problems with our German supplier in routine processing of mortgage loans," said Mr Kebbel, managing director of retail banking at Eurohypo. "There were problems with account statements not being sent out, or being sent out in duplicate within three days of each other. The error rate was so high that there was almost a panic that the bank would collapse if we moved that data processing work to another country."

However, most of the companies the Economist Intelligence Unit spoke to were very satisfied with the quality of the service they received from outside providers. For example F&C Management Holdings outsourced operational functions to a UK subsidiary of Mellon Financial of the US, a strategy that has proved successful: following its merger with ISIS Asset Management in 2004, the new group—F&C Asset Management—is now doubling the amount of processing it outsources. The increasing readiness to outsource to local third-party providers is highlighted by the survey results; just 20% of the respondents have no plans to pursue this strategy within the next three years.

Some regional patterns emerged from the survey results, with US companies generally more reluctant to outsource than their European counterparts. One possible reason for this is that US banks are more focused on cross-selling, and therefore their operations are more complicated. "Cross-selling requires more flexibility and cultural familiarity, making outsourcing more problematic" according to Tadd Spiegel, director of global business transformation at American Express.

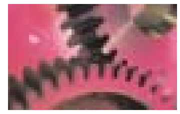
Offshoring to a third-party provider

Reflecting concerns over data security and reputation, companies are much less keen to send work abroad, either to a subsidiary or to a third-party provider, than

How significant are, or would be, the following risks to your organisation as a result of outsourcing as a result of outsourcing business processes?
(% respondents)

	All respondents	Retail banking	Wholesale banking	Asset management	Investment banking	Insurance
Reputational risk	66	63	63	73	59	67
Security of sensitive data	66	77	63	66	62	61
Customer privacy	60	68	59	59	47	57
Compliance risk	56	64	68	64	40	57
Fraud or error	56	59	53	52	43	67
Business continuity risk	55	46	56	64	40	57

Source: Economist Intelligence Unit, 2005



Do you currently outsource to a third party locally or do you plan to over the following time periods?
(% respondents)

	Currently employ	Plan to employ within 12 months	Plan to employ in one to three years	No plans to employ
Companies with global revenues of up to US$1bn	42	11	17	30
Companies with global revenues in excess of US$1bn	64	11	7	18
All companies	52	14	12	22

Source: Economist Intelligence Unit, 2005

they are to outsource to a third-party locally. According to the survey results, just 20% of financial services companies currently outsource to an offshore third-party provider, although 43% expect to be doing so within three years. The main obstacles are cultural differences and quality-control issues, as well as the negative publicity involved in shifting jobs to low-cost countries. However, attitudes vary significantly according to the size of the company, with companies with turnover above US$1bn almost three times as likely to offshore to a third party provider than those with turnover under US$1bn.

A decision to employ an offshore, third-party service provider raises a question: where to send the work to? In the first instance, the choice of location is typically governed by language and cultural considerations. For example, UK companies tend to gravitate to India, US companies to the Philippines, particularly for language-dependent call-centre operations.

For Richard Straus, chief financial officer of Citigroup Private Bank Asia, the main consideration is also the availability of skills: “we are focusing on a few core centres for call-centre operations, payroll processing, expense payables, system infrastructure, and software development,” he says. “We do it in low-cost, high-talent-pool locations. India and the Philippines have a huge pool of skilled English speakers.”

Companies that are outsourcing to third-party providers offshore generally report positive results, with the advantages not confined to lower costs. Royal

Do you currently outsource to a third party offshore or do you plan to over the following time periods?
(% respondents)

	Currently employ	Plan to employ within 12 months	Plan to employ in one to three years	No plans to employ
Companies with global revenues of up to US$1bn	12	9	8	71
Companies with global revenues in excess of US$1bn	32	15	15	38
All companies	20	11	13	56

Source: Economist Intelligence Unit, 2005

Do you currently outsource to a third party offshore and do you plan to over the following time periods?
(% respondents)

	Currently employ	Plan to employ within 12 months	Plan to employ in one to three years	No plans to employ
Retail banking	18	6	16	60
Wholesale banking	11	21	7	61
Asset management	19	14	7	60
Investment banking	37	15	15	33
Insurance	15	11	22	52
All companies	20	11	13	56

Source: Economist Intelligence Unit, 2005

& Sun Alliance, a UK-based insurer, is an example. It decided in 2004 to shift 1,000 jobs to India, mainly in call-centre and software development functions. “In part this was driven by a need to improve the quality of what we were producing,” says Tony Chaudhry, the company’s infrastructure director. “We wanted to introduce innovations and techniques which we felt were more achievable through a third-party provider.”

Offshoring to a subsidiary

Offshoring to a subsidiary abroad is currently the least popular strategy for re-engineering business processes. According to the survey results, only 16% of financial companies currently send work to a lower-cost country within the group, although 36% expect to be doing so within three years. Again, attitudes to offshoring vary significantly by size, with large organisations far more likely to offshore business processing to other parts of their group than smaller ones. For example, while just 7% of organisations with a turnover of up to US$1bn currently offshore to subsidiaries abroad, the comparable figure for those with turnover over US$1bn is 31%, and is expected to rise to 59% within three years.

The chief advantage to offshoring to a subsidiary, as opposed to outsourcing to a third party abroad, is that the financial institution can retain more direct control over operations, including the ability to change requirements and assignments at short notice without incurring additional contractual charges. A major disadvantage is that it generally requires more upfront infrastructure and training investment from the financial institution, while outsourcing usually allows a company to plug into a ready-made system. Companies that make an upfront investment in their own offshore centres say, however, that they expect this to pay-off in the form of lower longer-term operating costs than they would have incurred under outsourcing contracts with existing suppliers.

“Depending on the particular process you’re talking about, savings (from offshoring) could be anywhere from 50% to 60%,” says Rob Muth, head of global resourcing at HSBC. “Outsourcing would also have a financial benefit, although typically not of the same magnitude.” HSBC ‘s offshoring schemes currently employ approximately 13,000 employees in five different countries, and that will rise during the course of 2005 to approximately 18,000 or 19,000, with the proportion of the group’s total workforce employed in offshore facilities rising to 10% by the end of the year. “I think offshoring can only become faster and easier,” continues Mr Muth. “Telecommunications infrastructure is now pretty robust, with failures becoming less and less frequent and bandwidth cheaper.”

Do you currently offshore business services to a subsidiary abroad or do you plan to over the following time periods?
(% respondents)

	Currently employ	Plan to employ within 12 months	Plan to employ in one to three years	No plans to employ
Companies with global revenues of up to US$1bn	7	8	7	78
Companies with global revenues in excess of US$1bn	31	16	12	41
All companies	16	11	8	65

Source: Economist Intelligence Unit, 2005

Conclusions

After falling far behind sectors such as manufacturing and logistics in their execution of business processes, financial service providers are streamlining their operations along business-process lines in the face of mounting competition and the availability of increasingly sophisticated IT. They are finding that it is not only possible to improve the speed and quality of performance, but that it can be done without losing control of key processes.

