

SOURCING INSIGHT

BPO in Swiss Banking: Current Situation and Prospects

This Delphi study sheds light on the development of BPOs in the Swiss banking sector. Over 50 qualified persons from banks, BPO service providers and software developers were interviewed.

Complementary to the various quantitative studies, this study investigates, in a qualitative manner, the mechanisms that influence the development of the BPOs.

After 7 years of discussion on the industrialization in the banking industry, BPOs are being recognized as an acceptable form of back office organization. Nearly every bank makes use of the practice.

This study was conducted by management & advisory services ltd (www.mas-ltd.ch) and sponsored by Swisscom, COMIT and Sourcag AG.

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Preface

This Delphi Study **BPO in Swiss Banking - Current Situation and Prospects** was conducted during the first half of 2010. Conventional studies would be ineffective due to the complexity of the topic and therefore the Delphi Method was selected.

The Delphi method is a systematic, multistage consultation process which incorporates all feedback. It is an estimation technique that is used to understand future events, trends, and technical developments. It is mainly applied when facts are very complex, extrapolations from the past are not conclusive or when there are new trends. The method is named after the Oracle of Delphi of ancient times that gave its advice for the future to the audience.

This qualitative study form was chosen because the development of BPOs in Swiss banking depends on various factors many of which are not quantitative including individual and political factors. Analogous to the banking sector itself, the BPO market in Swiss banking is already complex in structure: the three different language regions clearly present cultural and linguistic hurdles. Other dimensions creating complexity are the very different sizes and types of transactions at a total of 320 institutions. A similar heterogeneity also applies to nearly 50 BPO service providers.

The quality of the Delphi study was ensured by careful selection of competent persons as well as through a sufficiently large number of interviews. The results of this study were also compared with several recent studies on the development of banking and BPOs in order to provide a consistent picture.

This study sheds light on the Swiss BPO scene in the banking sector from a holistic and therefore more qualitative point of view. Details on the study's approach can be found in the appendix.

We would like to extend our appreciation to Swisscom IT Services for the co-sponsorship and would like to explicitly emphasize that at no time were the views or position of Swisscom IT Services given preference.

ICT in Finance published two articles related to this study in Issue 3 | September 2010.

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Executive Summary

This Delphi study sheds light on the development of BPOs in the Swiss banking sector. Over 50 qualified persons from banks, BPO service providers and software developers were interviewed.

Complementary to the various quantitative studies, this study investigates in a qualitative manner the mechanisms that influence the development of the BPOs.

After 7 years of discussion on the industrialization in the banking industry, BPOs are being recognized as an acceptable form of back office organization. Nearly every bank makes use of the practice.

BPO is far from being a perfect product. Several aspects must be further developed in order to bring cost advantages of 30% profit for banks and 15% for service providers. Today that is not always the case.

The focus of attention is the standardization of processes using a model bank. What seems obvious is still difficult to enforce in the daily business. Banks must help the BPO service provider implement a business standard by installing a COO and reorganizing the middle office and the product structure.

For everyone involved, banks and service providers alike, a large cultural change is to be expected. While banks concentrate more on the customer and the details of the commodity functions, the service provider, must adapt, turning back office workers, accustomed to having a captive client, into service providers able to react to a constantly changing market. Both parties have in common that they must trim down and make processes more lean. Contrary to how it appears at the outset, this affects service providers more than the banks.

The banking BPO will continue to develop the relevant standard platforms whereby it is quite possible that there will be several service providers for larger and smaller banks.

Accordingly, the heterogeneity of the Swiss banking industry today with about 50 vendors remains quite fragmented and is likely to consolidate in the coming years.

Banking skills and the ability to create economies of scale for the model bank and operational excellence are the most important factors for success from the service provider side. On the banking side, the most significant components are the ability to define and simplify new processes and to realize the benefits.

Goal of the Study

For the past years, BPO has established itself as a factor of Swiss banking. Therefore it is time to take stock of experiences and lessons learned.

In 2005, the question was still 'How relevant is BPO in banking?' It was asked in conjunction with the continually expanding Banking Standards Platform and the accompanying increase in the use of the term BPO: 'Is the banking sector on the verge of industrialization?' Since then much has changed. The BPO market has developed further but it is far from being a mature product. Summing up:

Banks are more open to the idea of outsourcing but remain somewhat reluctant.

A lot has been done on the service provider end but there is room for optimization.

Today it is important to take stock. While previously basic matters such as discussing the *raison d'être* for BPO were most important, now the focus has switched to analyzing barriers to implementation and learning from previous experiences. Challenging issues remain for both sides:

When is it worthwhile for customers to outsource certain processes?

How does the outsourcer gain the needed critical mass in order to offer customers cost saving advantages? Can the customer (banks) save costs on the one side while the provider makes money on the other?

What have been the experiences so far? What are the difficulties for the outsourcing business model?

Based on experience, which processes qualify for outsourcing and which do not?

Where is there demand without a suitable offer?

And how does it look in terms of future developments? What is the current state of affairs and what are possible scenarios for the future?

Based on past experience, it is up to the parties involved (i.e. banks, BPO service providers, and software developers) to estimate what the future development in the banking BPO looks like.

Although theoretical approaches (strategies and business models) are important, the opinions and considerations of the most relevant players in the market are of crucial importance for implementation.

In 2005, the question was: Is the banking sector on the verge of industrializing?

Today that question can clearly be answered affirmatively. However, what are the obstacles to implementation and how can the process be sped up?

Environment & Trends

DEVELOPMENT

Since the current study has the aim to consider the trends and factors in the banking sector that could have a relevant influence on the development of BPOs, it will accordingly not be completely comprehensive.

The following themes provide a sample from the above mentioned factors and will be discussed in detail at a later point:

Increasing Pressure on Margins. Various studies explain these mechanisms in detail. It is essential for our consideration to realize how restructuring, the banking crisis, criticism of compensation policies, increased regulation, and increased competition can decrease margins in banking which will increase the pressure on costs.

Unstoppable Development of Internet-based Business Models and Increasing Importance of Social Networks. This development, which so far has dealt with 'standard e-banking', will bring far more profound industry changes with it and will consequently further increase the pressure on costs and on the adaptation of the product range.

Intensification of Competition and Focus on the Customer Side. Various polls show that the primary concern of the banks is customer retention and acquisition. Accordingly, investment in infrastructure will be relativized.

Increased Pressure for Regulation and Demands for Transparency. This trend places increased pressure on the primarily small and mid-sized institutions because this is not just a significant investment but also requires skills that are not in abundance and are expensive to train.

Further Trends towards Specialization and Standardization. As other industry sectors have in past years, BPO market players (banks and service providers equally) need to find ways to reduce vertical integration in order to gain economies of scale and to concentrate on their core businesses. A simple automation of processes is not enough; processes must be re-invented and made more efficient.

The Market Consolidation becomes Apparent. The consolidation in the BPO landscape has clearly begun in Switzerland when Swisscom purchased Sourceag and Bsource took over FinLog.

INCREASED PRESSURE ON MARGINS

Various studies and polls of relevant individuals anticipate that margins in banking will reduce dramatically in the next 5 to 10 years. Depending on the source it could be a reduction of 2/3 to 3/4! This trend will become apparent especially in the Basic Banking branch and will be confirmed through the irreversible development of direct banking. As in other industry sectors, banking service providers will increasingly be split into commodity and custom.

Why is it that the banking sector was not affected by the massive structural paradigm shift that has drastically affected most other industry sectors? We cannot explain it!

Two branches are emerging: Basic Banking and Value Added Banking.

Basic Banking is lean, highly automated and inexpensive comparatively speaking. This is not where the differentiation lies.

Value Added Banking, however, is highly technical and herein lays the potential for differentiation.

However, some say there has not yet been enough suffering...

...and still others have harkened to the march of time and have already begun the process of transformation.

Although bank managers' primary focus remains on the customer side (attracting new customer sectors, customer loyalty), the erosion of margins will increasingly force them to realize savings on the cost side. Although banks have been thinking about this evolution for years and have started implementing certain measures, the banking sector will have to prepare for changes of dimensions unseen so far.

Many experts agree that there is enormous potential for process optimization. Based on the processes, banks are facing a dual challenge. In addition to classic process optimization, banks must also assess their situation through the eyes of their customers. The key to relative competitiveness will be to improve and change processes in order to optimize customer benefit.

In turn, the optimization of the processes is to be viewed in conjunction with the design of the product portfolio. The above mentioned trend of increased differentiation between commodity and custom will create the need for a massively simplified and more transparent range of products.

