

Financial Services Offshoring: Moving Toward Fewer Captives and Global Cost Competitiveness

by The Conference Board and Duke Offshoring Research Network

Financial services companies show greater interest than other sectors in contracting with large international providers and becoming more cost competitive by moving operations to lower labor cost locations. They are also less likely to initiate captive operations. Many plan to expand current offshoring practices and start new projects in the near future.

As They Gain Experience, Financial Companies Tend to Shift Their Provider Focus

Historically, financial services and insurance (F&I) companies have been among the largest users of offshoring, and that still holds true—17 percent of all companies surveyed in the fifth annual Duke University survey (2009) come from the F&I industry. (Only manufacturing (28 percent) and professional and technical services (23 percent) have higher survey participation rates.) However, the service delivery model they have been using for offshoring has changed. Prior to 2001, 61 percent of F&I companies reported that they initiated offshoring through captive operations (Chart 1, page 2). As the decade progressed, the percentage of those starting captive operations dwindled,

and by 2006, most of the large financial institutions had already built significant captive operations. According to the 2009 survey, only 17 percent of F&I companies opened a captive delivery center in the past two years.

Glossary

Captive A delivery model in which the processes offshored are performed by a fully owned subsidiary in an offshore location.

Offshoring Processes are performed outside of the home country of the company. Offshore services can be provided by a captive unit (offshore captive) or a third-party service provider (offshore outsourcing).



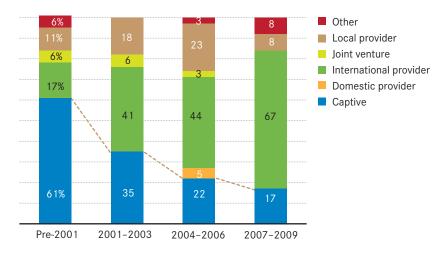


The Global Offshoring Research Network (ORN) was established at Duke University's Fuqua School of Business in 2004. ORN is a network of research partner Universities, scholars, and practitioners that has become the most recognized international research network tracking the globalization of services over time.

Respondents from F&I organizations with captive operations rate "part of a larger global strategy" (83 percent) the number one driver that influenced their offshoring decisions (Chart 2, page 3).

Chart 1 F&I companies are moving from captives to international providers

Percent of offshoring implementations in F&I industry using a particular service delivery model by launch year



Note: Percentages may add up to above/below 100 due to rounding.

Source: Duke University/Archstone Consulting Offshoring Research Network 2005 U.S. Survey, Duke University/Booz Allen Hamilton Offshoring Research Network 2006 U.S. Survey, Duke University/The Conference Board Offshoring Research Network 2007/8 U.S. Survey, Duke University/The Conference Board Offshoring Research Network 2009 Survey

Many F&I companies that recently initiated captive models are large financial institutions. Follow-up telephone interviews with survey participants revealed that when large institutions begin to globalize their operations, they prefer a

> captive model because it is perceived as a hedge against the "loss of managerial control" and a way to counteract internal resistance within the company.

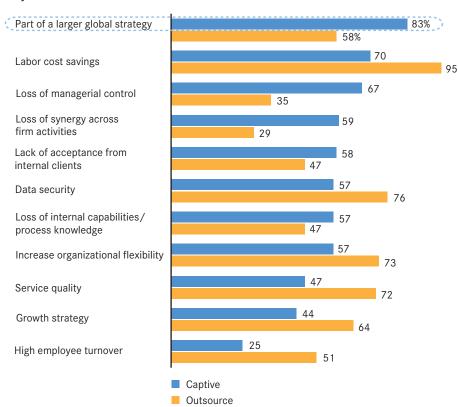
As these larger F&I companies become more experienced with offshoring, they tend to diversify their operations and put a greater emphasis on third-party "international providers." For smalland medium-sized F&I enterprises, many of which began offshoring more recently, captive operations represent a considerable investment in a delivery model that makes it difficult to achieve flexibility, cost savings, and continual improvements without significant scale and oversight. Given the maturation of the service provider industry, choosing a qualified third-party provider may also be easier for businesses of all sizes than it was even three years ago.

Editor's Note This Executive Action is based on preliminary findings from the 2009 Client Survey, which was administered between 2007 and 2009 as a joint effort by the Offshoring Research Network (ORN) at Duke University Fuqua School of Business and The Conference Board, and was conducted in conjunction with the 2009 ORN Provider Survey (sponsored by PricewaterhouseCoopers). While data were collected from companies in the United States, Europe, and Australia, this Executive Action focuses on respondents that have headquarters in the United States. The final data and analysis from both surveys will appear in a full report later this year. This report also uses insights shared during the Duke Offshoring Research Network Financial Services Executive Roundtable in November 2009.

