Partnering for innovation in financial services

The positive impact of partnering for business and IT services

IBM

Today, leading enterprises are sourcing for more than just cost reasons. They're partnering to innovate and to help them achieve the rewards of financial outperformance. The financial services sector is no exception. What's different for these companies is increased attention on agility achieved through new business and operating models, and responding better by anticipating market shifts. At the same time, they can seize an opportunity by doing more to tie metrics to business outcomes and implement enterprise-wide governance.

About the study

To understand the shifts underway in the business and IT services industry – specifically, why and how organizations are sourcing – we needed a sample of significant size and diversity. We've achieved that objective, with 1,351 sourcing decision makers from around the world and across many industries participating in a global cross-industry sourcing survey. 172 decision makers in the survey were from the financial sector.

Nearly 40 percent of the respondents were C-level executives; the rest were senior executives who directly influence services sourcing decisions. Roughly one-third of the respondents were business executives; the other two-thirds were IT leaders. In terms of company size, 35 percent have more than 10,000 employees, and 65 percent have between 1,000 and 9,999 employees. These decision makers sit in 18 different industries and 12 countries (30 percent from growth markets and 70 percent from mature markets).[1] This paper takes a closer look at the financial services sector respondents from that global survey.

For a more in-depth look at how leading companies differ in how they employ sourcing – and how they outperform by doing so – download our full report *Why partnering strategies matter: How sourcing of business and IT services impacts financial performance* (**ibm.com**/ibmcai/sourcing).

Sourcing today: beyond the drive for efficiency

Traditionally, sourcing has been about cost reduction: providers could handle processes better and cheaper, particularly those that offer little differentiation. Today, with new business opportunities emerging through advances in mobile, social, analytic and cloud technologies, motivations have shifted. While savings are still expected, organizations are now sourcing to meet more complex needs. For many, this strategy has become a matter of competitive differentiation.

A similar shift in motivations is occurring within the financial services sector. Banks, financial markets firms and insurance providers have faced many challenges in recent years which, combined, put pressure on cost and business agility. Global economic turmoil has left a lasting mark, slowing growth and along with it, demand. Added to this are rising levels of regulation, competition from non-traditional providers and a more complex customer landscape marked by new channels, product diversity and greater expectations.

To stay competitive, financial institutions see a need to build sophisticated insight, accelerate time to market, improve product design and customer service, and proactively address risk and regulation – all while finding new, creative ways to manage costs. Sourcing is seen as a viable strategy for business model, operations and IT innovation.

This outlook parallels a trend that spans industries across the economy. Not only are more CEOs now sourcing externally, 53 percent are doing so to drive innovation.[2] Among CMOs, 92 percent are increasing their use of external providers for customer and data analytics.[3] And two-thirds of growth-focused CIOs are partnering to change the mix of capabilities and expertise in their organizations.[4]

The "why" behind sourcing has evolved but the "how" still lags. Sourcing choices do not always reflect enterprises' higher-order motivations. Does this really matter? It appears so. According to the global IBM cross-industry study, enterprises that source more broadly – and to drive innovation – generally outperform their peers across a host of financial measures (see propensity analysis chart).

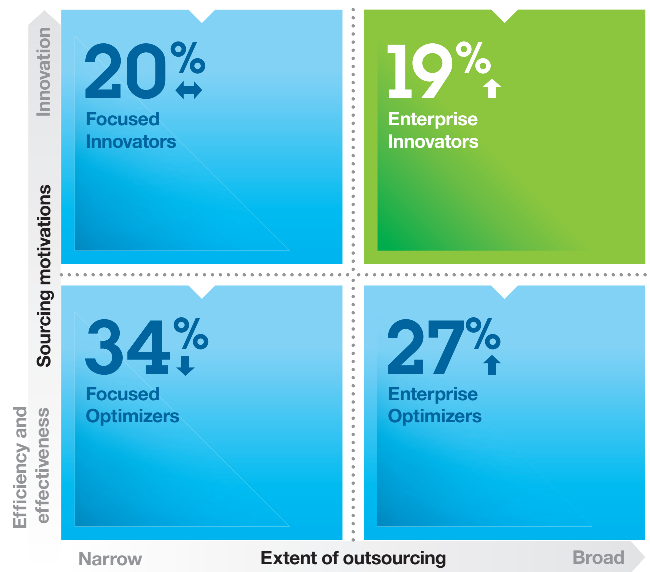
Strategies, from traditional to innovative

To better understand the changing dynamics of sourcing, our cross-industry study surveyed more than 1,300 sourcing decision makers from around the world, of which 172 decision makers were from financial institutions. Looking globally, the findings show a clear difference between leading companies that source broadly to innovate and those who still say that cost reduction and efficiency are the sole reasons they outsource.

