

# Deloitte.

---

Global Financial Services Industry

---

# Global Financial Services Offshoring

*Scaling the Heights*

Audit • Tax • Consulting • Financial Advisory •



# Contents

Foreword	1
Executive summary	2
Introduction	3
Improving margins from both ends	5
Divided opinions	6
Divided results	8
Choosing the right approach	10
Scale or fail?	13
Keys to offshore success – the four ‘C’s	15
Taking offshore to the next level	18
For more information	19
Contacts	21

## **About the survey**

Deloitte Research recently completed its Third Annual Global Offshore Survey – this survey was conducted on a “results-for-participants-only” basis. The final section of the survey covered industry issues, which were agreed to be used in public. The survey involved responses from 62 financial institutions based in twelve countries and included 8 of the top 10 in the world by market capitalization. Deloitte Research prepared this survey for Deloitte Touche Tohmatsu’s (DTT) Global Financial Services Industry (GFSI) Group; practitioners from various DTT member firms participate in this GFSI group.



# Foreword

Dear Colleague

I am delighted to present to you Deloitte Touche Tohmatsu's (DTT) Global Financial Services Industry (GFSI) group's third annual study of offshoring in the financial services industry. It is an issue that continues to impact operating models at all financial institutions, and therefore warrants significant attention.

Last year's offshoring study, **The Titans Take Hold**, predicted that offshoring would be dominated by larger financial institutions, unleashing a potent competitive dynamic that would completely transform the global financial services industry over the next five years.

This year's focus is on the application of best practice. Without doubt, offshoring is delivering exceptional results for financial institutions. DTT's GFSI group estimates that nearly half of all offshoring operations generate savings of over 40 percent, compared to the cost of running the same operation onshore. However this is merely the tip of the iceberg. The application of current offshoring best practice has the potential to treble these cost savings. The challenge going forward is to secure these improvements in operational efficiency. This will require significant management attention and the reinvestment of some of the existing savings to ensure demonstrable long term success.

This study examines the latest developments in offshoring to help financial institutions of every size understand the potential impact on their business – and provides insights to help them take appropriate action to be leaders in this quickly maturing business practice.

I hope you find this study useful and informative.

Sincerely,

A handwritten signature in black ink that reads "Jack Ribeiro". The signature is written in a cursive, flowing style.

Jack Ribeiro  
Managing Partner  
Global Financial Services Industry

# Executive summary

This report examines the overall offshore trends in financial services, and highlights the practices that leading companies are using to achieve superior and sustained performance.

**Scaling the heights.** Relentless margin pressure and intense competition have made offshoring a competitive necessity for most financial services companies. Yet the actual practices for operating offshore are still maturing. DTT's GFSI group has identified a huge divide in how different companies approach and manage their offshore operations – and the results they achieve. The ability to “scale these heights” will shape not only the future of offshoring within financial companies, but ultimately the entire financial services industry.

**Stratification of strategies.** Low-cost IT outsourcing used to be the predominant offshore activity. But today, companies are offshoring a wide range of functions and applying a wide range of approaches. The general trend is toward multiple functions and full service, with a shift toward captive operations and captive/outsourced hybrids. An increasing number of companies are also taking advantage of highly qualified offshore talent to improve service quality – not just reduce costs. Companies that apply these best practices generally enjoy a substantial advantage in cost savings and service quality.

**Money on the table.** According to DTT's GFSI group findings, the industry as a whole could treble the cost savings from its offshore operations. Using the sample of DTT's GFSI group annual benchmark, the participants could reduce their annual cost base by up to \$16 billion – trebling current savings of around \$5 billion. The additional benefits would come from two key sources. First, scaling head count from around 3.5 percent of total headcount offshore with average cost savings of 38 percent to the current best practice of 6.7 percent of total headcount and 60 percent cost savings. Second, the efficiency gains created by expanding the scope of operations to “full service” which means relocating all types of function from IT and back offices, to middle and front office activities offshore.

**Beware of 'offshore fatigue'.** Many companies report a sharp decline in offshore results after the third year. DTT's GFSI group believes this phenomenon stems from taking offshore benefits for granted, and not replacing top managers with equivalent talent when their tour of duty ends. Companies must stay vigilant, periodically rotating key managers and staff to maintain a constant mix of experience, skills and enthusiasm.

**Focus on the four 'C's.** Managing an offshore operation is a major undertaking. But as with most business activities, success ultimately boils down to doing a few things exceptionally well. There are four key elements to offshore success. Managing and minimizing **complexity**. Ensuring **compliance** with regulations – particularly those related to privacy and security. Creating a **culture** that helps onshore and offshore workers perform their best. And balancing near-term **cost savings** against the need for long-term strategic investment. Get those four things right and success will almost surely follow.

**Scale or fail?** Offshore operations that aggressively expand their scope and scale typically deliver much higher returns – and are able to sustain those benefits over time. On the other hand, financial institutions that make a half-hearted attempt at offshoring tend to fare the worst. The ability to generate and sustain around offshore operations will be of increasing future importance. Failure can leave offshore operations marooned. The message is clear: Don't dabble – stay home if you are not committed.

**The industry as a whole could treble the cost savings from its offshore operations.**

# Introduction

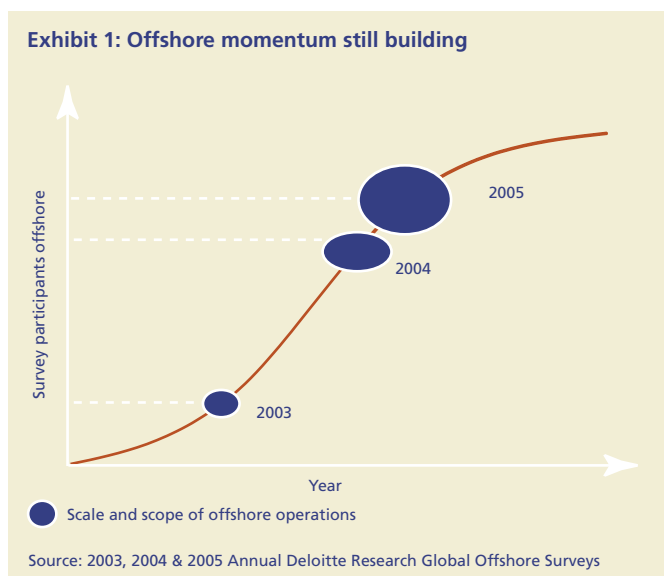
A new industrial revolution is sweeping stealthily through the financial services industry. As markets mature and margins decline, competition is heating up – putting companies under constant pressure to cut costs. Keen to retain investor confidence, many financial institutions are restructuring their operations to improve operational efficiency. Two key tactics are being deployed: i) re-engineering onshore business processes, and; ii) moving parts of the business to lower cost locations offshore.