The need to improve efficiency and control costs has already persuaded nearly two-thirds of the companies surveyed by the Economist Intelligence Unit to establish internal shared facilities. Although they remain far happier outsourcing back-office processes to outside providers, financial companies are overcoming their resistance to outsourcing core business processes to third-party partners, especially where those third parties are based locally.

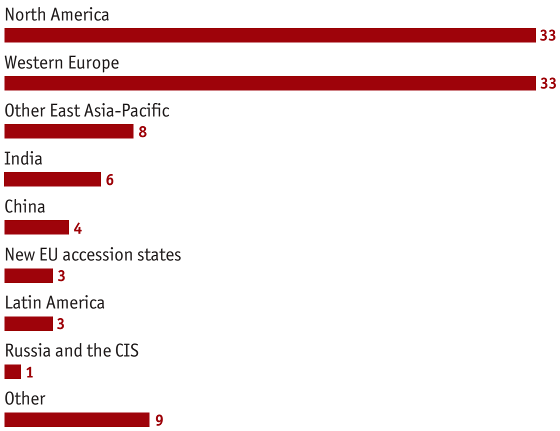
Some sectors, such as retail banking, are further down this path than others, for example insurance, but even here companies face mounting competitive pressures as a result of the emergence of more international insurance markets, and will have to change if they are to compete in a world of freer crossborder services. Companies with the ability to link their systems with those of providers and customers—without sacrificing data security or service quality— will be the winners in this globalised financial services market.

Appendix: Survey results

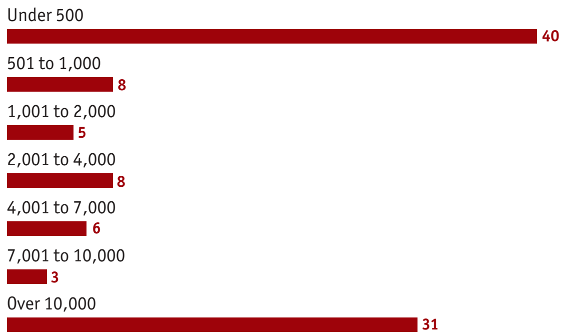
Better, faster, cheaper
Business process transformation in financial services

A total of 300 senior executives participated in our online survey on business process transformation in the financial services industry. The survey was conducted between March and April 2005, and our thanks are due to all those who shared their time and insights.

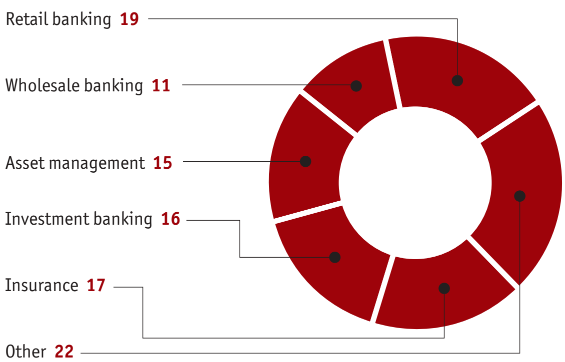
Where is your company headquartered?
(% respondents)



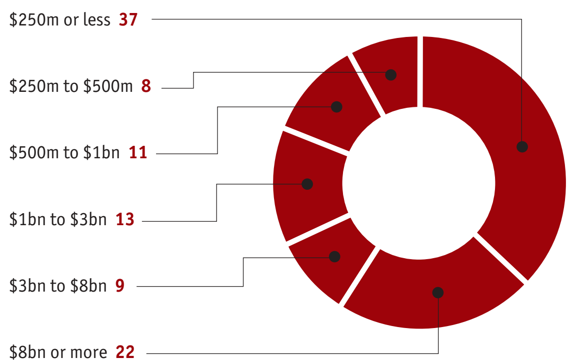
How many employees does your organisation have?
(% respondents)



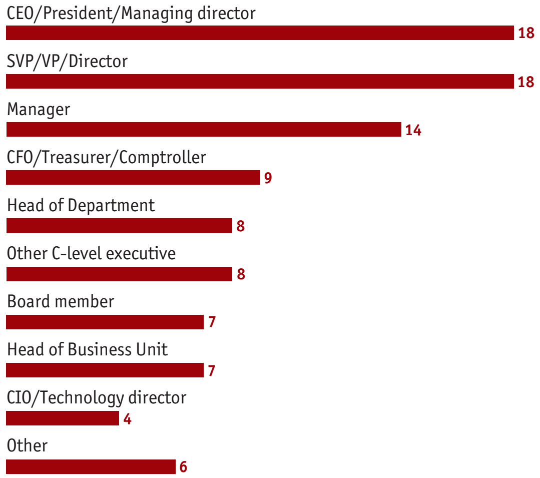
What branch of the financial services industry does your company represent?
(% respondents)



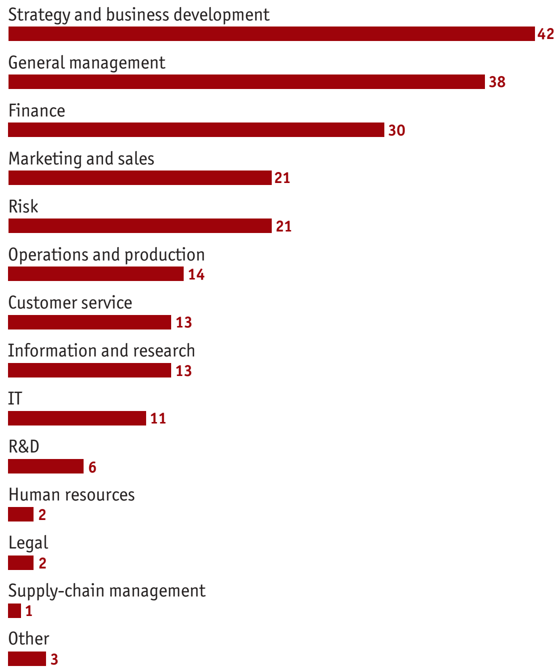
What are your organisation's global annual revenues in US dollars?
(% respondents)



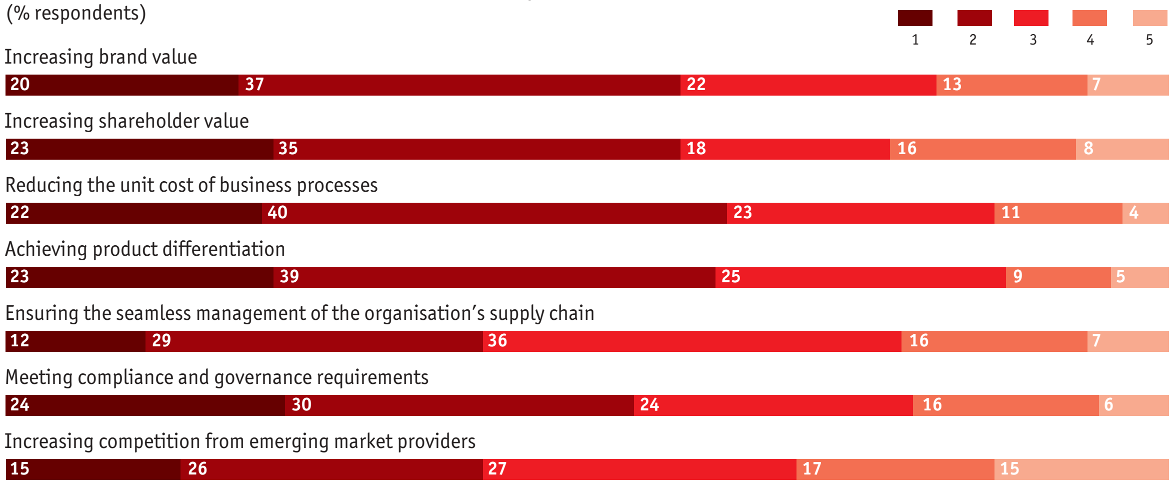
Which of the following best describes your title?
(% respondents)



