

Do German Banks Successfully Outsource Back-Office Processes?

GERMAN BANKS ARE HIGHLY SATISFIED WITH THEIR BUSINESS PROCESS OUTSOURCING (BPO) VENTURES. BENEFITS ARE ACHIEVED THROUGH THE COMBINATION OF A CLOSE VENDOR RELATIONSHIP AND A WELL-DEFINED OUTSOURCING CONTRACT. THE OUTSOURCING OF DOMESTIC PAYMENT PROCESSES IS MOST SUCCESSFUL WHEREAS THE OUTSOURCING OF CONSUMER CREDIT PROCESSES STRUGGLES WITH QUALITY IMPROVEMENTS.

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Introduction

According to a former E-Finance Lab (EFL) study, Business Process Outsourcing (BPO) provides unique potentials for German banks (Wüllenweber, Gewald et al. 2006). Specifically, potential cost savings and the ability to achieve quality improvements were found as main drivers why German banks outsource some of their back-office processes (e.g., settlement of securities or consumer credits). As these outsourced processes are close to bank's core business, BPO provides a considerable knowledge potential through the leverage of both outsourcer and vendor core capabilities.

However, these unique potentials come along with significant risks that have limited the growth of BPO. In particular, the lack of BPO management experience and the complexity of business processes increased managers' aware-

ness of financial and quality related risks. This risk awareness even limited BPO adoption in the German banking industry (Wüllenweber, Gewald et al. 2006).

This article addresses the question whether the benefits associated with BPO have been achieved by German banks that did engage in BPO ventures. In addition, empirical data is provided to analyze how German banks governed (managed) their BPOs in order to achieve the expected cost savings and quality improvements. We used four banking processes for investigation: settlement of securities, consumer credit, credit cards, and domestic payment transactions. These processes are ideal candidates for BPO as they are digitally enabled and do not represent core competencies that banks typically do not outsource. Wüllenweber, Gewald et al. (2006) found that bank managers

associate higher benefits with the outsourcing of domestic payment and security settlement processes than the external delivery of credit specific processes. Thus, we specifically analyzed outcome and governance differences across processes.

Methodology

From the Top 500 German banks, we determined that 1,027 business processes (out of potentially 2,000 processes (4 per bank)) were sourced out. In total, 335 bank managers (from 215 banks) responsible for one of these BPO ventures returned our questionnaire. This implies a response rate of 32.6%. Figure 1 shows the distribution amongst business processes.

The differences across processes are assessed using mean difference tests at significance level 0.05. All analyses are carried out using SPSS version 15 so that mean difference tests are weighted by standard deviations.

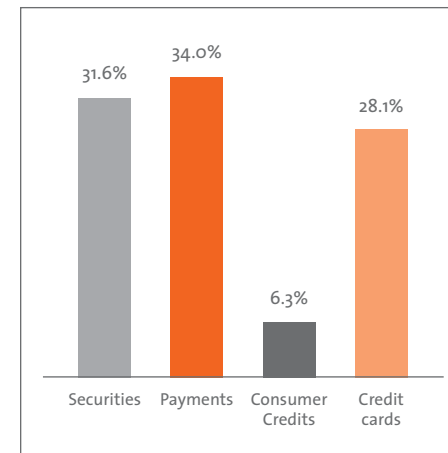


Figure 1: Distribution of processes in the sample

Some selected results: banks highly satisfied with BPO

Most of the banks are satisfied with their BPO projects. 86.6% of the respondents confirmed that their expectations have been fulfilled (mean=5.56 (scales range from 1 (indicating low satisfaction) to 7 (indicating high satisfaction)); standard deviation=1.23). Interestingly, the results differ according to processes: bank managers of domestic payment processes are more satisfied (mean=6.00, standard deviation=1.4) than bank managers responsible for securities, consumer credit, and credit card settlement (all mean=5.33; standard deviations=1.3/1.4/1.5).

Cost savings have been realized in more than 70% of all BPO projects (Figure 2). However, banks engaging in domestic payment BPOs were more satisfied with their cost savings than banks outsourcing their securities, consumer credit, and credit card processes.

Quality improvements have been achieved in 60.6% of all BPO ventures (Figure 3). Interestingly, banks outsourcing credit card settlement were more satisfied with their process improvements than banks engaging in consumer credit BPOs. The results for domestic payment and securities settlement BPOs did not significantly deviate from credit card BPOs.