We therefore find ourselves starting from a classic industrial approach: Competition and other factors place pressure on margins and require simplifying the product portfolio as well as optimizing the production system. In order to realize a return on investment, product volumes must grow. Such a development implies specialization and the reduction of vertical integration.

Outsourcing (e.g. ITO, BPO, etc.) and sourcing in general will become even more relevant as the trend towards simplification of the product range in Basic Banking continues and the conditions for industrialization are positively influenced.

In the next five years, a marked reduction in Basic Banking margins is unavoidable.

As a direct result of the erosion in margins, drastic cost reductions will be required.

There is great latent potential in the optimization of bank processes.

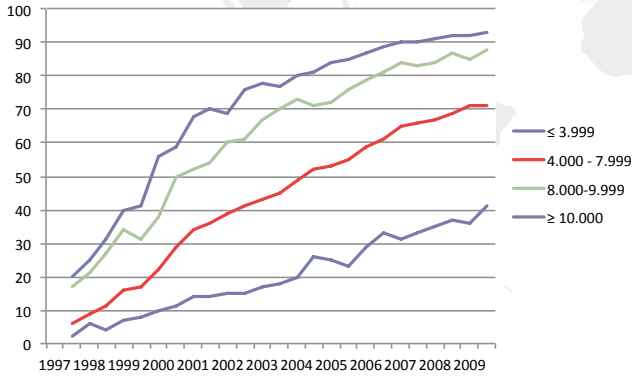
The production range in the commodity area must be simplified.

The trend towards industrialization in the banking sector is not just continuing but is increasing.

External sourcing and especially BPO will prove compelling!

INTERNET & SOCIAL NETWORKS ON THE RISE

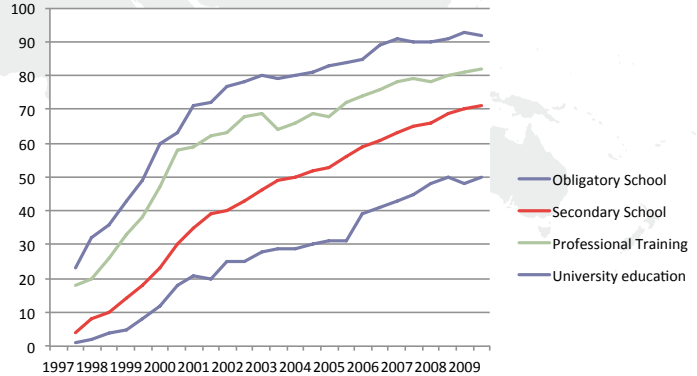
Internet use in Switzerland based on education, development from 1997 to 2009¹
Regular users in % of the population over 14 years



¹ Biannual results (average from April to September and October to March)

Sources: MA-Net; Net-Matrix-Base

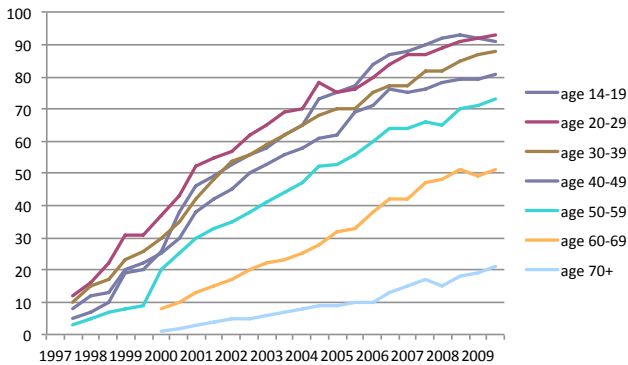
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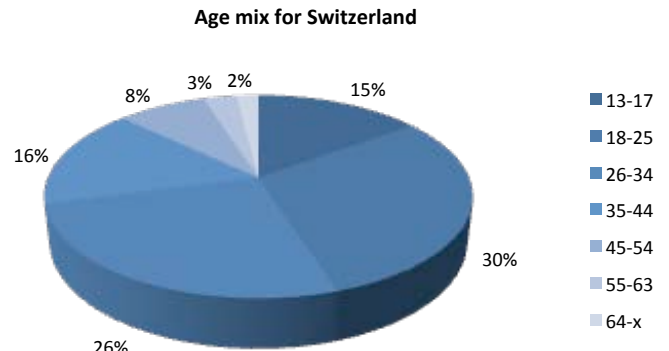
Sources: MA-Net; Net-Matrix-Base

Internet use in Switzerland based on age, development from 1997 to 2009¹
Regular users in % of the population over 14 years



¹ Biannual results (average from April to September and October to March)

Facebook demography Germany - Austria - Switzerland



Source: Thomas Hutter eConsulting & Coaching

For the last 12 years, Internet use in Switzerland has been increasing constantly and this reflects an irreversible societal development. The average intense Internet user is well-educated and well-paid. Although the category of older users is growing the growth curve reflects increased use in the younger users segment. The Internet allows you to reach the traditional customer segments as well. During the past year, the global increase in social networking has grown to 30% of the approximately 315 million active users. 55% of Facebook users are now over 26 years of age. 29% are over 35. Internet-based business models, as in all industries, will have to exercise high pressure on costs for basic services.

INTERNET & SOCIAL NETWORKS ARE CHANGING BANKING



Example from a Design Student's Thesis:

"New Trends in Trade

In my thesis project I would like to develop a mobile social software concept that stimulates bartering going beyond family practices today. In order to understand how technology might support family bartering, I firstly explore its social context in ethnography-based studies learning about motivations, obstacles, strategies, relationships, local connectivity, interactions, values, and important factors such as trust and credibility."

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Because person-to-person (P2P) lending works without a middleman, both creditor and debtor get better rates. But it also requires new mechanisms to distribute the risk of a debtor's default. The first P2P website, Zopa, appeared in 2005 and has mediated £25 million until 2008.

Renowned financial institutions among others, ZKB, Baloise, Maerki Baumann & Co. and PostFinance, as well as Microsoft are supporting research into a new business model.

It would behoove the banking industry to closely follow these developments and recognize the fact that they reflect a societal change that is not to be reversed. Solid partnerships and ability to negotiate are required.

DIRECT BANKING LEADS TO REDUCTIONS IN COST AND MARGINS

The growing importance of the Internet changes our society irreversibly:

- Marked and continuous changes in consumer behavior across all traditional customer segments have become an undeniable reality!
- Customers are not willing to lose time for commodity trading (including banking). In the commodity sector, lines between customer segments are blurring.
- Basic Banking (commodity) and core products (value added sector) pass through a parallel development.
- We are at the beginning of a period which offers massive potential to optimize customer process changes in time management and allocation.
- The service provider is available for the customer via his or her PC/mobile phone; no longer has the customer to go to him. (This only happens for reasons of lifestyle or leisure.)
- Developments take place across industry and customer segments.
- Before making investments, research is conducted online (for both electronic and in-person purchases.)
- Public opinion plays a more important role than advertisements, an enormous multiplier effect.
- What was once seen as impossible has become possible (e.g. online airline Check-In, printing train tickets at home or receiving them on hand-held telephones).
- The enormous potential of payment transactions in the Internet has been, for the most part, capitalized upon by new entrants (PayPal).

Direct business requires simple and cost effective processing.

High STP (straight through processing) rates have become a requirement.

Polarization between low cost commodities and more expensive custom products.

Process optimization from a customer viewpoint (vs. banking viewpoint) will become crucial.

The latest challenges in customer service will absorb resources and draw them from ICT and back office projects.



SWITZERLAND



SWISS BANKING, A HETEROGENEOUS MARKET

Swiss Banks Category	German-speaking Total Banks			Total Banks	Total P&L (MCHF)	French-speaking + Tessin			Total Banks	Total P&L	Total CH	Total P&L (MCHF)
	<5	<20	>20									
Cantonal Banks	6	7	4	17	304'510'339	1	5	1	7	84'805'715	24	389'316'054
Regional Banks	60	3	-	63	85'993'468	12	-	-	12	3'930'006	75	89'923'474
Raiffeissen	-	-	1	1	131'574'864	-	-	-	-		1	131'574'864
Total Universal banks	66	10	5	81	522'078'671	13	5	1	19	88'735'721	100	610'814'392
Private Banking	22	2	2	26	99'711'859	21	1	-	22	31'682'891	48	131'394'750
Foreign Banks	58	4	-	62	89'187'923	54	4	3	61	242'462'345	123	331'650'268
Foreign Bank Subsidiaries	24	-	-	24	13'079'550	6	1	-	7	10'637'091	31	23'716'641
Others	6	1	1	8	52'226'112	1	-	-	1	3'824'590	9	56'050'702
Banquiers privés	-	7	-	7	NA	-	7	-	7	NA	14	NA
Total Private banks	110	14	3	127	254'205'444	82	13	3	98	288'606'917	225	542'812'361
Total Swiss Banks	176	24	8	208	776'284'115	95	18	4	117	377'342'638	325	1'153'626'753

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Number of banks according to 2008 SNB statistics, without UBS and Credit Suisse and 7 institutions with a special field of business

An analysis of the Swiss banking landscape reveals:

- Its heterogeneity impedes cluster building and the creation of economies of scale and critical mass.
- The number of potentially profitable BPO providers is structurally limited.
- Switzerland, therefore, will most likely remain a protected market shutting off major foreign service providers.
- Whether or not the various small institutions will receive the same service by a BPO provider as the larger banks remains to be seen.
- A look back in time to the collaborative organizations shows a 'nominal breaking point' between the large and small institutions.