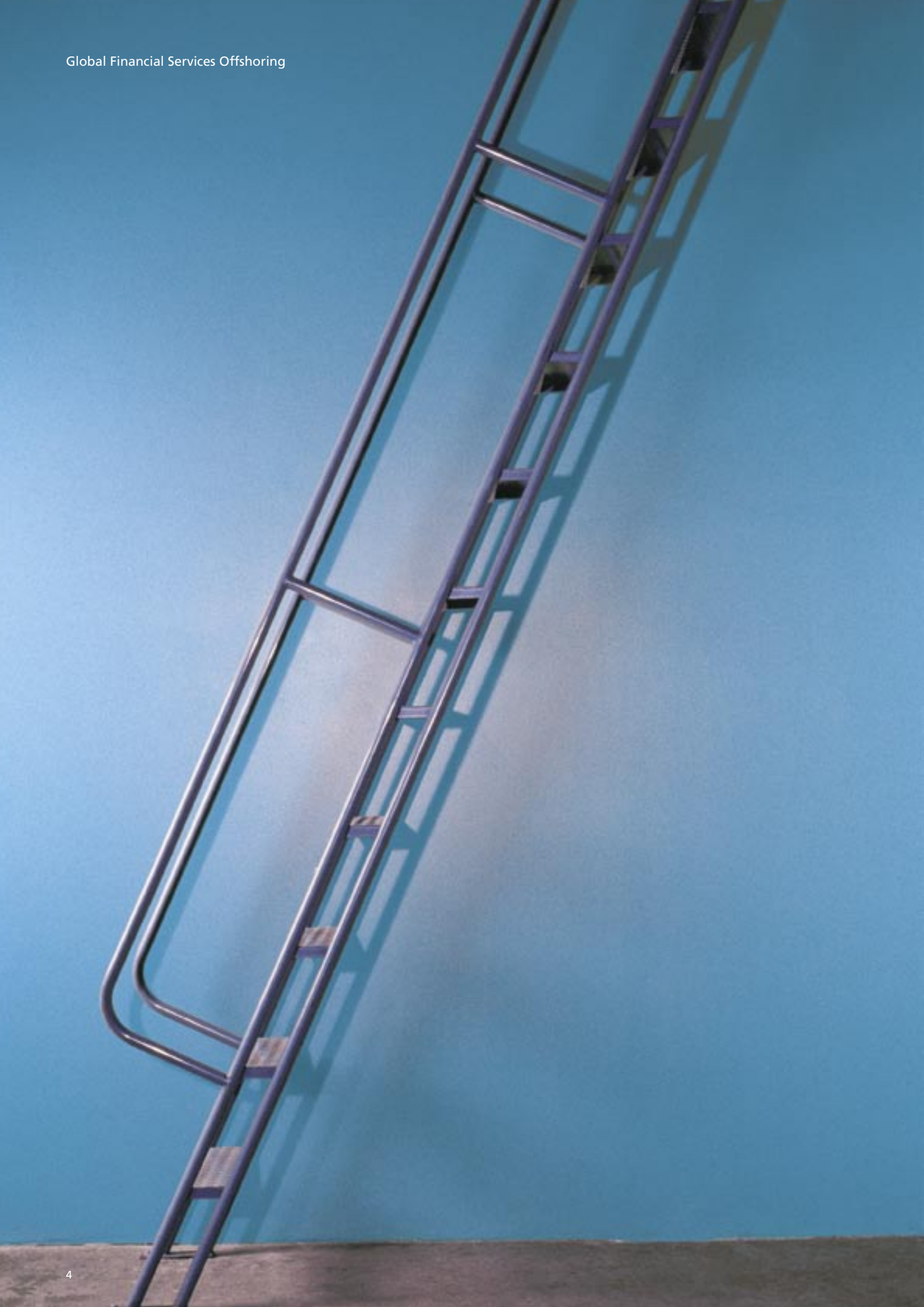
Today, offshoring is a common practice throughout the industry. Yet the benefits and impact vary widely, and most financial institutions are still learning how to do it well. The scale of offshoring continues to grow from 26 percent of all financial institutions in 2003 to 70 percent in 2005. This growth is outpaced only by the scope, range and variety of offshoring practices and results (See Exhibit 1). That's a sure sign of an industry still searching for the best way to do things.

At the same time, many smaller companies have consciously decided not to pursue offshoring, and are instead concentrating on improving onshore efficiency – largely because they lack the scale to fully capitalize on the benefits of offshoring. Such decisions are likely to produce a set of new competitive dynamics within the industry. Are these companies right to pursue such a strategy? And how much ground will they lose to the major players as a consequence?

This report examines the industry's growing divide in offshore strategies, business models, and operating practices. It also highlights the key factors that drive offshore performance, and reveals what the most successful companies are doing to achieve exceptional and sustainable results through the application of best practice.

**Today, offshoring is a common practice throughout the industry. Yet the benefits and impact vary widely, and most financial institutions are still learning how to do it well.**





# Improving margins from both ends

The primary impetus for offshoring in the financial services industry is margin pressure. In some mature product markets, net interest margins are falling below 100 basis points<sup>1</sup>. These razor thin margins force companies to relentlessly cut costs and improve operating efficiency – a trend that is sure to continue in the future. Industry estimates suggest that financial services companies in the U.S. have saved an estimated \$3.3 billion over the last four years by offshoring to India<sup>2</sup>.

Yet cost isn't the only driver. Offshore labor is often both affordable **and** exceptionally qualified, enabling companies to reduce their cost base while simultaneously improving service quality and operating efficiency. In fact, the U.K. financial services regulator recently published a report showing that many financial institutions intend to maintain their offshore sites regardless of economic or industry pressures – a change in thinking that may stem from quality that exceeds expectations<sup>3</sup>. As one senior executive at a major global bank explained: "Our challenge is to create a strategy that is not just based on cost".

A major U.S. Corporation's offshore experience illustrates this shift. Although the company was initially drawn to India by cheap labor rates, it has increasingly been taking advantage of the country's deep talent. It has hired 15,000 'highly skilled individuals' – a difficult task elsewhere – and has widened its range of offshore operations to include sophisticated activities such as 'high end analytics and financial remodeling'<sup>4</sup>.

An offshore operation also gives financial services companies a foothold in new and emerging markets where revenue opportunities may be significantly more lucrative than in mature markets back home. The opening up of Asian markets is likely to fuel this trend. DTT's GFSI group research shows that China is now the third most important offshore destination for operations, partly due to a number of the world's largest financial institutions acquiring stakes in China's four biggest banks.

**An offshore operation also gives financial services companies a foothold in new and emerging markets where revenue opportunities may be significantly more lucrative than in mature markets back home.**

1 Basis point is a hundredth of one percent.

2 Valanju, Sanjeevan, 1 July 2005, Financial Management.

3 Offshore Operations: Industry Feedback: Financial Services Authority. 2005. London.

4 Hype or Opportunity? IT cost benchmarking in European banking industry. 28 June 2005, The Boston Consulting Group.

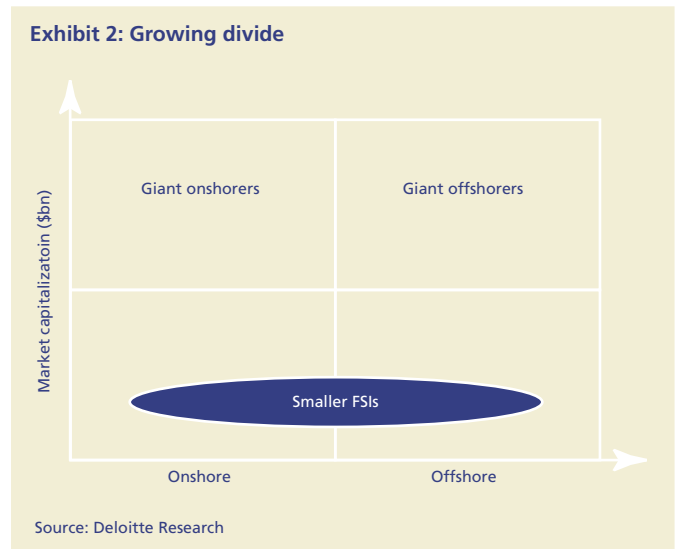
# Divided opinions

Momentum toward offshoring is greater than ever, with the majority of companies now accepting offshore activities as a competitive necessity. Yet there is also a sizeable minority consciously bucking the trend. According to DTT's GFSI group findings, roughly one in three financial institutions – after carefully weighing their options – have explicitly decided to keep all operations at home. That's up from the one in five reported last year (See Exhibit 2).

