# Outsourcing to Boost Liquidity

The global financial crisis is having a major impact on banks' liquidity. Outsourcing provides a cost-effective and flexible alternative at a time of major competition for investment capital. Nadeem Shaikh, Head of Financial Institutions in First Data's international business, discusses.

The financial crisis has cost banks $1.025 trillion in asset writedowns, bad debts and new capital since January 2007 (*). It has also had a very negative impact on the liquidity of the global banking system.

Despite government bailouts and other regulatory interventions in many countries, the drastic reduction in liquidity has led to an enormous lack of confidence across the whole financial sector and a significant decline in the funds available for banks to lend to personal and business clients, as lending requirements have tightened.

This has been matched by a decline in funds available for banks to invest in technology, at a time when the demands on banks' technology budgets – especially in relation to the burden of compliance - are increasing. PSE Consulting estimates that up to 70 percent of banks' IT spend in Europe is now on compliance - national, multi-national and system updates mandated by the international card schemes.

Increasingly, the financial crisis can be seen to be acting as a catalyst for outsourcing, with more banks considering the full range of options that outsourcing makes available. This is particularly relevant for retail banks that have made significant investments in branch networks, electronic payments infrastructure such as ATMs and other service delivery channels.

The financial crisis is not the only reason for banks to consider outsourcing – a Deloitte study showed that from 2003 to 2007 banks generated savings of 37 percent per process outsourced (**) – but it is certainly helping to focus their attention.

(*) source: Bloomberg, data relates to period between 1 January 2007 and 19 September 2008

(**) Deloitte Research, figures relate to 2003-2007, quoted in an article by Geeta Sankappanavar, VP of Strategic Global Outsourcing in Bank Technology News (July 2007)

## Implications of the Liquidity Crisis

According to Andy Efstathiou, director of the banking practice at analysts NelsonHall, the current liquidity crisis is having three main impacts on banks:

1) Capital constraints - the liquidity crisis is making it increasingly difficult for banks to allocate capital for IT infrastructure upgrades, especially for projects that do not immediately provide a positive return on investment.

2) Multiple distribution channels are increasing competition for investment resources. The tremendous proliferation of channels places a burden on banks to maintain adequate investment levels in all of them - or to prioritise which ones will be upgraded or refreshed. While declining branch numbers may have reduced the investment needed in physical locations, banks have made large investments in electronic payment infrastructures, internet banking and new delivery channels. These all require significant investment in upgrades and refreshing.

3) Many banks are increasing the geographic spread of their distribution channels. To drive volumes banks often need to enter new markets, either in-country or internationally. This often involves investing more in physical branch and ATM networks - increasingly, banks are outsourcing the ownership of this infrastructure.

In addition, many banks also need to replace legacy IT systems and update ATM estates. In the current environment banks are finding the capital squeeze is impacting their ability to make these investments.

Banks that do not invest in their IT infrastructure run the risk of it being outdated on two fronts – technologically and economically. From a technology perspective, legacy IT systems often become outdated and unable to cope with requirements for both increased efficiency and the need to innovate and drive new product development.

The economics of the business are changing, too. For example, in most countries the majority of ATMs are still deployed either in-branch or close to bank premises. There are large opportunities to drive increase footfall and revenue by placing ATMs in locations such as supermarkets. However, ATMs in these locations frequently need different facilities and services to bank-based units, such as higher security and different merchandising.

## The Case for Outsourcing

There are several key drivers for outsourcing:

- → Risk management – outsourcing can reduce or enable banks to avoid many of the risks they face in areas such as delivery, technological obsolescence and financial performance.
- → Competitive capability – outsourcing enables banks to focus on their core business and buy in the latest technology and improved processes. A report by the Management Consultancies Association and the British Bankers Association in June 2008 found that 58 percent of organisations said outsourcing made their company more competitive.
- → Cost – previously fixed costs such as people, systems etc. can become lower, variable costs.
- → Flexibility – outsourcing allows banks to improve capacity and pass on demand volatility.
- → Innovation and speed to market - even without the financial crisis, innovation is a major challenge for banks using incumbent legacy systems. The extra pressure on liquidity now makes it even more difficult for banks to find the investment funds needed.

## Building a Strong Business Case

A well-founded outsourcing arrangement can deliver many benefits. It provides greater clarity on the costs of running each distribution channel and product line. It also allows banks to manage their business on a best of breed IT infrastructure with guaranteed service levels.

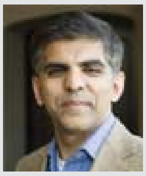
For banks interested in improving liquidity and driving innovation in their payments business, the key is to work with a specialist provider. Look for one who can offer outsourced solutions across a wide range of payment channels, including ATMs, POS networks and interfaces to national and international payment scheme switches.

Where solutions can be provided on a modular basis, this gives banks the flexibility to select which elements of the value chain to outsource, without having to pay for a 100 percent solution on a 'take it or leave it' basis.

The financial crisis is impacting banks' liquidity across their entire business. As they strive for both a higher return from their IT investment and the ability to provide differentiated and innovative products to clients, outsourcing gives banks the flexibility, choice and financial options they are looking for.

**For more information on how First Data can help your organisation develop and implement an outsourcing strategy, please contact Nadeem Shaikh at First Data: nadeem.shaikh@firstdata.com**

## About the Author



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Nadeem Shaikh leads the Financial Institutions line of business across First Data's international operations. In this role, he has responsibility for co-coordinating and driving strategic sales, product development and the delivery of payment solutions to banking and financial institution customers across Europe, Middle East, Africa, Asia Pacific, Latin America and Canada. Nadeem has overall responsibility for the strategic issuer processing business across the international business.

Prior to this appointment, Nadeem held executive management responsibility for First Data's Europe, Middle East & Africa business, comprising more than 6,000 employees. In this role he oversaw First Data's business in more than 20 countries with an annual turnover of US$1.0 billion.