

Andrew Carriline

Westpac Banking Corporation
Sydney

Outsourcing by banks of services – the legal
issues



Westpac
Australia's First Bank

Outsourcing by Financial Institutions of services

Some commercial issues

Andrew Carriline – General Manager
Strategic Sourcing

3rd August 2003

Today's presentation

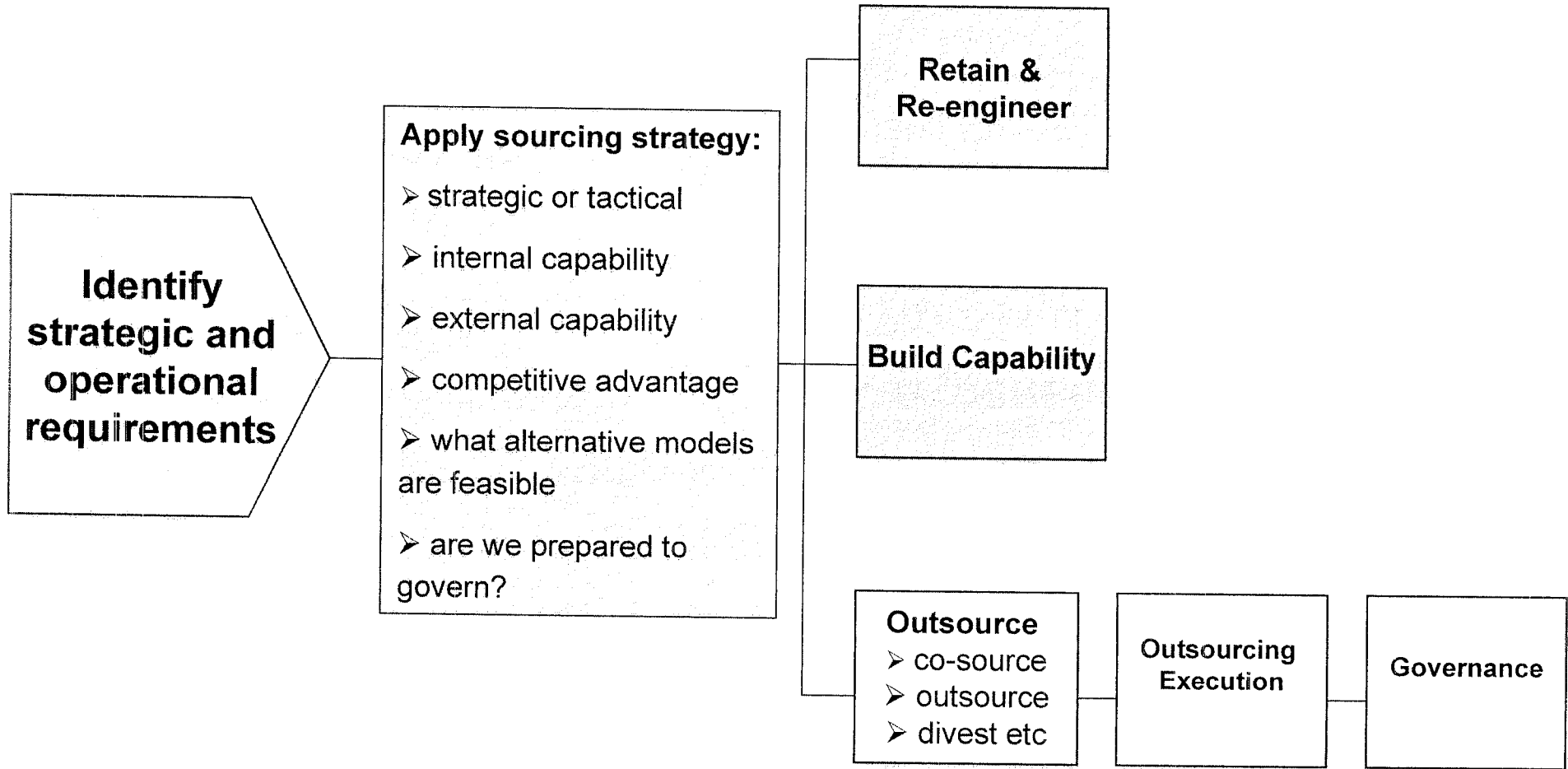
The framework for outsourcing:

- organisational capability
- what can be outsourced
- observations from Westpac experience

Some specifics:

- transition
- governance
- flexibility
- performance levels
- pricing

An organisation should not start a process by “deciding to outsource” – any decision should only emerge following a review of strategic and operational requirements



What can be outsourced?