When we examined both the extent of outsourcing and the motivations behind it, four partnering strategies emerged (see global respondent distribution chart):

- *Enterprise Innovators* are outsourcing more areas of their business and they're doing it to drive innovation in how they operate, their role in the value chain and how they monetize value.
- *Enterprise Optimizers* outsource a similarly broad set of business and IT functions, but their aim is primarily to drive greater efficiency and effectiveness.
- *Focused Innovators* outsource in a narrower manner. They engage service providers to innovate particular areas of their business.
- *Focused Optimizers* have a more traditional outsourcing strategy. They're tapping providers to improve efficiency and effectiveness in targeted areas.

Global respondent distribution by partnering strategy



⬇⬌⬆ Financial services relative to global respondents

Four distinct strategies emerge from looking at both the extent of and motivations behind sourcing. Enterprise Innovators are at the leading edge of this trend with financial services firms sourcing more broadly than their peers in other industries.[5]

Propensity analysis*: across industries, Enterprise Innovators perform better

The global IBM cross-industry sourcing study showed a correlation between sourcing for innovation and better performance. Enterprise Innovators, those who source broadly and who innovate, can achieve better financial results.

	Revenue	Gross profit	EBITDA	Net income	Earnings cont ops	Diluted EPS	Cash from ops	Levered free cash flow	Cap ex
Enterprise Innovators	9%	11%	15%	18%	24%	22%	15%	22%	10%
Other partnering strategies	4%	2%	5%	6%	3%	2%	7%	2%	-3%

*3-year CAGR %: FY 2011

Sourcing priorities differ for Enterprise Innovators

Across partnering strategies, sourcing decision makers, including those from financial institutions, share some common business objectives. Lowering cost is the top business priority. Other top objectives include: growing business with existing customers and attracting new ones, maintaining high technical skills and improving data quality and analysis capabilities.

Enterprise Innovators place a higher priority on business objectives – agility and responsiveness – that put them in position to innovate rapidly and capitalize on growth opportunities. This, in turn, motivates them to seek different capabilities from service providers (see differences in priorities and capabilities chart). In most ways, leading financial firms parallel these global trends, but there are differences. Enterprise Innovators in financial services look for innovation, the ability to respond to market shifts and to enable new business and operating models at a rate more than 20 percent higher than other Enterprise Innovators – all reflective of the changing face of the financial services industry.[6] At the same time, change management is a lower priority. This is not surprising, given the conservative nature of the sector – financial institutions historically handled change management internally and have only recently begun to look outside the organization.

As with Enterprise Innovators in other industries, those in financial services are driven by forward-thinking business strategies that favor fast action and sound decision making. Expansion into new geographic markets depends on how quickly the enterprise can transform to serve them. As a result, they're looking for providers that can help them wherever they want to go and help create more agile supply chains, all within a tightly regulated global business environment. Enterprise Innovators in the financial services sector are also likely to be experimenting with new business and operating models. They are, therefore, seeking providers with business strategy experience specific to their industry.

Differences in business priorities		Differences in capabilities sought	
Agility			
Expand into new regions	2.2x ↔	Extensive global infrastructure	1.7x ↔
Expand/integrate supply chain	2.2x ↔	Leader in driving industry standards and proactively implementing compliance shifts	1.5x ↔
Enable new business models	1.7x ↑	Business strategy and transformation experience	1.2x ↔
Responsiveness			
Anticipate/respond to technology and market shifts	1.8x ↑	Drives and capitalizes on technology innovations	1.4x ↔
		Robust cloud capabilities	1.4x ↔
Culture of innovation	1.5x ↑	Responsive organizational change management	1.3x ↓
Enable predictive modeling	1.4x ↔	Stong business analytics capability	1.3x ↔

