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Offshore outsourcing first at St George

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St George Bank is the most likely of the top five banks to outsource work to low-cost companies overseas in a bid to cut costs and gain a competitive edge over its rivals, according to an influential report based on surveys of bank executives.

Offshore outsourcing has been closely considered by all the banks but most have discounted the idea because of the political controversy of such a move and the corporate risks involved in using outsourcing operations overseas.

Some are choosing instead to create processing consortia, such as a voucher outsourcing plan by the Commonwealth Bank, the National Australia Bank and Westpac, as a way to cut costs without taking the plunge with offshore services.

But the report, issued by Credit Suisse First Boston last week, confirms an earlier forecast that the banks could save about 20 per cent by using offshore services and gain another 20 per cent from process improvements.

The CSFB study concludes that about $7.5 billion in collective bank costs at the top five banks could be moved overseas and that the selective use of offshore services in countries like India could result in a significant overhaul.

Included in the estimates are functions well beyond computer software maintenance or call centres, extending to labour-intensive activities like financial analysis.

The annual savings could amount to $190 million at St George, $587million at Westpac, $588million at the ANZ Bank, $808million at the Commonwealth Bank and $889 million at the National Australia Bank, the report says.

Banks that do not at least consider offshore outsourcing risk being beaten by international rivals with lower costs bases, warns the report, which is led by CSFB analyst Nick Selvaratnam and independent analyst Sri Annaswamy, founder of Swamy & Associates.

The report, a sequel to a CSFB study in June, surveyed executives from the big five banks to evaluate their progress on moving services offshore.

"St George Bank appears to be actively reviewing the scope for implementing offshoring strategies in the context of the group business strategy," the report concludes.

"We believe St George Bank's commitment to offshoring could increase near-term."

ANZ, in contrast, has a "tentative" commitment to further transnational outsourcing, although it already has operations in India and regards offshore services as an integral part of its operations, according to the report.

The Commonwealth Bank considered moving some projects under its ambitious "which new bank" restructuring program but chose instead to attempt to get lower costs from existing outsourcing partner EDS.

The National Australia Bank held "numerous internal debates" on the subject but no designated team is studying the issue, the report finds.

It notes, however, that the situation could change given recent top management appointments, including the engagement of a new chief information officer in Australia.

"Recent management change could potentially drive an unexpected greater commitment to offshoring in the future," the authors say.

Westpac has outsourced some operations in the past but nominated political and corporate risks as reasons to reject the option for the moment.

"Westpac, in our view, is unlikely to pursue offshoring initiatives in the near term and therefore could potentially see its relative position eroded on this basis," the report says.

The findings are the first detailed attempt to forecast the impact of international outsourcing on the major banks.

CSFB evaluated the progress of banks overseas, including mid-size banks in the US, and concluded that the gains from moving processes offshore were not only significant but could be achieved over just a few years if projects were carefully managed.

It questions the use of outsourcing consortia like the voucher-processing service contracted by Commonwealth Bank, the National Australia Bank and Westpac, and warns that the cost savings compare poorly with the offshore outsourcing projects at comparable banks overseas.

"We believe that it remains to be seen whether the consortium can deliver significant returns to the shareholders of the individual participating banks," it says.

But it also acknowledges any immediate action on major offshore outsourcing by a big bank in Australia is unlikely.

In general the banks are not prepared to outsource "analytics" functions like customer data mining, corporate valuation analysis, management analysis, equity research or insurance analysis.

But the authors note that other banks overseas have benefited from doing so. Greenpoint Mortgages in the US, for instance, outsources its mortgage processing to two companies with operations in India.

"As the response to our questionnaire demonstrated, no major Australian bank appears to have performed advanced research in relation to analytics offshoring as a group-wide strategy to create shareholder value," the report concludes.

"We expect that this might change significantly in the future, as a combination of a challenging business environment and new strategic thinking could force them to look towards analytics offshoring as a meaningful profit driver