

# Managed services for credit solutions: Driving business value in banking



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## Introduction

In a highly competitive market, banks have been forced to squeeze costs from their credit back offices through process optimization, enhanced solutions and formalized procedures. Despite these efforts, many banks are still under pressure to drive additional cost savings and are beginning to explore the benefits of a managed services arrangement, realizing that maintaining and supporting non-core functions, such as information technology (IT), are no longer the best use of their resources.

A managed services arrangement, which is an agreement for services associated with performance measurements, is certainly not a revolutionary concept for the banking industry. For some time, institutions have allowed external vendors to manage processes such as check-clearing and lockbox services. But banks have historically kept their software solutions in-house, especially those that extend across numerous functions and processes. The perception has been that those solutions are too strategic, too complex or too mission-critical to be entrusted to an outside firm.

That perception, however, is beginning to change for a number of reasons. For starters, the concept behind managed services has evolved beyond a contractual relationship into more of a collaborative partnership, with banks retaining more control and decision-making within the agreement. Moreover, while IT systems once provided banks with a strategic edge over the competition, that view has shifted in recent years. Banks now differentiate systems into two main categories: 1) core, those systems that directly relate to the bank's business strategy, and 2) non-core, those that are necessary but, by themselves, provide little strategic value. This is an important distinction, as it allows the bank to explore alternatives for getting maximum value out of its resources.

Given these recent trends, banks are recognizing that by partnering with an external services provider for application maintenance and support, they can reduce costs, add operational value and gain a strategic edge in an increasingly competitive business.

## Why managed services?

Initially, the key benefit driving many retail banks to outsource their credit applications has been cost reduction. Outsourcing maximizes efficiencies and drives down costs by simplifying, standardizing, centralizing and automating application development and support through the use of best practices, advanced technologies and experienced technicians. Managed services firms also pass on cost savings through economies of scale by offering similar services to a wide range of clients.

Cost reduction, however, is not the only compelling reason motivating banks to look to outside help with these applications. Outsourcing application maintenance and support is increasingly seen as a strategic tool that can provide value and improvements across all operations. Some of the strategic advantages to be gained include:

- **Greater focus on core competencies.** Outsourcing allows banks to focus on what they do best, while gaining access to world-class application expertise they could not otherwise attract or afford. The arrangement also enables the managed services firm to do what it does best: write and repair application code, ensure that application upgrades are applied in a timely manner, and recruit and retain employees with the right mix of technical skill and industry knowledge. By introducing best practices to the credit management operation, managed services providers can offer improved service levels—not only in IT performance, but across the organization.

- **Reduction in risks.** Service level agreements and guarantees place the responsibilities of quality and timeliness on the vendor, reducing risks—such as application degradation, technology and skills obsolescence, loss of key personnel and project delay—once shouldered entirely by the bank.
- **Improved regulatory compliance.** An IT service provider with an understanding of both the business and technical aspects of credit management also has a thorough familiarity with regulatory requirements, including state and federal privacy regulations, fair lending practices and other key governmental requirements such as the Sarbanes-Oxley Act of 2002. Managed services providers with this dual expertise can modify systems on an ongoing basis to meet existing and evolving regulatory demands.
- **Faster time to market.** Because credit is a key part of a bank's portfolio, completing projects and applications quickly is critical to achieving a competitive edge. Through resource scalability, managed services enables banks to launch more projects faster and easily prioritize projects in response to market changes.
- **Accurate cost calculations.** Managed services provide executives with a true picture of what they are spending on IT maintenance and support, now and in the future. This understanding makes for easier and more accurate long-term planning and budgeting.
- **Improved customer relations.** Outsourcing ensures that applications are performing optimally, guaranteeing, for example, a mutually agreed-upon percentage of system "uptime." This helps banks improve customer service and relations and, as a result, effectively retain existing customers and attract new ones.
- **Increased revenues.** Better performing systems mean higher quality and more income. While quality sounds like a nebulous term, the benefit of it within a managed services credit solution can be effectively measured through quantitative calculations, such as the decrease in outstanding delinquent receivables, the increase in operational productivity, the increase in outbound collections call volume, the number of recoveries dollars, the number of loan originations, the cost of loan origination, the increase in new customers acquired, the cost of new customers acquired and overall customer attrition rate.

### Making managed services work

For all of its benefits, outsourcing can be a complex undertaking. A managed services agreement is generally long-term, or at least three years in duration. To achieve maximum cost savings, many banks may opt to receive services from different locations, including different countries, both near-shore and occasionally offshore. As a result, an effective partnership often depends on how well differences in culture, communication and expectations are addressed.

Successfully transitioning a major revenue-inducing business support area such as credit application maintenance to an outside service provider is a decision that requires careful deliberation, planning and execution. To reap the full benefits, banks should consider the following steps:

**Step 1: Counting the cost.** Many banking executives worry about whether outsourcing will provide lackluster savings. According to Gartner, more than 80 percent of enterprises base their infrastructure sourcing decisions on inadequate financial information.

An in-depth cost analysis should be conducted to ensure that the cost of outsourcing does not exceed the expected value. Four cost scenarios should be compared: 1) the current cost of managing all tasks related to application maintenance and support; 2) the cost of conforming in-house functions with best-of-breed standards, practices and technology; 3) the cost of not achieving business goals due to less than optimal use of bank resources; and 4) the cost of outsourcing application maintenance and support.