PRIMARY FOCUS ON THE CUSTOMER

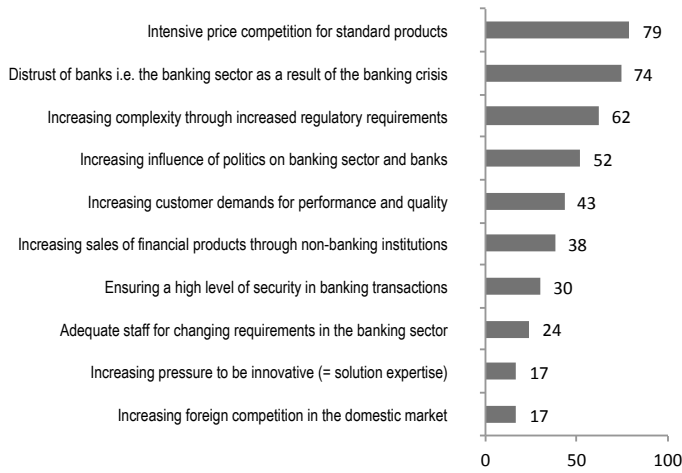


Chart: Strategic Challenges, N = 362

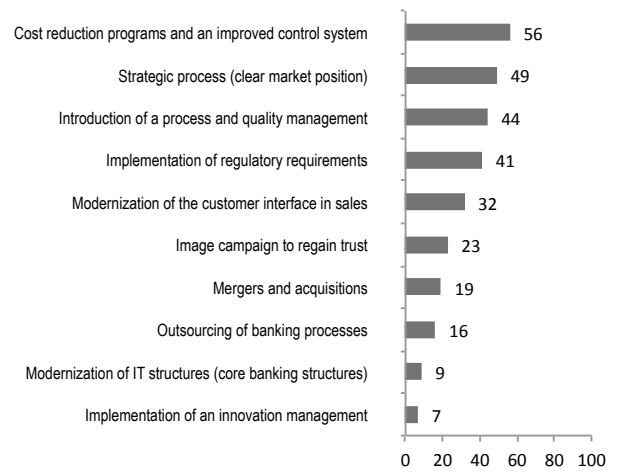


Chart: High Visibility Strategic Projects in 2009, N= 360

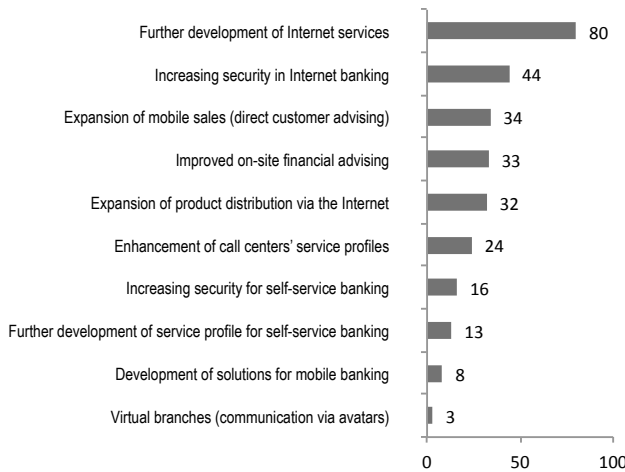


Chart: Investments in Direct Services, N = 345

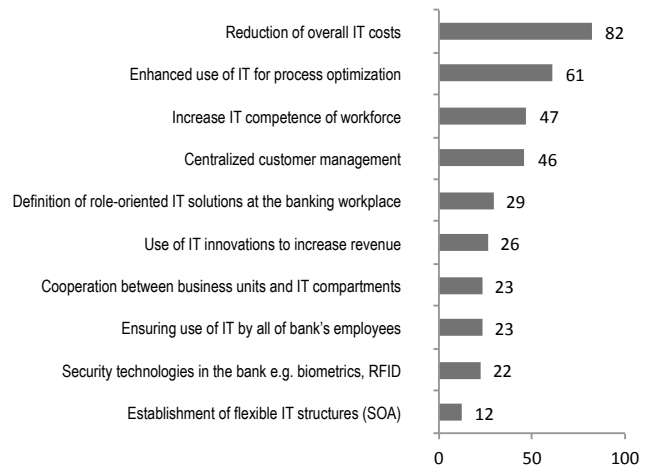


Chart: Challenges in IT Management, N= 351

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Quantitative surveys, independent of the Delphi study, sustain many important deductions:

- Price wars in the standard product sector have eroded margins and required reduction in costs.
- Improved process optimization and simplification.
- Strengthened IT use to support the various defensive and aggressive measures.

A precise analysis of the current study shows various conflicts in goals as well as some contradictions especially concerning IT implementation. IT support is supposed to increase while at the same time IT costs shall be reduced.

Escaping this dilemma will automatically lead to additional standardization, industrialization, and concentration. Swiss Banking, a Heterogeneous Market.

WHAT WILL THIS MEAN FOR BPO?

Structural changes are forcing banks to save on the processing side and to invest on the client side. This increases the pressure to reduce vertical integration and to outsource non-competitive or related functions to external specialists.

If BPOs are to be established as a long term alternative, a tangible attempt must be made to solve these dilemmas within the BPO framework – whether it be on the cost side, in quality and stability, in the implementation of technological solutions or in a combination of these factors. As a COO of a large bank put it, 'If the BPO provider is only as good as we are, then it is not worth the effort!'

That creates extremely high expectations for the BPO provider! Simply shifting the former resources of the banks across the border is certainly not a solution. The BPO provider must reach a substantial optimization in costs as well as advance and enforce standardization (model bank). He also needs to review his own manufacturing depth.

If the banks' expectations are to be met, additional cost management measures and quality standards must be guaranteed for the banks.

In addition, it is also clear that massive cultural changes must take place on both sides. The belief that the ball lies in the banks' court is ignoring the fact that today's BPO employees are the former employees of the customer banks. Therefore, from where should the change come?

Summing up:

Yes, BPO is a logical answer to increase the efficiency of Swiss banking; however, demands on both sides remain high and require changes on all sides.

The prerequisites for the development of BPO are essentially favorable.

However, establishing BPO is not possible without substantial effort!

'The BPO provider must offer a better alternative to banks in order to make it worthwhile!'

Both banks and providers must drive the necessary cultural changes forward.

