Business Process Outsourcing on the rise in wealth management

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Business Process Outsourcing (BPO) is at the top of the agenda of many COOs of wealth management institutions—defining the scope, identifying the right model, building the case and assessing the opportunity.

According to a recent Deloitte European survey[1], the focus of wealth management institutions is becoming increasingly customer-oriented: 79% of respondents agreed that their focus is on client relationships rather than on executing back office processes and activities in-house.

Thus, COOs are now looking beyond how well they can run their back office processes and activities in-house. The issue to be considered is whether managing these functions internally is part of the core strategy of the business, or whether a business process outsourcing solution would be appropriate for the majority of operations and IT or for certain processes.

Recent estimates and market analysis indicate that around 30%[2] of Luxembourg wealth management institutions are prepared to consider outsourcing operations and IT in the future. Business Process Outsourcing is thus about to become one of the key topics on the agenda of many COOs.

On the supply side, the BPO solutions currently offered in Luxembourg remain very limited, with only a few players providing such services for wealth management institutions. The relatively low level of maturity will need to be taken into account when identifying the right BPO model.

Despite the numerous advantages of BPO, this opportunity must be carefully assessed, and the right model needs to be selected to ensure that BPO meets the expectations of your organisation.

In this article we will look at the activities that can be outsourced, and those that should be kept within the firm. We will then describe the different models a COO can consider for these activities, look at how to build the case, and finally, suggest how to assess the opportunity.

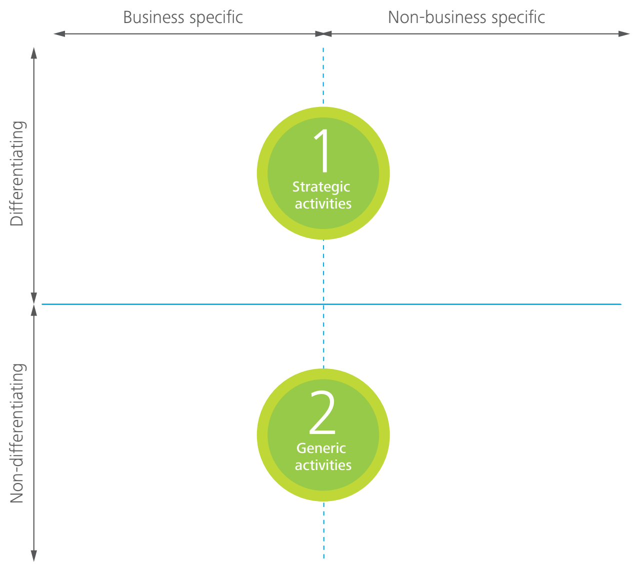
Defining the scope—should you outsource all processes or keep them all in-house?

There is no easy answer. A key element of a BPO project is to identify the activities you want to outsource, and those that should be retained internally. Identifying the right scope of the project is essential to all the steps that will follow and above all to the success of the project.

1 *Wealth management and private banking—connecting with clients and reinventing the value proposition, Deloitte, Efma 2015*

2 *Deloitte market analysis 2014*

Figure 1: Activity analysis and defining the scope



An analysis of the level of differentiation and business specificity of all the activities of your organisation that may come under the scope of a BPO solution is required. The activities can then be split into two main categories:

1. **Strategic activities**—these activities are differentiating and mainly business-specific. Generally, these are the core competencies of the wealth management institution and have a strategic significance for the organisation. Business relationship entry, digital channels or portfolio management are typical examples of the strategic activities of wealth management institutions. Strategic activities should always be kept in-house, and not be part of the outsourcing.
2. **Generic activities**—these activities are non-core and non-differentiating for the organisation. For a wealth management institution, these may be data management and pricing, for example, or IT services. An outsourcing solution may be an option for generic activities.

If you consider Business Process Outsourcing for your organisation, you should ensure that only generic activities are included in the scope.
Failure to properly define the project scope will make your organisation overly dependent on the BPO provider. Furthermore, your organisation risks losing its competitive advantage, as its business processes will be shared with your potential competitors. It is crucial to keep full control over core/strategic activities.

For example, if one of the main differentiators of a mid to large wealth management institution is its leading position in digital innovation, it should not outsource any digital strategy-related activity, in order to protect its competitive advantage. However, smaller institutions that are unable to keep pace with digital developments might opt for full outsourcing of such activity, thereby gaining access to leading-edge technology without having to invest in it themselves.

Identifying the right model—there is no 'one size fits all' BPO approach and the model you select will ultimately impact the future of your organisation

Once you have performed your activity analysis, the various transformation options can be considered, depending on the type of your activities.

Although outsourcing is not recommended for strategic activities, if your objective is to improve quality and efficiency, you may decide to:

1. Transform the activity locally, e.g. by renovating an existing platform
2. Transform the activity by creating a Shared Services Centre (SSC) or Centre of Excellence (CoE) at group level to bundle activities and share best practice

If you decide to investigate the BPO options for your generic activities, you have the choice between two basic strategic options:

1. **Transformational outsourcing—the 'divest completely' approach**
   In this case, the activities identified as being best managed externally are outsourced permanently to a BPO provider that will take care of the transition and transformation phases.
   The key requirement for this option is a proven, experienced service provider. Unfortunately, a very limited number of such providers are currently available to large wealth management institutions.
2. **The creation of a joint venture as a first step towards outsourcing—but retaining a degree of control**
   In this alternative option to the straightforward form of transformational outsourcing, an organisation can create a joint venture with a partner that has the requisite knowledge to manage BPO activities. The organisation can decide to stay in the joint venture and transform a cost centre into a profit centre or disengage at a certain moment in time.

