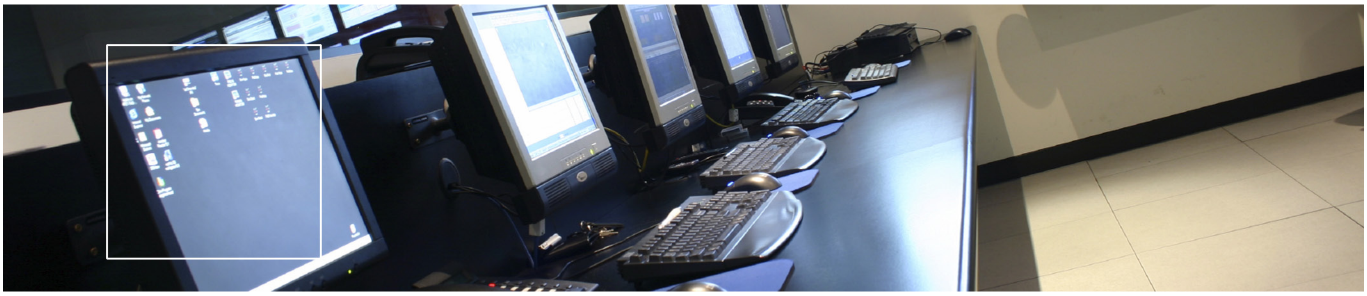
Arthur D Little

Evolution of the species

New IT sourcing models for a changed business environment



Few IT departments are in good enough shape to meet the challenges arising from the current financial crisis. Their typically complex and inflexible systems generate high costs and hinder business innovation. Optimizing the IT sourcing model can provide a solution. Arthur D. Little proposes a service integrator approach: by outsourcing IT to a service integrator, companies can focus internal resources on core competencies, escape the complexity trap and position IT for a successful future.

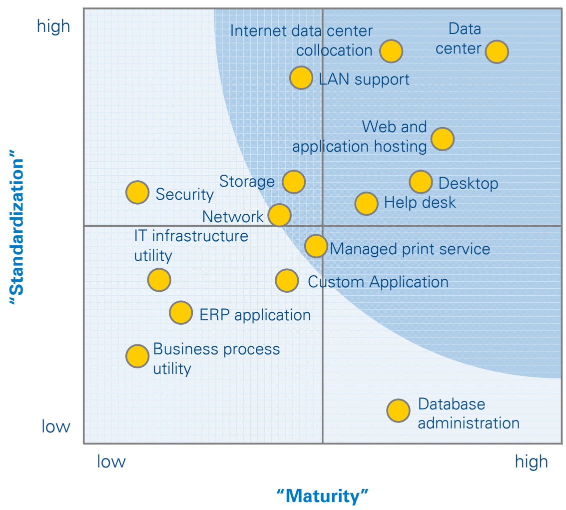
Outsourcing: time for a reappraisal?

The ongoing financial crisis is generating particularly severe pressure on the cost base of financial services companies. Cost control and cost cutting have once again become important topics. Arthur D. Little estimates that growth in IT spending in global financial services will decline to 2-3% in 2009, with extensive cuts in the brokerage and banking segments. The pressure will be most severe on IT services expenditure, which is forecast to be flat, and on internal services expenditure, which is expected to shrink by 13-15%. However, in the overall context of corporate cost savings, IT is problematic for many financial services companies; it is often perceived as rigid, complex and inflexible, yet is nevertheless the channel through which innovation and growth will flow when the markets rebound.

The high volatility of the financial services market, the need for greater transparency, the expectation of more stringent regulation, an increase in M&A activity – all combine to increase the demand for flexibility in internal IT departments. This demand is in stark contrast to the reality of highly complex systems that are often characterized by a mixed application portfolio rather than standardized services and interfaces. Most IT departments lack the transparency and organizational scalability required to allow CIOs to respond to the volatile environment and to new business challenges.

