IDDmagazine.com

The insider's guide to investment banking and capital markets.

Banks' Outsourcing Options Mature

Concerns about risk are changing the landscape

By Jessica Papini

February 11, 2008

Some investment banks are changing how they run their outsourcing operations in countries such as India or China by building their own center in the region or hiring a third-party provider to support their in-house capabilities. This is a twist from five years ago when banks relinquished certain in-house responsibilities and hired companies overseas to perform functions such as business processes, information technology and research -- ultimately to cut costs.

"There have been significant changes over the last year, where business processes that were typically outsourced to a third-party provider are increasingly done in-house utilizing a captive model," says Jess Varughese, managing partner at Milestone a financial management consulting firm.

A recent Milestone survey -- which interviewed senior executives at global financial institutions about outsourcing arrangements -- found 78% planned on increasing their outsourcing using multiple strategies. Also, the survey revealed 79% of executives' chosen model for 2008 activities was to build a center overseas.

"There is migration of investment banks having captive facilities built, owned and operated by [themselves] rather than a third party," agrees Peter Lowes, principal and leader in Deloitte Consulting's outsourcing advisory services practice.

Related Items

- Articles
  - Morgan Stanley Net Falls Sharply, But Tops Views
  - Quattrone Sets Up Shop
  - No Slowing Down For The Fed
  - Goldman, Lehman Ease Some Concerns
  - Morgan Stanley Arrives In Kiev
- Blogs
  - This Is No Bear Market
  - Confidence Builder. Not.
  - The Same Old Song
  - Nothing Foreign About This Idea
  - Subprime: Insurers' Best Friend?
- White Papers
  - Developments in High-Risk Entity Screening
  - Commodity Heads Just Kept on Walking, Rising ... and Rolling

Outsourcing processes overseas was "viewed as a salvation" recalls Lowes, but years later, there is no on-shore comparison to make, and it's harder for banks to keep using the cost-saving argument, he says.

When banks started outsourcing it was a new concept and experience, says Lowes, adding many banks did not have a good handle on the process. Banks started working with third-party providers as they had expertise in the area, and used them as a pilot program. Over time, they have become more comfortable with offshoring, he said.

Banks are paying more attention to offshore units, and they are reengineering offshore operations, and performing rigorous analyses of the businesses.

The cost of building a captive offshore center is expensive and banks must take into account infrastructure, management of the center, and expenses for professionals to travel. "It's quite an ordeal," Lowes notes.

But, despite the challenges of creating an offshore captive center, banks still opt to go overseas. "Banks are choosing to build off-shore or near-shore captive operations primarily because they are concerned with rising levels of operational risks that they do not directly control," Varughese says, adding that if these operational risks increase it can lead to potential regulatory and reputation problems.

Meanwhile, many banks choose to build and run their own facilities overseas because of competitive issues. Banks want to protect their intellectual property, and do not want to train a third-party provider to perform certain functions, says Lowes.

Some firms also are not certain that third-party providers can take on processes that require a level of sophistication such as clearing and settlements and complex trade analytics. However, third-party providers are not entirely out of the picture. "While there has been a move to create captive centers, they may become less viable over time as third-party providers improve their expertise, delivery of products and security," says Rodney Nelsestuen, senior analyst at TowerGroup, a Needham, Mass.-based research and advisory firm.

"Third-party providers are able to leverage specific functional skills better across multiple clients," Varughese said, adding "financial institutions might want to question what are their core competencies." Milestone's survey found that 21% of respondents planned to contract with a third-party provider.

Then there are so-called hybrid options for banks weighing outsourcing functions. Such hybrid options have investment banks working with boutique third-party providers that offer a very focused product and can be hired for short periods. "These boutiques are thriving," says Lowes.

Outsourcing has also shifted from cutting costs to a war for talent. Banks want highly-qualified employees with PhD's and quantitative analysts to conduct quantitative research and provide analysis. Financial institutions are willing to set up shop wherever teams of these highly educated professionals want to be located.

Navigating The Compliance Labyrinth

Sovereign Wealth Funds: The New Power Brokers of Global Capitalism

- Podcasts

A Conversation with CIT's Walter Owens

Talking Shop

If talent is discovered in the Czech Republic, banks will hire a small team and set up shop for them, says Lowes. Retention is not an issue as the professionals perform very specialized work, and are compensated well.

For more information on related topics, visit the following:

- Investment Banking
- Financial Services