Opportunities for Action

The Golden Rules of Successful Offshoring

The offshoring of business processes to low-cost countries, having grown substantially over the past few years, has become an increasingly important part of the senior management agenda at most *Fortune* 1000 companies. The trend has been led by institutions in the United Kingdom and the United States, and it is far more developed in some industries than in others. But there is a growing realization that offshoring is a phenomenon that companies in virtually all sectors must now evaluate.

The financial services industry (along with other industries such as telecommunications and airlines) has been a leader in embracing the offshoring concept. Indeed, many major financial institutions now offshore significant parts of their operations. And it's not difficult to understand why. Companies that have offshored successfully are realizing cost savings of more than 30 percent, often accompanied by significant quality improvements. Higher revenues can result, as well, since lower delivery costs allow new customer segments to be targeted. For certain activities, such as credit card servicing, offshoring is becoming the norm.

Yet for every institution that has succeeded at offshoring, there is another that failed to understand the basics before taking the plunge–resulting in lost time, lost money, and dissatisfaction with the entire process. Indeed, quite a few offshorers today are still not satisfied with their overall results. But few have abandoned the exercise, and some have regrouped from bad experiences to offshore on a larger scale.

What is it, exactly, that determines whether an offshoring program ultimately succeeds or fails? Although there is no easy answer, we believe that financial institutions should learn from the experiences of early movers and carefully weigh different choices as they embark on their offshoring journeys. Part of that process involves observing best practices that have emerged as prime drivers of offshoring success.

Ten Guiding Principles

Our work with financial services institutions on a wide variety of offshoring and outsourcing issues suggests that the ten maxims listed below–although not a guarantee of success–will greatly increase the probability that your company's offshoring activities will, in time, deliver the desired results.

1. Ensure full support from the CEO. Offshoring is not easy. It creates profound anxiety across entire organizations. Employees are put in jeopardy of losing their jobs or being transferred (along with their families) to an unfamiliar part of the world. Such weighty issues necessitate the attention and full commitment of the CEO, who will have to manage the company through any social and political repercussions that arise from the offshoring initiative. The CEO will not assume responsibility for this task unless he or she believes that offshoring is absolutely necessary for the company to remain competitive. Moreover, the CEO must demonstrate and communicate his or her commitment to the rest of the senior management team in order to make the initiative successful.

2. Develop a clear vision of the value at stake. It is vital for companies to be clear about the full value on offer from offshoring. When internal discussions about offshoring begin, senior management must develop a lucid outlook on which specific activities in each business unit are able to be moved offshore, the potential savings, the investment required, and a likely time frame for starting the process. Naturally, activities suitable for offshoring will likely differ among players with different business focuses. For example, a primarily wholesale bank may perceive little downside in offshoring customer-facing processes, whereas retail banks must gauge the benefits and risks to their retail-customer relationships of such a move. In our experience, many retail players view the potential benefits of offshoring differently even among themselves–some seeking cost savings only, others pursuing quality improvements as well–and may thus arrive at different conclusions about how to approach the initiative. But all types of players need a clear view of the total value on offer. Without that, the effort will often lose momentum–especially in large organizations–or be discredited outright.

3. Derive an optimal sequence. The key factors to weigh when formulating the best sequence of processes to offshore are strategic risk, offshoring feasibility, and organizational readiness. Our experience with financial institutions indicates that it is critical to establish initial success with processes that are relatively easy to offshore. For example, in mortgage servicing, it may be better to start with simpler post-closing operations, such as auditing, before moving on to first- and second-tier call centers that account for most full-time equivalents (FTEs).

It is also important to be aware of any major technological hurdles. Sometimes relatively simple data processes are technically more challenging because they are specific to certain organizations or run on legacy systems.

4. Evaluate locations with care. Countries and regions should be considered on criteria such as economic growth rate, political stability, vendor-market maturity, cost advantage, language resources, availability of peer experience, confidentiality, time zone advantages, and integrity of legal enforcement. Proximity to a core market can also be a factor. One global bank we're familiar with chose to start part of its offshoring activities in Malaysia, even though that country was significantly costlier than India. A prime reason for the bank's decision was that Malaysia was closer to the institution's key markets–and hence more advantageous for certain tasks that had to be completed on the same business day.

5. Choose the right business model for your organization: captive, outsourced, or hybrid. Most early-moving offshorers to India already had local operations in the country and chose the captive route because there were not many credible vendors available. For example, Citigroup, HSBC, and Standard Chartered all set up captive entities, leveraging their established local presences. But this trend is starting to change. Vendors are now more mature, and many companies with no operations in India are finding the outsourcing route an easier way to start, especially for noncore activities.