BPO Situation

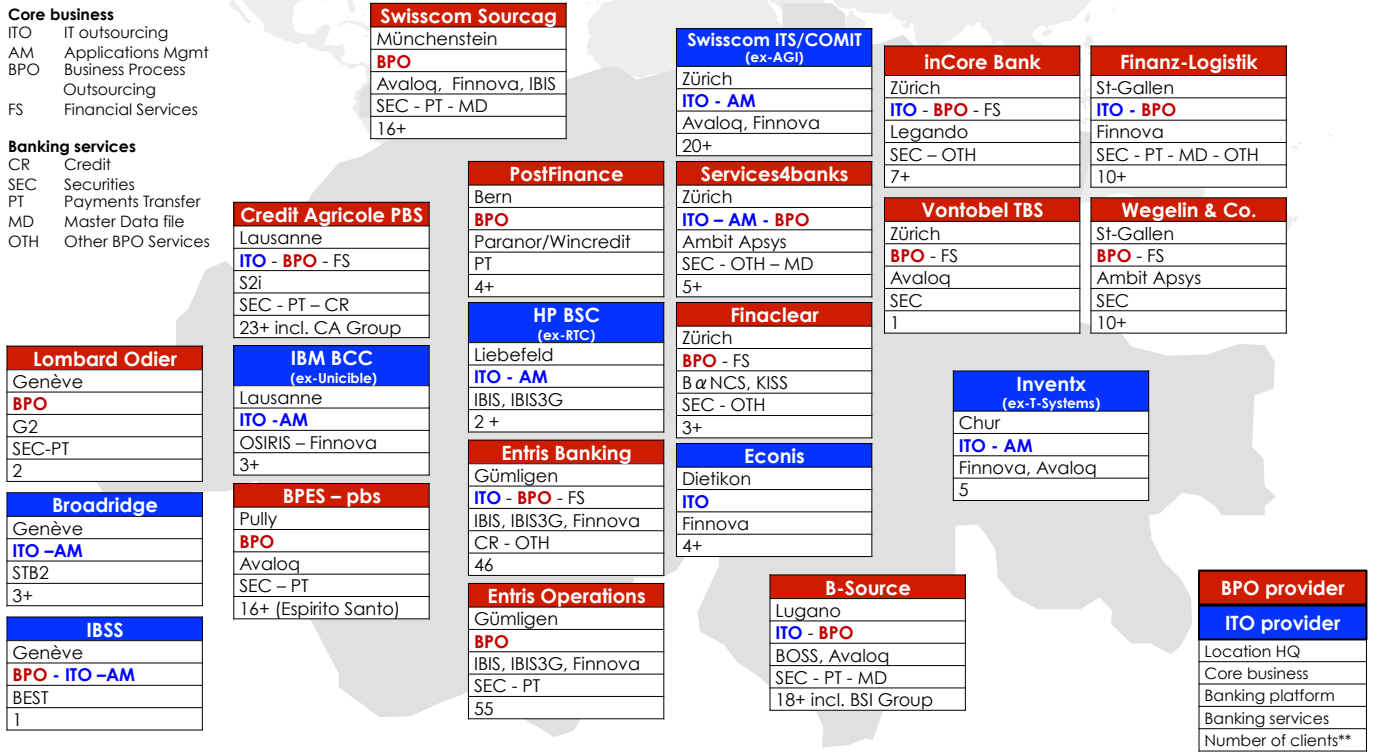
OVERVIEW OF THE MAIN GENERAL BPO AND ITO PROVIDERS (STATUS 02/2011)*

Core business

ITO	IT outsourcing
AM	Applications Mgmt
BPO	Business Process Outsourcing
FS	Financial Services

Banking services

CR	Credit
SEC	Securities
PT	Payments Transfer
MD	Master Data file
OTH	Other BPO Services



* Not exhaustive - Extract of about 50 major or niche BPO providers - Based on public available information and mas market intelligence. Estimated number of clients which are official banks. The «+» means that the company has more clients which are financial companies, insurances, brokers, etc.

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- The majority of BPO service providers were created as a result of initiatives from the banks (carve-outs).
- In the BPO arena foreign providers currently play a marginal role.
- BPO service providers are not comparable to one another 1:1.
- The collaborative organizations of the 80s and 90s have virtually all been replaced by new structures.
- BPO services emerged around the most important platforms except around Olympic. The main volume is already with Avaloq und Finnova.

THE EVOLUTION CONTINUES, NO REVOLUTION!

Banks and not large service providers primarily drive BPO endeavors:

- T-Systems disappeared from the BPO market and the cooperation between Trinkaus & Burkhardt in Germany and Vontobel in Switzerland is no longer active.
- IBM main focus remains on ITO/AM.

In contrast:

- Vontobel and Raiffeisen renewed their contracts.
- Valiant and PostFinance started a new cooperation with ValFinance in credit BPO.
- Crédit Agricole regularly won over new, small, and foreign-based banks.

This confirms the 2nd study that, within the banks, changes and innovations are not driven by the IT but by the functional departments.

In the consolidation process, communities and common interests play a vital role, e.g. the same standard software platform or common business interests. As in the past, small customer-service groups will form and evolve and look at the impact of a larger unit due to scale effects. The acquisition of Sourcag by Swisscom IT Services can be interpreted in this sense as a step towards consolidation of the market.

The external sourcing of products and processes is connected with increased efforts in change management, potentially higher as in the case of IT platforms:

- Perception that banking processes are part of the core business, or at least that they are closer to it than IT.
- Processes must be optimized / simplified which is very important for the bank organization.
- Importance of redefining core competencies and jobs.
- Increased industrial thinking and planning for reduced margins.

The launch of a new service must make sense from a volume perspective for both bank and supplier. It is followed by process optimization and standardization which is the basis for the inclusion of further volumes and for the progressive reduction of the service costs.

A definitive factor in the BPO business is the ability of the provider to create trust:

- High competence in the banking process and credibility.
- Designated service and operational excellence.
- Fair and transparent pricing models based on clear SLAs.

In fact, banks are the driving forces in the further development of the BPO business.

Gradual consolidation of smaller communities.

Change management plays a decisive role.

Considerations require a relevant volume from which to start.

Need for trust to be built step by step through high quality and competency as well as through fair pricing.

WHAT IS NECESSARY IS NOT NECESSARILY DONE

As a result of industrialization, banks and service providers will need to specialize further. Each player will have to be aware of his core competencies and focus on them. The main factors will be the need to trade on economies of scale, the current volume of investment, and the skills. The boundary between core competencies / creativity and industrialization / commodity must be redefined.

At least small and mid-sized banks clearly demand that services be delivered from a single source. In order to meet this need - despite specialization and a breakup of the supply chain – more ‘assemblers’ (see page 24) must be created. Focusing on customer value, these will compose an individual solution merging a bank’s own and the different non-exclusive external services and components.¹

Banks and service providers lag behind in terms of this new thinking:

- On the banking side, with regards to concentrating on core competencies, the homework has not always been done. Too much focus has been placed on tasks and products that do not belong to the bank’s core competencies. As a result, the procurement of outside service providers has been viewed with skepticism.
- On the provider side, not enough attention has been paid to standardization and cost optimization. As a result of well-intended customer focus, an unnecessarily high variety of products has been allowed which does not necessarily create a real difference in profits but keeps costs fixed on a higher level. Such situations can cause difficulties to the providers.

Outsourcing does not endanger core competencies! For the private banker, outsourcing of the mortgage processing to a highly specialized provider can be very positive: the customer is retained but can be provided with professionally prepared decision making documents (analogy: Intel Inside). This enables them to focus their full capacity on the portfolio management where more customer value is placed without running the risk of providing the client with poorly prepared mortgage documents.

In the future, more attention must be paid to which competencies the various players wish to focus on. Only leadership in a single segment makes sense. Through targeted sourcing, production resources can be saved and the front office can be expanded.

A standardized process model is available (Model Sourcing Competence Center HSG); the application of standard processes is too often questioned for the wrong reasons and because of historical ways of doing business.

Specialization will, as a rule, be unavoidable - on the customer as well as on the provider side.

Full service will become an ‘assembly product’.

This new school of thought is not yet established – neither with the banks nor with their service providers!

Cultural aspects and misunderstandings often get in the way.

Sourcing / Outsourcing allow reallocation of resources.

¹ A simplified example from the automotive industry: Porsche concentrates, for example, on their core competencies of brand management, design and motors; the rest is outsourced.

BPO IS THE NEXT CYCLE IN BANKING LOGISTICS

In the coming years, BPOs will become more relevant:

For all market players (banks, BPO service providers, IT consultants, ITO service providers and software developers) it must be made clear that the large scale migration to the new standardized platforms has been realized and that the focus must increasingly shift to process simplification and cost reductions.

At the same time and in opposition to this development, IT is becoming a key factor in the cost reduction and process optimization!