In response to the offshoring challenge, some financial institutions – particularly smaller players – are focusing their efforts on reengineering onshore processes and reducing headcount. For instance, a U.K. insurance broker considered moving jobs to India to reduce costs and improve efficiency, but may now simply cull some of its 1,500 call center staff to achieve its targets<sup>5</sup>.

For the most part, it's smaller companies that are electing to stay on shore. Their primary concerns are reduced **quality** and **flexibility** – as well as adverse reactions from customers and the public. These smaller firms acknowledge the potential cost savings of moving selected operations offshore, but given their relatively small scale they don't believe the savings will justify the trade-offs.

Ironically, companies already working offshore cite **quality** and **flexibility** as two of the primary **benefits** (See Exhibit 3). It's easier to adjust an offshore workforce to changes in the market because labor is relatively plentiful and labor laws are less restrictive. And because qualified labor is cheaper, companies can afford to maintain a larger, more capable staff than they could at home – improving responsiveness and service quality.



In South Africa, for example, offshorers are seeing increases in both skills and work quality<sup>6</sup>. In Malaysia, many young graduates are deciding to avoid working in established sectors of the domestic economy such as manufacturing<sup>7</sup>. The average offshore employee in Malaysia is 26 years old, and most are skilled in sophisticated disciplines such as information technology, law and accountancy<sup>8</sup>.

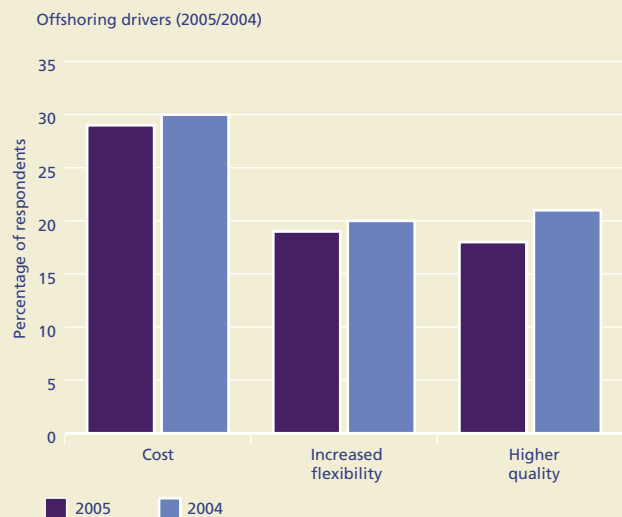
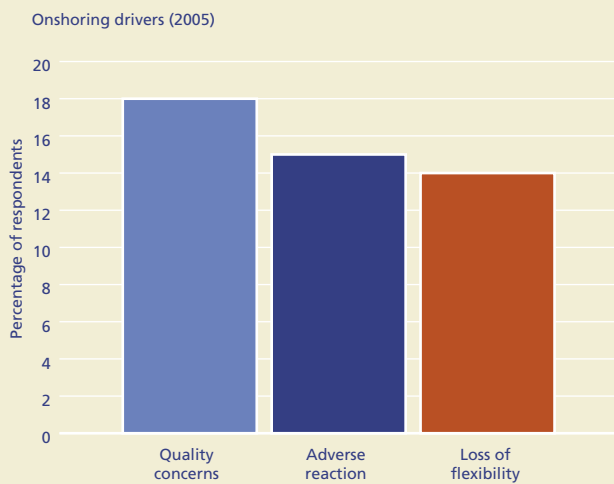
The offshore boom and search for suitable countries has led to expansion into the Philippines. The Philippines is the third largest English-speaking nation in the world (after the U.S. and the U.K.). Filipino IT professionals are highly trainable, with a typical learning curve of six to eight weeks. The Philippines also has the largest pool of high quality accountants in Asia. During the first quarter of 2005, there were about 113,300 licensed accountants in the country, recognized as 'among the best in the world'<sup>9</sup>. Schools in the Philippines produce more than 100,000 graduates in finance, accounting and management every year, and that number is rising<sup>10</sup>.

5 Career Path, winners and losers, 30 June 2005, Post Magazine.  
 6 Contact Centres and Business Outsourcing in Cape Town. Calling the Cape. 2004.  
 7 The times are a-changing. Anna Taing, 8 August 2005, The Edge.  
 8 Ibid.  
 9 EU firms show keen interest in RP IT services.  
 10 The times are a-changing. Anna Taing, 8 August 2005, The Edge.

The media focuses a lot of attention on the public's negative reaction to offshoring – particularly for call centers. There's no question that poor call center quality has the potential to undermine all offshoring activities. However, DTT's GFSI group research shows that call centers and other 'front office' activities only account for 12 percent of total offshore spending. Over 75 percent of offshore staff do not interact with customers. At the same time, onshore call centers have been expanding their operations, with Scotland alone boasting 300 call centers with a combined workforce of more than 60,000<sup>11</sup>. In the end, customers will decide for themselves. If they show an overwhelming preference for low prices – as they have in virtually all other areas of consumer business – then the use of offshore call centers will continue to grow.

So far, onshore operations have been able to stay competitive through aggressive process improvements and cost-cutting. But at some point onshore players will exhaust their improvement opportunities and have no other way to cut costs. Meanwhile, their offshore competitors will eventually achieve similar efficiencies – on top of a much lower cost base – leaving the onshore companies unable to compete. Positioning themselves as premium-priced, 'hi-touch' providers might work for a while, but is probably not sustainable. In the long run, companies with offshore operations can use their built-in cost advantage to subsidize their own high-end operations, outdoing whatever their onshore competitors are able to offer.

**Exhibit 3: Strategic opposites: onshore – offshore drivers**



Source: DTT GFSI group

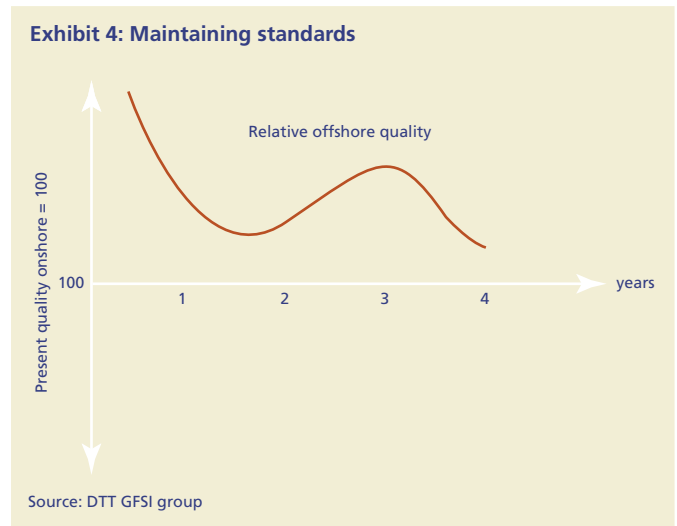
11 The rise and rise of the Scottish call centre, 12 August 2005, The Scotsman.

