

An Industry Snapshot based on an exclusive survey

A Reeling Financial Services Industry Seeks Salvation from Partnerships

By Deborah Asbrand

For the U.S. financial services industry, business lately has been a perfect storm of perils. The sector has been roiled by the collapse of the credit markets due to a flood of bad mortgages and then tossed by a turbulent stock market. Now it faces a sinking economy.

The situation is desperate, but globalization offers a possible life preserver. Facing extreme mandates to reduce costs, bolster their balance sheets and find new sources of low-risk revenues, the financial services industry is also reaching out to emerging markets. Collaborating with third parties, especially in new markets, is helping banks, securities firms and insurance companies to slash costs and attract fresh capital and customers, according to a recent survey by BusinessWeek Research Services (BWRS).

The BWRS poll found a growing interest among C-level executives at financial services firms in collaborating with external partners around the world to help rescue both their income statements and their balance sheets. Approximately one-fifth of the 353 responses to the survey of executives at North American companies were from the financial services sector, and these executives indicate that such collaborations have improved revenue growth, profitability and other key metrics at their companies.

Of course, banks and brokerage firms were early to outsource IT and other back-office functions, but the sector's collaboration profile has expanded beyond transaction processing. Survey responses indicate that the financial services sector now has sophisticated relationships with third parties for almost all functions, including R&D, marketing, sales, customer service and HR. While the data indicates that financial services' functional collaboration pattern will vary substantially over the next several years, the overall upward trend is clear. Many large U.S. firms are following the capital flows across oceans and borders.

Banks, investment firms and insurers outsource core applications and systems like IT and call centers to the tune of 16 percent of operations, according to the survey's financial services respondents. Furthermore, they predict that number will reach 18 percent in three years.

Following the Money

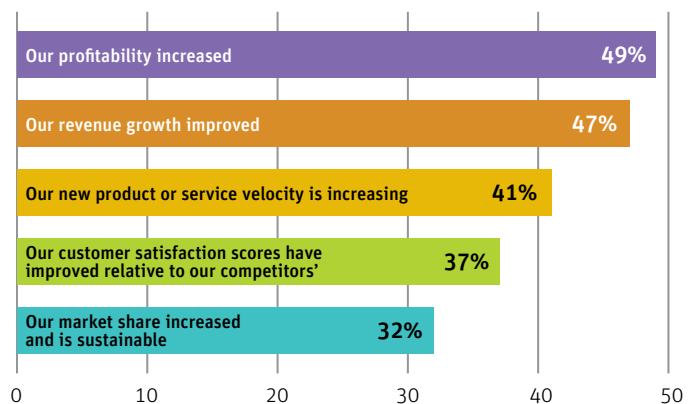
Financial services firms that have embraced third parties have found substantial business benefits. Almost half of the survey respondents cite revenue growth and profitability increases as important benefits achieved from external collaboration. And four out of 10 note customer service

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Chart 1

Bottom-Line Benefits to Collaboration

(% of financial services respondents indicating that the benefit was one of the three most important achieved by their third-party relationships)



Source: BusinessWeek Research Services, 2008

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has improved. More than 41 percent cite the increased velocity of new product and services introductions as an advantage of third-party collaboration, as well (see Chart 1, “Bottom-Line Benefits to Collaboration”).

These business benefits accrued to those financial services because of not only access to new ideas, skills, products and markets but also reduced costs through traditional outsourcing arrangements. Three-quarters of the financial services survey respondents say access to new skills, products and ideas has been a major dividend of third-party unions over the past few years.

Furthermore, 41 percent say access to new markets and customers is one of the three most important benefits of working with external partners. Interestingly, the financial services industry is far ahead of others in realizing that third-party collaboration can fill skill and idea gaps as well as provide a launching pad for sales in new markets (see Chart 2, “Financial Services Ahead of the Adoption Curve”).

Expectations of future benefits for financial services have dimmed. For example, while access to new markets will continue to be a key outcome, a few respondents don’t expect further cost reductions or additional access to ideas to be as important in the future. This indicates that some financial services executives believe they’ve already picked the low-hanging fruit.