As a consequence, the credit crunch may lead some financial services companies to reassess IT outsourcing options. Outsourcing, correctly managed, can provide an effective instrument for tackling the complexity crisis. Analysis by Arthur D. Little identifies the differing degrees of maturity (see figure 1) of candidates for outsourcing within the application and infrastructure outsourcing markets. Many IT services no longer constitute a competitive advantage and have become commodities. However, Arthur D. Little's study of the current state of IT applications and infrastructure (see figure 2 overleaf) highlights that many have scarcely been touched by outsourcing. This suggests that many banks and insurance companies are failing to make sufficient use of outsourcing both to address the cost issues and to generate added value by providing a flexible IT platform that is prepared for the challenges of the future.

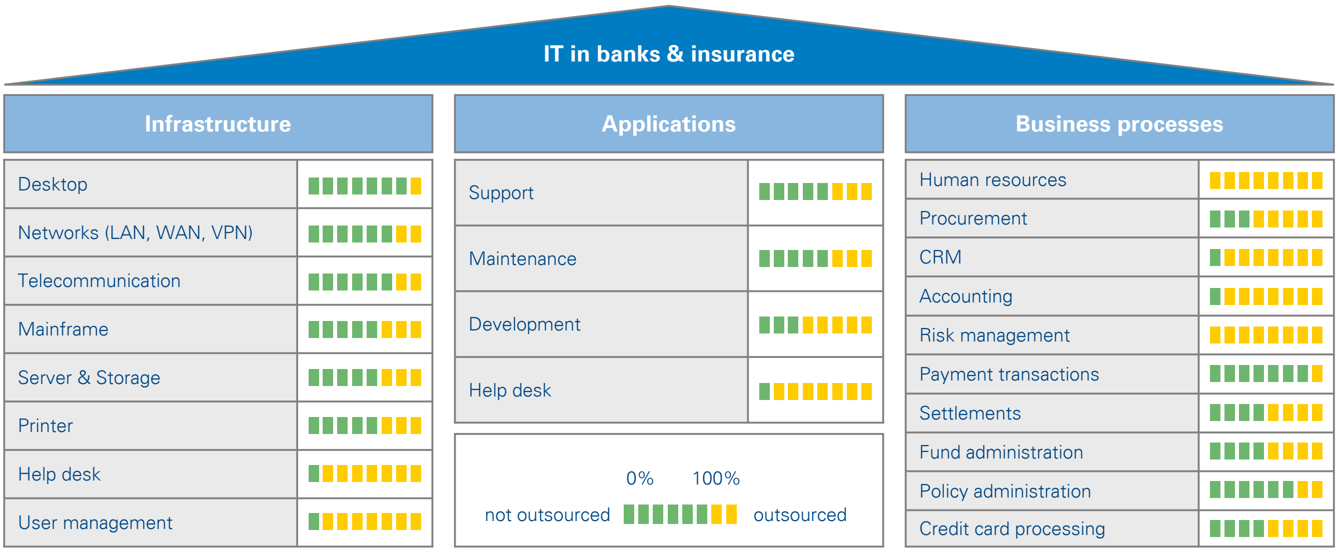
Figure 1: Outsourcing readiness



Source: Gartner, Arthur D. Little

Ready to outsource

Figure 2: IT outsourcing in banks & insurance



Multi-sourcing: the re-emergence of complexity

Market research shows that 50% of all outsourcing partnerships[1] are either unsatisfactory, are terminated ahead of schedule or fail completely in the first five years, with 20% failing in the first two years alone. Typical reasons for the early termination of agreements are coordination problems and operational risks between outsourcing partners. Other reasons include low performance, poor service, cost overruns and changes in strategic direction.

As best-of-breed approaches are applied more frequently and multiple outsourcing partners are engaged, the more difficult it becomes for the outsourcing customer to coordinate service providers and monitor performance. Figure 3 illustrates the trend to more numerous, lower-volume multi-sourcing. Figure 4 shows by means of Deutsche Bank's outsourcing portfolio how a high number of outsourced services and outsourcing partnerships can create complexity, that in case of Deutsche Bank is being handled by a professional retained organization (see figure 4).