# Divided results

Opinions aren't the only source of division. Global financial institutions are also showing significant differences in offshore performance. Top industry performers report cost savings of up to 60 percent, whereas bottom performers report savings of less than 20 percent<sup>12</sup>. Offshore service quality also varies widely – although in most cases it remains superior to that of similar onshore operations according to financial institutions in DTT's GFSI group benchmark study.

Time and experience are two of the biggest factors affecting both cost and quality. Surprisingly, DTT's GFSI group research shows the best results are often achieved during the first few months – perhaps due to intense scrutiny from management and initial excitement. Performance typically declines throughout the first year, as companies confront the learning curve and struggle to increase scale. Then the trend reverses, with performance steadily improving over the second and third years as companies gain offshore experience (See Exhibit 4).

**A global head of offshoring at a major financial institution captures this shift: “When the offshore unit was small it was fine, but now that it is growing, we don't have the right set of people to manage and this is in fact holding us back”.**



Offshore performance during the first three years is generally consistent with expectations. It's beyond that point where things get interesting. According to DTT's GFSI group findings, many companies – particularly those that outsource their offshore activities – encounter an alarming drop-off in cost savings and quality after the third year.

Why is this the case? DTT's GFSI group believes the main reason is 'offshoring fatigue'. An innovative business model that once held the company's full attention can become 'business as usual', falling short of its true potential. At the same time, many companies have trouble replacing the top managers who got the operation up and running but have grown weary of travel and life offshore. Moving to India or the Philippines from the U.S. or the U.K. isn't always appealing to financial executives. The result can be a sharp – and often permanent – decline in offshore benefits.

A global head of offshoring at a major financial institution captures this shift: “When the offshore unit was small it was fine, but now that it is growing, we don't have the right set of people to manage and this is in fact holding us back”.

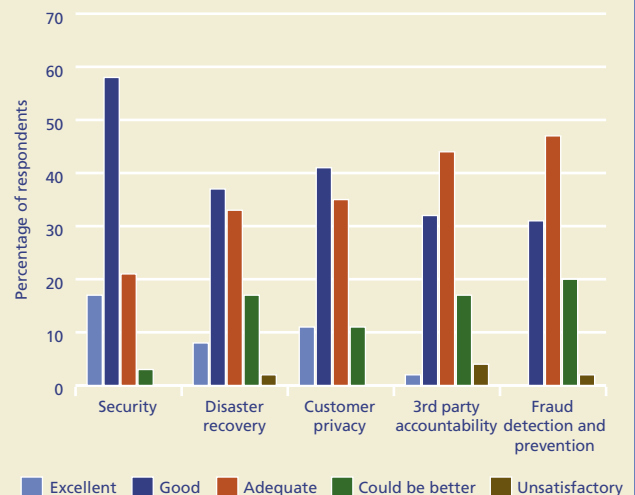
12 DTT GFSI group 2005.

## Stepping up

DTT's GFSI group asked the executives in the benchmark about their future perceptions on the challenges and opportunities facing the **global financial services industry** around offshoring in the future. They highlighted four critical issues:

- Cost base & headcount:** The total cost base of financial services moved offshore is expected to grow dramatically from less than 10 percent in 2006 to over 20 percent by 2010 – this is consistent with DTT's GFSI group forecast in 2003 that offshoring is likely to displace up to two million financial services jobs by 2010<sup>13</sup>. In terms of head count, executives responsible for offshoring expect to see similar trends, with around 60 percent forecasting less than 10 percent offshore in 2006, compared to 40 percent seeing 10 to 20 percent of global financial services employment offshore by 2010.
- Governance:** A key issue to ensuring the future success of offshoring will be governance issues. As Exhibit 5 shows executives have growing concerns around disaster recovery, customer privacy, vendor accountability and fraud detection for the industry as a whole. It is critical such issues are addressed to ensure success for the industry.
- People issues:** The importance of people issues can't be stressed too greatly. When asked to rate the industry at dealing with people issues, over three-quarters of executives said adequate, or below.
- Legislation:** The emotive issue of offshoring has featured in election campaigns and TV shows. Although the debate appears to be cooling in most countries the specter of legislation to curtail possible job losses still remains. However, over 60 percent of executives thought it unlikely that the current situation would be changed.

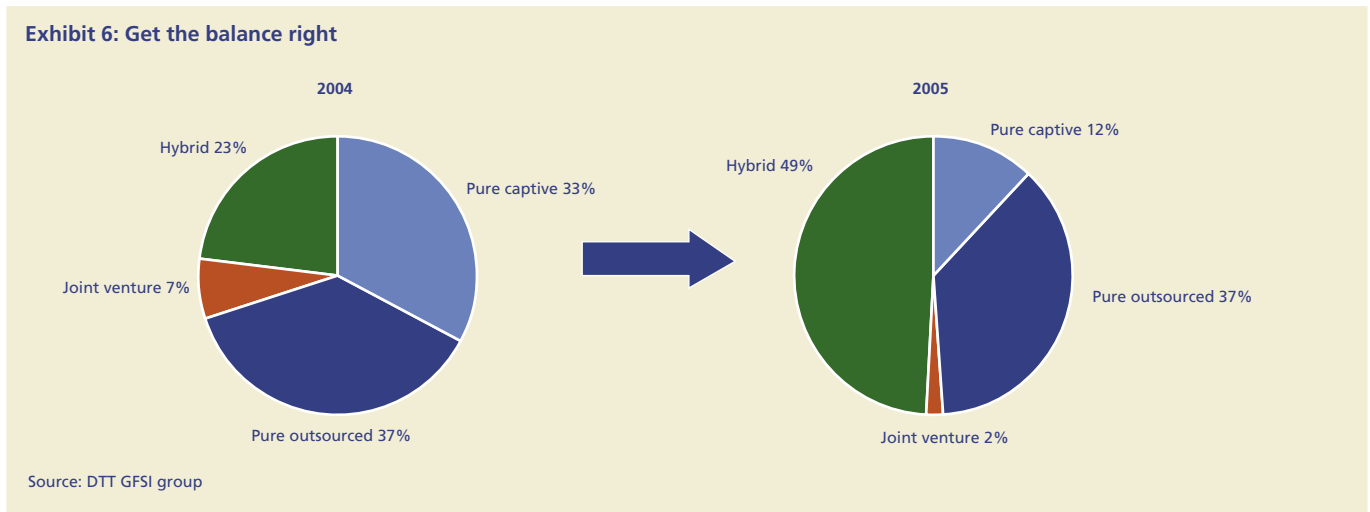
**Exhibit 5: The performance of the global financial services industry on the following offshore governance issues**



Source: DTT GFSI group

13 DTT GFSI group. The cusp of a revolution. 2003.

# Choosing the right approach



One of the keys to sustained offshore performance is choosing the right approach. Unfortunately, offshore practices are still maturing and there is no consensus on best practices for offshoring operations.

The first question is generally ‘build or buy?’ Should a company build its own captive offshore operation, or outsource its offshore activities to a third party? Both approaches have their merits. That’s why a growing number of companies are adopting a blended or hybrid approach, retaining direct control of some activities while outsourcing others.

One major U.S. financial services company got started offshore by outsourcing two development projects to an Indian firm in the late 1990s, employing an Eastern European company to help integrate its brokerage systems following a merger<sup>14</sup>. More recently, it has been looking to expand its offshore presence through captive operations in India and Costa Rica. These activities epitomize a ‘best of breed approach’, and by 2007 are expected to reduce headcount by up to 4,000, saving the company \$1 billion a year<sup>15</sup>.

