

CHAPTER 5

Business Process Outsourcing (BPO)

5.1 BPO in general

Business Process Outsourcing (BPO) simply means using a contractual service to completely manage, deliver and operate one or more business processes or functions. The following are some common areas of outsourcing:

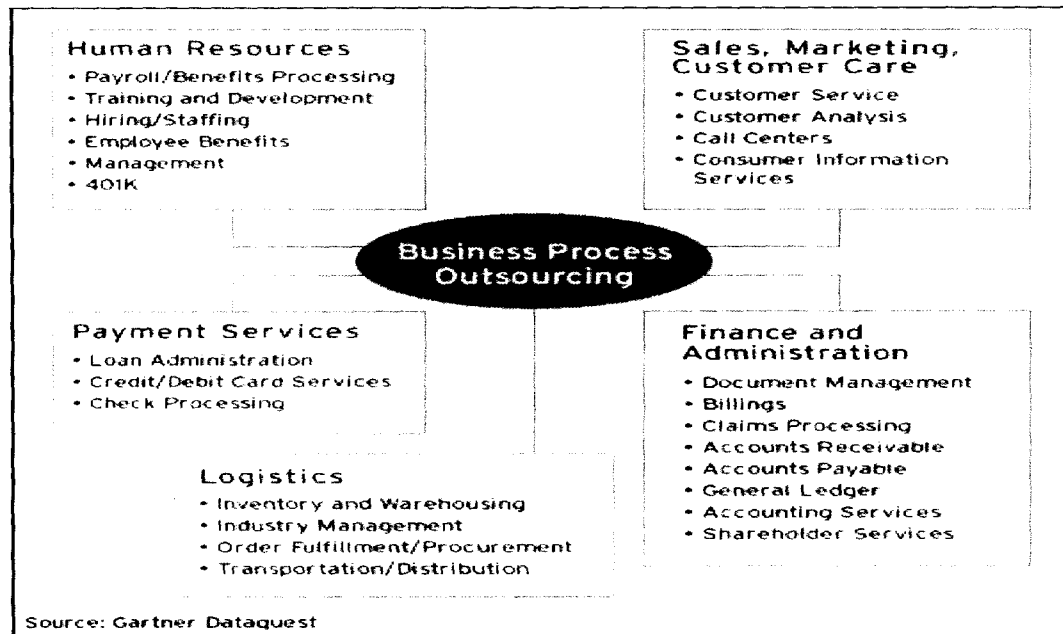


Figure 5.1

Business Process Outsourcing

With outsourcing, a company is free to place its energies and resources where they matter most ie into building its core competencies rather than issues such as space requirements, technology and staffing. As a result, companies can focus on meeting the key goals and objectives of the business such as:

- Increasing revenues
- Controlling costs
- Expanding market share and product offerings
- Improving operational efficiency
- Enhancing customer service

With BPO, companies can reduce costs and “variabilize” their infrastructure to be more responsive to the needs of the business. According to a research by AT Kearney, potential cost savings to companies through BPO is significant, ranging from 15% to 40% as a result of scale and process efficiency.

Benefits of scale efficiency (economies of scale) are:

- Ability to support increased volumes
- Transform fixed cost into variable costs
- Leveraged fixed costs across multiple products and clients
- Improve management of cost structures and decrease volatility

Benefits of process efficiency are:

- Gain access to standardized processes
- Avoid complexity and the need for more resources
- Minimize risks associated with implementing new technologies
- Increase focus on customer

Based on the perceived benefits, growing number of companies across the globe is turning to BPO. According to research firm IDC, worldwide spending on

BPO services totaled USD712 billion in 2001 and the market is expected to reach USD1.2 trillion by 2006⁴.

Perceived disadvantages of outsourcing include:

- Possibility of losing control
- Loss of personnel for functions outsourced to BPO provider
- Failure of the BPO provider to deliver the desired results
- Lack of flexibility (if exclusive rights granted to BPO provider), resulting in possible inability to meet changes in marketplace.

In order to avoid the potential pitfall of losing control by outsourcing, the golden rule to be observed is that outsourcing shall only be applied to non-mission critical (non-core) functions. In order to determine suitability of a function for outsourcing the following guidelines could be referred to:

⁴ AT Kearney, 'The Many Sides of BPO', Executive Agenda, Volume VI Number 2, Second Quarter 2003.

Table 5.1

BPO Rules

Crucial	Process that differentiates company from competitors.	Research & development.	Do not outsource.
Beneficial	Process that contribute to output volume, but do not generate decisive business value.	Manufacturing, supply chain management, sales.	Could be outsourced.
Necessary	No direct impact on output volume, but due to cost contribution, may adversely affect output value if substandard.	Human Resource, Finance, Information Technology, Administration and Procurement.	Highly suitable to be outsourced.