The main advantage of the creation of a joint venture is that you share the risks and keep control. Both parties commit to the success of the BPO project. If the BPO deal fails to meet the initial expectations, both sides lose, while a positive performance will bring about a win-win situation. For the wealth management institution, the joint venture may even represent an additional source of revenue. Furthermore, this option enables the wealth management institution to keep partial control over the outsourced business processes in the short, medium or in the long run. As resources will be provided from both sides, this is also a major opportunity for a wealth management institution to mitigate the HR impact of a BPO project.

The joint venture option is especially relevant when the provider market has a low level of maturity, as it allows the wealth management institution to retain control, manage risks more effectively and gain first-mover advantage.
In any event, a cost-benefit analysis (qualitative and quantitative) should be performed to identify whether a joint venture or transformational outsourcing approach is the right solution for the organisation.

Figure 2: Transformation models

Building the case for BPO—the business case is a crucial element

The project scope will serve as a baseline for the business case you will need to build to assess the financial advantages of BPO. It should be clearly defined and documented to ensure a proper and common baseline.

To build the business case, two aspects will be evaluated: transformation costs and the BPO running costs/savings.

To assess the transformation costs, a detailed analysis of the technology, migration, legal, change management and HR costs is required. The transformation costs have a significant impact on the net present value of the overall project.

For the assessment of the running costs/savings, clear visibility on the organisation's costs, volumes and structure, as well as appropriate forecasts, is key. In addition, the main levers for variable and fixed costs should be identified and the impact of additional volumes, new clients, products, etc. on the current variable and fixed cost base should be evaluated. This is often more challenging than expected.

Based on this assessment and the project scope, the areas that will be impacted by the BPO project can be identified. This will allow the potential operational cost savings to be identified and compared with the cost of the BPO project. The resources needed to manage governance aspects and the relationship with the provider—which represents an additional overhead—also need to be taken into account.

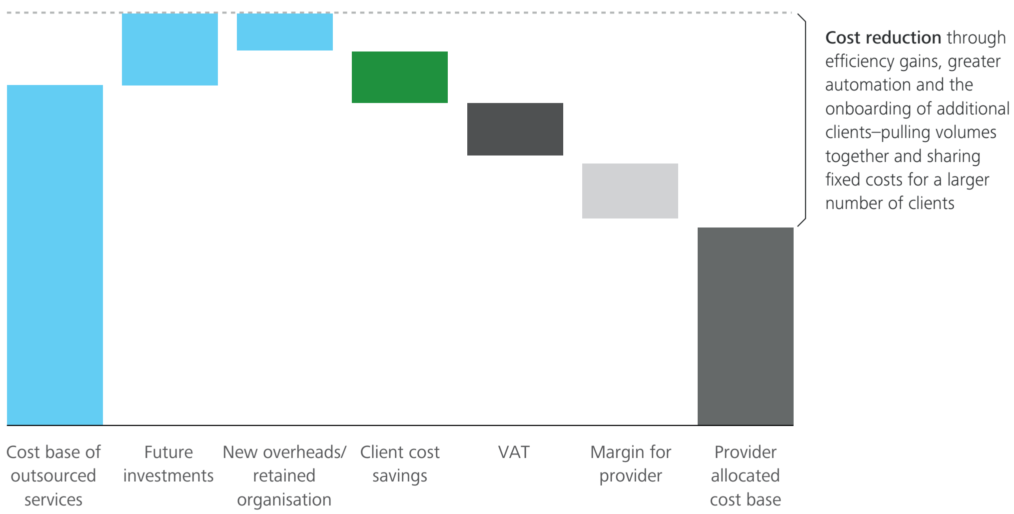
The business case must be made in order to assess the BPO opportunity. A solid business case requires that you (non-exhaustive list):

- Clearly define and document the project scope and assumptions
- Ensure budgets (and the business case) have scope and time contingencies
- Integrate specific provisions for unclear elements
- Formalise commitments from the beginning and link them to assumptions

Depending on the starting position, creating a cost advantage for the client and a margin for the provider can be challenging. To ensure the attractiveness of the BPO deal for the client, the BPO provider needs to significantly reduce the client's current costs. This can be achieved mainly through efficiency gains, greater automation and the onboarding of additional clients—pulling volumes together and sharing fixed costs for a larger number of clients. The provider will need to take into account its actual costs, its margin and the VAT to be applied in its pricing model. The difference between the price and internal costs will represent the cost savings of the client.

The avoidance of potential future investments will also need to be considered by the client when evaluating the BPO opportunity.

Figure 3: Cost structure in business process outsourcing



Assessing the opportunity—business process outsourcing is about more than cost reduction

However, BPO is not only about cost reduction—it is about strategic impact. The business case is one element that will enable you to make the right decision for your organisation. Other objectives and aspirations, such as increasing flexibility or service quality have to be taken into account when deciding whether BPO is the right solution for your organisation. Furthermore, you will need to assess other operational, HR, legal regulatory and tax implications to conclude whether BPO is an opportunity you should take forward.

If you decide to embark on this path, you will be at the beginning of a long journey. The next challenge will be to identify the right provider, so that you can plan all the underlying aspects of the transition and transformation in detail.