Last year, DTT’s GFSI group reported 70 percent of financial institutions were using either a pure outsourced model or a pure captive model – while only 23 percent used a hybrid of the two<sup>16</sup>. This year, the latter figure more than doubled, with nearly half the companies in this study now following a blended approach (See Exhibit 6).

The vast majority of companies that have adopted a hybrid model have been offshoring for at least three years – gradually evolving from a **pure** approach to a **mixed** approach, as they expanded their offshore operations from a single function to multiple functions and eventually to ‘full service’. However, more than half of the financial institutions that are still in the planning stages also intend to follow a blended, best-of-breed approach, suggesting that the hybrid model may now be emerging as a standard offshore practice.

<sup>14</sup> Bank looks to trim spending on application support by 15 percent to 20 percent, Thomas Hoffman, 4 July 2005, Computerworld.

<sup>15</sup> Ibid.

<sup>16</sup> DTT GFSI group.

Overall, IT is the function most likely to be outsourced. That's clearly true for the 'pure' outsourcers – many of whom only offshore IT and nothing else. But it's also true for the 'hybrids' – many of whom retain direct control of virtually all offshore activities **except** IT. Why is IT such a popular candidate for offshore outsourcing? One reason is because it was the first function to move offshore and suppliers have become very good at it. In addition to a top-notch workforce, they now boast industry best practice CMM level 5 methodologies and management processes. Another reason is the dizzying pace of technology development. Many companies have grown weary of trying to keep up with the latest technology advances and prefer to shift the responsibility (and risk) to a firm that specializes in IT.

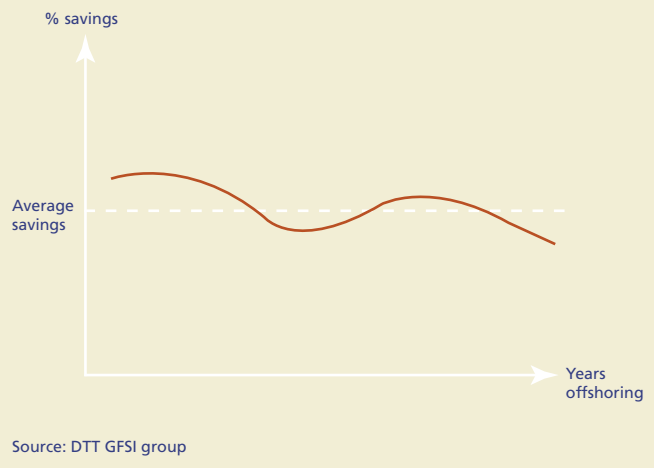
Outsourcing offers a number of advantages over a captive operation. It allows a company to move offshore quickly: provides greater flexibility to tweak the workforce in response to changing market conditions; allows management to focus more attention on the core business and provides a theoretical cost advantage by capitalizing on the vendor's increased scale of operations from serving multiple clients (although in reality most of the intrinsic cost savings are captured by the vendor as profit margin). That's not to say there aren't challenges; as one insurance executive expressed "communication was difficult with the vendors and we needed to define very specifically every detail".

Of course, a captive model provides its own unique advantages. In addition to giving management direct control over all aspects of the operation, a captive approach also offers the greatest potential for cost savings since there's no middleman to eat into the benefits!<sup>17</sup> A recent survey report by the global investment bank Morgan Stanley reported that Chief Information Officers (CIOs) are increasingly willing to send more sophisticated, higher-end work offshore. This is a problem for many India-based outsourcing firms – which are viewed as unable to cope with these advanced requirements – prompting a shift toward captive operations. In fact, 25 percent of the CIOs in this year's study reported using captive units for offshore IT work, compared to only 10 percent last year<sup>18</sup>.

Current best practices in financial services suggest that the largest cost savings (up to 60 percent) are achieved by keeping the majority of offshore activities in-house<sup>19</sup>. Captive operations also appear more capable of sustaining and improving cost savings and service quality over time (see Exhibit 7).

Yet in many cases, a hybrid model is the best approach. By blending the flexibility of outsourcing with the direct savings and control of a captive model, a hybrid provides the best of both worlds – allowing a company to choose the optimal approach for each situation and to actively manage its mix of fixed and variable costs.

**Exhibit 7: A jaded agenda?**



<sup>17</sup> MNCs eat into 25 percent of offshore work, 26 June 2005, Indian Express.

<sup>18</sup> Ibid.

<sup>19</sup> DTT GFSI group.



# Scale or fail?

Most companies get started with offshoring by dipping a toe in the water, then gradually expanding the **scale** and **scope** of their offshore operations over the course of several years. Yet many financial services firms are not expanding quickly enough to reap the full value of offshoring – or to keep pace with the leaders.

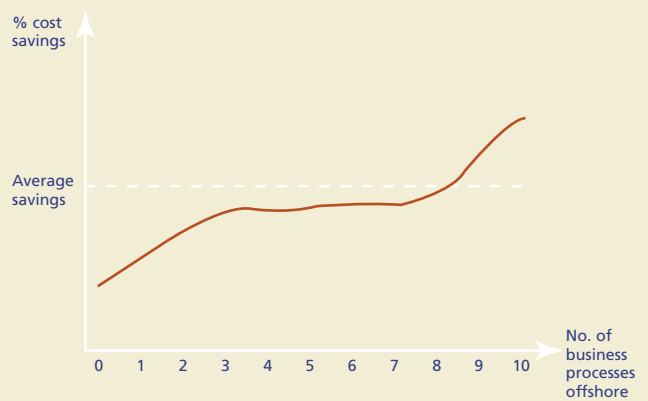
## Expanding scope

Cost savings rise significantly as companies expand the **scope** of their offshore operations to multiple functions or full service. And in many cases offshore markets are more than capable of handling the additional responsibility.

Offshore operations in India are becoming more sophisticated, taking on specialized functions such as 'share-transfer registry' work, superannuation fund accounting and trust administration accounting. At the same time process and system improvements developed offshore are increasingly being adopted back home, and many companies now routinely ask their India-based managers for feedback on how to improve overall operations.

Financial institutions that only move a single function offshore typically report average cost savings of 20 percent<sup>20</sup>. In contrast, companies that offshore multiple functions enjoy an average cost savings of 40 to 50 percent or more, suggesting that there are significant benefits to expanding the **scope** of offshore operations (see Exhibit 8)<sup>21</sup>. That's not to say that all functions are equally suited to offshoring. For example, 70 percent of the financial institutions benchmarked with an offshore presence have chosen to do software application development offshore, compared to only 10 percent for payroll<sup>22</sup>.

**Exhibit 8: Savings by offshore scope**



Source: DTT GFSI group

**Process and system improvements developed offshore are increasingly being adopted back home, and many companies now routinely ask their India-based managers for feedback on how to improve overall operations.**

<sup>20</sup> DTT GFSI group.

<sup>21</sup> Ibid.

<sup>22</sup> Ibid.