Still, a captive operation does offer certain advantages. A captive environment allows employees to develop a deeper understanding of the business, which is sometimes necessary for carrying out more nuanced and innovative types of work. For example, outsourcing certain aspects of accounting, such as account payables transactions (debits and credits), can be easy. Dealing with a customer who pays regularly but is difficult to work with and needs special attention may require staff with proprietary knowledge, which is better developed in a captive environment. Retaining and promoting key talent may also be easier in captive operations. Only 25 percent of respondents with captive operations say "high employee turnover" is an important risk, while 51 percent of respondents who outsource say they are concerned about losing key staff at their providers (Chart 2).

Chart 2 Companies with captive operations place a higher priority on strategy than those that outsource

Percent of F&I companies rating drivers and risks as "important" or "very important," by dominant function model



Source: Duke University/Archstone Consulting Offshoring Research Network 2005 U.S. Survey, Duke University/Booz Allen Hamilton Offshoring Research Network 2006 U.S. Survey, Duke University/The Conference Board Offshoring Research Network 2007/8 U.S. Survey, Duke University/The Conference Board Offshoring Research Network 2009 Survey

Many Companies Are Lowering Overall Costs by Expanding Their Footprint

In the past two years, F&I firms have faced a number of significant challenges, ranging from compliance with the Troubled Asset Relief Program (TARP), geopolitical issues (e.g., the November 2008 terrorist attacks in Mumbai), the Satyam scandal, open letters, daily calls from the media, etc. Moreover, they have had to weather these storms in the midst of a recession. In spite of these obstacles, many companies have still increased their offshoring operations.

These recent events have led many companies to rethink where and how their work gets done. For example, while the client-facing work of a teller at a bank in Manhattan cannot be relocated to Oklahoma or Hyderabad, 35 percent of his/her

work could be classified as administrative, back-office tasks, according to a participant at the Duke Offshoring Research Network Financial Services Executive Roundtable's biannual meeting in November 2009 (hosted by global sourcing advisory firm TPI). If tellers could be freed from their administrative work, they would be able to devote more time to revenue-generating customer-service activities, including cross-selling of products, promoting investment opportunities, and general relationship building. Banks could even recruit individuals who excel in interactions with customers. The remaining administrative tasks could then be effectively outsourced or offshored.

In addition to the functions they choose to outsource/offshore, many F&I firms are reconsidering where they send these functions. While India remains the primary destination, many financial services firms are locating operations elsewhere. India's market share of U.S. outsourcing has declined slightly in recent years due to higher wages for Indian workers with master's

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degrees and PhDs, shortages in certain IT capabilities, and the rising cost of office space. There have also been increased concerns about time differences. For example, staff in India must work the overnight shift to coincide with business hours in the United States, which leads to high turnover rates and the use of less-qualified workers. Having an outpost in Argentina or Costa Rica means workers are only one to three time zones away from many U.S. business centers. As a result, F&I companies in the United States are increasingly choosing Latin American destinations such as Mexico and Colombia for contact centers and IT support (Chart 3).

Many financial services firms report expanding their operations in second- and third-tier cities, both domestically and abroad (Table 1). In addition to lower operating costs and access to talent, these locations lower the risks companies run from national disasters and geopolitical unrest. For example, companies that had outsourced to multiple locations in India fared better during the terrorist attacks on Mumbai than those who had operations only in Mumbai. Smaller cities also offer lower rents and operating costs, as well as better labor arbitrage deals.

As companies expand their outsourcing footprint, especially in response to the increasing demand for highly skilled software development staff, they may not even choose to offshore. Popular locations now include offices in second- or third-tier U.S. cities, such as Research Triangle Park (RTP) in

Table 1
Emerging offshore locations

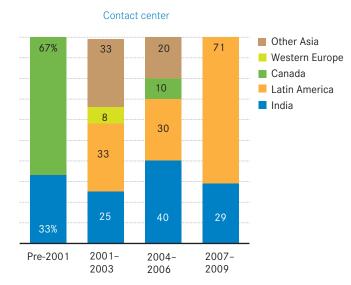
Contact center	Finance & accounting	IT	Software development
El Salvador	China	Australia	Belarus
India	Costa Rica	Belarus	China
Mexico	India (Dehli, Hyderabad,	China	India (Hyderabad,
Philippines	Pune)	India (Hyderabad,	Bangalore)
South Africa (Cape Town)	Korea	Mohali)	Korea
	Philippines	Singapore	Philippines (Cavite)
	Vietnam		()