Furthermore, many midsize financial institutions, now eager offshorers, may not have sufficient scale to establish captive organizations. Our empirical observation is that a captive entity becomes viable only after it surpasses 1,000 FTEs. If the entity can reach a maximum of just 500 FTEs, outsourcing may be the best option. However, these model choices may not be as stark as they appear today. Organizations may end up having a captive entity that sources and manages vendors for them, enabling the organizations to retain only a few key processes and outsource most of the established ones to credible vendors that enjoy scale.

6. Move inefficient processes before fixing them. A common refrain when a company delays decisions on offshoring is "Our processes are so inefficient that we need to fix them first, or we'll lose leverage with insourcing vendors." Yet our experience in working with financial institutions indicates that offshoring initiatives are similar to postmerger integration (PMI) issues. With PMIs, it is generally best to integrate things in their established mode before improving them. Otherwise, no one—neither the offshorer nor the vendor—fully understands the new process, and that is a recipe for confusion. One global financial-services institution, for example, chose to move certain business processes to its locations in India without waiting for standardization. This step allowed the company to capture most of the potential labor-arbitrage savings up front—which made up 70 to 80 percent of the total savings—and to generate momentum for reengineering without dealing with the baggage of how the processes had been carried out in the past.

There is a caveat, however. If a process is already being fixed, it is best to finish repairing it and then allow time for the process to stabilize before moving it offshore.

7. Appoint the right leadership. Below the CEO level, offshoring activities need to be led by someone who is powerful within the organization and can be a worthy champion for the project in its initial, difficult phase. Even organizations that have had no presence in the offshore location are often better off picking someone who knows the company well and is sent offshore as an expatriate, rather than hiring someone locally who knows the offshore geography well. Still, the expatriate typically needs to be supported by a locally hired person who can run the day-to-day operations of the offshore center—allowing the expatriate to manage the internal organization and to set the company's standards and expectations for the center. Fidelity Investments, for example, has an expatriate running its growing and very successful captive center in India.

8. Design an efficient governance structure. Which entity should own the processes and the people? Should it be the business units, or should a shared-services model be followed? In our view, it is best to let pragmatism win in the initial stages by providing the business units with more control. Doing so makes for a smoother transition and helps instill the business units with the confidence they will need. In the later stages, however, governing the offshore center as a shared service becomes somewhat inevitable, given the multiplicity of processes and business units involved and the need to take a coherent view across the organization.

9. Know your service benchmarks before going offshore. Dissatisfaction with offshoring performance often results from not having any credible service benchmarks. Such benchmarks are important whether your institution chooses to follow mainly the captive or the vendor route. Yet few financial institutions have robust internal service-level agreements between business units and operations that can serve as a basis for comparison once the offshoring activities have had time to settle in. For example, one organization we know was thoroughly dissatisfied with its offshore captive operation—not realizing that the entity was saving it roughly $24 million per year and providing the same service level that the organization had enjoyed in its home country. All offshoring advocates should insure themselves by having clear means by which to measure their projects' progress.

10. Don't use pilots to decide whether offshoring works. Pilot programs should be used to fine-tune implementation progress, not serve as a litmus test for a go-no-go decision on offshoring. One reason is that pilots are carried out on a small scale and therefore do not accurately reflect the potential savings from offshoring activities. Pilots typically take three to six months to stabilize, and they should be used to adjust the speed with which processes are offshored.

A common pitfall of offshoring is to immediately compare the operating metrics of a newly opened offshore center, run by inexperienced staff, with those of a long-established center, run by experienced personnel in the home country–if the home metrics indeed exist. In our experience, it takes at least six months for performance to be directly comparable on this basis. It also typically takes about 18 months for the entire transition to settle in.

Seizing the Initiative

Throughout the entire financial-services industry, insufficient understanding of offshoring has spawned many myths and masked real issues that senior management needs to confront. These issues are not easy to master, and the risks involved in offshoring are substantial. Common reasons for dissatisfaction with offshoring, in addition to not observing the maxims explained above, include poor choice of vendors, unrealistic expectations, and a lack of patience in allowing the initiative to develop and come to fruition.

Yet offshoring is increasingly critical to competitiveness. What is more, a handful of leading financial-services players have already achieved a significant offshoring imprint. For example, Citigroup, Bank of America, JPMorgan Chase, HSBC, and GE Capital collectively offshore more than 30,000 FTEs, mostly to India. Some financial institutions have more than 12 percent of their global work forces located in India–a figure that will continue to rise. In our view, tomorrow's leaders in financial services will be the companies that have the capability to use all the resources that the global business landscape has to offer.

Finally, if there is one overriding observation regarding the evolution of offshoring in financial services, it is the following: half-hearted attempts inevitably lead to failure. The rule to follow is "Think big, start small, and ramp up quickly." Indeed, if your organization is not fully committed to offshoring now, then wait. But beware–don't wait until you are the only high-cost player in your market.

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