

CHAPTER 6
FEASIBILITY OF OUTSOURCING FRONT-OFFICE CONSUMER BANKING
FUNCTIONS OF BMMB.

In order to determine whether outsourcing is right for BMMB, the following questions need to be addressed:

6.1 What are the goals of that BMMB wishes to accomplish?

BMMB in its Corporate Strategic Plan 2003-2005, aims to achieve a RM50 million net profit by 2007 through the following:

Loans:

- i) Increase its consumer loan portfolio by RM2.0 billion
- ii) To achieve the above-mentioned increase in sales with a lower cost i.e to lower its cost to income ratio to 50%.

Deposits:

- i) Provide safe, efficient and convenient means of transferring monies by customers
- ii) To achieve the above in the lowest cost possible.

In short, the bank wishes to address the problem of its high cost to income ratio by increasing its loan portfolio at a rate greater than the corresponding increase in cost.

6.2 What are the functions involved in accomplishing the goals? Are these functions categorized as non-core?

The functions involved are:

1) Loans:

Front-office

- i) Loan origination i.e sales

Back-office

- i) Loan processing and decision
- ii) Loan documentation and disbursement
- iii) Loan management and collection
- iv) Loan recovery

2) Deposits:

Front-office

- i) Marketing of deposits/Account opening
- ii) Cash deposit & withdrawal
- iii) Cheque deposit

Back-office

- i) Cheque clearing
- ii) Cash-in-transit

Function (i) under loan activities i.e loan origination can be categorized as non-core. This activity despite being beneficial in generating input, do not carry decisive business value in determining the level of output. The level of output (in terms of turnaround time, volume and quality of loans) will be determined by the subsequent back-office functions i.e loan processing and decision, disbursement, monitoring and collection. Thus, the loan origination function seems to fit the criterion for outsourcing.

Front office deposit management functions, due to the inherent operational risk involved, are core activities that carry decisive business value. Outsourcing of these functions, though not as straight forward as the case of loan origination, it is possible if sufficient controls can be put in place to ensure security of depositors' monies and maintenance of reasonable service standards.

6.3 How much does it currently cost the bank to carry out these functions internally?

Based on BMMB's management account, branches overhead whereby the front-office loan and deposit management functions are carried out account for about 55% of BMMB's total annual operating cost ie RM73 million in 2003. On average, it costs BMMB RM1.78 million per annum to operate a branch.

The following are the breakdown of BMMB branches overhead:

Table 6.1

Breakdown of BMMB's overhead

1.	Staff cost	44%
2.	Property cost (rent, utilities, maintenance)	27%
3.	Information Technology (IT) expenses	27%
4.	Marketing expenses	2%

6.4 Will the bank save money if these functions are outsourced?

These items namely staff cost, property cost and IT expenses that make-up 98% of the total the branches overhead are fixed cost. Currently, BMMB has outsourced its IT management to a 3rd party service provider.

In the event the other 2 fixed cost components namely staff cost and property cost can be 'variabilized' through outsourcing, BMMB could see some significant cost saving as these 2 components makes up 71% of the branches total overhead.

6.5 Can the goals be achieved in the time required if the functions are kept internally?

The number of branches that BMMB currently has seems justifiable for the bank to achieve its objective to increase its customer reach. However, these branches are not generating enough income to offset the corresponding increase in overhead. Based on the track record of BMMB's performance, income from financing (loan) increased by 10% from 2001 to 2003 while overhead expenses increased by 29.1% in the same period.

BMMB, alternatively, can switch to high-tech banking. However, this may call for a huge capital investment, which the bank may not be in the position to do so given its limited capital base and current unhealthy financial position. It seems that BMMB need to find ways and means to leverage and make full use of its existing branch network to achieve its profit target.

BMMB needs to embark on an endeavor that could increase its income through branch banking at a rate more than the increase in cost per transaction. In the event the current performance continues, it appears unlikely that the profit target of the bank could be achieved in 2 years if the functions (sales origination, in particular) are kept internally.

6.6 Is the bank willing to change? What obstacles will probably be raised by the corporate culture? How will these people issues be addressed?

BMMB's management willingness to change is reflected in its decision to embark on a bank-wide transformation programme called the Muamalat Transformation Programme (MTP) in early 2004.

As in any other organizational change programme, the greatest obstacle that will probably be raised will be people's resistance towards change. In addressing this a proper change management programme needs to be put in place. This includes proper communication and managing the rate of change to be instituted i.e. not to be too drastic as to avoid total resistance from its people.

6.7 Are there any possible statutory or legal impediments that would affect the feasibility of outsourcing the functions? How would the outsourcing be done to work-around it, if any?

Banks are governed by the secrecy provision under the BAFIA and IBA that entails banks not to divulge information on customers credit and deposit facilities to any third party without the customer's consent.

Outsourcing of loan origination (sales) shall not contravene to the secrecy provision as agents do not have any access to the bank's customers information. The information obtained by sales agents for the purpose of applying for loan could not be construed as a breach of secrecy due to the following reasons:

- i) The information is given on a voluntary basis by applicants who are bound by the full disclosure requirement of banks.
- ii) The applicant, prior to acceptance of credit facilities offered by banks; has yet to become a customer of the bank.

On the other hand, total outsourcing of branch operation may entail the franchisee having access to privileged information on the bank's customers. The arrangement may amount to contravening the secrecy provision if the franchisee is a third party. In order to avoid such complications, franchisee should be an employee of the bank (either permanent or on contract basis) who will be bound by the secrecy provision as part of the terms and conditions of the contract for employment.

6.8 Will there be an adverse impact on customers' confidence on the bank if the outsourcing takes place?

Customers' confidence and preference of banks are based on their perception of security of their deposits and overall service quality that includes convenience delivered by banks. (Refer to Figure A4.18 in Appendix 4)

In so far as outsourcing is concerned, customers' confidence can be effectively managed if the parties engaged to carry out the outsourced functions are effectively managed such that the overall service quality and security of depositors'

monies are at least on par, if not better than the way it used to be when these functions are carried out internally by the bank.

It appears unlikely that customers would lose their confidence on BMMB if the bank proceeds with the outsourcing of its loan origination and total operations of its branches if the outsourcing arrangement is properly managed.

6.9 How will the process be managed, in the short and long run?

A strategic plan (complete with milestones) in outsourcing the bank delivery network functions in short and long run needs to be put in place. In the short run, the outsourcing shall start with the non-core activity/ies carried out in branches. This shall be followed by adding on the core activities that eventually see a total outsourcing of the branch operations by way of franchising.

Above all, in order to retain sufficient control on the security of depositors' monies and quality of the bank's products and services, the outsourcing shall be properly managed by a specific department. The department in charge shall monitor the performance of all outsourcing service provider based on the Service Level Agreements to be signed by BMMB and all service providers.