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OUTSOURCING PRACTICES IN INDIAN BANKING SECTOR: A STUDY

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INTRODUCTION

The effect of globalization and economic reforms during 1990s witnessed paradigm shift in the functioning of the banking sector. Due to globalization, deregulation and large scale adoption of technology, the age-old public sector banks in India were exposed to increased competition and challenges. Further, post liberalization saw emergence of new generation private sector banks in the Indian banking arena. These banks, armed with Information and Communication Technology (ICT), posed the biggest challenge to .the public sector banks. Intense competition resulted in pressure on their margins. To overcome the twin challenges of "Cost reduction" and "technology adoption", banks went for outsourcing.

Literally outsourcing means "out""source" i.e. external source or simply purchasing activities from the market instead of doing it within the organization's boundary with its own employees. The idea of outsourcing has its roots in the 'Competitive Advantage' theory propagated by Adam Smith in his book, "The Wealth of Nations". Over the years, the meaning of the term 'outsourcing' has under gone a major change. Basically it started during the great industrial revolution era, with an objective of shifting of manufacturing of goods to countries providing cheap labour. But over the years, its meaning and objectives have totally changed.

Outsourcing was not identified as a business strategy until 1989' and it was in 1990s that saw the emergence of outsourcing when Multi National Companies (MNCs) established wholly owned subsidiaries which catered to the offshoring requirements of their parent companies. Study on determinants of outsourcing decisions of companies shows 'cost savings' as one of the major factors for outsourcing decisions. Researchers have mostly used 'cost theory' to investigate the antecedents to outsourcing. Comparative cost advantage due to the low transaction cost and need for cost reduction have encouraged organizations to go for outsourcing in the early days. The companies that outsourced, had a significant cost focus and the needs for cash.

Though IT outsourcing has benefitted the banks, it has exposed them to serious risks. According to Beasley Bradford and Pagach, the severity of IT outsourcing risks in companies is enormous. A mere occurrence of an IT shutdown can exponentially increase the enterprise's risks. Outsourcing risk is manifested in loss of control on some key functions and likelihood of opportunistic expropriation by vendor.

LITERATURE REVIEW

There is limited research on wider implications of outsourcing, sigh as how it has already impacted or might impact on particular sectors or national or regional economies. Mukherji and Ramachandran (2007) in their study on outsourcing practices have found that specialization and outsourcing are complementary business imperatives in the present age of innovation-driven competitiveness. In their opinion in seeking to understand which of the organization's activities should be conducted in-house and which should be outsourced from the market, managers need to understand the cost benefits of both options.

Companies are actually under pressure to outsource so as to enhance competitiveness by achieving higher ROA (Return on Assets) and increase their abilities to adjust quickly to a changing environment. Pujals (2005) conducted a study on offshore outsourcing in the European Union Financial services industry. He found that financial organizations are likely to outsource activities with a motive to

I. reduce cost,
II. access new technology,
III. improve quality of service,
IV. focus on core activities and
V. flexibility

As information technologies (IT) evolved during the 1980s and I990s, financial services firms began to outsource a greater variety of IT activities in order to lower their operating costs and gain faster access to state-of-the-art technology. He also mentions that outsourcing is not free from risk. Outsourcing may result in

I. loss of control over service,
II. loss of internal skill,

III. operational risks,
IV. decline in quality,
V. socio-cultural problems,
VI. technical limitations and
VII. loss of competitive advantage.

Harland et al (2004), in their study on pros and cons of outsourcing relating to organizations, sectors and nations have found that outsourcing offers benefits to organizations, sectors as well as the nation as a whole, but at the same time, organizations at all levels are exposed to risks, Heiko Gewald (2010) in his study on outsourcing in the German banking industry has observed that there is a significantly higher value associated to the programmability cost in case of Business Process Outsourcing (BPO) than actual cost savings.

Schniederjans (2006) has conducted a study on Strategic and Tactical perception of Outsourcing in US commercial banks. His study reveals that there is significant difference in the perceptions on outsourcing goals between the top management (board members) and Information System (IS) professionals at the tactical level. When top management consistently and significantly aim at strategic achievements through outsourcing, IS/IT professionals look at outsourcing from a different angle. The study also found that though factors like bank size influences outsourcing decision, the top level perception on outsourcing remains the same.

Barako et al (2008) in their study on outsourcing practices in Kenyan banking sector have found that IT enabled services like ATM and Card processing are the major activities outsourced in Kenyan banking sector. Federal Reserve Bank of New York (1999) conducted a study on outsourcing of Financial services activities. The survey finds that banks outsource financial services mostly for

(1) enhancement of performance,
(2) reduction of costs,
(3) access to superior expertise and
(4) strategic reasons.

The study also indicates that outsourcing of financial services has potential risks like

(1) strategic risk,
(2) credit risk,
(3) compliance risk,

(4) reputation risk,
(5) transaction risk and
(6) country risk.

Survey by European Central Bank on outsourcing activities in the European banking Sector finds that though outsourcing of an activity is beneficial, in reality; many banks believe that outsourcing introduces new challenges and risks. The study highlights the benefits of outsourcing like technology; diversification, streamline services; focusing on core activities; freeing of scarce resources; quality and flexibility of services etc. The study also reveals several risks associated with outsourcing, namely, operational risk, legal and strategic risks, country risk reputation risk, loss of flexibility loss of control and cultural/social problems.