With different activities being outsourced to a variety of partners, the retained IT department may become overburdened by an increase in complexity and coordination tasks. Arthur D. Little's experience indicates that approximately two-thirds of in-house IT staff have technical rather than management skills and are therefore unlikely to meet the requirements profile for modern

Figure 3: Development of outsourcing deals

Development of outsourcing deals since 2001

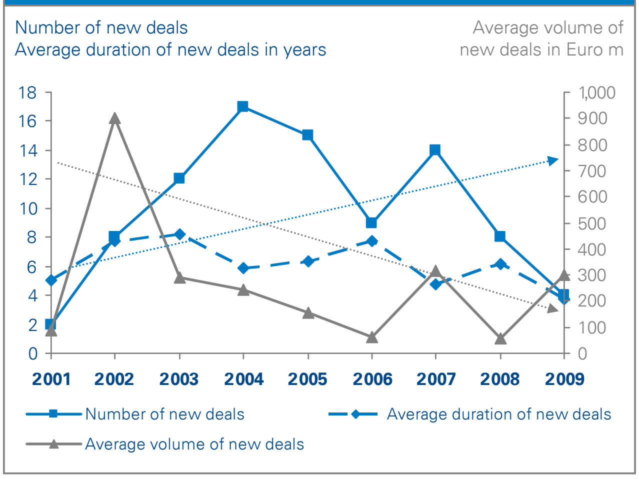


Figure 4: Showcase outsourcing portfolio

Deutsche Bank's outsourcing portfolio

Start year	Type	Provider	Outsourcing area
1999	BPO	PAGO	Back office activities
2001	ITO	Siemens	IT systems & help desk
2001	ITO & AM	HCL	Offshoring to India
2002	ITO	IBM	Mainframe, server
2003	AM & BPO	Accenture	App. mgmt. & dev., procurement
2004	BPO	Postbank	Payment transactions
2004	BPO	Xchanging	Fund administration
2005	AM	Logica	Application development
2006	BPO	Luxoft	CRM (Russia)
2008	BPO	Capita	Policy administration

1 Dun & Bradstreet

IT provider management. Outsourcing is not just a "make or buy?" decision; it is also a question of re-skilling. Without the appropriate business structures and operational management, outsourcing can become a serious threat to effective end-to-end service delivery, leading to insufficient control within the organization, finger-pointing between in-house departments and external providers, and tangible operational risks.

For financial services companies to meet the challenge of managing the complexity of multi-sourcing, IT departments need to move away from unplanned sourcing and unbalanced provider portfolios and systems architecture. Instead, they need a strategically designed sourcing solution that adopts the benefits of multi-sourcing, controls its inherent complexity and leverages developments in the IT outsourcing market.

Service integrator model as an option

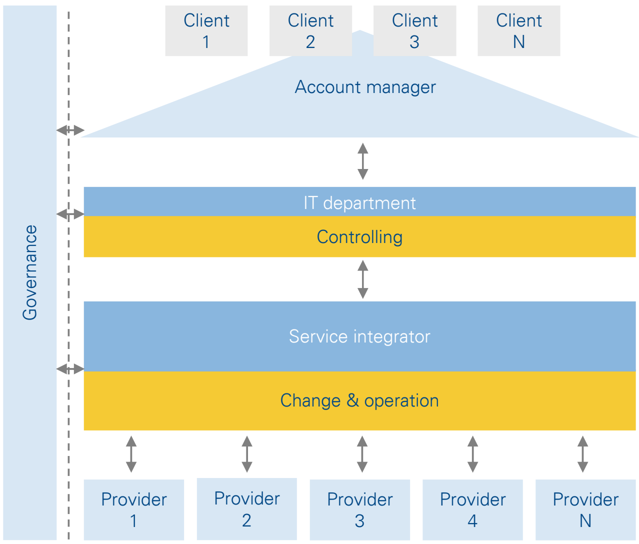
To master multi-provider complexity, companies should **introduce** an **internal** or **external service integrator** that specializes in coordinating multi-provider relationships on behalf of the IT organization in a back-to-back SLA environment.