- In theory:
 - anything
 - back end, customer facing
 - operations, product creation
 - sales and marketing
- Management theory:
 - non-core activities
 - new activities where company cannot access skills
 - not strategy or policy setting

- In practice:
 - commodity activities
(stable, mature, scalable, standardisable, highly substitutable)
where a supplier can achieve a 30% or higher cost reduction, including investment
 - project delivery (but not design or direction)

Commercial drivers for outsourcing

- Focus investment on core activities
- Access to skills, scalability
- Free up capital
- Convert fixed to variable costs
- Lower costs/leverage scale
- Access to technology and R&D
- Speed up transformation
- Reduce risks/change risk profile

Potential realities of outsourcing

- Diametrically opposed aims
- Change changes everything
- Flexibility vs certainty
- Economies of scale often don't materialise
- If you are outsourcing a non-core activity, the supplier must be able to provide it for at least 30% cheaper to provide discernible benefit to the customer

The traditional contractual framework is immature for large scale, long term outsourcing

- Flawed logic – all the tough clauses in the world can't make it work
- Alignment – need to get the parties aligned. How?
- Flexibility – things will change; how can you plan for it now?
- Service levels, penalties – blunt instrument.
- Transformation and operations are different and should be structured differently.
- Hunger - How do you really keep the supplier interested in improving?

How to get the framework right for effective outsourcing that benefits both parties

- Get your strategic intent right from the beginning and stick to it
- Be honest and expect that from the supplier
- Get your assumptions and the supplier's assumptions right – understand business models
- Communicate your objectives clearly and understand theirs
- Don't outsource accountability, thinking or problems
- Get your house in order before outsourcing and use that as your price point
- Be balanced, but drive the deal hard
- Leave something on the table for both parties
- Governance, internal syndication, expectation mgmt

In summary:

- Treat outsourcing as a tool to effective sourcing
- Understand as much as you can about your internal capability, the external market capability and the drivers of suppliers
- There is real potential for significant misalignment of objectives between a customer and a supplier
- Contractual framework only goes some way to addressing this misalignment
- A contract tool that aligns supplier and customer initially, and continually adjusts over time, would be a good start. *I haven't yet found the silver bullet*

Managing transition to a service provider

- Treat it as a project
- Communication – honest, positive message
- Process is destabilising but exciting. It can be a good opportunity for people
- Do your own homework
- Don't transition until service is stable and testing is complete
- High level of co-operation is necessary

After outsourcing, governance should become a core competency

- Identify governance model well in advance of contract execution
- Ensure continuity of knowledge
- Educate the team to use the things you negotiated
- Have the means to monitor account performance and your supplier's general health
- Deal with under-performance and non-compliance
- Good governance equally communicates with, and manages the expectations of, internal business customers

Flexibility

- Banks change quickly – since outsourcing IT&T, WBC bought 3 businesses, sold 1, re-shaped 2, invested in new areas, growing organically
- Supplier needs to respond
- Transparency and modular pricing will help this
- Project capability is critical

Performance levels – incentives – remedies

- Service levels set the baseline for performance
- Incentives
 - we will pay you for services, but we won't reward you for doing what you said you would do
 - consider paying extra for tangible, measurable benefits – benefits that support the corporate objectives, eg cost saving, productivity improvement
- Remedies
 - \$ penalties often lead to negative behaviour, but it does focus the supplier
 - more effective - the right to remove services, re-tender
- Keep contestability

Pricing and price adjustments

- Break it down to components
- Transparency – know what the supplier's drivers are
- Flexibility:
 - plan for change to the company and the supplier
 - don't mortgage the future
 - maintain industry comparisons
- Tie payment to achievement



Westpac
Australia's First Bank