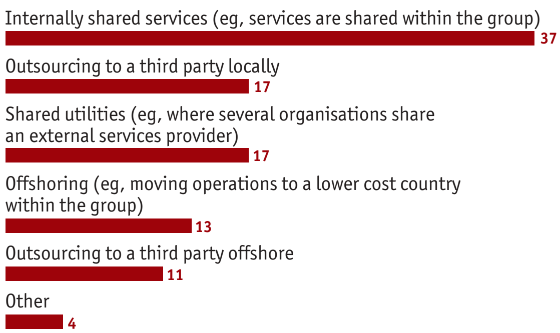
What are your main functional roles?
Please choose no more than 3 functions.
(% respondents)



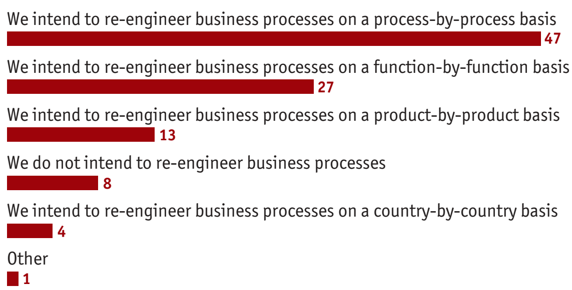
How significant do you think the following challenges will be to your organisation in five years' time? Rate on a scale of 1 to 5, where 1 = unimportant and 5 = very important.
(% respondents)



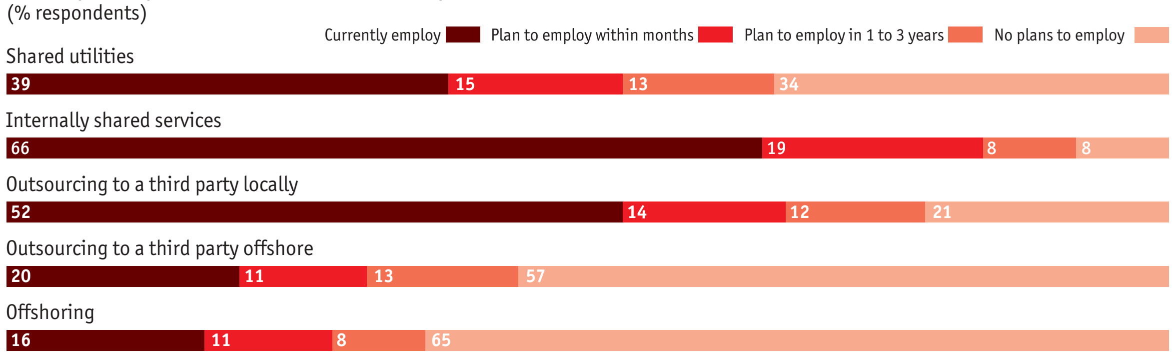
Which of the following strategies is, or would be, most effective in improving the efficiency of your organisation's business services?
(% respondents)



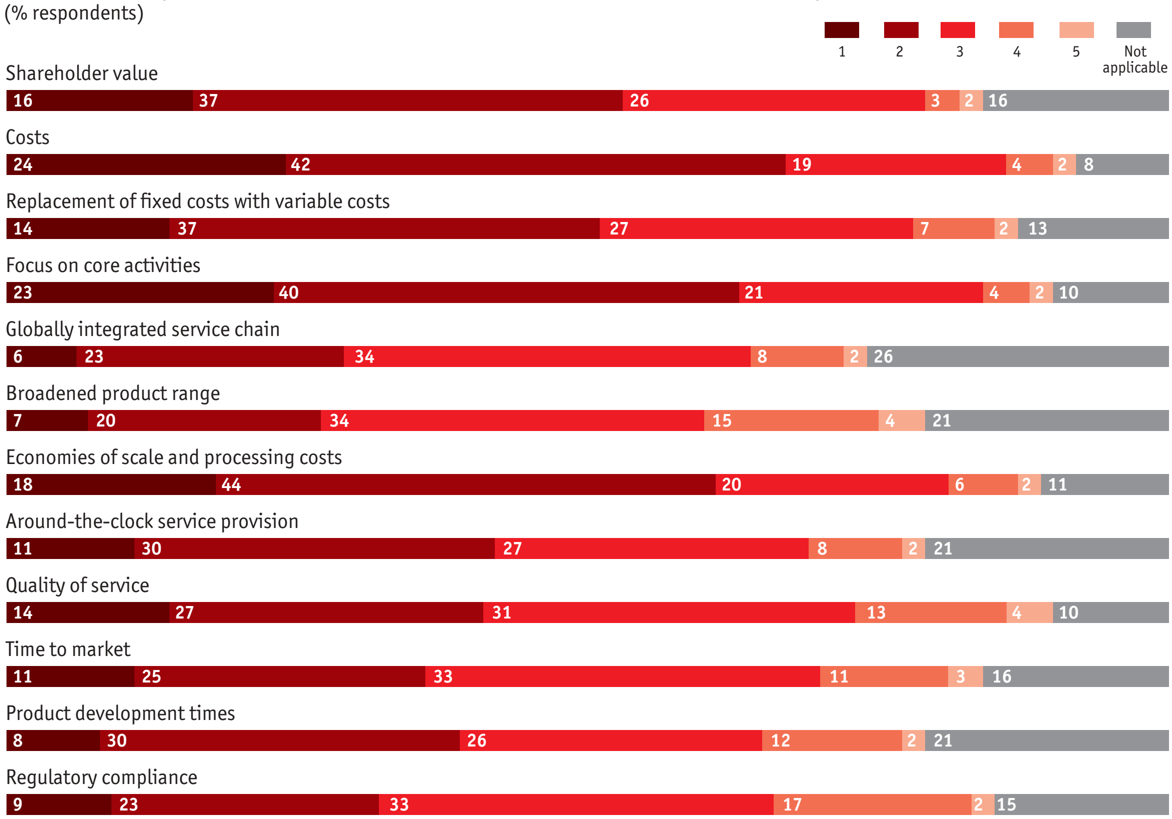
Which of the following statements best describes your organisation's plans to re-engineer business processes?
(% respondents)



