Growth Obstacles Facing Financial Outsourcing

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Outsourcing – defined as contracting, sub-contracting, or externalizing non-core activities to free up cash, personnel, time, and facilities in order to focus on core competencies - is seen by many companies and countries as an extraordinary tool for economic growth. Lower costs lead to lower prices and lower prices lead to higher standards of living and more job creation.

After manufacturing, outsourcing spilled over to the service industry and high tech research & Development (R&D). One of the beneficiaries of outsourcing is the financial sector. Banks, capital markets and insurance companies are relying more heavily on companies from emerging and transitioning countries to handle their IT and customer relationships as well as more sophisticated tasks such as their back-office services.

This activity transfer to foreign countries and the permeability of our economies raise some fear: what are and will be the visible and invisible consequences of the loss of our ability to do at home the very activities that enabled our countries to become industrial and service leaders?

An Increasing Sense of Danger

In a global world the rationalization of human activity resulting in greater efficiency makes sense, but the relinquishment and delocalization of activities are a growing concern for many countries both for economic and military reasons, even more so when some countries like China have made of outsourcing a strategic priority. For instance, the United States complains about the loss of its manufacturing capability. A July/August 2009 article from the *Harvard Business Review* on global competitiveness elaborates saying that "many high-tech products can no longer be manufactured in the United States because critical knowledge, skills, and suppliers of advanced materials, tools, production equipment, and components have been lost through outsourcing."

In the financial sector, India was hit in January 2009 by one of its largest corporate scandals when Satyam Computer Services announced it had misrepresented and inflated its earnings and assets for years. Satyam had served as the back office for one-third of Fortune 500 companies, including large international banks. It is a dire reminder of the potential danger that goes with a growing dependency on companies that operate in countries without well-established good governance standards and control mechanisms.

As the BRIC countries (Brazil, Russia, India and China) as well as countries like Malaysia and the Philippines make a push to get a greater share of the financial outsourcing market, they will have to pay closer attention to the issues identified in this article and think about how to address them. A concerted effort between governments, trade associations and companies will be needed to elaborate solutions and safeguards. Failure to do so may end up in the medium to long-term to growing resistance from end-using countries (notably the United States), protectionist measures, and tougher enforcement of existing trade agreements. Once restrictive regulations are in place, it will require significant efforts over many years to overturn them, thus the need to make sure they are never adopted.

The specter of protectionism

On April 1, 2009, following a meeting between President Barack Obama and President Hu Jintao, the "U.S.-China Strategic and Economic Dialogue" was established. A commitment was made to more open trade and investment and to fighting protectionism to promote economic growth, job creation and innovation – but, the power of the American public opinion and of special interest groups to lobby Congress and pressure the President to adopt decisions that may curtail outsourcing activities and result in the adoption of protectionist measures should not be dismissed. The belief that a job outsourced is a job lost is easy to spread at a time of raising unemployment. Though until now more jobs are created than destroyed from outsourcing operations, those who lose their jobs to outsourcing are not necessarily those who get the jobs created from outsourcing. Furthermore, the redistribution of jobs is not necessarily to the benefit of the country that loses the jobs. As a result, "outsourcing" is a cursed concept that the US Government and every elected official prefer to fight rather than to promote out of fear of being associated with job delocalization.

In a White Paper released by the office of Senator John Lieberman in May 2004, Lieberman was already expressing concerns that "if our engineering, design, and research and development (R&D) capabilities continue to follow the manufacturing and services facilities going abroad, our competitiveness will be weakened, putting our economic prosperity and national security at risk." He furthers added, "there are no assurances that we will remain a global leader in innovation, and maintain our jobs, our standard of living, and our global market share."

Weaknesses in Project Management and Governance

The increased exposure of financial institutions to operational, legal and reputational risks resulting from the weaknesses of its service providers is a growing concern and what happened with Satyam Computer Services is a good case study. This exposure coupled with daring cyber-attacks against governmental websites (for example: Estonia in 2007) and electronic financial crimes against the financial services industry and the clients it serves (for example: identity theft and fraud) demonstrate our growing dependency on foreign companies and of the need to set standards that are accepted and implemented worldwide. It means that some countries will need to adopt and enforce legislation protecting intellectual property rights and guaranteeing information security and privacy. For some companies, intellectual property and for others sensitive financial or medical data are their most valuable asset, the loss of which could lead to negative publicity and even their demise. Providers of outsourced services have to make sure they are not the "weak link" in the food chain.

Lack of Language, Technical and Management Skills

The quest for new clients has led to cutthroat battles to win contracts and accelerated staffing to fulfill these contracts. Despite the high number of graduates coming out from technology institutes, many companies lament the lack of operational and management skills of its new staff, which requires significant in-house training or re-training. One solution, successfully implemented by Intel, has been to nurture greater collaboration between institutes of higher education and end-users to create study programs that produces a workforce with needed practical skills, not just theoretical.

In the short to medium term, some companies and their country of origin could loose their credibility when trying to conquer market shares bigger than their ability to meet clients' needs such as uninterrupted services, constant level of quality and simply the need to be understood. Rising costs and salaries, lower quality of services provided and high turnover are curtailing the competitive hedge of market leaders from India and China. Poor English proficiency is not an option as the devil is the details and companies using outsourcing services have limited patience for approximation.

Safeguarding existing clients (which is a big selling point), notably by having the same team of professionals serving clients over time, goes with the need to be accountable and the need to meet the highest world industry standards that can be well beyond those in place domestically.

Conclusion

Commercial pragmatism has fostered until now a mutually beneficial boom in outsourcing activities. Now there is a need to develop sustainable growth through a concerted approach elaborated and preferably suggested by the industry rather than enforced by regulators after the eruption of scandals. This view is maybe a bit idealistic as many, like the financial sector on Wall Street, prefer to use the system as much as possible until they get caught rather than restrict their freedom by self-imposed regulations that would protect the interest of all.

As for the countries that feel that their competitiveness and national security are at stake, they should question why they are losing their competitive edge rather than resorting to protectionism and giving in to those that are preying on the fear of the unknown. Protectionism is a quick fix to address issues that have deep roots.