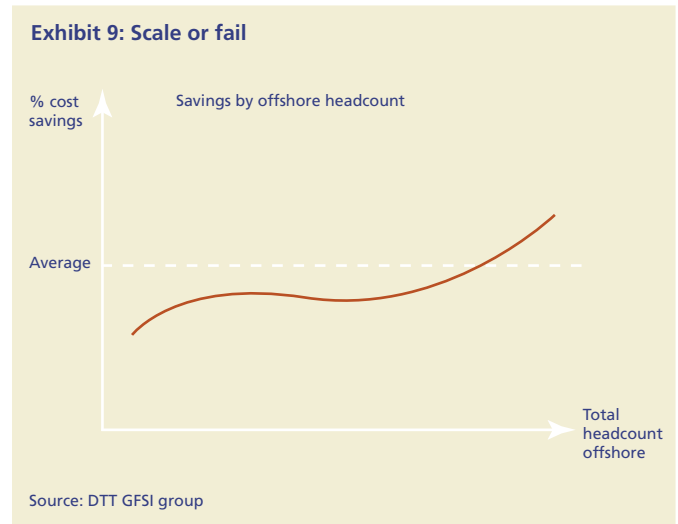
Further, the efficiency and effectiveness across the industry again reveals stark differences. Captives report the best performance in terms of cost savings versus outsourcers who report lowest average cost savings, some 13 percentage points below captives<sup>23</sup>. The banking sector has some of the highest reported cost savings, particularly amongst Anglo-American type institutions. By contrast insurance companies, although offshore the longest, are reporting some of the lowest cost savings. This is largely driven by a heavy reliance on outsourcing – but also conveys the huge variations in offshoring in financial services.

**Increasing scale**

The other way to boost cost savings in absolute terms is by expanding the **scale** of operations through increased offshore headcount, keeping the same mix of onshore and offshore functions but moving more of the work within a particular function offshore (see Exhibit 9). A company that doubles the size of its offshore workforce can literally double its total savings, assuming it can maintain its current level of efficiency while operating on a larger scale. According to this study, that requirement is easily met. In fact, financial institutions with more than 5,000 offshore workers report average cost savings of 45 to 50 percent – even higher than the overall average of 38 percent (which includes many companies operating on a smaller scale).

The right balance between onshore and offshore resources is different for every company. For instance, one European insurance company has created 8,000 jobs in India, while maintaining a healthy balance of 41,000 jobs in the U.K. following an acquisition.

Yet DTT’s GFSI group findings suggest that most companies need to increase the scale and effectiveness of their offshore operations. Despite the fact that nearly half of financial companies offshore save 40 percent or more, most remain below five percent of their total headcount. Further, nearly a quarter of offshoring institutions have only one business process currently offshored.



**Nearly a quarter of offshoring institutions have only one business process currently offshored.**

23 DTT GFSI group.

# Keys to offshore success – the four ‘C’s

The challenge for the financial services industry is to take offshoring to the next level. Although companies are experiencing some offshore growing pains, there are still significant opportunities to reduce costs and improve quality. The big question is how to capture these opportunities.

When managing an offshore operation there are literally thousands of things that can go wrong. But as with most business challenges nearly all of these potential pitfalls can effectively be neutralized by doing a few critical things right.

There are four major elements to offshore success: complexity, compliance, culture, and cost (see Exhibit 10). DTT’s GFSI group believes that focusing on these four key elements is the best way for a company to maximize the performance and value of its offshore operations.

**Complexity – Scale or fail.** The biggest operating challenge for any financial institution is managing complexity. Whatever the improvement strategy – onshore reengineering, offshoring, or both – the key to success is simple and effective business processes and reporting mechanisms.

A company with offshore operations is potentially more complex than its ‘stay-at-home’ counterparts. There are more parts to the organization; more physical locations to address; more vendors to manage; more diverse cultures, laws and languages to overcome; plus the unavoidable barriers of time and distance.

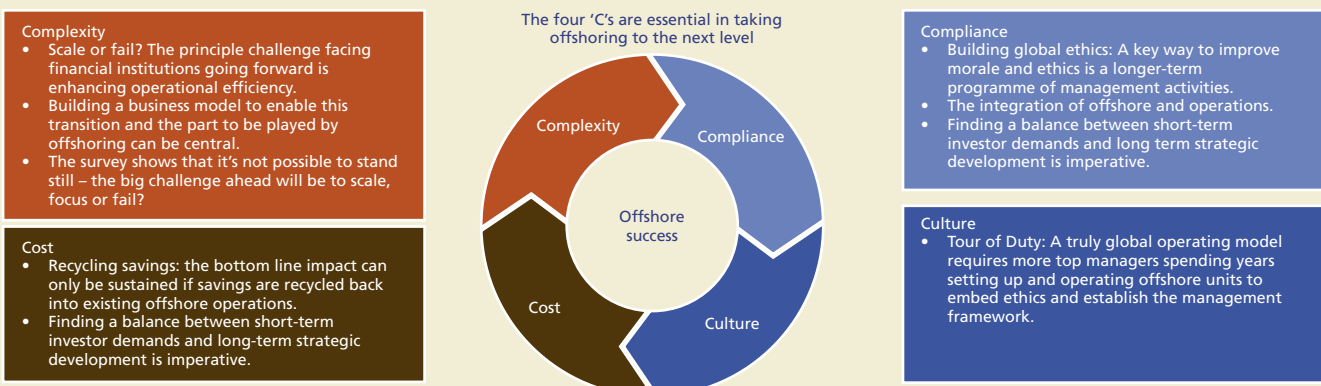
This complexity makes it hard to get established, and even harder to achieve the necessary scope and scale.

The way to overcome complexity is to attack it relentlessly, constantly working to improve efficiency by streamlining processes and systems. Many companies miss out on a prime opportunity to simplify operations by following a ‘lift and shift’ strategy – taking their existing systems and processes and moving them offshore. Nearly three of every four financial institutions surveyed report using a ‘lift and shift’ type strategy in relocating functions offshore. That approach might work for a while – and it’s certainly the fastest way to get the job done – but it also creates significant drag as the operation attempts to expand.

Interestingly companies who have been offshore for more than five years report a more balanced strategy by equally deploying ‘re-engineer and move’, ‘move and re-engineer’ (lift and shift) and ‘build-operate-transfer’ (BOT) methods to relocate activities. Further, the migration decision also depends on the individual function being moved. For instance, ‘re-engineer and move’ is most commonly deployed for finance and accounting functions, but nearly all call centers use a ‘lift and shift’ method.

Simplicity and efficiency are the keys to unlocking economies of scale and scope – and are absolutely essential in an environment where the guiding principle needs to be the scaling of operations as quickly as possible.

**Exhibit 10: Offshore actions: taking offshoring to the next level – four key implementation challenges**



Source: DTT GFSI group

**Compliance – building global ethics.** Privacy, data security, regulatory compliance and ethics are challenging issues for any organization. But when an organization spans multiple countries, companies, legal systems, languages and cultures, the challenge is even greater. That's probably why the financial institutions consistently report ethics as the number one issue related to people – higher than wage demands, job experience, qualifications and churn.

Issues related to offshore compliance, security and ethics continue to grab headlines. For instance, in April 2005 three members of an Indian outsourcing company were arrested following the theft of more than \$300,000 from U.S. bank accounts in New York. This is driving some banks to opt for captive offshoring rather than outsourcing because of the security issues. However it is important to temper the hyperbole of press reports with the view from the U.K. FSA report in May 2005 which was highly complimentary of security and regulatory compliance in India, stating that security was not only solid, but in some cases was better than in the U.K.<sup>24</sup>

Tackling these types of issues requires extensive management and oversight. Without formal and effective governance, the risk associated with offshoring will continue to grow – choking off many of the benefits. Companies have started making progress in this area. Forty percent of respondents with offshore operations formally monitor at least seven of the eight areas laid out in the European Foundation for Quality Management self-assessment framework, suggesting a holistic and comprehensive approach to governance.