Enterprise Innovators vs. Focused Optimizers (global)

↓↔↑ Financial services Enterprise Innovators relative to global Enterprise Innovators

Compared to Focused Optimizers, Enterprise Innovators are more focused on agility and responsiveness – which changes the mix of capabilities sought in providers.[7]

Enterprise Innovators in financial services are even more focused on anticipating market and technology shifts than those in other industries. They seek providers with a proven track record of capitalizing on disruptive technologies like mobile, social and analytics. For example, they want providers that can design, launch and scale those innovations quickly via cloud technology. To respond faster, Enterprise Innovators put more emphasis on predictive modeling and trying to find out in advance what will happen next. This means they're looking for providers that bring advanced analytics capabilities and can help them discover new insights and opportunities.

Partnering to innovate

Mexico's Grupo Financiero Banorte sought to make its banking arm, Banorte-Ixe, a sector leader in customer experience and service – on par with the best in the world. The bank wanted to become a leading example of innovation achieved through the smarter use of advanced technologies.

To support its goal of deeply understanding client needs through big data business analytics and thereby deliver superior customer service, the bank partnered to create a new customer-centric banking model that is expected to improve efficiencies to nearly 50 percent and offer a return on equity of over 20 percent. The unique global partnership model establishes corporate governance to monitor investment in new projects and the re-routing of existing spending to control costs, while positioning the bank to differentiate itself using big data, analytics, cloud computing and social business.[8]

Leaders marked by evolving provider relationships

Not only are Enterprise Innovators seeking a different kind of provider, they're also establishing an inherently different type of relationship. To accomplish their business objectives, they recognize the need to alter the way they structure and manage their long-term alliances. For example, where a traditional sourcing arrangement might measure success with specific metrics such as call handling time, Enterprise Innovators are more likely to include business-oriented outcomes.

The global cross-industry study showed that in general, Enterprise Innovators are ahead of Focused Optimizers. When broken out by sector, however, this progress is uneven. While Enterprise Innovators in financial services are generally on par with those in other industries in initiatives such as aligning services to business objectives, they do lag in a few key areas (see sourcing priorities chart). For example, financial institutions generally focus more on measurement of financial performance than business outcomes and their metrics are aligned accordingly. Regulations have also placed limits on freedom of action regarding roles and governance, but a shifting environment is opening up new opportunities to work with sourcing providers for some functions.

Sourcing priorities

Metrics tied to outcomes		
Metrics tied to business outcomes	1.5x	↓
Services aligned with business objectives	1.3x	↔
Transformational scope		
Transform roles of in-house personnel	1.7x	↓
Broad range of delivery models	1.4x	↔
Provider influences strategy	1.7x	↔
Vertically integrated contracts	2.1x	↔
Integrated governance		
Services integration across providers	1.5x	↔
Enterprise-wide governance	1.4x	↓

Enterprise Innovators vs. Focused Optimizers (global)

↓↔↑ Financial services Enterprise Innovators relative to global Enterprise Innovators

While financial Enterprise Innovators share the same overall focus of their counterparts in other industries, in some areas sourcing priorities differ from their peers.

Metrics tied to outcomes

Historically, service level agreements have focused on operational or cost-centric measures like system availability or cost per service desk call. But Enterprise Innovators are leading the charge toward more business-oriented measures. They're aligning provider metrics with bigger, more strategic business objectives. In the financial services sector, that might mean driving uptake in mobile banking or adding new capabilities through social media. This shift in thinking gives rise to new vendor valuation models – ones that can help assess a provider's contribution to broader business objectives beyond cost reduction.

On a global, cross-industry basis, Enterprise Innovators tie metrics to outcomes more often than do Focused Optimizers. While financial services Enterprise Innovators align services with business objectives in a similar way to Enterprise Innovators globally, they are less likely to have taken the next step by linking metrics to the extent their peers do. This suggests that while the focus is there, execution has yet to fully catch up.

Transformational scope

Enterprise Innovators are sourcing to get capabilities they need to innovate on a broad scale. So there's a transformative focus to their sourcing relationships. For instance, contracts are likely to be more vertically integrated – inclusive of business process, applications and technology infrastructure – to enable more holistic change. Innovation and broad-scale change are also likely to require a mix of service delivery models. They want their provider to help reshape how the marketing function works – to drive beyond understanding customer segments to understanding individual customers and from describing what's happening to helping to predict what's next.

