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OUTSOURCING OF FINANCIAL SERVICES IN INDIA: NEED OF THE HOUR

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ABSTRACT

Evolution of Outsourcing of financial services in India, India became a prominent for outsourcing in the services sector in the 1990s. Outsourcing to India started with the IT industry, which has responded to the changing market requirements by increasing the scale of operation and capability to handle complexity. Outsourcing, and particularly the globalization (off shoring) of business services, has been one of the most talked about and significant business trends of the new millennium. The business need for cost containment, growing capabilities and maturity of the offshore outsourcing vendors have contributed to this rush largely.

***Key Words:* Financial Services, Globalization, RBI.**

INTRODUCTION

The financial services industry is one of the most industrial dynamic, and competitive in the global market and also one of the most regulated. According to a recent report- 77% of the retail banks now outsources atleast one part of their business to a third party financial services provider. It is estimated that organisations save about 20-40% of their costs when outsourcing, depending on whether the processes are located locally or abroad.

Organisations are constantly under pressure to reduce their overhead cost to increase their revenues. Businesses need to understand dynamic and ever changing nature of the financial Industry and be updated with the latest developments. They need to tweak their processes according to the new trends in the market which will help them generate better revenues.

The Indian IT Industry fares impressively when compared to the growth of the Worldwide IT Industry. The Indian outsourcing industry consists of global and Indian companies that rank high on size, maturity, quality, domain expertise, global footprint, customer base, complexity of projects undertaken, and process-oriented delivery models.

One service industry in India that has been doing aggressive outsourcing of varied functions and jobs is the banking industry. A preliminary informal survey-inquiry made among nationalized banks and private banks in India indicate that banks are increasingly outsourcing more and more regular bank-related activities and functions.

FUNCTIONS AND SERVICES THAT ARE BEING OUTSOURCED BY BANK

First, there are the traditional non-banking activities that are being outsourced such as janitorial services, security services, equipment and property maintenance and food/catering services. Unions accept the outsourcing of these activities as understandable, for they are not directly related to the business of banking. However, what many unions are questioning is the outsourcing of functions or services directly related to the operations of a banking business, some of which are central or core to the banking industry. These include the following:

- Customer services
- Credit card service (sales, billing and collections)
- Encoding of bank transactions and data processing
- Statements renditions
- Cheque preparation and clearing
- Replenishment of ATM machines
- Backroom operations (credit processing, corporate and trade services)
- Marketing of banking products (loans, insurance)
- Internal messengerial (documents dispatch and collection)
- Human resources management (recruitment, payroll, benefits administration, etc)

of course, not all the banks follow a uniform pattern of outsourcing, as some have more function outsourced and others, less. Some are just starting in the outsourcing business and others, with a longer period. The most commonly outsourced services are:

- Marketing of bank services and products (e.g. credit card, loan services, etc.)
- Credit collection
- Customer service
- Statement renditions and
- Payroll

The above functions do not involve the direct handling to bank deposits. In general, the big transnational banks have more extensive outsourcing patterns and are more aggressive in doing outsourcing, as this is part of the continuous process of making their operations leaner and meaner, with an eye on the bottom lines. However, some Indian banks competing with the American and European banks are also aggressively doing outsourcing in key areas.

ROLE OF RBI ON OUTSOURCING OF FINANCIAL SERVICES BY INDIAN BANKS

Outsourcing brings in its wake, several risks. Some key risks in outsourcing may be Strategic Risk, Reputation Risk, Compliance Risk, Operational Risk, Exit Strategy Risk, Counterparty Risk, country Risk, Contractual Risk, Access Risk Concentration and Systemic Risk. The failure of a service provider in providing a specified service, a breach in security/ confidentiality, or non-compliance with legal and regulatory requirements by either the service provider or the outsourcing bank can lead to financial losses/reputational risk for the bank and could also lead to systemic risks within the entire banking system in the country. It would therefore be imperative for the bank outsourcing its activities to ensure effective management of these risks.