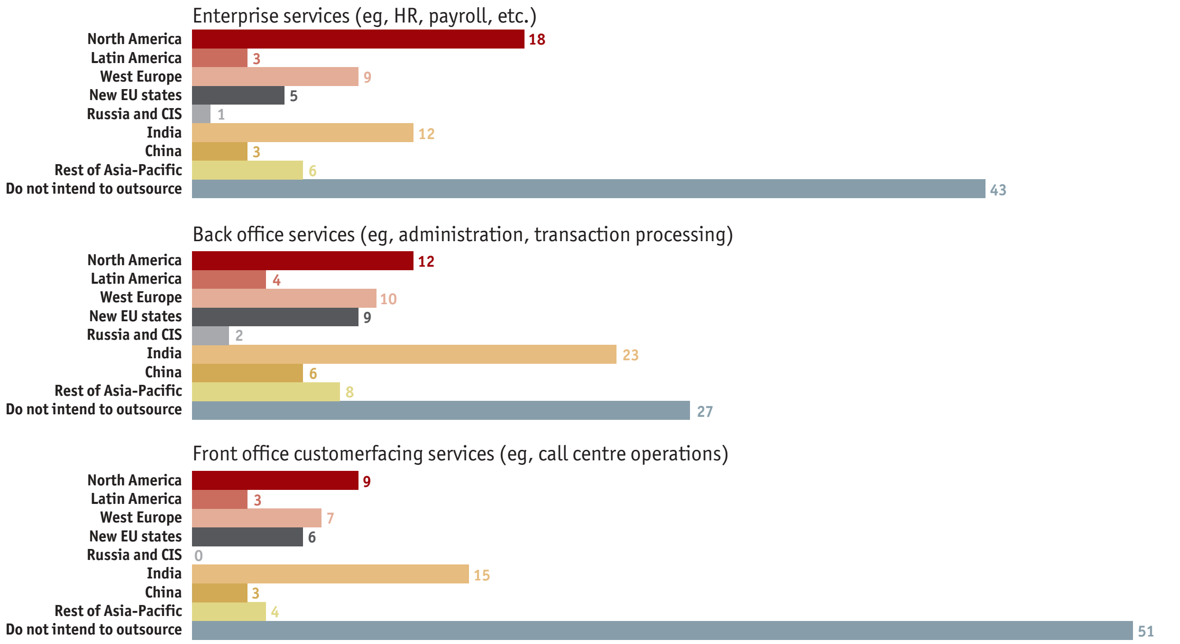
Which of the following strategies for optimising business processes does your organisation currently employ and which does it plan to employ?
(% respondents)



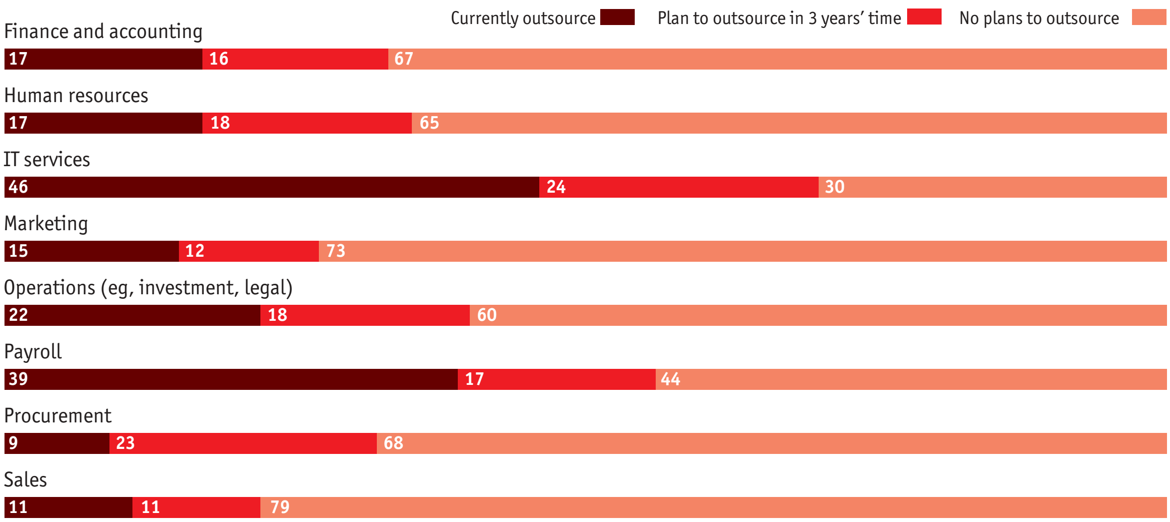
If your organisation uses, or plans to use, business process outsourcing, how do you expect the following factors to be affected over the next five years? Rate each on a scale of 1 to 5, where 1=Unimportant and 5=Critically important.
(% respondents)



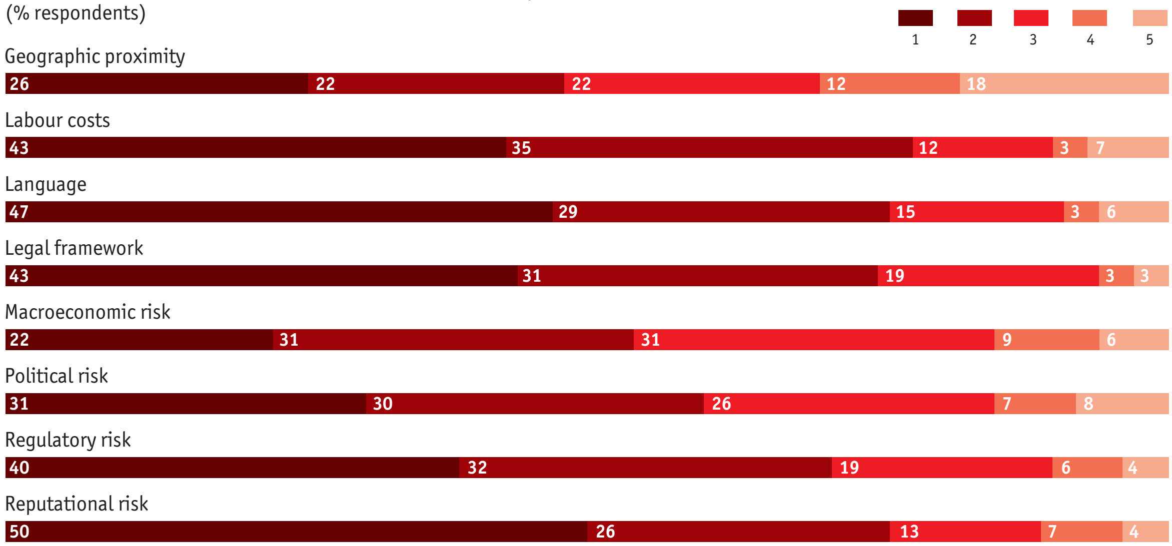
Which business processes and services does your organisation feel comfortable outsourcing to the following countries/regions?
(% respondents)



Which of the following enterprise business services does your organisation currently outsource and which does it plan to outsource in three years' time?
(% respondents)

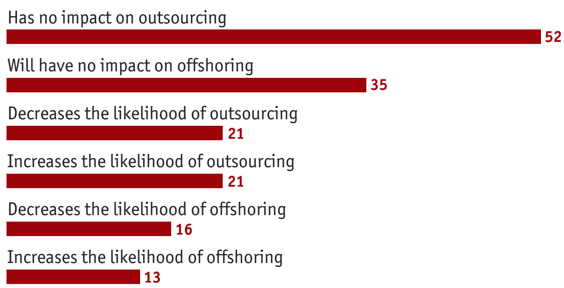


How important are the following factors to your organisation in determining where to locate outsourced activities? Rate on a scale of 1 to 5, where 1 = unimportant and 5 = very important.
(% respondents)

