Research

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Australian Banks

Saying hooroo to the outsourcing guru

- **Banks look set to ramp-up outsourcing** — In pursuit of a better understanding of the banks' "productivity" agenda, we recently met with Sri Annaswamy, Founder and Director of Swamy & Associates, one of Australia's leading advisors on outsourcing. Sri shared his views on the topic and the likelihood that current industry challenges will provide a catalyst for increased outsourcing. Here we provide our notes from the lunch, highlighting which banks appear likely to be more aggressive in the area.

- **Catalysts for change** — Often it takes a sense of organisational urgency, typically driven by poor historic performance, to drive a switch in philosophy toward outsourcing/offshoring. Sri sees SUN and PPT as organisations which fit this profile.

- **CBA poised to step out** — Sri believes that a new CEO may provide the catalyst for increased outsourcing, and highlights BPO opportunities in procurement and CommInsure. We believe that with the experience of the difficult EDS arrangement, management may still be reluctant.

- **Recent acquisitions to drive NAB forward** — With the imperative to deliver synergies from recent wealth acquisitions, Sri sees an increased focus on outsourcing within MLC – in particular, wrap platforms.

- **Organisational crisis a catalyst for SUN** — Having survived a near-death experience, under a new CEO Suncorp has embraced change, including adopting BPO in lending and personal insurance. Sri sees the logical next step in BPO of commercial and workers comp insurance. In recent comments, SUN management has noted the emphasis of its outsourcing activities is on back office functions, technology, and information management, with minimal customer facing roles affected.

- **WBC to remain conservative** — Despite its new focus on 4 IT providers, Sri thinks WBC would have been better served pursuing a broader ITO / BPO agenda. We think the recent restructuring and adoption of a Group Services division and Group COO role might indicate further focus on outsourcing opportunities.

- **ANZ in-house model considered sub-optimal** — Sri's view is that this approach cannot compete with the scale advantages of the major service providers.

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Outsourcing and Australian Banks – Present and Future

Best-practice examples globally indicate outsourcing can reduce cost and free up capital, as well as provide opportunities for incremental revenue.

However as indicated in Figure 1, currently traditional IT (ITO) still constitutes 60% of outsourcing arrangements, with product related BPO and analytical activities still underdeveloped areas. Despite this, Sri's view is that as banks are compelled to broaden the scope of their productivity focus, opportunities in the latter areas will be pursued further.

Figure 1. Outsourcing Road Map – Mix of deals in Australian Financial Services

	Business Line				Mix of deals	
Outsourced Function	**Retail Banking**	**Wealth Management, Life and General Insurance**	**Institutional, Investment and Business Banking**	**Finance, Accounting, IT, HR and other centre functions**	**Present**	**3 Years time**
IT, Infrastructure and support (ITO)	Core Banking system – app development and maintenance Data mining, and warehouse support	Life Policy systems maint and app development Master trust and wrap platform development and support	Loan accounting and trading systems – app dev and support SME customer database support	Group HR, payroll and shared services applications Group procurement and payable systems.	**50 – 60%**	**30 – 40%**
Product based Transaction processing and Customer contact centers (BPO)	Mortgage and personal loan origination, processing & servicing Collections and eDisputes processing	New business and administration Investor and adviser query handling and telemarketing. Insurance claims admin and payment	Project finance documentation support FX, currency ops and Derivatives settlement Trade Finance and LoCs – advice and settlement	Accounts receivables and payables processing General ledger management functions Employees super fund administration	**25 – 30%**	**30%**
Analytics Outsourcing activities (KPO)	Mortgage and personal loans portfolio pricing Data warehousing, mining and mktg. analytics	Fund performance analysis, reporting and accounting Actuarial support, product pricing including DFA models	Equity research and M&A analytics support (financial modeling) Credit proposal analysis, preparation and documentation Portfolio analytics – EDF, LGD, ROEE	Management accounting reports and budget analysis Economic Equity and CAM model maintenance and risk-related analytics Trust accounting, US GAAP accounting, and similar analytics activities	**10 - 20%**	**25 – 30%**

Source: Swamy & Associates, CIRA

Current Outsourcing Relationships

Among the Australian banks, the existing spread of outsourcing relationships is summarised below:

Figure 2. Current outsourcing relationships

Service Provider \ Bank	CBA	NAB	WBC	SUN
Infosys		Credit card and business lending ops	IT apps development & maintenance	ITO, HR, credit card and mortgage processing
Genpact (BPO)		Business bank and card operations	Wealth, WIB, Unsecured lending	Personal insurance
Wipro			IT apps development & maintenance	
Accenture	Core banking	Finance, procurement, HR		
HP	IT, cards processing			
IBM			IT apps development & maintenance, mortgage and credit card collections	
WNS				Personal Insurance - new business admin & claims mgmt
Xchanging			Procurement	
TCS	IT applications		IT apps development & maintenance	
HCL	IT applications		IT apps development & maintenance	

Source: Swamy & Associates, CIRA

Near-term opportunities

Experience indicates that challenging environments and management change tend to provide a catalyst for increased adoption of outsourcing. With this in mind, Sri thinks the institutions most likely to pursue opportunities are CBA, NAB and SUN. Here we outline the potential outsourcing deals for each bank

CBA

While until recently CBA has lacked a burning platform for change, Sri believes the recent appointment of a new CEO may provide it.