As Reserve Bank of India is the Apex Bank of our country, the Role of RBI on Outsourcing is intended to provide direction and guidance to bank to adopt sound and responsive risk management practices for effective oversight, due diligence and, management of risks arising from such outsourcing activities. The RBI guideline is applicable to outsourcing arrangements entered into by a bank with a service provider located in India or elsewhere. The service provider may either be a member of the group/conglomerate to which the bank belongs, or an unrelated party. The underlying principles behind these guidelines are that the regulated entity should ensure that Outsourcing arrangements neither diminish its ability to fulfill its obligations to customers and RBI nor impede effective supervision by RBI. Bank therefore have to take steps to ensure that the service provider employs the same high standard of care in performing the services as would be employment by the banks if the activities were conducted within the banks and not outsourced. Accordingly banks should not engage in outsourcing that would result in their internal control, business conduct or reputation being compromised or weakened. In relation to outsourcing by bank following guideline is applicable:

- Banks should frame and put in place a comprehensive outsourcing policy approved by Board and senior management. The contract between the banker and the service provider on outsourcing should be in writing and the agreement should be legal
- Banks have to construct managerial structure for monitoring and regulating the outsourcing activities. A central record of material outsourcing has to be maintained which should be readily accessible to the Board and senior management and it should form a part of Corporate Governance review.
- Outsourcing involves various risks such as strategic risk, reputation risk, country risk, compliance risk, counter party risk etc. It is imperative to the banks to ensure sound, effective and responsive risk management practices regarding outsourcing activities.
- Banks cannot outsource the core management functions like Corporate planning, Organizing, management, control and decision making function like Complying KYC norms for opening deposit account, sanctioning loans and managing portfolio.
- The Outsourcing function should adhere to the regulatory and supervisory requirements prescribed by RBI. Banks must conduct a self-assessment of their existing and proposed outsourcing arrangements and rectify the deficiencies or shortcomings.
- Banks cannot outsource their works in the countries where there is no branches.
- Banks should get permission from RBI for off-shore outsourcing.
- To undertake door-step banking, bank should get permission from RBI.
- Outsourcing contracts should include contingency plans to ensure disaster recovery and Business continuity. Banks should consider alternative service provider or to bring activity back in process during emergency. It is to be ensured by the banks that all documents, records of transactions and information of the bank given to service provider can be removed from the possession of service provider by deleting or destroying or unusable during adverse conditions.
- The Outsourcing work should be audited by the internal auditor or outside agency.
- The Policy should provide for the clause for inspection of the service provider and their books of accounts by RBI.
- The recovery agents should adhere to the instruction of fair practices code. The service providers should not harass or ill-treat the customers.

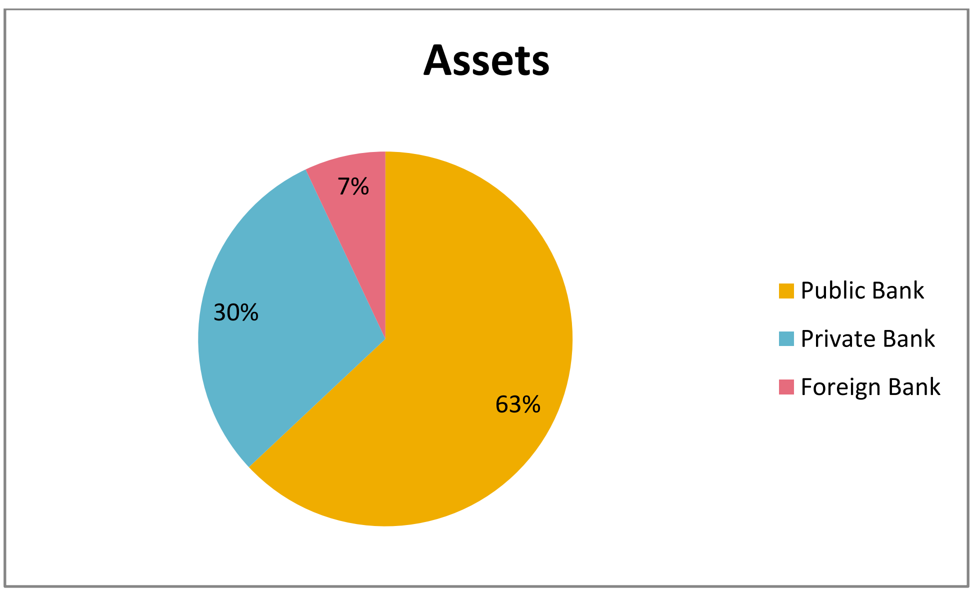
- Banks should constitute grievances redressal machinery which should resolve the problems faced by the customers. A time limit of 60 days should be given to the customers for filling a complaint.
- Bank should limit and restrict the access of customer information to service provider in order to ensure protection and preservation of security and confidentiality of customer information. Bank should also review, monitor the security practices and control processes of service providers at regular basis.
- Banks should not engage in outsourcing activities that may weaken the internal control or compromise their business contract or reputation.