Sources: Duke University/The Conference Board Offshoring Research Network 2007/8 U.S. Survey, Duke University/The Conference Board Offshoring Research Network 2009 Survey

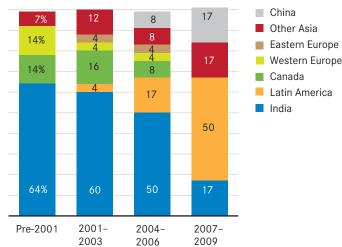
Chart 3

Latin America is becoming a preferred location for contact center and IT offshoring

Distribution of offshore destinations chosen by F&I companies by launch year







Note: Percentages may add up to above/below 100 due to rounding.

Source: Duke University/Archstone Consulting Offshoring Research Network 2005 U.S. Survey, Duke University/Booz Allen Hamilton Offshoring Research Network 2006 U.S. Survey, Duke University/The Conference Board Offshoring Research Network 2007/8 U.S. Survey, Duke University/The Conference Board Offshoring Research Network 2009 Survey

North Carolina and Jacksonville, Florida. One motivation may be employee retention. In the case of RTP, the companies located in the science park are able to capitalize on the desire of graduates from North Carolina universities to work in the state.

Countries and cities are actively trying to attract business services outsourcing or corporate captives. The enticements they offer include tax incentives, new infrastructure, assistance with recruiting staff, and help smoothing bureaucratic obstacles with the central government. In many cases, these incentives often feature investments in human capital to increase the local supply of talent. Such incentives can influence where F&I companies choose to locate. According to Michael Rehkopf, partner, director North Asia, TPI, several cities in China (e.g., Huaqiao) offer a range of incentives rental, wage, and training subsidies; improved transportation; tax relief; and visa assistance—to increase their attractiveness. The Chinese government has designated 20 cities as outsourcing hubs, including Wuxi and Hangzhou, where new office facilities are being built where manufacturing facilities used to be. This is in anticipation of surpassing India as an

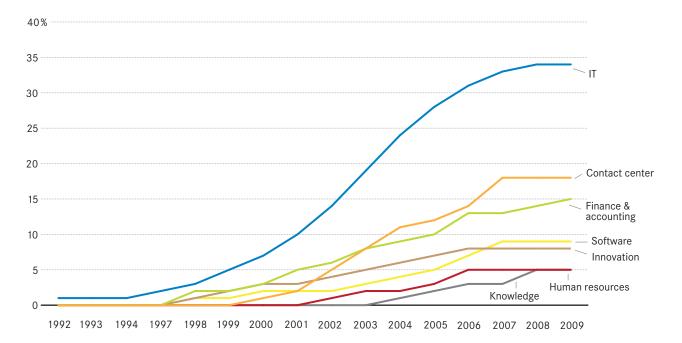
outsourcing destination. According to development plans, Wuxi expects to eventually attract \$30 billion to \$40 billion in service outsourcing business and help create service outsourcing jobs for 1 million people by 2020, which is equivalent to that of India as a whole in 2007.¹

Where Is Offshoring Headed?

While there has been a gradual increase in the types of functions offshored, offshoring has generally leveled off over the past few years (Chart 4). While this may be a reflection of respondents' feelings about an increasingly hostile business environment, it may also indicate that the increase in offshoring has stalled only for the moment. There is the possibility that once companies feel they are able to emerge from the current recession, they will continue to expand their offshoring initiatives.

Chart 4

Cumulative percentage of F&I companies offshoring, by function



Source: Duke University/Archstone Consulting Offshoring Research Network 2005 U.S. Survey, Duke University/Booz Allen Hamilton Offshoring Research Network 2006 U.S. Survey, Duke University/The Conference Board Offshoring Research Network 2007/8 U.S. Survey, Duke University/The Conference Board Offshoring Research Network 2009 Survey

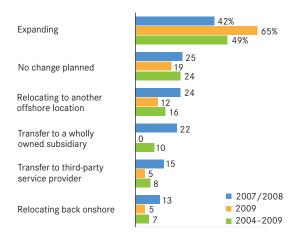
Wang Ying, "Wuxi Is Ready to Become a 'Little India'" *China Daily*, November 2, 2009. (www.chinadaily.com.cn/bizchina/2009-11/02/content 8879754.htm).

