CENTRAL BANK OF EGYPT
Egyptian Banking Institute

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CURRENT TRENDS

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Outsourcing in the Banking Sector

MOVING FORWARD WITH CONFIDENCE...

Background

Outsourcing has been around for centuries, however only recently banks are just discovering how it can empower overworked staff and bring added value for both the banks and the customers. Additionally, banks started to perceive outsourcing as an option of great potential in helping them address some of the most pressing challenges in the sector today: cost and technological change. At its best, outsourcing can make banks more efficient and drive innovation in an increasingly competitive environment. As a result, outsourcing of business functions has become an integral part of banking operations.

Defining the Concept Outsourcing in the Banking Sector

The term outsourcing can be defined as the use of a service provider by the bank to contract out part of its day-to-day banking activities to reduce its cost of operation, enhance customer satisfaction, utilize specialized skills, and reap other strategic/operational benefits.

Over the last few years, outsourcing banking operations has gathered momentum and the nature of the outsourced tasks has evolved. Up until recently, IT processes and client relationship management especially in retail banking, accounted for the majority of large-scale outsourcing. However, the types of outsourcing services had doubled to range from compliance processing tasks to critical day-to-day business activities.

Benefits of Outsourcing in the Banking Sector

Outsourcing banking operations can make a swift and positive impact on the bank's bottom line while freeing up its internal resources to focus on the core competencies. Many financial institutions already outsourced core administrative functions like payroll, regulatory compliance, and digital banking services. Outsourcing proved its efficiency in:

- Eliminating the cost of hiring full-time processors.
- Involving trained processors with accumulative knowledge and experience.
- Providing more time for the banks' management to focus on its core competency.
- Leveraging big data analytics and modeling.
- Accelerating Customer's satisfaction.

Outsourced Process Lifecycle

- **Defining objectives:** The foremost pillar of a successful outsourced process is to have clearly articulated business objectives. These objectives drive all the subsequent decisions for the remainder of outsourcing life cycle. These objectives ought to be unequivocal, specific, and measurable.
- **Identifying outsourcing risks:** all the risk associated with the outsourced process are to be identified and analyzed during the process. Risk indicators need to be established on an ongoing basis.
- **Establishing key metrics:** Once the outsourcing objectives and related risks are defined, it is important that key metrics are established to manage risk levels and achieve performance targets. Well-defined metrics should:
    - Align with defined objectives
    - Track and measure all identified risks
    - Measure performance objectively
    - Incorporate realistic performance targets
    - Measure performance both quantitatively and qualitatively
    - Be flexible to changing environment
    - Provide results and trends proactively
- **Selecting tools to measure performance metrics:** select a tool that can effectively measure the performance of the outsourced process. The following is important to be considered once selecting the right tool:
    - Cost effectiveness
    - Ease of implementation and operation
    - Ease of disseminating information to key stakeholders
    - Scalability and flexibility to meet future demands
    - Reliability and relevance of information provided

Risks of Outsourcing in Banking

While outsourcing in banking has become a standard business practice, it has also created new risks. These risks can be broadly grouped into the following categories:

- **Strategic risk:** While outsourcing is primary used by banks to reduce operation costs and enhance quality, failure to clearly articulate the outsourcing objectives can expose the bank to strategic risks.
- **Operational risk:** While operational risks are intrinsic to any banking process, the probability of materializing the risks can significantly increase if such processes are outsourced without adequate due diligence.
- **Regulatory & Compliance risk:** lack of comprehensive awareness of the regulatory requirements by the service provider might lead to weak internal controls and may even harm the consumer and the bank itself.
- **Reputational risk:** any errors in the implementation or inconsistency between the bank's standards and that of the service provider will be translated into a reputational loss to the bank. Thereby, minimizing the risks associated with outsourcing in banking and securing successful outsourcing requires adhering to all the legal requirements applicable to the product or the service being provided by the service provider. Those requirements ought to be implemented carefully and effectively.

Outsourcing Decision in Banking Industry: Outsourcing Decision Matrix

When considering outsourcing, a common question is which activities should be outsourced and which tasks should be done in-house. Banks generally use following decision matrix for effective outsourcing decision

Outsourcing decision matrix: in outsourcing decision matrix, two important factors are considered in outsourcing a particular function to be performed by a bank. Those factors are:

- How strategically important is the task to the business of a bank? and
- What is the task's impact on the bank's operational performance?

The quadrants of the outsourcing decision matrix are:

- **Form strategic alliance:** Tasks in this quadrant are high in strategic importance, but contribute little to operational performance. Although a bank needs to retain control of them to ensure they are done exactly as it wants, they are relatively insignificant in terms of cost or smooth running. Therefore, such tasks are not worthy of full in-house focus. This means that the bank should form strategic alliance with another competent party.

• **Retain**: Tasks in this quadrant are high in strategic importance and have a big impact on operational performance. Banks should keep such tasks in-house to exercise maximum control over these.

• **Outsource**: Tasks in this quadrant are important for successful operational performance, but are not strategically important. Bank could safely outsource such tasks. They're simply not worth spending in-house, examples are: Marketing of bank products, Opening, settlement and closing of accounts, internal Audit…e.t.c.

• **Eliminate**: Tasks in this quadrant are not important to the bank's overall strategy. Moreover, such tasks do not make a significant contribution to its day-to-day operational performance.

All in all, usually, banks are less likely to outsource the services that are directly related to their strategic objectives. According to Deloitte (2018), Banks can leverage outsourcing in some of the following:

- Loan application management
- Know your client (KYC) support
- Customer support
- Mortgage and other loan servicing management
- Deposits services management
- Default management
- Complaints management
- Information technology (IT) infrastructure and technology help desk support

Illustrative Videos on Outsourcing in Banking

Outsourcing in Banking Industry:
https://www.youtube.com/watch?v=Mc8D5MiDWog

Outsourcing Decision in Banking
https://www.youtube.com/watch?v=3oYA2lBgSZk

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