With the RBI norms, banks have to a platform to outsource its financial services to outside agencies and services providers. Thus, by strategic Outsourcing in banks will be in a position to reduce the cost, utilize the hi-tech skills, offer superior products and have competitive advantage.

CURRENT INDIAN BANKING SCENARIO:

The Indian Banking industry has witnessed an 18.4% growth in its assets in the fiscal year 2010-2011. A sustainable overall economic growth has laid the foundation of a robust banking sector. The Industry has been largely classified on basis of its origin & ownership into Indian Public Sector Banks, the Indian Private Sector Banks and the Foreign Banks. Their respective size and coverage as on March 2011 is as illustrated below:

Exhibit-1: Assets Size

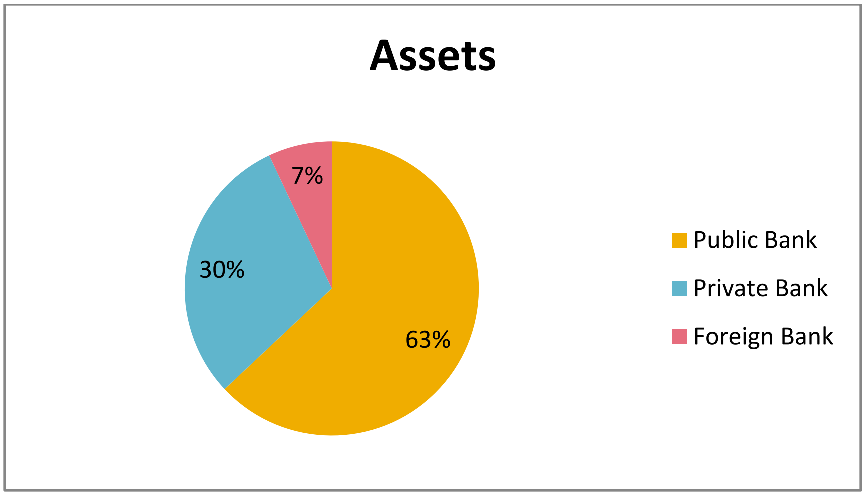


Source : Annual Report of RBI 2016

• Assets Composition

The total asset size is approximately Rs. 121,83,522 crore of which 63% is controlled by the Indian Public Sector Banks. The Indian Private Sector Bank segment continues to grow and at present holds 30% of the assets (18.2% of the entire asset base in 2016 while the foreign banks hold 7%).

Exhibit-2: Branches (54,791)