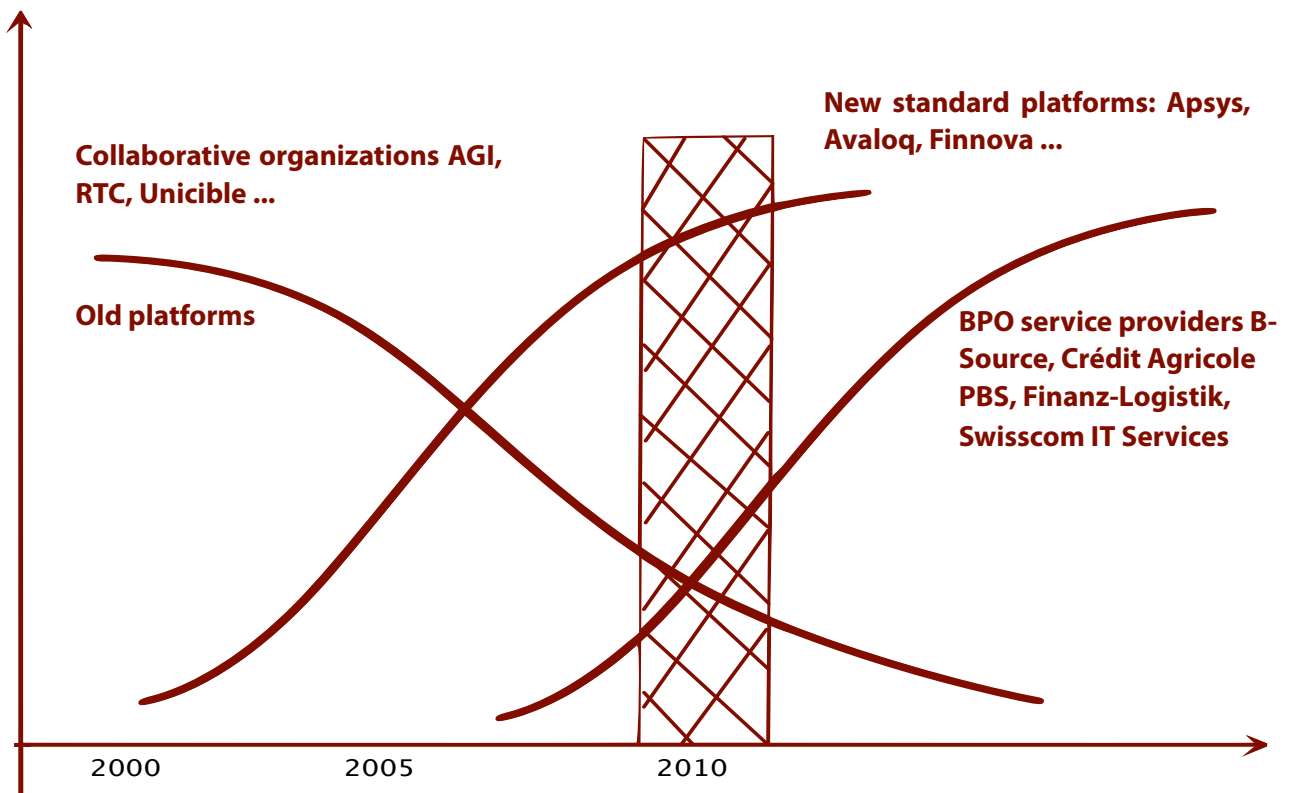
Today it is viable for a bank to migrate from its old platform directly to a BPO solution without having to develop an entirely new IT platform.

Over the last 10 years, the vertical integration in banking IT has fallen sharply with the spread of the new standard platform.

Against the background of the BPO services, banks increasingly have at their command different sourcing options for IT and back office services, which have to be carefully evaluated.

When looked at closely, these issues rather represent an optimization of the current status than an reinvention of the banking sector.

In connection with the rise of Internet-based models, further investment in technology is expected and, accordingly, the investment and project portfolios must be assessed carefully to avoid bad investments.



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MARKET PATTERNS EMERGE

Varying environments and needs determine the creation of different segments that have to be specifically addressed. For example:

- Small and mid-sized banks (private banks, foreign banks, regional banks, etc.): Size, specialization, and skills set the possibilities and limits.
- Universal banks, for the most part cantonal banks: They characterize themselves by the breadth of their service; however, depending on their size, it is difficult to maintain this.
- Relatively autonomous foreign banks: They have no legacy and need only provide consolidation figures. This is the situation of many new entrants to the Swiss market.
- In the cantonal banking sector, the political framework sets conditions and limits for outsourcing and the use of capacities.

Larger conglomerates and banking groups form a provider category (Global Sourcing Centers) for which the largest ITO / BPO service providers compete (i.e. HSBC, UBS, etc.).

For large international players, Swiss banking BPO markets remain only moderately attractive. Switzerland is a complex island with limited volume and divided in various cultural circles. However, it is worth to have a close look: international providers can offer favorable conditions for specialized and functional services abroad and the presence of large banks prove the feasibility.

Experts underline the chances various mergers or alliances would have. However, their implementation will not happen in the near future due to political and tactical reasons as well as due to the lack of sufficient pressure on margins:

- Alliances of the cantonal banks in the back office.
- Cooperation SIX / Swisscom as national bank-infrastructure-provider.

BPO providers will be customers themselves buying services of other providers. The sourcing principle is not only at play in the relationship between customer and provider; providers must also consider their own objectives and give thought to the question 'Make or Buy'.

The classic integrators for SW platforms must reinvent themselves. They possess valuable banking know-how that must be redefined and applied. This can be part of BPO advising.

The demands that the various banking groups have regarding BPO differ greatly.

Large banks provide themselves with BPO services.

The risk of new players that could enter the market is slightly increasing.

Many 'non events' due to political or regulatory questions.

BPO providers will themselves be customers of other players.

New field of action for integrators.

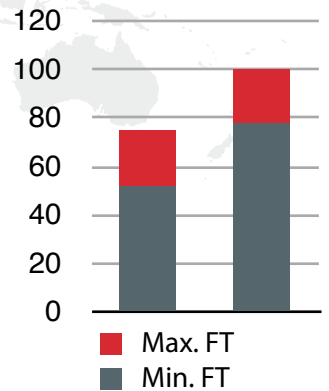
Challenges for the Banks

Reduction of the Vertical Range: There is much talk of industrialization in banking – but the reality looks different. ‘Transformation Bank 2015: Business Processes and Value Chains’: The study shows a large gap between the target and the current vertical integration of the banks. However, a certain focus on sales and consulting becomes apparent.

The change in processes, however, is quite different for ‘General Services’ (product development, financial planning, etc.), ‘Design/Implementation’ (client reporting, account management and the like) and ‘Support’ (document management, marketing, etc.).

Of 21 processes that are defined in the study for these areas, currently 17 have a production facility depth of 76-100%. The other four are between 51-75%. For 2015, the respondents forecast for 14 processes a reduction of 51-75%, with another four from 26-50%. No further outsourcing is foreseen for the processes of ‘Risk Management’, ‘Accounting’, and ‘Personal Information’.

A reduction of the vertical range is underway but still has a lot of potential:



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Industrialization changes the Skills Needed and the Corporate Culture:

New skills which must be built up on the banking side:

- Sourcing Skills: ability to compile within its own infrastructure an appropriate mix of internal and external services.
- Partner & Contract Management: accordingly, it will be very important to select partners and manage them.
- Industrial Logic: continual development of the culture and skills for standardization of offerings and processes.
- Strengthening of the middle office skills in industry compliant product development.

Central Role of the COOs and Middle Offices:

The COO gives orders to the BPO provider. His role consists of optimizing the cooperation between the two entities:

- On the one hand, the needs of the front need to be taken into account (differentiation).
- On the other hand, standardization and simplification need to be encouraged and advanced (standardization).



If economies of scale are to play a role, then the model bank of the BPO provider must be implemented preferably. At the same time, product structures and processes need to be thoroughly scrutinized, especially in light of the trends mentioned, i.e. the split between Basic Banking and Value Added Banking.

Process Standardization: On the conceptual side, much work was completed at the Sourcing Competence Center at the University of St. Gallen regarding process standardization. Many banks, software developers and BPO service providers have been made aware of these findings. Now, these need to be implemented!

Challenges for the BPO Service Providers (I)

Neutral governance is crucial; the era of collaborative organizations is over. Many conflicts of interests can generate a high complexity and limit marketability.

In order for outsourcing to be attractive, there must be a 20-30% reduction in costs for the banks. A bank is more or less interested in outsourcing depending on its current state: Is it a new market entrant, has it just upgraded to a standard platform, is migration still to come, etc. At this point it must also be clear that the BPO service provider must also achieve a margin of 15%, which adds extra pressure on the cost side.

The share in % the customer volume holds of the provider's total volume is one indicator for the degree of cost efficiency. The volume a polled service provider held at his own provider was at nearly 8% allowing savings of 80% of the transaction costs.

New skills are also required on the provider side:

- New methods of selling: 'Turkeys don't vote for Christmas'. Selling to those primarily involved in outsourcing and BPO is, a priori, not effective. Accordingly it is the CXO who must be sold on the idea.
- Business case and consulting skills are required (the former leader of Financial Industries Consulting Practice of Arthur D. Little will be responsible for business development of Xchanging Europe).
- During all processes, from sales to implementation and optimization of BPO services, it is vital to provide evidence of banking expertise.
- Assembly and sourcing skills as a prerequisite for integral solutions mixing own and third party services.

In terms of service development, providers need to adapt the customer's perspective. A service that is profitable for the provider without enabling integral customer-based solutions will not be marketable. A high level of standardization of offerings is crucial; for an appropriate price, customized products can be an option but must carefully be tested.