Successfully governing BPO projects

While BPO offers unique potentials that come along with distinctive risks, organizations are unprepared for their governance (Mani, Barua et al. 2006). When BPO benefits depend heavily on leveraging capabilities by aligning structures and resources between outsourcer and

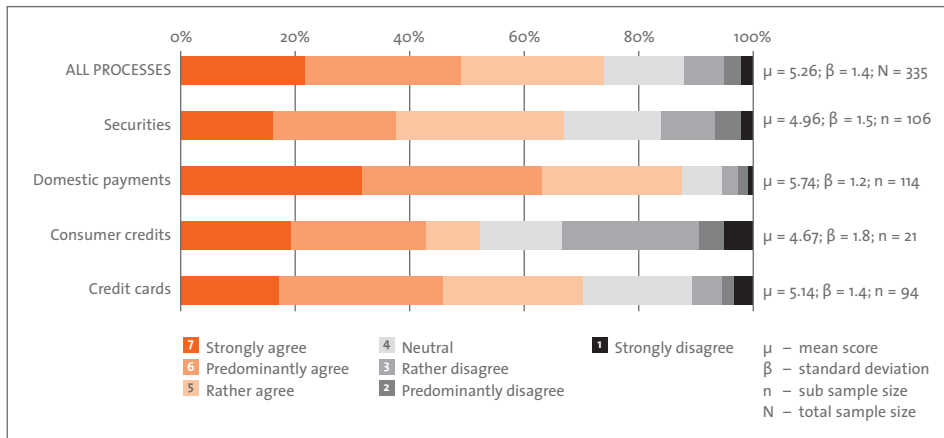


Figure 2: Assessment of statement: "We achieved to reduce process costs through BPO."

vendor, intensive cooperation is necessary to achieve their attainment. Thus, a great extent of embeddedness through personal and social bonds/networks is critical from a governance perspective. Relational norms (such as commitment or flexibility) and processes (such as joint problem solving or frequent coordination) have to act as self-enforcing control mechanisms. Nevertheless, relational governance cannot be seen as substitute for contractual governance: outsourcing contracts legally define obligations and provide exchange parties with an instrument of control and escalation.

The results of our study show that bank managers were satisfied with their relational and formal governance: almost 60% of the respondents confirmed that their relational governance is suitable for their BPO ventures (mean=4.64, standard deviation=1.4). In more than 75% of BPO ventures, the outsourcing contract was assessed as highly effective (mean=5.17, stan-

dard deviation=1.3). Thus, the BPO ventures were governed by both relational and formal governance instruments implying a use of these instruments.

However, the effectiveness of governance varied across processes: relational governance has been more effective in domestic payment BPO projects than in credit card BPOs (Figure 4). In addition, relational governance is regarded significantly better in credit card BPOs than in securities settlement BPOs. Interestingly, relational governance has been assessed as effective for all processes except securities settlement: the mean score of securities settlement BPOs is not significantly higher than the mean Likert point (4.00) resulting in neither an effective or ineffective role of relational governance. With regard to formal governance (Figure 5), the data reveal that contracts in domestic payment BPOs are regarded significantly better than those in consumer credit, credit card, and

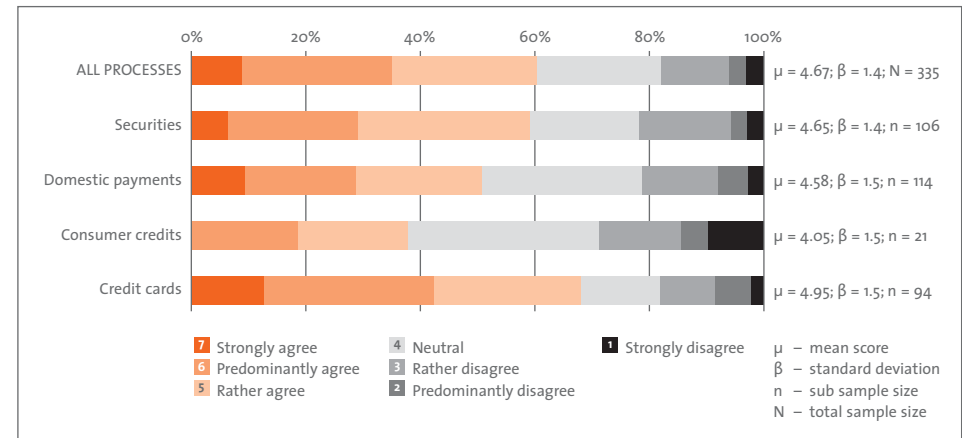


Figure 3: Assessment of statement: "We achieved to improve process quality through BPO."

securities settlement BPOs. Nevertheless, the outsourcing contracts from the latter three are effective as the mean scores are significantly higher than the mean Likert point (4.00).

Measurability and standardization as success factors

As the assessments of satisfaction and governance instruments vary across processes the unique characteristics of these processes were analyzed. Specifically, the degree of standardization (i.e. process transparency and programmability through uniform business rules, process logics, and data models; implementation of process standards such as SWIFT messages) and output measurability (being able to assess and track the quantity and quality of vendor's activities) were evaluated. The data show that domestic payment processes are significantly more standardized than credit card processes (mean scores: 5.95 vs. 5.63; scales

range from 1 (indicating a low degree of standardization) to 7 (indicating a high degree of standardization)). The credit card process, in turn, is significantly more standardized than the securities settlement process (5.15). The securities settlement process, in turn, is significantly more standardized than the consumer credit settlement (4.52).

With regard to output measurability, our data reveal that the output of domestic payment processes (5.52; scales range from 1 (indicating low measurability) to 7 (indicating high measurability)) is more measurable than the output of securities (5.14) and credit card settlement (5.01) processes. No significant differences have been found towards the settlement of consumer credits (5.10).