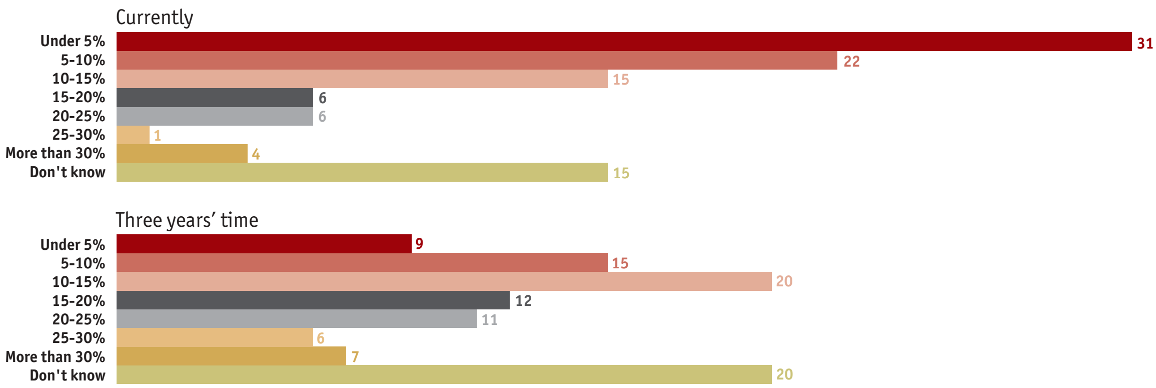


What will be the biggest changes to the competitive landscape of the financial services industry brought on by business process outsourcing?
(% respondents)

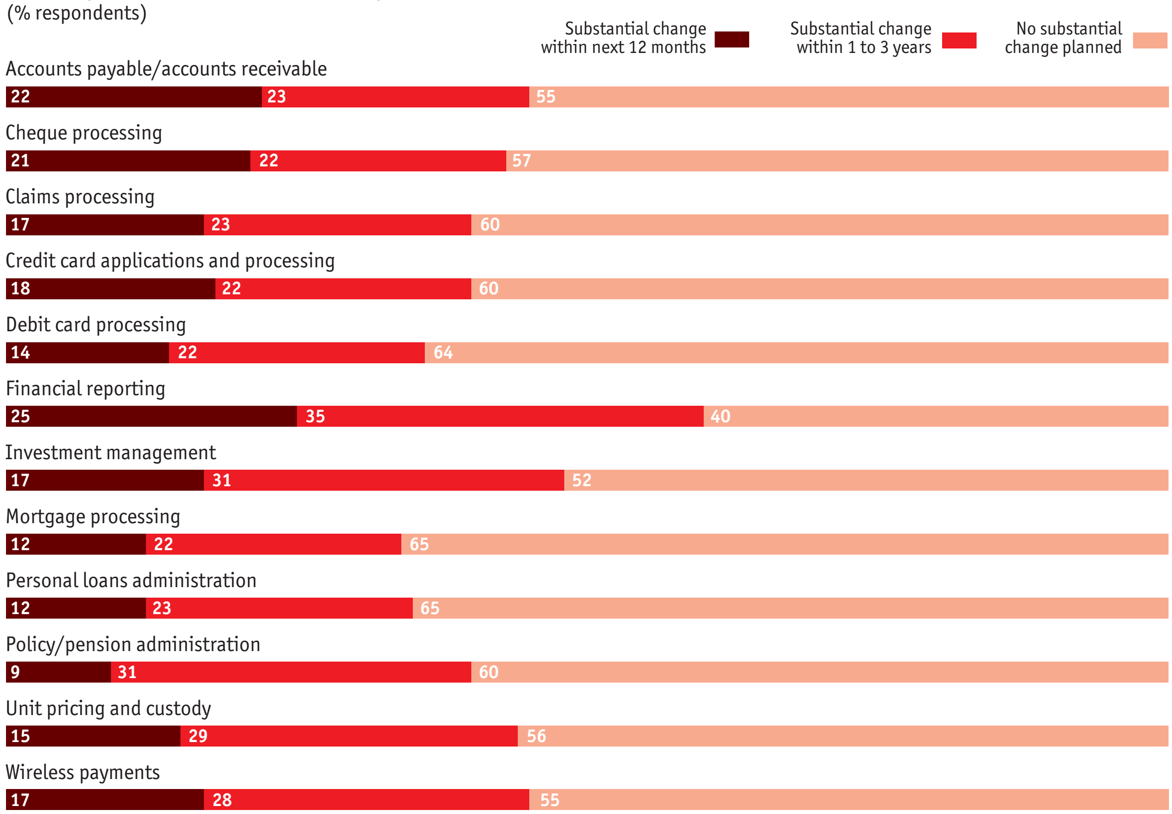
In your view, what is the impact of legislation such as Sarbanes-Oxley and Basel II on your organisation's decisions to outsource/offshore business processes?
(% respondents)



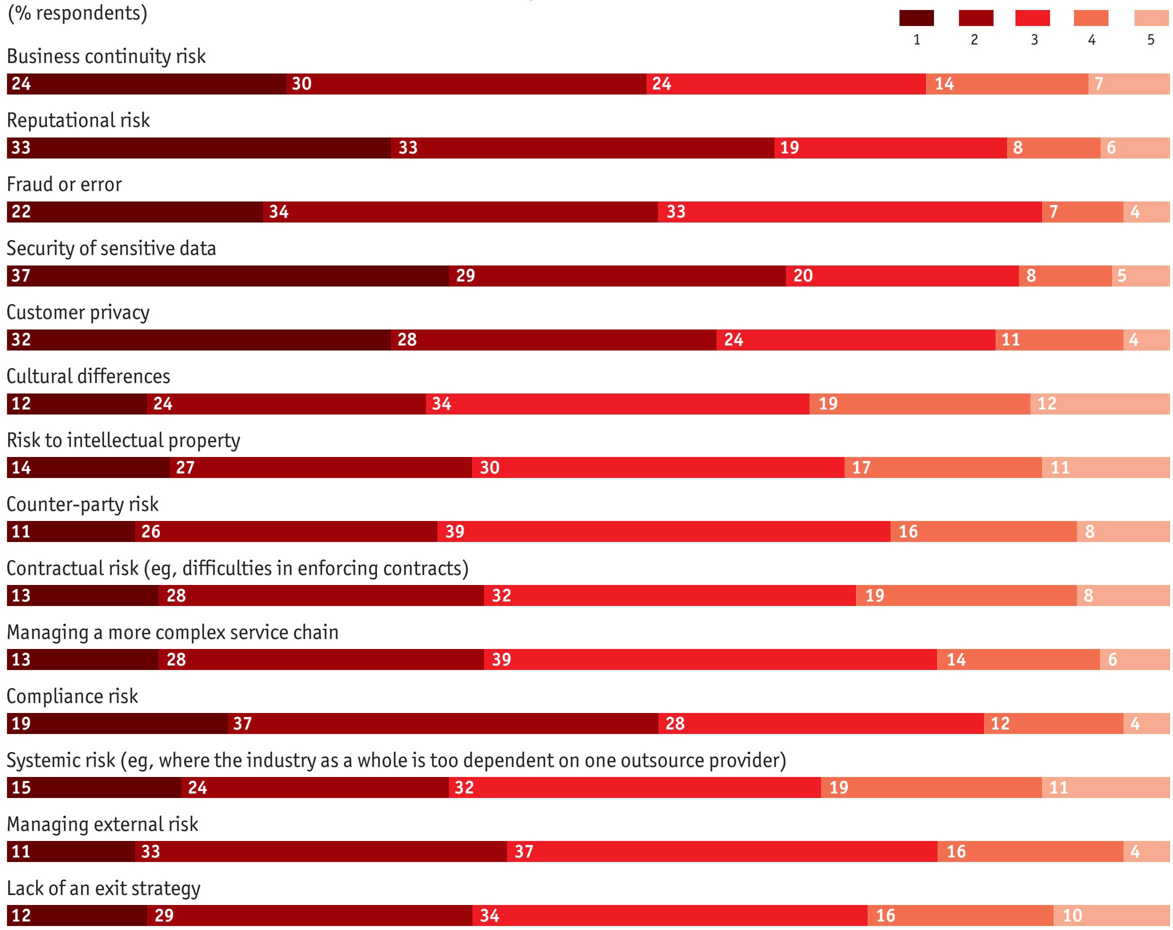
What do you estimate the cost of your organisation's business process outsourcing contracts to be as a proportion of overall costs at present, and what proportion do you expect them to comprise in three years' time?
(% respondents)