5.2 BPO in banking

5.2.1 Outsourcing of back-office banking operations functions

Outsourcing is not a new concept for labour intensive, back-office operations within the banking industry. As banks seek a way to shift their internal resources and remain efficient, many are considering outsourcing non-core business process as a viable alternative.

Banks worldwide such as HSBC, Standard Chartered and Citibank have been outsourcing their back-office functions such as customer care call centers to

lower cost countries such as India and Malaysia. Outsourcing is found to be beneficial for these banks for the following reasons:

- Accomplishing strategic goals
- Expanding revenue
- Reducing costs
- Leveraging resources
- Improving customer satisfaction

5.2.2 Outsourcing of front-office banking functions

Branch banking is costly as it is associated with overheads and face-to-face assistance provided to customers who mainly do not wish to pay for what it cost for the bank to provide such assistance. As a result, branch banking could become insufficiently profitable. This calls for banks to explore alternative delivery means to deliver its banking products and services.

As an alternative to over-the-counter services, ATM machines are essential for cash deposit and withdrawal, cheque deposit, loan and bills payment etc. Instead of incurring heavy capital expenditure as well as the overhead to establish and maintain an ATM network, banks could outsource the function by utilizing the existing (other bank's) ATM network for a fee. This alternative is available in Malaysia whereby almost all banks subscribe to the Malaysia Electronic Payment System (MEPS) membership that enables their ATM cardholders to transact via all MEPS members' ATMs nationwide.

Virtually all other banking services namely funds transfer and payment etc can be done through electronic media such as telephone and the internet. These can also be outsourced. For instance, telephone banking call centers can be outsourced. The similar goes for internet banking service.

The collection of information and provision of credit (loan origination) may require little personal contact, and what contact it requires can be more cheaply provided by sending a banker to pay a visit to the customer's place rather than maintaining an expensive network of branches. Outsourcing this function to sales agents can further reduce the costs associated. These sales agents (who are not employees of the bank) are paid on commission basis, thus banks do not incur fixed overhead in term of salary.

The advent of MEPS GIRO in 2004 that enables inter-bank funds transfer be carried out either over-the-counter at any participating bank branches and via electronic means via ATM or internet will further change the way banking business is carried out. This facility gives the flexibility for banks to reach out to customers even in areas without their physical presence. With MEPS GIRO, a customer needs the minimal face-to-face contact with his bank i.e at the outset of opening a deposit account or loan account. The subsequent operation of the account such as funds transfer or loan repayment can be done remotely via other bank's delivery channels such as over-the-counter branch service, ATMs or internet banking. With MEPS GIRO, banks virtually can outsource its delivery channel i.e granting access to

customers by riding on other banks' infrastructure for a fee. This capability is fully exploited by Citibank Malaysia that virtually serve the whole nation with just 3 branches namely in Kuala Lumpur, Johor Bahru and Pulau Pinang.

Banks worldwide, including in Malaysia have embarked on the outsourcing of the origination of consumer loans (a front-office function), which is a high fixed cost banking function. The following are potential benefits to outsourcing consumer loan origination functions:

- Increase revenue with additional capacity and decrease expenses by converting a fixed expense function to a variable expense
- Increase competitive ability without investing in personnel, space or technology
- Optimization of existing resources
- Access to industry expertise not presently in house
- Reduces time to market for new products
- Utilize automation to provide consistent and timely credit decisions
- Ability to operate beyond the normal operating hours
- Providing disaster recovery functionality.

5.2.3 Franchising

Essentially, ICT has brought about the options of outsourcing the banking services that used to be carried out over-the-counter at branches. As a result, branches may ultimately be unnecessary for modern banking. This has led to quest of banks

worldwide to becoming high-tech in order to reduce their cost to serve to the extent of having pure internet (branchless) bank eg NetBank in the USA and Egg Bank Plc, UK.

Nevertheless, of late, there has been a shift back towards branch banking when banks realized that some functions or customer segments require face-to-face interaction such as in selling wealth management services to high net worth individuals or in the case of serving sub-urban or rural customers that have yet to be acquainted with high-tech banking. For these banks that would like to continue having branches as their part of their delivery channel (in addition to high tech means), the challenge will be to provide branch services at the least cost possible and without having to their capital tied up to the branches. In meeting this challenge, some banks such as the Colonial State Bank and Bank of Queensland in Australia and Abbey National Bank, UK have gone one step further in BPO by franchising the operation of their branches. The concept is also evident in retail financial services in the US as practiced by the ACE Cash Express that runs check cashing and related financial services business by way of franchising.