Implications

The data show the pattern that processes which are highly standardized and measurable

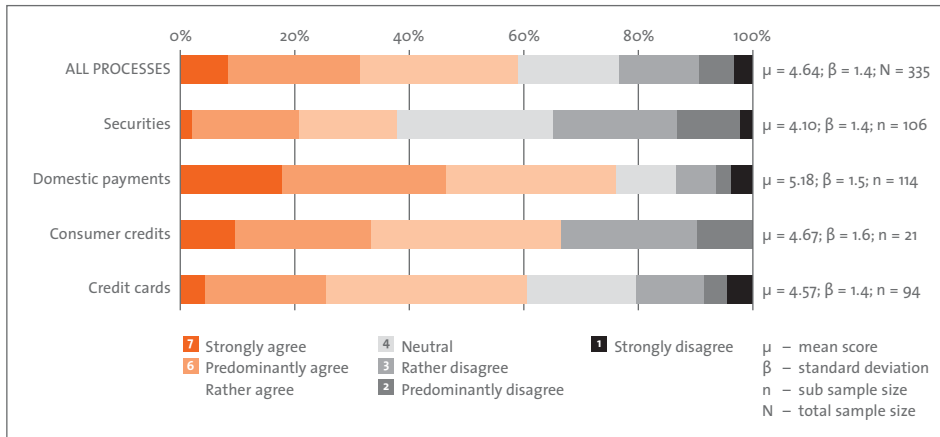


Figure 4: Assessment of statement: "Overall, we have a good relationship to our service provider."

(domestic payment and credit card processes) can better achieve cost savings and quality improvements. In addition, they enable effective design of relational and formal governance instruments: if processes are highly standardized (i.e., transparent and programmable) and highly measurable, individual contract clauses can be designed more detailed and precisely. Moreover, relational governance activities such as joint planning and informal conflict resolutions benefit since both the outsourcer and the vendor have a common and well-defined ground for their discussions and negotiations.

A similar argumentation applies to the achievement of outsourcing benefits: through higher programmability and transparency of the process the vendor can more easily exploit economies of scale, scope, and skill and therefore reduce process costs. With respect to quality improvements, formal contracts

can be designed to explicitly achieve higher quality standards. For example, it can be formally required that the settlement of payment transactions can be achieved in "t+1" (one day after the payment) instead of "t+2".

Conclusions

The potential benefits and potential losses of Business Process Outsourcing (BPO) have been controversially discussed by practitioners. To shed some light on these discussions, this article analyzes the outcomes of 335 BPO ventures from the German banking industry. Specifically, the following findings have been made:

1. Bank managers are highly satisfied with their BPO ventures.
2. Cost savings have been realized across all processes. Domestic payment BPOs achieve

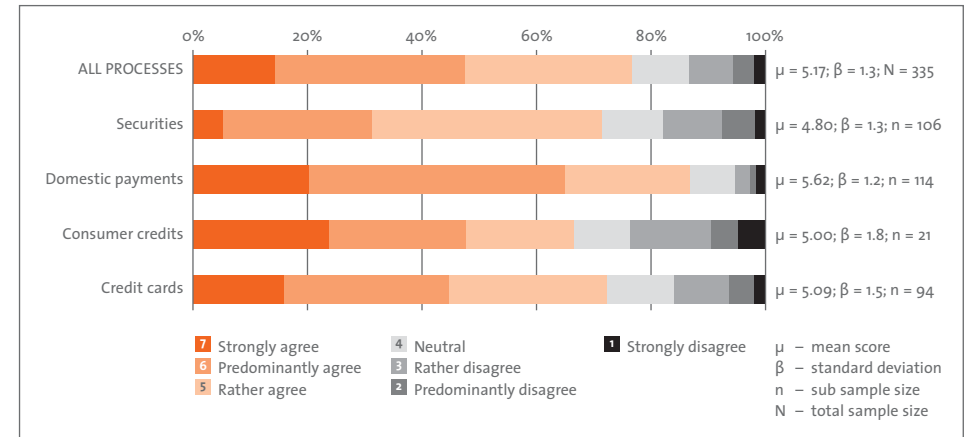


Figure 5: Assessment of statement: "The outsourcing contract covers all our requirements and expectations."

higher cost savings than security, consumer credit, and credit card BPOs.

3. Quality improvements have been achieved in all processes except in consumer credit BPOs.
4. Bank managers are highly satisfied with their governance instruments. Specifically, a close vendor-relationship (relational governance) is used in combination with a well-defined outsourcing contract (formal governance) to govern (manage) the BPO ventures.
5. High output measurability and a high degree of process standardization (such as in domestic payment BPOs) positively influence the quality and effectiveness of formal and relational governance instruments.

These positive results promote further adoption of BPO in German banks. Vendors should take special attention to provide outsourcers with maximal output measurability. In addition, they should invest in processes standards to streamline activities in order to further exploit quality improvements.

References

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