BPO services must continue to be designed as a block. Cost savings can only be achieved through high STP over the entire process chain with as few interfaces as possible as they are labour intensive and can jeopardize the profitability of the entire process.

Strong project management expertise and stringency during transfer of the business cases on both sides is crucial. Two well-known players (customers and service providers) from the Swiss market have taken several years to come close to achieving the business returns described in the business case study. This was not primarily due to the assumptions made but mainly due to a lack of consistent implementation and enforcement.

Professional governance is critical.

Cost reductions for banks of 20-30% are required.

The bank's volume must represent a small percentage of the provider's entire volume.

Big changes are required on the service provider side as well.

BPO providers must sell differently in the future.

The service developments on the provider side also require revisions.

Outsourcing self contained services as completely as possible.

In the beginning, BPO is a business project.

Challenges for the BPO Service Providers (II)

For BPO service providers, the implementation of a model bank is pivotal:

- It is a keystone for realizing economies of scale.
- Cost advantage for the banks and the profitability of the BPO service provider depend on it.

The BPO provider is completely dependent on the active help and cooperation of various stakeholders: primarily the bank with the COO as previously mentioned. A conflict may arise with the integration of a service provider whose business model is focused rather on 'customizing' than on the widest possible implementation of a standard.

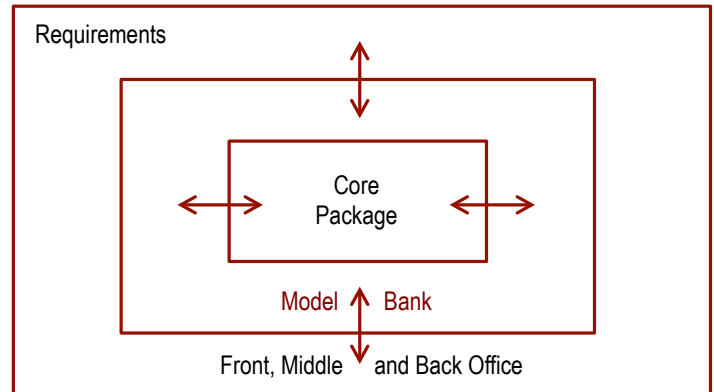
The model bank is the core element of cost efficiency for the BPO provider.

Enforcing the model bank must be done in close cooperation with the banking COOs, the SW developers, and the consultant.

The BPO providers will build the model bank based upon:

- Existing functionality of the IT platform.
- Existing reference model (i.e. CC Sourcing).
- Requirements of the lead bank.

The SW developer remains in close contact with the banks and the BPO provider for the further development of the platform.



The service provider faces a similar problem as the software developer, i.e. the definition of reasonable perimeters of the model bank. In addition to questions of a merely functional nature, the challenge is to cover the needs of banks – large and small, private or international. Can the provider use the same scheme for all of them?

The model bank is the core element of cost efficiency for the BPO provider.

At this point, the crucial importance of the banking competence of the BPO provider becomes apparent. The provider must be able to speak with the bank at eye level in shaping the entire processes.

Enforcing the model bank must be done in close cooperation with the banking COOs, the SW developers, and the consultant.

Challenges for the Software Developers

To achieve a widespread use of standard platforms and the corresponding migration of a large number of migration projects, software developers must consider where further developments would be possible:

Expansion of the Functions and Interfaces to Market Standards: The natural trend is to extend the functional coverage; of course, on the other hand, it must be clearly recognized that specialized solutions have been established for different regions. Accordingly, the SW developer should provide 'certified' interfaces.

Overall Integration of the Processes with BPM (Business Process Management): In larger institutions which have heterogeneous additions to the core banking platform over a large number of peripheral systems the end-to-end overall view of the processes from a customer perspective (final customer and bank) is required. An optimized interaction with the major BPM products is very important.

Development of Customer-Oriented Functions and Direct Banking: At the same time, there must be demands for consolidation, simplification, and cost reduction on the back office side.

Expansion of the Model Bank: Essentially the model bank should cover the core business and be further optimized in close cooperation with the BPO service providers. This will support the BPO service providers in their search for scale effects.

Optimization of Operating Costs: By the same logic, the operating cost of a platform should continuously be optimized.

Revision of Revenue Models: As the segment of medium and small banks on the one hand and the BPO service providers on the other hand are increasingly dealt with, the individual implementation of the standard platform-oriented pricing model must be revised.

BPO providers also represent an important customer segment; they are not competitors!

Excessive proprietary approaches (in the revision phase) make it difficult to achieve scale effects for the BPO service provider.

Facilitating end-to-end process optimization across the various systems for the bank is a real added value.

Challenges for the Consultants

The decrease of vertical integration and standardization of the platforms as well as the progress of the BPO changes the starting position for the consultants:

Rather than customizing a standard platform according to a client's specific requirements, the implementation of a model bank has priority. The BPO provider would do well to certify the consultants in order to ensure that the standard approach of the model bank is sold and implemented.

The reorganization of the interface between the middle office and the outsourced back office is equally important.

The consulting process obliges to take the chance and optimize and simplify processes end-to-end. Not the existing processes should be reflected, otherwise the desired scale effects will not be achieved. The maximum improvement in efficiency can be achieved when the product portfolio is also analyzed and optimized.

The common challenge for all parties involved (banks, consultants, BPO providers, and SW developers) will be to separate the commodity business from the value-added features and to map the differentiation of the bank in the market.

Consultants face various weighty challenges:

From technical integration to implementation of the model bank.

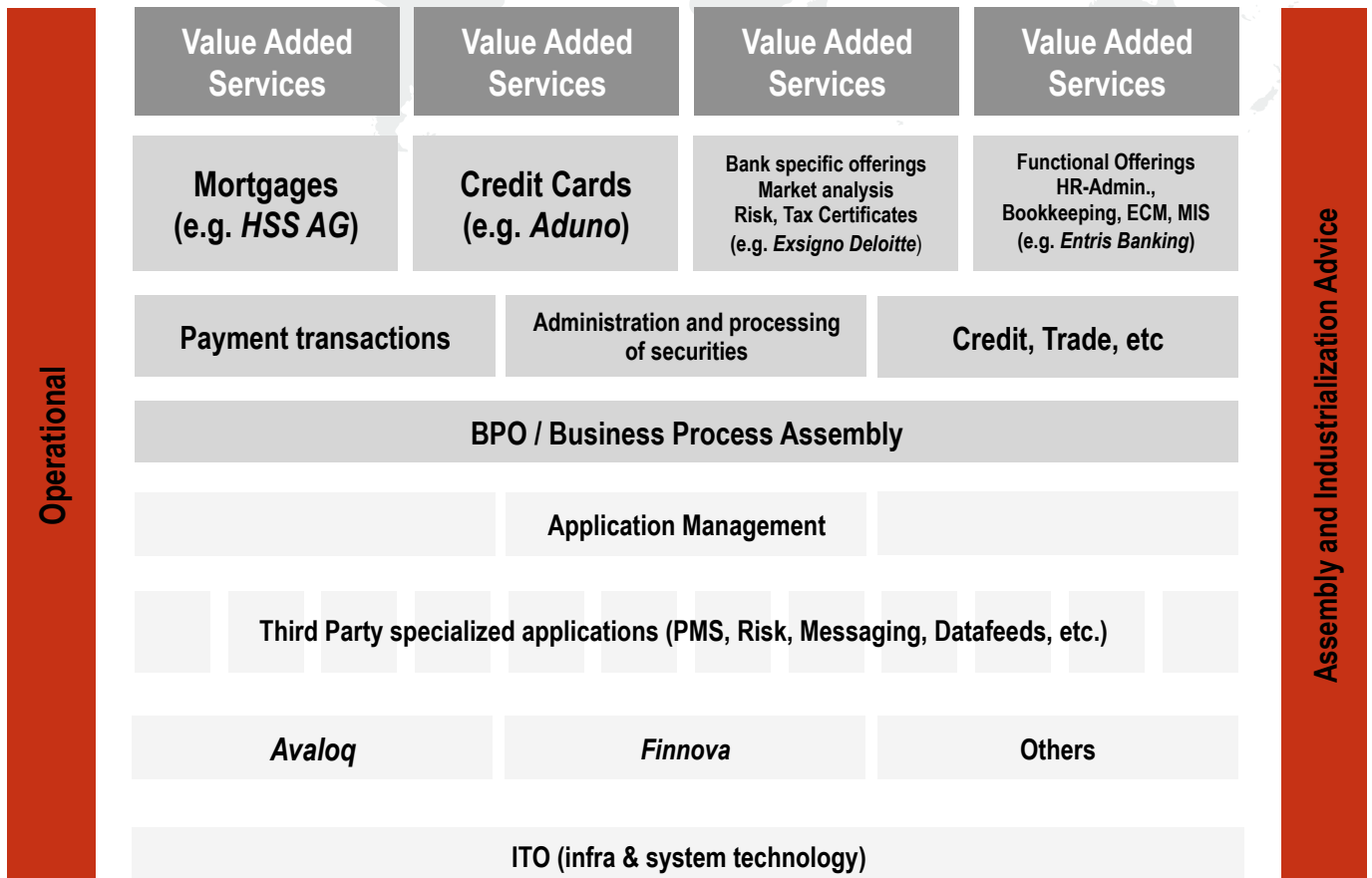
From IT know-how to bank specific know-how.