New Markets Mean New Opportunities

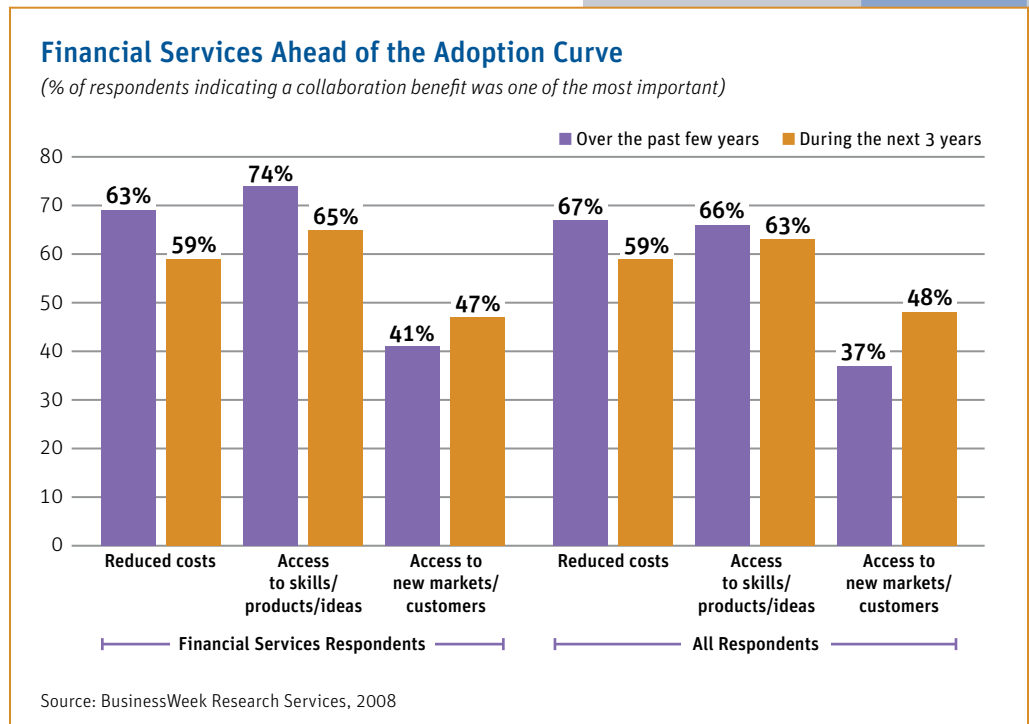
Clearly, though, there’s more fruit to be plucked when it comes to new markets. New research from McKinsey & Company on investment banks reports that global revenues from emerging markets in Asia, Europe, the Middle East and Latin America will jump sharply over the next three years.

To sell more products into that growing pool of customers, financial services firms are capitalizing on the marketplace’s desire for immediacy. They face a fickle public. To younger customers who grew up with the Internet and instant messaging, a bank or insurer isn’t a brick-and-mortar building. It’s a Web site.

These Generation X and Y consumers want individualized offerings and speedy service. Not available? They’ll switch

Banks, investment firms and insurers outsource core applications and systems like IT and call centers to the tune of 16 percent of operations, according to the BWRS survey’s financial services respondents.

Chart 2



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suppliers in an instant messaging minute. And the generational divide is narrowing: Older consumers, too, want products and services delivered quickly and efficiently.

Acting on Opportunity

How do financial services firms match that spirit of spontaneity? By seizing the opportunities that come with change. Some meet customers on their own turf by broadening their marketing campaigns to include Web-based social networks like Facebook and Second Life. Others deliver services through partners like Wal-Mart or the local supermarket. Still others enlist third parties to help them create mobile applications that enable consumers to access their accounts, buy insurance and pay bills using their cell phones.

When it comes to R&D, however, financial services firms show more hesitancy. Indeed, few do much R&D relative to the manufacturing industry. When the National Institute of Standards & Technology examined service-sector R&D in 2005, it found that few retail banks acknowledged engaging in R&D. Only the largest thought they were performing development activities at all.

Within the industry, there remain distinct differences in the way capital markets, banking and insurance approach new product development. “Capital markets has a lot more spending on R&D,” says Bart Narter, senior vice president for the banking group at research firm Celent. “Insurance has the least amount of R&D, and banking is somewhere in the middle.”