Baseline in-house costs include such tangible expenses as staff salaries and infrastructure maintenance and upgrades, as well as intangibles such as the investment it takes to achieve expected quality and performance levels and hidden cost benefits such as reduced risk, less downtime and greater availability.

The process of baselining costs is often performed using a single point in time, such as the current year's budget, and then using a straightline projection to estimate costs in future years. However, a truer picture of likely "business as usual" costs can be obtained by analyzing trends in historical data over a two to four year period. By using factors such as growth rates in customers, revenues and staff, it is possible to create a series of forecasts in the out-years that is more likely to reflect the real future possibilities.

A third metric involves an estimate of outsourcing costs for the specific processes and service levels required. This estimate should clearly specify items that are included and excluded to avoid the risk of hidden costs.

**Step 2: Building consensus.** Getting buy-in at every affected level of the bank is critical to the success of a managed services strategy. Executives should see the cost-benefit analysis and understand that choosing a managed services partnership is an industry practice, not something ground-breaking. At the operational level, employees need to understand that managed services actually provides an enhanced form of control, freeing employees from performing routine, day-to-day operations and allowing them to focus on tasks that elicit additional bottom-line results and that control the strategic direction of the credit operation.

**Step 3: Choosing the right partner.** Although there are plenty of IT vendors available to provide application maintenance and support to credit operations, they can differ markedly in their expertise and knowledge levels, as well as in their approach to managed services. Below is a list of key criteria to consider in selecting a provider:

- **Experience and expertise.** Assess the depth and breadth of a service provider's ability to successfully manage your software assets with these questions: How long has the service provider worked within the credit industry? How many banking or credit clients have they worked for and how many do they currently serve? What types of services do they offer? Do they develop credit solutions in-house? What kind of depth do they have among their professional staff? What are the training requirements?
- **Service levels.** Level of service is the single most important criteria in choosing a potential outsourcing provider. Here are key questions to ask: Does the provider offer explicit service level agreements? Is it willing to agree to higher-than-standard performance levels and measurements? What is the provider's record of delivering on time and on budget? Does it provide flexible change management processes? Does it adhere to rigorous quality assurance and application development standards such as ISO:9001 and SEI-CMM Level 5? What access will you have to helpdesk support? Does the provider have well-defined business continuity plans in place?
- **Infrastructure.** A site visit provides a clear picture of a vendor's physical infrastructure and management expertise. Ask these pertinent questions: What type of systems does the provider use? Are these systems proprietary or dependent on other technology companies for maintenance and support? How often does the provider upgrade or update its hardware infrastructure? What are its current and future infrastructure investment plans? What security measures and disaster recovery plans are in place? How experienced and how stable are the vendor's outsourcing managers? Does the provider offer geographical diversity in terms of its locations? Where are its offshore and near-shore facilities located?
- **Financial health.** Research the vendor's financials to assess its solvency over at least the length of the outsourcing contract. The ideal candidate should have been in business for more than 10 years, have a track record of profitability and growth, a strong cash flow, large capital reserves, low debt and a diverse client base.

**Step 4: Negotiating the contract.** A good managed services contract reflects concurrence on all issues, but especially those related to scope of services, performance and pricing. The heart of any contract is the "service schedule" or "statement of work," which carefully documents which services will be provided and the agreed-upon service levels. To ensure that both parties see the agreement as win-win in nature, performance incentives and penalties should be vital components of the contract. The agreement should clearly stipulate what penalties will be assessed when the vendor fails to meet service level requirements and what financial rewards will be given when expectations are exceeded.

Other contract necessities include procedures for changing the scope of services; definitions, measurements and pricing for continuous improvement efforts; a governance provision defining the steps to take when disputes arise; and a clause allowing either party to terminate the contract in the event of defined worst-case scenarios.

**Step 5: Ensuring continued value.** Although the managed services provider will be responsible for providing the contractually agreed-upon services, the bank's management team must now oversee the work performed. Continuous supervision and communication is critical to the long-term success of the partnership.

By investing time and effort in the relationship, both the provider and the bank's management can ensure alignment with the bank's business objectives and any changes that might affect services and service levels. Applying contractual metrics is the best method for keeping the relationship on track. Quantitative measures should be used to evaluate performance, as well as qualitative input from internal customers. Appointing an individual or group to handle all interactions with the managed services provider as a single point of contact is an effective means to ensure that the needs and concerns of both parties are addressed on an ongoing basis.

## Conclusion

The race is on for banks to deliver more value to their customers while driving down costs, and the competition is fierce. Outsourcing is proving to be a valuable strategic tool for banks, particularly in the credit solutions area. By turning the management of their credit applications over to outside experts, banks can reduce their costs while focusing more attention on their core business, driving business value and ensuring future survival. The challenge is to find the best possible partner and build an enduring, mutually profitable relationship. By considering the right criteria and asking the right questions, banks can form a managed services partnership that will take them to new levels of success in today's volatile banking industry.

## About CGI

For nearly 30 years, CGI has worked with clients to help them leverage the strengths of IT to optimize their business performance and produce value-driven results. With in-depth banking expertise, CGI delivers credit management solutions to help banks and their credit operations automate and streamline the entire credit life cycle; improve customer acquisition, satisfaction and retention; reduce delinquencies and charge-offs; prevent identify theft and fraud; support rapid rollout of new products to multiple channels; eliminate redundant systems and processes; and achieve a lower total cost of ownership. To learn more about our banking services and solutions, visit [www.cgi.com](http://www.cgi.com).