As offshore operations expand, companies will need to seamlessly integrate them with their onshore operations – making it easier to monitor and enforce compliance. Over the long-term, they will also need to establish a global ethic that transcends cultures and national boundaries. Accomplishing these lofty goals will require a significant financial commitment, forcing executives to strike the right balance between short-term earnings and long-term value.

**Culture – Tour of Duty.** Many of the issues related to complexity and compliance are ultimately driven by people and culture. Financial institutions must establish an organizational culture that extends beyond national boundaries – and even beyond the company's own workforce to include outsourcing vendors and other business partners.

One of the keys to achieving this goal is seeding an offshore operation with top talent. As noted earlier, most companies do a good job of applying their top talent at the outset, but tend to lose momentum. In contrast, companies that sustain a high level of performance make an offshore 'tour-of-duty' a standard part of the management fast track, rotating top people in and out to maintain a healthy mix of experienced management and fresh talent. For instance, a major global bank is now staffing offshore operations with young and hungry senior executives to manage its offshore operations.

## Potential impact on the industry's cost structure

Most financial services companies are currently capturing only a fraction of the potential benefits from offshoring. The majority are nowhere near achieving a full scope of offshore services. And the average scale for offshore operations is 3.5 percent of global headcount – far less than the 6.7 percent average reported by top performers. Through the application of best practice, most companies could improve their total offshore savings by a factor of three.

What would happen to the industry's cost structure if every company with an existing offshore presence were to match the scale and scope of today's top performers? A good indication can be found in considering the companies in DTT's GFSI group annual benchmark study. Analysis suggests that collectively these companies could reduce their annual cost base by around \$16 billion – more than trebling the current savings of \$5 billion. These additional benefits would come from two key sources: first from scaling offshore headcount from an overall average of 3.5 percent of total headcount to the seven percent reported by top performers; second from expanding the scope of offshore operations to 'full service' (multiple functions).

24 Offshore Operations: Industry Feedback: Financial Services Authority. 2005. London.

**Cost – Recycling savings.** Cost savings are what motivate most companies to pursue offshoring in the first place. But blindly focusing on short-term cost reduction is a recipe for long-term failure. Efficiency, scope and scale are essential to sustained improvement and success. But the best way to achieve these things is by recycling some of the short-term savings into continued investment – balancing short-term investor needs against the company's long-term strategic development. A major global bank has for several years been unaware that most of the costs of offshoring had been leaking away through its Asia Pacific division.

As demonstrated in this report, financial services offshoring is achieving high cost savings. But to 'scale the heights' and ensure the long-term sustainability and contribution to the operational efficiency of a financial institution, investment into achieving best practice is key.

**Efficiency, scope and scale are essential to sustained improvement and success. But the only way to achieve these things is by recycling some of the short-term savings into continued investment – balancing short-term investor needs against the company's long-term strategic development.**





# Taking offshore to the next level

Offshoring is now a common operating practice for the global financial services industry. However, the contribution offshoring makes to the competitive advantage of a financial institution varies hugely. This points to the fact that offshoring is experiencing some growing pains – which may sound odd when over 40 percent of offshore firms are making cost savings of greater than 40 percent<sup>25</sup>. Huge opportunities exist for the application of best practice across offshore operations in financial services. In short, it is critical that financial institutions that choose to move offshore increase the scale and scope of these activities rapidly, otherwise failure is very possible. The message is clear; don't dabble offshore.

The development of offshoring in financial services is reaching a critical phase. Arguably offshoring is enjoying its first full decade, since the pioneers first established operations in India in the mid-1990s. The key to success for the industry is how quickly it can reduce risk while scaling operations over the next five years. A new breed of executives has been created in many major financial groups with titles such as head of global offshoring or outsourcing. This is a sure sign offshoring is coming of age. But significant challenges wait, not only for this new and senior cadre of executives in the leading companies, but for all financial institutions. DTT's GFSI group has identified five groups of financial institutions with clear stratification in strategies occurring across the industry.

- **Offshore giants** with established offshore operations need to focus on scope and scale, streamlining their systems and processes – where they haven't already done so – and aggressively expanding offshore functions and headcount. They also need to integrate their onshore and offshore operations, including a global standard for ethical behaviour. Most importantly, they need to guard against offshore fatigue that can undermine their ongoing efforts and eat away at the benefits.
- **Experienced offshorers** need to scale where possible. Often these institutions have been offshore for some time and now have to inject new momentum into their offshore operations. In particular, smaller players need to increase offshore headcount to between 10 and 20 percent of total staff numbers.

- **New offshorers and planners** have the opportunity to rapidly adopt best practice from the industry leaders. Also it will be important to build momentum rapidly to avoid fatigue creeping into the process. To ensure this comes about, introducing a tour-of-duty culture will be critical.
- **Onshore giants** need to improve operational efficiency by streamlining onshore operations. Ahead, it will be critical to ensure the industry offshore leaders are not establishing too great a gap in cost efficiency over the onshore giants. It maybe wise to add into acquisition target reviews, financial institutions with strong offshoring capabilities.
- **Smaller onshorers** face the toughest challenges in the future. Lacking scope and scale, smaller players need to continually look at a variety of strategic options. Perhaps highest on this list should be the consideration of using shared service back offices to gain economies of scale. These smaller firms may be able to sidestep the trend – at least temporarily – but will eventually be forced to address the growing cost gap.

Offshoring has become a competitive necessity in the financial services industry, and the overwhelming majority of companies have no choice but to pursue it with gusto. This report has shown the diversity of offshoring models in use today – however it is clear offshore practices are still maturing.

Whatever the situation, it is clear that offshoring is here to stay. Financial services companies must acknowledge that fact and adjust their strategies accordingly. In the end, those companies that can take their offshore performance to the next level through the application of best practices will be the ones most likely to 'scale the heights' of success.

# For more information

## Jack Ribeiro

Managing Partner  
Global Financial Services Industry  
Deloitte & Touche USA LLP  
1 212 436 2573  
jribeiro@deloitte.com

## Americas

### Peter Lowes

Deloitte Consulting LLP  
New York  
1 212 618 4380  
plowes@deloitte.com

## Europe, Middle East and Africa

### Anna Celner

Deloitte Consulting GmbH  
Zurich  
41 1 318 7111  
acelner@deloitte.com

### Vimi Grewal

Deloitte MCS Ltd  
London  
44 20 7303 7859  
vgrewal@deloitte.co.uk

## Asia Pacific

### Steven M. Butters

Deloitte & Touche LLP  
Shanghai  
86 21 6141 1868  
sbutters@deloitte.com

## Research

### Chris Gentle

Global Financial Services Industry  
Deloitte & Touche UK LLP  
44 20 7303 0201  
cgentle@deloitte.co.uk

The scope of this survey was global, and, as such, encompassed financial institutions with worldwide presence with head office operations in one of the following geographic regions: North America; Europe, Middle East, Africa (EMEA); Asia Pacific (APAC); and Latin America and the Caribbean (LACRO). Attributes such as size, global presence, and market share were taken into consideration. Due to the diverse focus of institutions surveyed and the qualitative format of our research, the results reported herein may not be representative of each identified region.

Survey users should be aware that Deloitte Touche Tohmatsu has made no attempt to verify the reliability of such information. Additionally, the survey results are limited in nature, and do not comprehend all matters relating to security and privacy that might be pertinent to your organization.