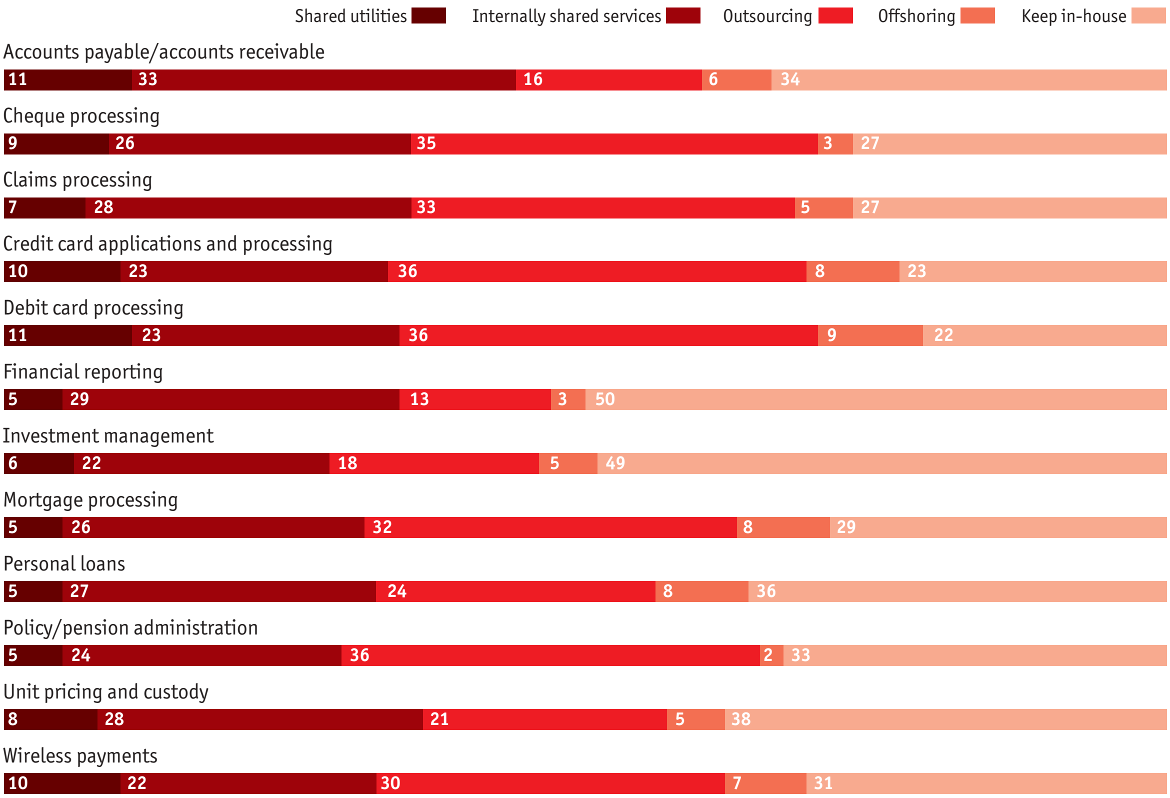
Which payment and credit processes does your organisation plan to re-engineer over the following time periods?
(% respondents)



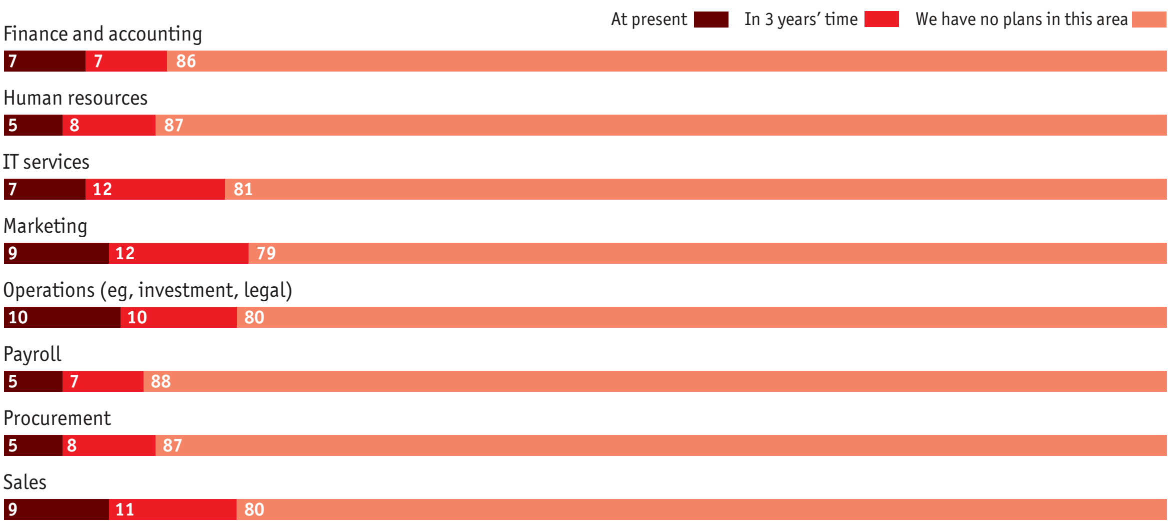
How significant are, or would be, the following risks to your organisation as a result of outsourcing business processes? Rate on a scale of 1 to 5, where 1 = unimportant and 5 = very important.
(% respondents)