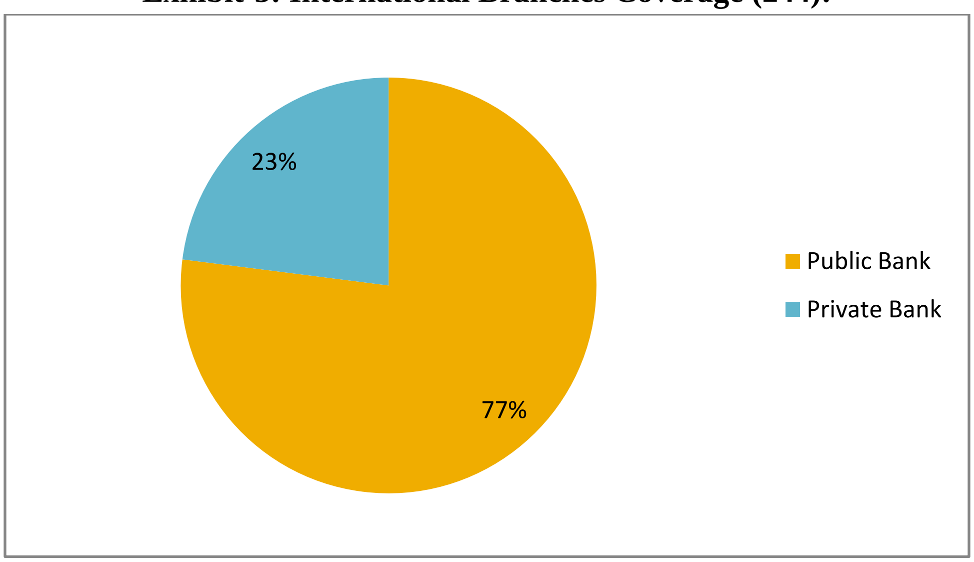


Source: Annual Report of RBI 2016

Branches

The total number of branches of schedule Commercial Banks at end-March 2011 increased to 74,130, comprising 21,705 rural branches, 19,800 semi urban branches and 16,945 urban and 15,680 metropolitan branches.

Exhibit-3: International Branches Coverage (244):



• International Branch Coverage

As on March 2011, eighteen Indian banks had overseas operations spread over 47 countries with a network of 157 branches (including offshore units), 7 joint ventures, 24 subsidiaries and 56 representative offices. Bank of Baroda had highest overseas presence with 47 branches, 9 subsidiaries, one joint venture bank and 3 representative office in 20 countries, followed by State Bank of India with 46 branches, 5 subsidiaries, 4 joint venture banks and 8 representative offices in 29 countries and ICICI Bank with 8 branches, 3 subsidiary, and 8 representative offices in 14 countries.

RECAPITULATION:-

With greater success in IT outsourcing, Public Sector Banks will be more inclined to outsource their business processes thus leveraging on the benefits gained through investments in IT. Although Banking Institutions have outsourced activities such as payroll processing for years, outsourced activities have recently included information technology, accounting, audit, electronic funds transfer, investment management, and human resources. The most frequently outsourced activity, in the banks, is in area of information technology support like hardware maintenance etc.

India's banking market is one of the fastest growing in the World. The reasons are numerous: a burgeoning national economy, financial sector reform foreign investment that has risen in step with an easing regulatory climate, and a highly favourable demographic profile, to name a few. Some leading international banks have already demonstrated that it is possible to establish a presence in India and achieve profitable growth amid local competition. But India's potential is so vast that significant opportunity still awaits foreign banks that have not yet explored the country. It is an opportunity that few can afford to ignore. Fueling India's banking growth is a greater than $ 600 billion economy that is expanding at about 6 percent per year, stimulating per capita income and consumption. Large numbers of households are shifting into the middle class, crating booming markets in Housing, Motor Vehicles, Televisions, Computers, Mobile Phones and other products-most of which require financing. Total banking assets have doubled over the past five years, and industry profits have tripled over the past three years. The current profit pool of about $ 20 billion and may reach $ 40 billion within a decade resulting from a rapid expansion of revenue that will parallel that of the overall financial services sector. What is more, about 60 million new households should be added to India's bankable segment by 2010. And the countries will likely have a surplus of 47 million people aged 15 to 59 by 2020- a time when most other large economies will face a shortage in this age bracket.[20] Infrastructure gaps, although glaring in some areas, are improving, and a stable political reform consensus bodes well for continued economic growth. Of course, entering India's banking market is no small task. More than a few foreign institutions have tried to secure a foothold, found the going slippery, and departed with not much to show for their effort and investment. But the fact that success is attainable should make international banks take notice: Indian in the twenty- first Century is about far more than outsourcing and Off shoring.

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