While other sectors—notably manufacturing (see article, “How Business Network Collaboration Is Transforming Manufacturing”)—plan to grow their product-development ecosystems of third parties, the financial industry is taking a different approach.

According to the BWRS survey, these companies partner less on R&D than the overall survey population. Roughly a third of financial services firms say they use R&D partners to a modest extent, versus 47 percent among all respondents. And a steadfast 41 percent go solo on their R&D. Among the overall group, only 33 percent prefer to carry out their R&D independently.

Relying on Third Parties for R&D

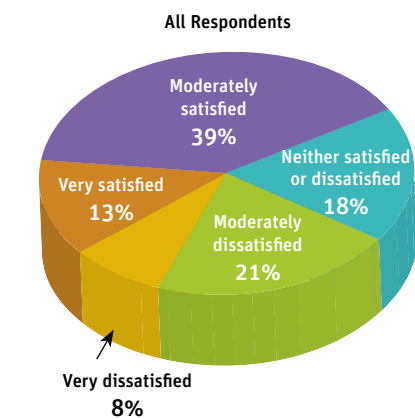
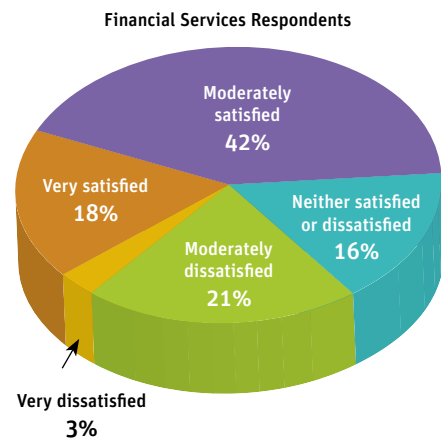
But among those financial services firms that do partner on R&D, greater numbers report relying heavily on the unions. More than a quarter depend on the partners to a large extent. The cross-industry figure, on the other hand, dips to just below 20 percent.

One example of a financial institution relying on third parties for R&D is Mumbai-based ICICI Bank. It uses commercial and academic partners to seed low-cost experiments. The bank, India’s second largest with assets of US\$100 billion, has notched an impressive list of new products and services, and it was the first to introduce online banking and brokerage services to the country.

Chart 3

IT Is OK

Financial services executives are more satisfied that their IT infrastructure can support their future level of collaboration. (% of respondents indicating a specific level of satisfaction)



Source: BusinessWeek Research Services, 2008

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In their book *The New Age of Innovation*, authors C.K. Prahalad and M.S. Krishnan point to the collaborations as key to ICICI's ability to churn out a steady stream of new products that range from corporate cash management applications to rugged ATMs suited to India's intense humidity. They note that senior managers and R&D lab managers regularly peruse new technologies for their business relevance.

A Positive Outlook on IT

A long tradition of investing in information technology, plus a current financial environment that precludes new investments unless absolutely necessary, have combined to leave financial services executives relatively confident that their systems are up to the levels of collaboration expected in the future.

BWRS survey respondents in financial services express more satisfaction than their peers in other industries with their corporate IT department's ability to support collaboration. They're less worried about infrastructure issues (see Chart 3, "IT Is OK"). In many cases, this is the result of banks, brokerage firms and insurance companies having to invest in IT to satisfy ever-higher customer expectations. Consumers and corporate customers, as well as regulators, demand real-time online access to accounts and products as standard operating procedure.

"Financial services firms have embraced Internet technology and portals in part to create an integrated flow of information within and outside the company," says Guillermo Kopp, executive director at research firm TowerGroup.

Satisfying the industry's complex value chain is an important driver for collaboration. Says Kopp: "Collaboration thrives in a multifunction platform, where everyone can look at financials." ■

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– GUILLERMO KOPP
TOWERGROUP

Deborah Asbrand is a senior editor for Triangle Publishing Services Co. Inc. of Newton, Mass. Her articles have appeared in The Industry Standard, The Boston Globe, Corporate Dealmaker, Forrester Reports and MIT's Technology Review.

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