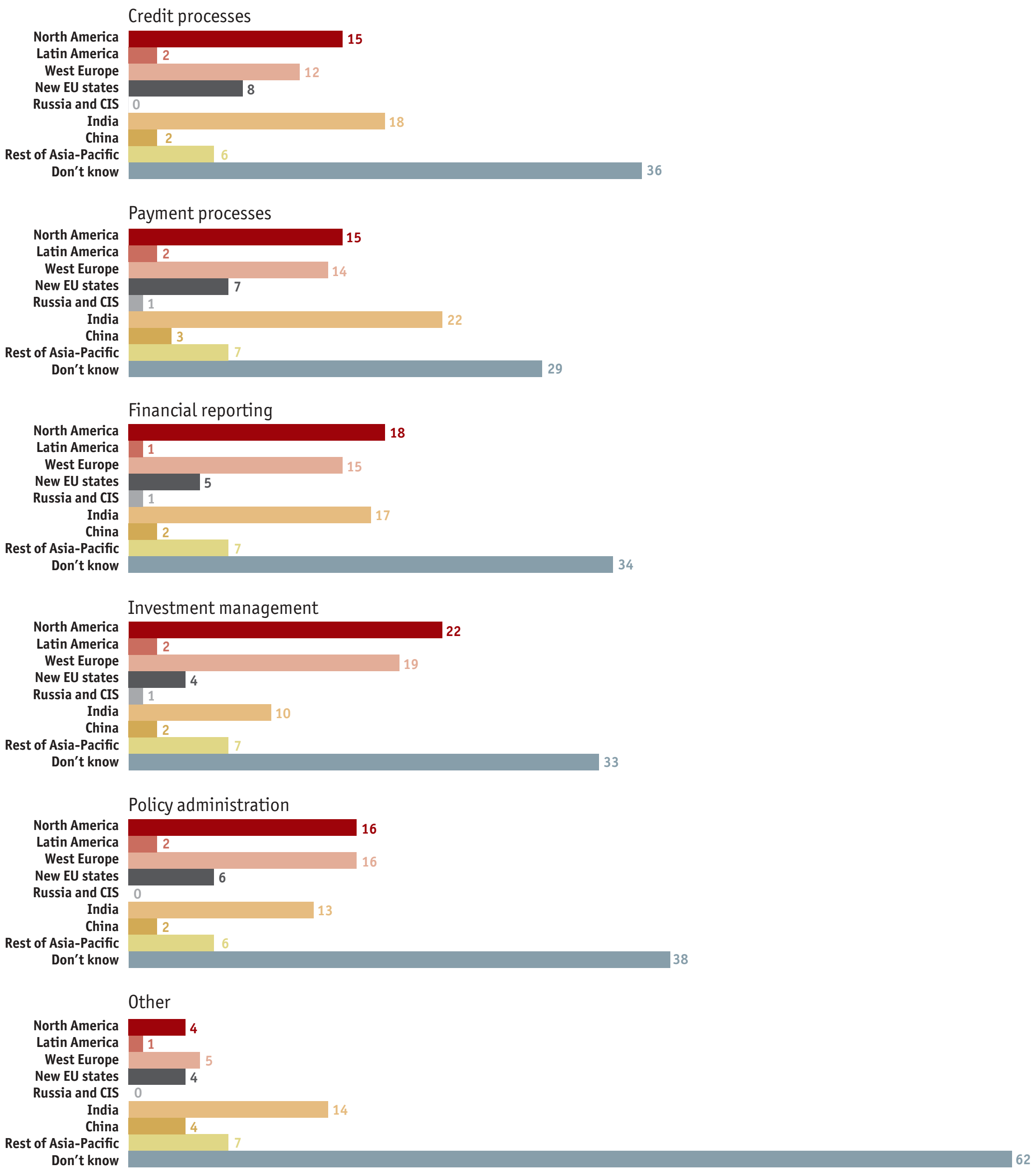
Which strategies do you consider most appropriate for each of the following processes?
(% respondents)



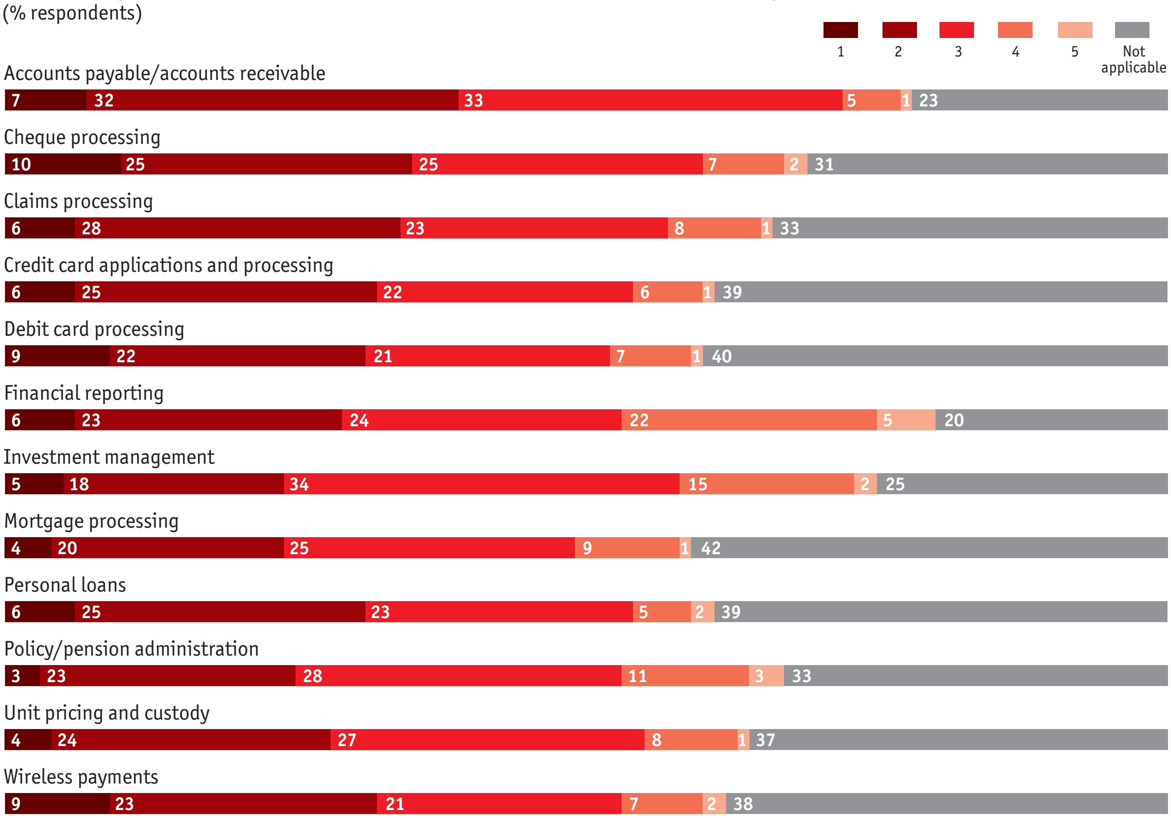
Which of the following activities do you currently undertake in China and which do you plan to undertake in three years' time?
(% respondents)