In the **internal service integrator** model, an internal department is given responsibility for controlling, administering and managing a portfolio of service providers. Management complexity is effectively devolved to that department and a single interface exists between the business relationship manager and the service integrator. However, the service integrator role demands specialist knowledge of methodologies and tools for contracting, SLA and service delivery management.

If the organization does not want to buy in these skills or build them up internally or if coordination tasks are also to be outsourced, the **external service integrator** approach is the solution of choice. An external prime contractor as single contractual partner assumes end-to-end responsibility for managing service delivery. The client may retain the option to influence the choice of subcontractors (best-of-breed providers) or can also delegate this responsibility completely to the prime contractor.

Regardless of whether the service integrator is internal or external, the concept successfully combines best-of-breed assets and a 1:1 management interface. The service integrator, acting as a single and continuous point of contact for the client, offers access to a broad spectrum of competencies and increases the client's potential for innovation, scalability and flexibility (see figure 5).

Figure 5: Service integrator model



Service integrator pays off

By taking a consistent strategic approach to IT sourcing, businesses can achieve a range of benefits and meet the need for increased flexibility at reduced cost:

- **Quality and flexibility:** In a multi-sourced environment, IT tasks are left to best-in-class service providers leading to higher service quality and flexibility.
- **Transparency:** One single point of contact and accountability as well as end-to-end oversight and integration capabilities reduces complexity, enhance flexibility and enable modularization.
- **Costs:** Net operating costs can be reduced by 10-20%. Integrated reporting helps to reduce compliance costs. New services offered off-the-shelf by service providers can usually be implemented at a fraction of the cost of an internal implementation project.
- **Scalability:** The model allows for integrating additional service providers within the overall framework. In addition, the outsourcing of IT functions brings a shift from fixed to variable costs, and the opportunity to adjust supply to fit demand more quickly.
- **Reduced operational risks:** The unexpected downtimes in some dealer and trading systems may be reduced, re-establishing trust between business and IT. The service integrator model also improves the contractual visibility of SLAs and handles project risks arising from migrations or regulatory changes more effectively.

Finally, the retained organization is freed to refocus on strategic issues, aligning IT and business and driving innovation.

Conclusion

By making use of a service integrator, financial services companies can refocus their assets on their core capabilities. In addition, adopting a service integrator approach also allows banks and insurers to leverage the strengths of specialist providers and encourage new technological approaches, thereby improving innovation throughout the business. IT outsourcing generates a number of benefits – and the service integrator model offsets the known risks of the modern, multi-sourcing construct.

Case study

A large European asset management bank asked Arthur D. Little to address quality problems, restore the transparency of IT and enhance the bank's ability to 'plug and play' new business services and technologies. Data center, desktop and network had already been outsourced and other areas were in line to follow.

An initial audit revealed not only immature IT service processes but also a lack of skills for managing the existing multiple IT providers. The client's sourcing portfolio was the legacy of tactical sourcing decisions made over the past ten years. Crucially, the retained department had not adapted to the demands of multi-sourced service provisioning.

Since building up provider management skills internally was not feasible in the short term, Arthur D. Little proposed the external service integrator model. Essential competencies required by the service integrator would include multi-provider governance and an integrated framework of IT Service Management methods and tools. In addition, the service integrator would require experience in industry-standard processes such as ITIL (IT Infrastructure Library) or COBIT (Control Objectives for Information and related Technology), best-practice role definitions and organizations, performance indicators and tool support. Arthur D. Little recommended that conflicts of interest between the service integrator and other outsourcing partners (e.g. if both parties are active in the same outsourcing market segment) should be avoided.

In preparation for the implementation of the service integrator model, a service catalogue was compiled. As a result, the organization had, for the first time, an overview of all services provided. Selected ITIL processes and roles were also introduced, enabling seamless process interfaces for IT operations and plug and play infrastructure providers.

The bank's IT department has been restructured into a service-oriented and efficient department. It offers transparent services through a service catalogue, ITIL-compliant processes for release, incident and change management and the multi-provider management function benefits from consistent interfaces with its providers. The bank is now ready to switch to a service integrator.

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Arthur D. Little

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