Suhaimi et al.(2004) in their study on Information systems (IS) outsourcing in a Malaysian bank have found that the motivating factors for banks for going for IT outsourcing were to focus on core competencies, turning non-profit activities into profit-generating activities and cost reduction.

The results of various studies indicate that banking organizations choose to outsource their activities with a motive to have access to advanced technology, focus on core activities, reduce cost and improve quality of services and other strategic objectives. The studies also reveal that outsourcing is associated with risks like loss of control and internal skills, decline in quality, loss of competitive advantages, operational risks etc.

Most of the prior studies have exclusively focused on the Western developed economies where banking is controlled by the private sector banks. But the situation in India is quite different. The banking activities in the country are largely controlled by the Public Sector Banks (about 75%). The Private Sector Banks (both old and new generation) control only about 20% of the banking business/activities.

Study of literature on outsourcing asserts that transferring certain activities to third parties will result in a range of benefits to organizations, like focus on core activities, cost savings, access to scarce resources, better service to consumers, reduction of time to market, access to technology and other strategic benefits. At the same time, various studies have reported potential risks associated with outsourcing, including loss of control, operational risk, reputation risk, strategic risk, compliance risk, contractual risk, access risk, exit risk, unforeseen costs and even it may lead to redirection of managerial attention away from core business. (Rouse and Corbit, 2003)

The risk-benefit analysis in decision theory compares the extent of risks associated with benefits. As long as perceived benefits outweigh the perceived risks, the decision maker will be inclined towards a particular decision. This concept is also applicable to outsourcing decisions. Overall potential risk reduces the usefulness of an activity and checks decision maker's intention to conclude the deal. In this study risk-benefit frame work is applied to examine outsourcing decisions and decision to outsource is positively influenced by perceived benefits of outsourcing.

STATEMENT OF THE PROBLEM

Outsourcing is entering into a Contract with another organization /agency to operate and manage one or more of its business process .In other words, Outsourcing deals with the people and processes in and around a business. The outsourcing concept has been there in the industrial sector from ages. No manufacturer produces all the parts required for the finished goods that he manufactures. He gets lot of things manufactured from others as per his Specifications.

Outsourcing is a viable strategic tool for the banks enabling them to focus on their core competencies by shifting direct operational responsibilities to a third party service provider and gaining industry expertise. But the Success of Outsourcing decision Primary rests in the edifice of three pillars, Viz.

I. The Proper Identification of activities to be outsourced
II. Selection and Monitoring of a service Provider to ensure that there is no disruption in the timely delivery of quality service as per the agreed terms and most importantly
III. Review of regular intervals in the event of any unforeseen situation.

It is to be well ingrained in the minds of people who are party to the bank's, Outsourcing decision that Changes in banking are taking place with rapid speed and are unprecedented many times. Unless these aspects are factored into the process of outsourcing decision mere delegating of activities for cost implications alone does not bring desired efficiency or effectiveness for the growth of the organization. Our problem revolves around the outsource list practices in Banking.

OBJECTIVES OF THE STUDY

Our study would try to

1. Elaborate the need and importance of outsourcing practices in Indian banking sector
2. State the pros and cons of outsourcing practices in banking sector in Indian context
3. Narrate the future expectation about it,
4. Consider any other related problems.

IMPORTANCE OF STUDY

The activities that a bank normally outsource are

I. Opening and Closing of accounts, issue of Cheque books, statement of accounts
II. Processing of Cheques
III. Customer query management (call centres)
IV. Selection, recruitment and training of Personnel
V. Admission of Pay-rolls and TDS
VI. Marketing of bank's Products
VII. Maintenance of computers and other electronic gadgets
VIII. Cross selling of bank's product (Insurance and Mutual Fund)
IX. Credit Card / Debit Card Services
X. Maintenance of ATM's

There are various issues to be taken into consideration while deciding on an outsourcing arrangement. The decision to outsource should weigh all the pros and cons of the arrangement. The study will try to elaborate on the need and importance of outsourcing practices in Indian Banking Sector, state the pros and cons of outsourcing practices as well as suggest ways to reap benefit of adoption of outsourcing practices in Indian Banking Sector. Hence, the study is very much relevantion the present one.

HYPOTHESIS

Our study would be based on the followings Hypotheses:

- The Banking Sector is witnessing a concerted move towards business process Outsourcings.

- Banking industry is ideally suited for outsourcing, given large transaction volume, structured decision-making and reliance on rule-set processes.
- Outsourcing strategies are being driven by the twin objectives of cost rationalization and quality enhancement.

RESEARCH METHODOLOGY

Date and information for our study would be collected from both primary and secondary sources. The primary data would be collected through interview with the beneficiaries, managerial personnel, executives etc. The secondary data would be collected from various related books, magazines; Net reference would also be made to download some information from the websites as per need of the study.

The study will be analytical in nature and for the analysis of collected data and information suitable statistical tools and techniques like mean, standard deviation percentage analysis etc, will be used.

CONCLUSION

Outsourcing can be a huge success story but there are challenges. Though simple in theory, it is tough to execute especially when companies with high expectations outsource the wrong things for the wrong reasons in the wrong way. Poorly planned deals have grave shortcomings – companies overestimate the economic benefits of the deal, fail to establish the right baseline for price negotiations and performance tracking, or are not fully prepared to manage the transition and post-deal situation.

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