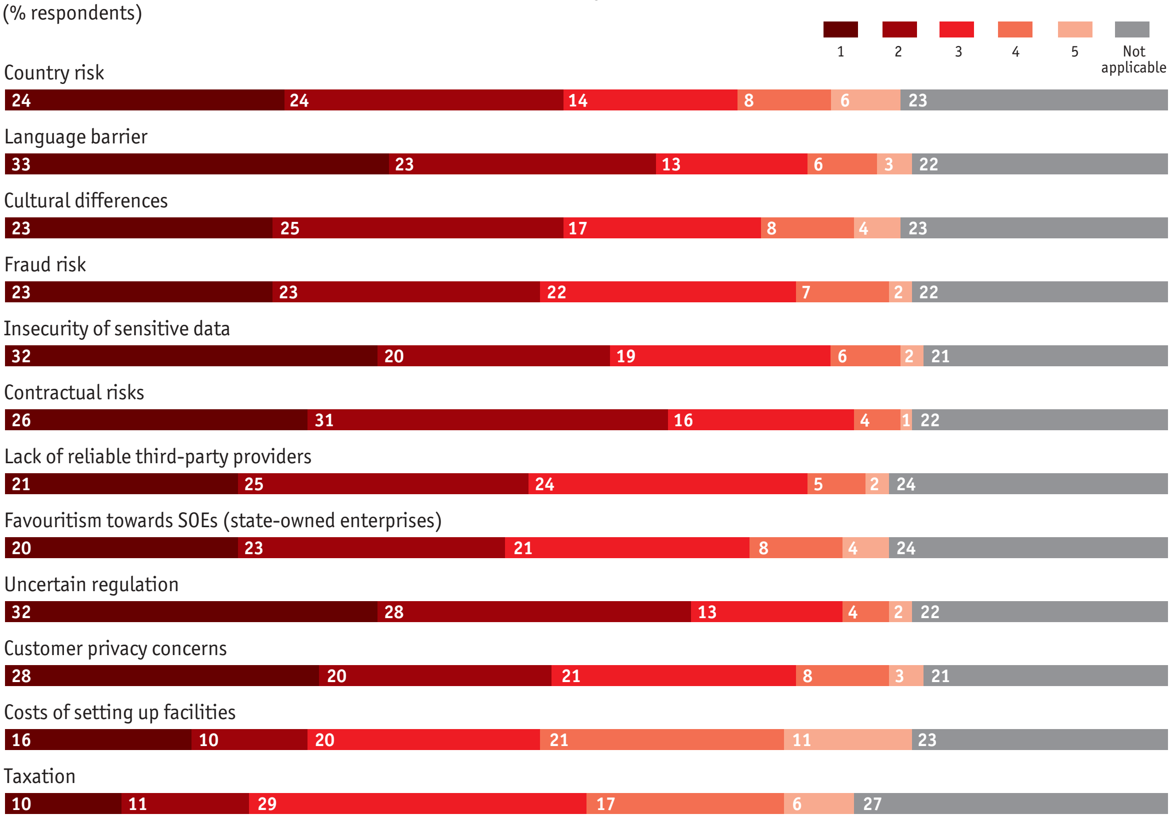
Which country/region is the most attractive destination for the outsourcing of the following payment and credit processes?
(% respondents)



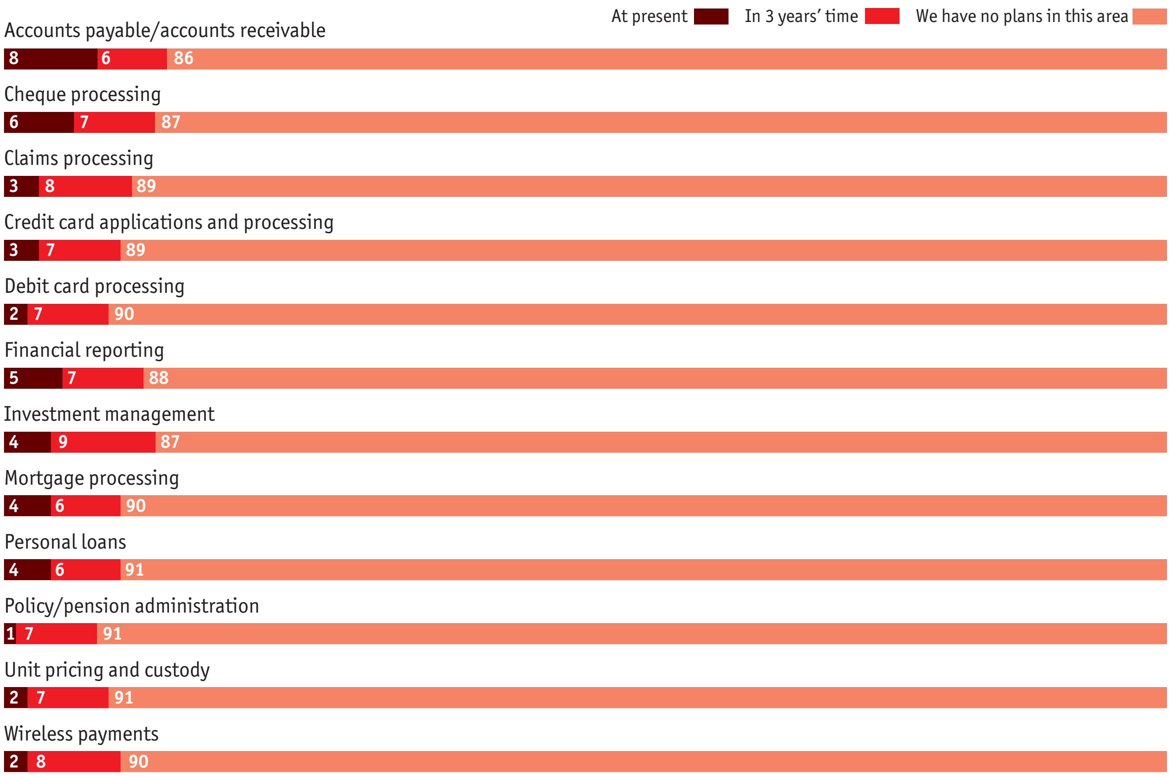
How do you expect the unit cost of the following payment and credit processes undertaken by your organisation to develop over the next five years? Rate each on a scale of 1 to 5, where 1=Unimportant and 5=Critically important.
(% respondents)



What are the principal obstacles for your organisation to locating business services and processes in China? Rate each on a scale of 1 to 5, where 1=Unimportant and 5=Critically important.
(% respondents)



Which of the following business processes do you currently carry out in China and which do you plan to carry out in three years' time?
(% respondents)



LONDON
15 Regent Street
London
SW1Y 4LR
United Kingdom
Tel: (44.20) 7830 1000
Fax: (44.20) 7499 9767
E-mail: london@eiu.com

NEW YORK
111 West 57th Street
New York
NY 10019
United States
Tel: (1.212) 554 0600
Fax: (1.212) 586 1181/2
E-mail: newyork@eiu.com

HONG KONG
60/F, Central Plaza
18 Harbour Road
Wanchai
Hong Kong
Tel: (852) 2585 3888
Fax: (852) 2802 7638
E-mail: hongkong@eiu.com