Our discussions with management suggest that senior management remain wary about outsourcing, having had difficulty with their EDS technology arrangement. Management tends to believe it can re-engineer processes to maximize value.

Current opportunities are summarised below:

Figure 3. CBA – potential outsourcing deals (next 12 months)

Platforms	Potential large opportunities	Potential deal sizes (FTEs)	Deal probability
Corporate services	Procurement	150 – 180 across mainly finance and procurement teams	**High** – Procurement advisor, Portland has already recommended BPO
CommInsure ops (mainly Homebush)	Life policy administration and operations	180 (120 to 140 service closed book life policies and about 60 new business administration)	**High** – strategic review of life operations has commenced
Colonial First State ops (mainly Parramatta)	First choice and First wrap (avanteos)	130 to 140 supporting two platforms performing new business admin	**Medium** – an important pain point and likely to get worse
Business lending (Homebush)	Business banking centre admin (mainly NSW and Victoria)	280 to 300 supporting reviewing credit applications, checking documents and sending out letters	**Low** – not an important pain point as CBA's focus is mortgages and wealth management

Source: Swamy & Associates, CIRA

NAB/MLC

At the Divisional level, NAB operates an "opt in" model for outsourcing – meaning business unit heads decide whether they wish to pursue it. And for varying reasons, most divisions are currently not prioritizing outsourcing. For instance, it has been trialed in the Wholesale Bank and in Finance – however management has not been satisfied with results. In addition, Personal Bank management has decided outsourcing is not a good fit with strategy, hence elected not to pursue it.

However given the imperative to deliver synergies from recent acquisitions, there appears to be a greater focus on outsourcing within MLC. Sri sees the key opportunities as follows:

Figure 4. NAB – potential outsourcing deals (next 12 months)

Platforms	Potential large opportunities	Potential deal sizes (FTEs)	Deal probability
MLC wrap platforms	Masterkey and Navigator (the ex-Aviva Aus wrap platform)	150 to 175 supporting mainly Navigator performing new business admin (fund switches and quarterly/ half-yearly statements)	**High** – Aviva Australia integration is complete and the team is looking for the next level of synergies
MLC Life Insurance operations	Life policy administration and operations for both MLC and Aviva Aus policies	250 to 300 (120 to 140 service closed book life policies and the rest new business administration)	**Medium** – an important pain point for MLC but not the biggest

Source: Swamy & Associates, CIRA

Suncorp

Potentially franchise threatening events in recent years triggered a change in CEO. Given the context, the new CEO had a clear platform to pursue change. As part of this mandate, SUN has already undertaken ITO, as well as lending and personal insurance BPO.

With personal lines outsourcing already having been undertaken, current opportunities appear to be in Commercial and Worker's Comp:

Figure 5. SUN – potential outsourcing deals (next 12 months)

Platforms	Potential large opportunities	Potential deal sizes (FTEs)	Deal probability
Commercial (2nd largest in Aus and NZ)	Broker & third party support, and claims management	350 to 400 FTEs across these two areas mainly customer service reps servicing brokers as well as claims assessment and managers	**High** – they have already commenced PL and so, commercial lines are the logical next candidates for BPO
Workers comp (a non-core business for them, they are 3rd largest - a service provider could acquire it in a carve out deal)	Administering state based schemes in Qld and Victoria	250 FTEs across all aspects of workers' comp administration	**Medium** – non core operation but restructuring could easily help lift their performance

Source: Swamy & Associates, CIRA

In recent comments, SUN management has maintained that the emphasis of its outsourcing activities is back office functions, technology, and information management. There will inevitably be a small amount of routine customer interface but this will be relatively limited.

Perpetual

While a diversified financial company rather than a bank or insurer, PPT does have loan servicing operations which may be non-core. Given historic underperformance and a recent change of CEO, Sri believes a catalyst exists for both these and other non-core functions to be disposed of or restructured via an outsourcing arrangement.

Others

WBC

Recently WBC has elected to focus its outsourcing agenda on 4 IT providers – TCS, Infosys, Wipro and IBM. BT is currently sourcing IT from HCL but is expected to change to Wipro. The bulk of the work is application development, maintenance and testing. According to Sri, about 3,500 FTE are involved and would be mainly offshore (probably only about 700 would be onshore).

Of the 700 onshore, the service providers will replace about 200 - 300 existing local IT contractors with their own staff. In addition, the service providers will staff another 400 - 500 roles that would have been hired by the bank onshore but will now be relocated from India via 457 visas.

Given the current ITO agenda there appears to be few other near-term opportunities being pursued.

Sri's view is that WBC would have been better served by pursuing a broader ITO / BPO deal structure.

In the past WBC has undertaken BPO with Genpact and IBM. However it also lost out on a great opportunity to adopt a third-party administrator model (this involves selling business functions to a third party who uses them as an "anchor" client to pursue like operations from other firms in the industry). In the EDS mortgage centre in Adelaide, WBC tried to establish such an operation and win business from other banks. However it was unsuccessful and ultimately decided to bring its operations back in-house.

Despite past experiences, given the recent establishment of the Group Services division and appointment of John Arthur as Group COO, we think WBC still sees opportunities to further expand its outsourcing agenda.

ANZ

While ANZ is the only Australian bank to run in-house offshore centres (for IT and some BPO), at 4,500 FTE it is sub-scale and may struggle to compete with the major service providers. Sri believes ANZ should have sold out years ago, but may still seek to extract some value by selling to a larger provider.

Appendix A-1

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