Where the financial services industry differs is in changing the roles of in-house personnel. While Enterprise Innovators in other industries embrace this, financial institutions are less likely to do so because for them, this critical task is traditionally handled in-house.

Integrated governance

In a compliance-focused and highly regulated industry like financial services, governance is, and has always been, a top priority. It is not surprising, then, that Enterprise Innovators counter the trend when it comes to establishing enterprise-wide governance structures; chances are a robust governance structure already exists.

At the same time, Enterprise Innovators recognize the need for input and collaboration across business units, as well as providers to achieve business outcomes. For example, if the goal is accelerating the launch of new products and services, then parts of the business not normally involved in sourcing, such as marketing and sales, may need a voice in the sourcing decision-making process. Achieving broad business goals often requires the involvement of multiple service providers, too, elevating the need for integration.

The path forward

As sourcing motivations evolve within the financial services industry, executives are moving up the sourcing hierarchy of needs, seeking higher-order business outcomes like innovation. Their business strategies are pushing them to take a more expansive view of where providers can contribute and their sourcing strategies are designed accordingly. Enterprise Innovators are approaching the sourcing question with a broader, more integrated view that offers room to achieve targeted business objectives within the rigorous requirements of a highly regulated industry.

If you have not recently thought through why you're outsourcing and what business outcomes you seek, this broader conception of sourcing's role might be the place to start. If you already have clear aspirations for your sourcing relationships, the next and more complex question is: do the "*how*" and the "*why*" behind your sourcing strategy align? The considerations outlined on the next page can help guide you as you look to seize the opportunity that sourcing can offer to help you take on the challenges of an industry facing tough conditions.

Questions to consider

Metrics tied to outcomes	• What business outcomes do you hope to achieve? • What capabilities do you need to deliver desired outcomes? • How should your vendor evaluation criteria evolve? • What will service-level agreements need to look like?
Transformational scope	• Is cloud part of your delivery mix? • Are your strategic sourcing contracts structured vertically? • Are you sourcing generic or customized services? • Are your long-term sourcing providers influencing your strategy?
Integrated governance	• How will you structure your governance model – contract-by-contract, centralized, enterprise-wide – and who needs to participate? • What are the essential control points? • How will the CIO's role need to change? • Will you manage and coordinate services across providers or use a service integrator?

Acknowledgments

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The IBM Center for Applied Insights introduces new ways of thinking, working and leading. Through evidence-based research, the Center arms leaders with pragmatic guidance and the case for change.

Notes and references

[1] The growth markets studied include Australia, Brazil, China, India, Russia and Singapore. Mature market countries studied include Canada, France, Germany, Japan, the United Kingdom and the United States. To smooth possible geographic distortions, responses were weighted based on an IBM assessment of each country's total IT spend.

[2] *Leading Through Connections: Insights from the Global Chief Executive Officer Study.* IBM Institute for Business Value. May 2012. http://www.ibm.com/ceostudy

[3] *From Stretched to Strengthened: Insights from the Global Chief Marketing Officer Study.* IBM Institute for Business Value. October 2011. http://www.ibm.com/cmostudy

[4] *The Essential CIO: Insights from the Global Chief Information Officer Study.* IBM Institute for Business Value. May 2011. http://www.ibm.com/ciostudy

[5] On the x axis, the dividing point is based on the number of IT functions, applications and business processes outsourced – those to the left are outsourcing fewer than the trimmed mean of the sample, and those to the right are outsourcing at or above that level. On the y axis, those above the mid-point selected innovation as their primary motivation for outsourcing IT infrastructure, applications or business processes. Those below the mid-point did not select innovation, choosing other motivations instead, such as staff augmentation, cost reduction, process efficiencies and effectiveness.

[6] The diagrams in this paper have been constructed so that differences between financial sector respondents and global respondents of less than 20 percent are shown as equivalent.

[7] The directionality of the financial services sector findings should be interpreted with caution due to small sample size.

[8] Banorte-Ixe Partners with IBM to Establish a Unique Client-Centric Banking Model in Latin America. IBM press release. March 12, 2013. http://www-03.ibm.com/press/us/en/pressrelease/40619.wss

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