Franchising or licensing operators is a concept that allows businesspersons to:

- i) Own and operate their own business
- ii) Profit from the use of an established brand name
- iii) Benefit from a proven system of operations

- iv) Receive guidance and consultation on personnel, training, audits and controls, and
- v) Share in the success of a marketing plan.

Franchising the total operation of bank branches works on the basis of the use of ownership and empowerment to increase revenue, manage cost and provide consistent branded customer experience (all throughout the branches) with a view to grow the bank's business organically.

In this franchising model, individuals purchase the right to run a banking franchise and provide all branch services. On this model, the bank does not have capital tied up in physical branches while maintaining the face-to-face services provided to its customers. Driven by profit targets and other KPIs such as efficiency that will all determine their reward and remuneration, these managers who own the branches will strive for their best.

In the Abbey National Bank, UK franchising model, the bank (franchisor) provides:

- i) The national brand name
- ii) Physical branch network
- iii) National back-office support from head office
- iv) Operating systems, policies and procedures
- v) Proven franchising support system

On the other hand, branch managers/owners/franchisees provide:

- i) Local knowledge

- ii) Entrepreneurial flair/drive
- iii) Commitment (not necessarily capital)
- iv) Micro management

The Abbey National Bank, UK model was proven to benefit all stakeholders as follows:

Franchisor

Increased returns to shareholders by delivering:

- i) Increased in sales
- ii) Effective cost management
- iii) Greater innovation
- iv) Effective knowledge management
- v) Higher ability to attract talents to join the bank

Franchisee

- i) Increased sense of ownership and self-drive
- ii) Greater autonomy
- iii) Higher potential for performance reward
- iv) Market discipline on central support functions (to better manage cost)

Customers

- i) Improved service
- ii) Banking tailored to local needs

- iii) Improved brand experience and loyalty

In general, Abbey National Bank experienced the following as a result of its franchising programme introduced in 2001:

- i) An overall increase in sales of 28% bank-wide
- ii) An average increase in sales by 9% per branch that was franchised
- iii) Sales per employee increased by 6%
- iv) Income per unit of cost increased by 5%
- v) A 2% increase in pre-tax profit
- vi) Marked improvement in sales quality and risk control without any deterioration in credit quality
- vii) No deterioration in customer satisfaction and employee satisfaction

Abbey National Bank's model appears to be a viable model premised on the following reasons:

- i) The model is based on the concept of one market, one manager
- ii) Local initiatives drives sales
- iii) Empowered managers are self-driven if given clear targets and performance reward
- iv) Managers who are 'bottom-line' driven will actively challenge processes in order to drive down cost.

As success of a franchising program lies in both the viability of the business as well proper management by the franchisee, a proper program for franchisors to guide the franchisee needs to be in place. In order to ensure success of a franchising program, the following program adopted by ACE Cash Express Franchise Group. US (ACE) can serve as a good reference. The program includes:

i) Site identification and Acceptance.

ACE will conduct demographic research, micro-market analysis and site inspection of the proposed location of the business prior to granting the franchise to ensure the highest potential for success.

ii) Development Assistance.

ACE personnel will work with new franchise owners through all stages of creating their new ACE financial center.

iii) Classroom training.

ACE provides franchise owners a ten day comprehensive training program that covers areas of customer service, security, risk analysis, Point-of-sale training, management and accounting training, collections, products and services and marketing. As supplement to classroom training, full set of manuals and employee training materials are also provided.

iv) Store opening and On-site training.

During the first week of store opening, ACE will place its franchise support representative to ensure that the new center gets off to a good start.

v) Ongoing evaluation and support.

Every franchise owner is assigned an ACE franchise support representative as a primary contact for any and all questions. A franchisee support call center accessible by toll-free hotline 7 days a week is also available.

vi) Marketing support.

ACE devises the annual marketing plan, national signage program, creative marketing materials and other promotional programs and provides these items to all franchise owners.

vii) Point-of-sale system.

All franchise owners are equipped with front-end (point-of-sale) system to facilitate quick transactions over-the-counter at the centers. The system, connected to a central processing hub managed by the franchisor (ACE) enables quick creation and retrieval of customer information as well as providing comprehensive reporting features that helps franchise owners manage their business.

viii) Free software upgrades.

ACE provides new products and services along with system upgrades are provided to franchise owners for free.

ix) Annual conference.

ACE holds a yearly annual conference of franchisees. With programs that include vendor exhibits and presentations, company update by management,

open panel discussion etc, franchise owners could exchange ideas and learn from their peers in improving their businesses.

x) Intranet

ACE provides an intranet communication channels for franchise owners to communicate with franchise support personnel more efficiently, offer feedback on center development and stimulate shared communications between franchise owners. Intranet is also the medium to disseminate training manuals, newsletters etc.