From functionality to end-to-end process optimization.

Perspectives

BUSINESS PROCESS ASSEMBLY AS AN OPPORTUNITY

In order to meet the various diametrically opposed demands, the market could develop in the direction of specialization and assembly.



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Focus and specialization can be supplemented with assembly expertise.

Specialized service providers also outsource and are able to develop their own value added services.

High volume service.

Due to the various interfaces, BPO is being forced to develop Business Process Assembly.

Different varieties, depending of the type of bank:

- Platform-centered 'full-service' (small and private banks).
- Assembly-oriented (larger banks).

Standard platforms naturally build communities.

BANKING ASPECT

Goals of Outsourcing: Today's banks are much more willing to consider outsourcing. They are motivated by:

- Economies of scale, primarily for the big banks with the goal of reducing costs.
- Focus on the core business banking and time-to-market.
- SLAs will hopefully allow for a professionalizing and formalizing of IT and the back office.
- Stability thanks to the size of the BPO provider and consequently availability of the necessary skills.
- In the case of smaller institutions, the aspect of costs is put into perspective considering other aspects.

Developing New Skills and Behavior: Despite (or because of) this increasing willingness, the need to further develop several conditions becomes obvious:

- Acceptance of standardization in the commodity sector.
- Clear separation of commodity and value added services/products.
- Readiness to optimize the product portfolio and structure as well as processes but, at the same time, this must increasingly be done from the customer's point of view.

Readiness to thoroughly reorganize the Middle and Back Office:

- Readiness for a consequent reorganization of the middle office and the interface with BPO provider based on the model bank.
- Consequently developing sourcing skills and reducing the manufacturing depth while systematically testing and implementing the possibilities for external sourcing possibilities.
- The COO will now assume the role of "Sourcing Officer".

Stringency in Cost Management: Various examples have shown that the target business cases only add up slowly because often the possible cost saving measures have not been implemented. Furthermore, often banks instinctively build in a certain amount of duplication with the BPO provider: this as a matter of security and due to the fact that trust has not been fully established. Therefore it is important to examine the entire case and not just the external costs of the BPO providers.

Development of a Clear Sourcing and Logistics Strategy: Entering into a BPO arrangement cannot be compared to the procurement of new software for a specific and clearly defined sector or department. It is a radical restructuring of the production process which must be systematically planned in order to fulfil the above sourcing objectives.

Given the investment required on the customer side, there is a clear need for strategic project portfolio management.

As sourcing options increase, it is highly important to carefully weigh sourcing alternatives with the business strategy as key driver.

ASPECTS OF BPO SERVICE PROVIDER (I)

Bank specific Know-How: In BPO, bank specific know-how plays a central role. Some reason for the restraint banks display towards BPO can be found in their uncertainty whether the sufficient banking know-how exists. Their doubts are fuelled by the fact that many service providers have emerged out of IT business.

Without outstanding banking skills, a BPO service provider cannot survive. These skills must be better than those of the average banker.

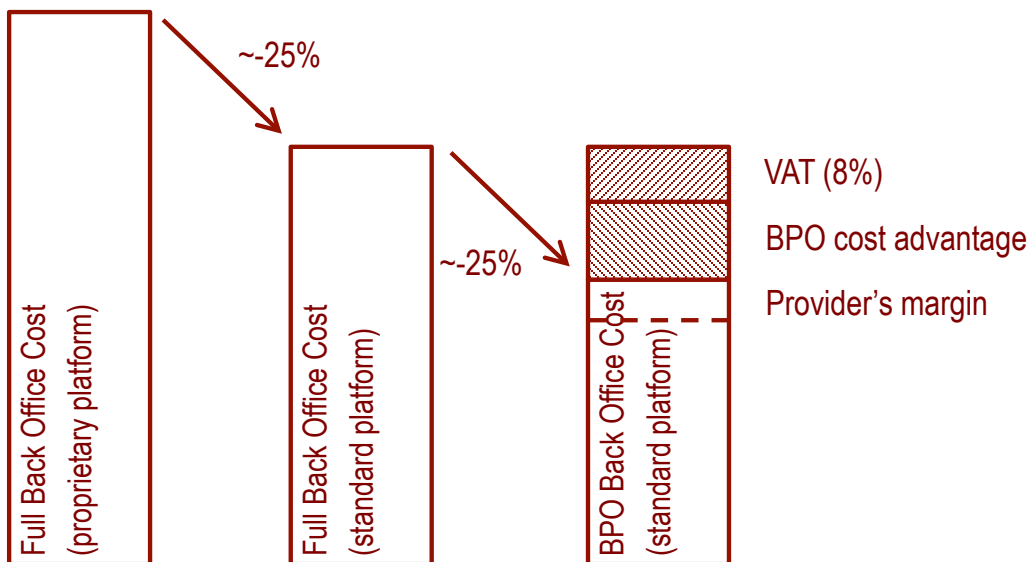
Quality of Service, SLA's Culture and Market Orientation: The employees of the BPO service providers generally come from a carve-out of the customer banks. Very seldom do they operate with market logic and they are more used to a 'captive market'. Especially here, great efforts are necessary to maintain a good reputation.

Scale Effects and Cost Advantages: A BPO provider that cannot achieve economies of scale will not survive very long. Although the scale effect is based on the model bank, it is dependent on sales and implementation by the customer. An interaction between the COO and the consultants must be orchestrated.

Service Offers and Consulting: Starting from the sales phase, the implementation of a BPO solution in a consulting project is difficult. The BPO service provider must be able to discuss the case options with the client and develop them at the CXO level.

Depending on the starting position, it is not at all trivial to earn price advantages for the bank and a market-based margin for the owner.

With the services offered we must begin with the customer's starting point. Which package is best for a small bank, which for a larger bank? What is the outlook for a bank that has recently just invested in an expensive change over to a new standard platform?



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ASPECTS OF BPO SERVICE PROVIDER (II)

Integrated Offer: Despite the fact that the value chain is forced open, clients often expect the BPO provider to offer the service of a general contractor. With the breakup of the value chain, the customer often expects a 'GC'-like approach on the side of the BPO provider.

Sales Skills: Given the importance of enforcing the standards for the banking model, new demands are made on sales: more conviction and perseverance and in-depth banking expertise are required.

Governance: Since most of the BPO service providers have emerged as a carve-out of banks, the governance often does not reflect the necessary independence and professionalism. Often, conflicts of interest are built in, which inhibit the development of the company.

In light of the industrialization of banking, the BPO service provider finds himself facing a major task. This is not only true for the services he provides for the customer but even more within his own organization.

Appendix: Case Studies & Study Approach

Conditions of the Study

Delphi Method: Theoretical foundations, financial models and process analysis are needed to understand BPO and BSP. Further development and expansion of these services depends heavily on non-quantifiable parameters, and many interdependencies. The best possible method to estimate the likelihood of various future scenarios is to interview a large enough number of relevant stakeholders.

Confidentiality and Neutrality: Although the names of the panel members may be well known, no correlation to the statements are made, so that confidentiality is assured; only *mas* know the context.

If statements are made about individual service providers, one only learns the opinions of the relevant service provider expressed, provided one participates in the study.

Qualified Panel Participants: The quality of the results depends to a large extent on the expertise of the panel members. For this reason, a careful selection was made.

Give and Take: All participants receive a report of the study in return for their participation. There is no further requirement of participants; *mas* will present the study at the participating organizations. The study will be presented at an event and published.

Financing und Sponsors: The study was financed by *Swisscom IT Services* and *mas* and supported by *ICT in Finance* from the media.

Disclaimer: a) The authors provide no guarantee for the completeness of the study or for its derived measures. The opinions of those interviewed do not necessarily reflect the opinions of their firms.

Evaluation of the Study

In addition to the interviews, in the interest of cross checking, various studies will be evaluated among others: *Fraunhofer Institut*, *Universität St. Gallen*, and *CC Sourcing*.