The survey results provide some insight into where financial services offshoring is headed in the next few years. Compared to the 2007/2008 survey, when only 42 percent of F&I industry respondents said they intended to expand their offshore operations, 65 percent of 2009 F&I participants say they expect to increase their offshoring presence (Chart 5). Also, a large number of F&I firms are planning new offshoring initiatives across functions over the coming 18 to 36 months. More specifically, 67 percent foresee new IT infrastructure initiatives, 45 percent expect new accounting and finance initiatives, 42 percent anticipate new custom software development projects, and 24 percent look forward to new contact centers (Chart 6).

Looking back over the past six years (2004–2009), almost half of F&I companies (49 percent) said they planned to expand their existing offshoring activities in the next 18 to 36 months. Only 7 percent planned to relocate operations back to the United States, 10 percent of the F&I companies planned to switch from a third-party provider to a captive, and 24 percent indicated they were not planning any changes (Chart 5).

Follow-up interviews with survey participants and comments made by participants of the 2009 November roundtable reveal several trends emerging:

Chart 5
Future plans for F & I companies



Note: Multiple answers were allowed, so percentages may add up to more than 100.

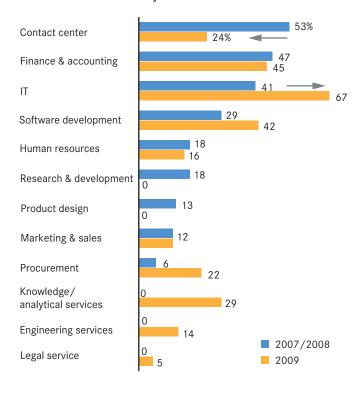
Small- and medium-sized F&I companies are hesitant to expand global services operations The global recession left some companies wondering whether they would remain in business. And even if they remained viable, offshoring as a practice always contains risks—perils include contractual issues, political instability, and fluctuating exchange rates. Creating an enterprise risk management plan to overcome these obstacles can be overwhelming for smaller operations.

Call centers shift to "contact" centers F&I companies continue to have plans for expanding their contact centers, although the growth rate is lower than in past years.

Chart 6

More than half of F&I companies plan to offshore in near future

Percent of F&I companies indicating "plan to offshore new function" in the next 18-36 months by function



Source: Duke University/The Conference Board Offshoring Research Network 2007/8 U.S. Survey, Duke University/The Conference Board Offshoring Research Network 2009 Survey

Meanwhile, new forms of contact centers are emerging that embrace digital technologies. For example, an increasing number of people are using email for outbound contact and social networking to ask questions regarding use of a service. Another trend involves relocating voice call centers to the Philippines. In particular, according to a large midwestern diversified manufacturing company that participated in a case study for the Duke ORN, U.S. clients find that agents in Filipino voice contact centers tend to provide better customer service. Roundtable participants indicate a strong interest in closely tracking how digitization is transforming contact centers applications.

Cost avoidance versus cost savings The initiation of new captive offshoring projects has slowed as companies have shied away from the upfront investments required for launching captive operations offshore. Several companies now have service providers take on these costs—sometimes in return for longer contract periods. They are also having service providers re-engineer processes after the contracts have been signed (rather than streamlining processes before the outsourcing starts) and undertake continuous process improvement after the functions/processes have been outsourced. These new models are leading to new types of gain-sharing contracts, earlier realization of potential upfront savings, and, for providers, retention of the benefits of continuous process improvements.

F&I industry outsources additional business services and negotiates new contracts The F&I industry in the United States is likely to continue its expansion of the outsourcing of business services, ranging from contact centers to custom software development. It will also remain one of the larger users of outsourcing, especially as providers compete for business by offering better terms—particularly for information technology outsourcing (ITO) and business process outsourcing (BPO) services—and adding new service offerings that companies once considered impractical to out-

source. This is especially true for knowledge and analytical services, including legal process outsourcing (a fast-developing application), forecasting, credit analyses, and marketing applications.

A few F&I companies are in the early stages of negotiating new ITO and BPO contracts that require the provider to make greater use of the company's enterprise resource planning (ERP) system for certain analyses and reporting. The idea is to rein in the costs of custom software development. Ultimate success, however, requires a strong internal governance system for curbing custom reports and making do with the more generic reports that are available through an ERP system.

Conclusion

The trend away from captive centers will continue as providers become more sophisticated and gain the trust of F&I companies. New outsourcing destinations will continue to become available, and within countries such as India and China, second- and third-tier cities will attract new outsourcing contracts as firms look for access to talent, risk reduction, and lower-cost operations. Lowering the global cost footprint by globally sourcing for transaction processing, back-office operations, and call/contact centers is no longer a strategic option but a necessity if companies want to remain cost competitive.

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