Deloitte Touche Tohmatsu makes no representation as to the sufficiency of these survey results for your purposes. Reported survey findings should not be viewed as a substitute for other forms of analysis that management should undertake, and is not intended to constitute legal accounting, tax, investment, consulting or other professional advice or services. Prior to making decisions or taking action that might affect your business; you should consult a qualified professional advisor. Your use of these survey results and information contained herein is at your own risk.

Deloitte Touche Tohmatsu will not be liable for any direct, indirect, incidental, consequential, punitive damages or other damages, whether in an action of contract, statute, tort (including, without limitation, negligence) or otherwise, relating to the use of these survey results or information contained herein. These survey results and the information contained in this report are provided "as is," and Deloitte Touche Tohmatsu makes no express or implied representations or warranties regarding the results or the information.

For more information on the Global Offshoring Survey, please contact your local Deloitte Touche Tohmatsu professional listed above.

# Deloitte Touche Tohmatsu Member Firm Financial Services Industry Contacts

## Americas

Argentina  
Fabian Djurinsky  
54 11 4320 2700  
ext. 4008  
fdjurinsky@deloitte.com

Bahamas  
Raymond Winder  
1 242 302 4841  
rwinder@deloitte.com

## Europe and Africa

Austria  
Dominik Damm  
43 1 53700 5440  
ddamm@deloitte.at

Belgium  
Frank Verhaegen  
32 3 800 8853  
fverhaegen@deloitte.com

Central Europe  
Mike Jennings  
Prague  
420 2 248 955 76  
mijennings@deloitteCE.com

Denmark  
Lone Møller Olsen  
45 33 76 38 03  
lolsen@deloitte.dk

Finland  
Petri Heinonen  
358 20 755 5460  
pheinonen@deloitte.com

France  
José-Luis Garcia  
33 1 40 88 28 15  
josgarcia@deloitte.fr

Germany  
Friedhelm Kläs  
49 69 75695 6111  
fklaes@deloitte.de

## Asia Pacific

Australia  
Gerry Schipper  
61 3 9208 7085  
gjschipper@deloitte.com.au

Keith Skinner  
61 2 9322 7580  
keskinner@deloitte.com.au

China  
(People's Republic of)  
Wade Deffenbaugh  
852 2852 6629  
wadeffenbaugh@deloitte.com.hk

Bermuda  
Roger Titterton  
1 441 299 1313  
rtitterton@deloitte.com

Brazil  
Clodomir Félix  
55 11 5186 1655  
clodomirfelix@deloitte.com

Canada  
Catherine Bateman  
1 416 601 5953  
cbateman@deloitte.ca

Greece  
Nicos Sofianos  
30 210 678 1219  
nsoufianos@deloitte.gr

Iceland  
Sigrún Ragna Ólafsdóttir  
354 580 3112  
sigrun.ragna.olafsdottir@deloitte.is

Ireland  
Mary Fulton  
353 1 417 2379  
mfulton@deloitte.ie

Israel  
Dan Halpern  
972 3 608 5471  
dhalpern@deloitte.co.il

Italy  
Riccardo Motta  
39 02 833 22 323  
rmotta@deloitte.it

Kuwait  
Tim Bullock  
965 243 8060 ext. 101  
tbullock@deloitte.com

Luxembourg  
Eric van de Kerkhove  
352 451 452 468  
evandekerkhove@deloitte.lu

India  
Dileep Choksi  
91 22 2202 6073  
dcc@deloitte.com

Indonesia  
Rinie Winarsih  
62 21 231 2381 ext. 3886  
rwinarsih@deloitte.com

Japan  
Yoriko Goto  
81 3 6213 1372  
yoriko.goto@tohmatsu.co.jp

Yukio Ono  
81 3 6213 3630  
yukio.ono@tohmatsu.co.jp

Cayman Islands  
Glen Wigney  
1 345 814 2202  
gwigney@deloitte.com

Chile  
Alberto Kulenkampff  
56 2 270 3180  
akulenkampff@deloitte.com

Colombia  
Ricardo Rubio Rueda  
57 1 546 1818  
rrubio@deloitte.com

Malta  
Andrew Manduca  
356 21 346 662  
amanduca@deloitte.com.mt

Middle East  
Joseph El-Fadl  
961 1 363005  
jelfadl@deloitte.com

Netherlands  
Rob Stout  
31 70 337 2907  
rstout@deloitte.nl

Norway  
Terje Boasson  
47 23 27 92 09  
terje.boasson@deloitte.no

Portugal  
Maria Augusta Francisco  
351 21 381 6020  
mafrancisco@deloitte.pt

Russia  
Vadim Sorokin  
7 095 787 0626  
vsorokin@deloitte.ru

Slovak Republic  
Gerry Stanley  
421 2 582 49177  
gstanley@deloitteCE.com

Korea  
Joseph Shin  
82 2 6676 1100  
yishin@deloitte.com

Malaysia  
Meng Kwai Ng  
60 3 7723 6560  
mng@deloitte.com

New Zealand  
Ian Perry  
64 4 495 3917  
iperry@deloitte.co.nz

Philippines  
Avelina Gille  
63 2 581 9055  
agille@deloitte.com

Mexico  
Carlos A. Garcia  
52 55 50 80 60 93  
cargarcia@dtmex.com

United States  
Jack Ribeiro  
1 212 436 2573  
jribeiro@deloitte.com

Venezuela  
Hernan Marambio-Cortes  
58 212 206 8641  
hmarambiocortes@deloitte.com

South Africa  
Geoff Pinnock  
27 11 806 5194  
gpinnock@deloitte.co.za

Spain  
Fernando Ruíz  
34 91 514 5692  
feruiz@deloitte.es

Sweden  
Jan Palmqvist  
46 8 506 723 82  
jan.palmqvist@deloitte.se

Switzerland  
Philip Göth  
41 44 421 6228  
pgoeth@deloitte.com

Turkey  
Hasan Kilic  
90 212 317 64 16  
hkilic@deloitte.com

Ukraine  
Natalia Samoilova  
380 44 490 9000  
nsamoilova@deloitte.com.ua

United Kingdom  
Russell Collins  
44 20 7303 2929  
rcollins@deloitte.co.uk

Singapore  
Prakash Desai  
65 6530 5585  
pradesai@deloitte.com

Taiwan  
Ray Chang  
886 2 2545 9988 ext. 3029  
raychang@deloitte.com.tw

Thailand  
Russell Toy  
66 2 676 5700  
rutoy@deloitte.com

Deloitte Touche Tohmatsu is a Swiss Verein (association), and, as such, neither Deloitte Touche Tohmatsu nor any of its member firms has any liability for each other's acts or omissions. Each member firm is a separate and independent legal entity operating under the names "Deloitte," "Deloitte & Touche," "Deloitte Touche Tohmatsu," or other, related names. The services described herein are provided by the member firms and not by the Deloitte Touche Tohmatsu Verein.

Deloitte Touche Tohmatsu is an organization of member firms devoted to excellence in providing professional services and advice. We are focused on client service through a global strategy executed locally in nearly 150 countries. With access to the deep intellectual capital of 120,000 people worldwide, our member firms, including their affiliates, deliver services in four professional areas: audit, tax, consulting, and financial advisory. Our member firms serve more than one-half of the world's largest companies, as well as large national enterprises, public institutions, locally important clients, and successful, fast-growing global companies. For regulatory and other reasons, certain member firms do not provide services in all four professional areas.

Designed and produced by The Creative Studio at Deloitte, London # 5130 ©Deloitte Touche Tohmatsu 2005.