Interviews 1 : 1

- *Aduno*: B. Stocker, CEO, D. Anders, COO
- *Avalog*: R. Sawaf, BPO
- *Bank Coop*: A. Waespi, VGL
- *BCF*: Ch. Meixenberg, GL
- *BEKB*: J. Hopf, GL
- *BKB*: P. Gertsch, GD
- *B-Source*: W. Hoppler, CEO
- *Crédit Agricole PBS*: J. Bourachot, CEO
- *CA SG*: St. Weigelt, CEO
- *Entris Operations*: J. Hopf, GF
- *Exsigno Deloitte*: K. Ruesch, GL
- *Finnova*: Ch. Matter, CEO
- *HSBC*: Ch. Lapaire, Head Operations
- *HSSAG*: Th. Ankenbrand CEO
- *InCore Bank AG*, A. Bolliger, VRP
- *Netcetera*: A. Vckovski, CEO
- *Postfinance*: E. Lardelli, GL
- *PriBaSys*, P. Haist, CEO
- *Raiffeisen*: P. Gisel, GL
- *SDFB*, G. Buurmann, Prof.
- *SGKB*: Ch. Schmid, CFO
- *Sourcag*, B. Lehmann, CEO
- *VSKB*: H.-P. Hess, Geschäftsführer
- *Valiant*: M. Durrer, Ex CEO
- *Xchanging*: M. Frick, COO CE
- *ZKB*: J. Schneider, CIO
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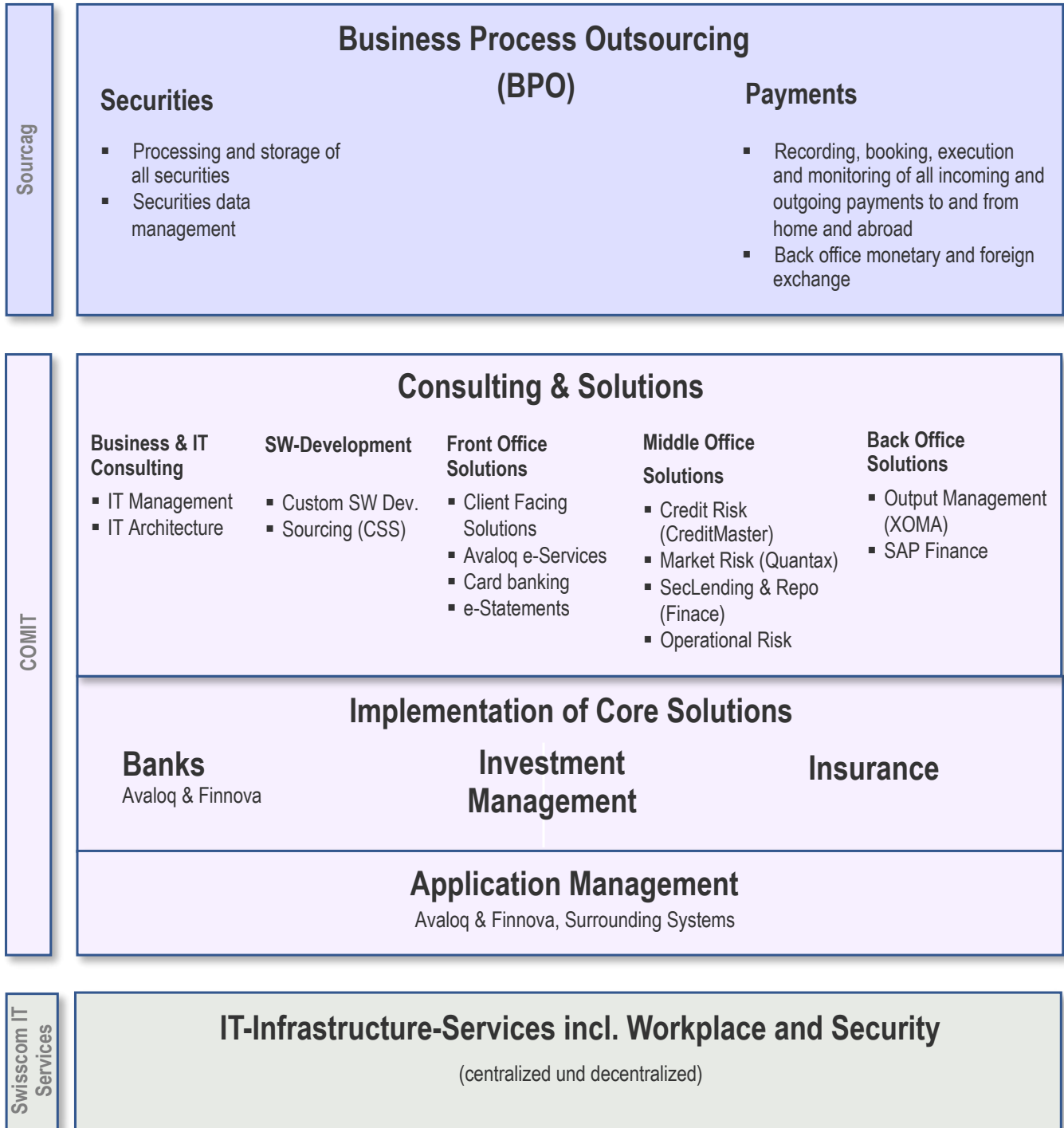
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Glossary & References (I)

ASP Application Service Providing

BPO Business Process Outsourcing

Business Process Outsourcing (BPO) is a specialized form of outsourcing and describes the outsourcing of entire business processes. BPO is different to other forms of outsourcing in that it is not a part of the organizational structure (i.e. an organizational unit or department) that is outsourced, but rather a part of the process organization. The business process is usually outsourced together with the underlying IT system. The term Knowledge Process Outsourcing (KPO) is applied for BPO processes requiring more analytical skill.

BPM Business Process Management

BSP Business Service Providing

Business service providers (BSPs) are companies that offer state-of-the-art business applications over the web. These are application service providers where applications are built and delivered as web services - designed with modern security, management, and identity standards to facilitate the plug-and-play integration of these services with other BSP services or with internal corporate web services. The integration platform for BSP services within a company is the enterprise service bus.

A Business Service Provider can also provide a combination of web-based software with the additional support of outsourced human administrative services.

CC Sourcing Competence Center for Sourcing at the University of St Gallen, HSG

ITO IT Outsourcing

STP Straight Through Processing (= rate of automation)

Glossary & References (II)

The following studies were examined subsequently for consistency with the present Delphi study (to ensure neutrality):

1. 'Transformation zur Bank 2015' (German-speaking study about the transformation of banks for 2015 of the sourcing competence center of University St. Gallen) and University Leipzig, 2010

The following key results support our findings:

- Client focus simultaneously on electronic media (the commodity sector) while maintaining the personal consulting (value-added range).
 - Increased mentioning of the benefits provided by product and process standardization. However, rarely applied in practice.
 - Accordingly a very high production level remains.
2. 'Trends 2009 in der Bankenbranche. Der Einfluss der IT auf den Unternehmenserfolg in Krisenzeiten', 2008. (German-speaking study about trends in the banking sector for 2009 which surveys the influence of IT business success in times of crisis)
 3. 'Trendstudie Bank & Zukunft 2009 Innovationsstrategien in turbulenten Zeiten', 2009 (German-speaking study about banks and their future in 2009 exploring innovative strategies in turbulent times)

ICT in Finance 3| September 2010

- Delphi Study on the State of BPO in Banking.
- Status of BPO in Banking: Report from a Panel Discussion with BPO Market Players.

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- Service Level Agreements
- Consolidation / Centralization
- Project Implementation
- Change Management
- Procurement Support
- Risk Assessments
- Performance Audits
- Compliance Reviews
- Benchmarking

Framework

Activities

1	Identifying potential	<ul style="list-style-type: none">▪ Confirmation of objectives, benefits and risks.▪ Assessment of options using proven methodologies.
2	Analyzing status quo	<ul style="list-style-type: none">▪ Current state analysis and benchmark of existing sourcing landscape.▪ Business case/ risk evaluation of potential versus current state.
3	Planning target state	<ul style="list-style-type: none">▪ Establishment of requirements for selecting vendor/ model.▪ Vendor and location selection process.
4	Transformation to target state	<ul style="list-style-type: none">▪ Planning and implementing transformation phase.▪ Support in business continuity management and go-live.
5	Continuous optimization	<ul style="list-style-type: none">▪ Ongoing optimization of business model.▪ Vendor sustainability and risk / compliance audits.

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