

Realignment of transaction processes is inevitable

An experienced partner can help a bank optimise processes by outsourcing, in-sourcing or smart-sourcing, writes banker and business mathematician Bert Kersten.



Bert Kersten,
principal consultant.
CMG Finance

□□□ There are two good reasons for financial institutions (FIs) to rationalise their transaction lines. One is because they have to, and the other is because they have to. Apart from the obligations resulting from the Basel Committee proposals, banks need to know the costs of their processes to be able to outsource, in-source, improve them or manage them in any other way. For both purposes, large amounts of data about the processes have to be obtained, combined and interpreted. That's where an experienced partner can be very helpful.

It is a classic example of an obligation turning into an opportunity. Following the recommendations of the Basel Committee, financial institutions face the need to rationalise their business lines. They will have to take a close look at internal assessment processes, assessing their various financial risks. If they want to comply with the Committee's new framework, banks will have to produce new information about their own processes before 2005.

systems and processes lack flexibility; they are unable to respond quickly and effectively to developments, like the euro and international competition.

In short, there are many reasons for banks to want to be able to manage their transaction processes as well as they can.

Beat the costs

Processing payments, credit requests and mortgages is expensive. What can the FI do to beat the costs? There are several alternatives.

Outsource the back office or, on the other hand, in-source transactions from competitors, as some of the largest Dutch banks have done and found to be a profitable procedure. In that case, economies of scale can be leveraged. Alternatively, resources can be shared with other financial institutions, they can be 'smart-sourced' (jointly managed), or the costs can be driven down by better organisation of processes.

Which is the best option? The only way to tell

□ Business mathematics can be used to isolate large differences between transaction costs at different banks or between processes within banks □

The science of 'getting to know the business lines' (business mathematics) is developing rapidly, not only because of the work of the Basel Committee. Financial institutions realise the importance of being able to translate their activities into manageable facts and figures. Transaction costs are increasing. Financial transaction processing produces little added value as a rule. Large investments in computer systems for processing the transactions risk being overtaken by new technologies. Often, the

is by comparing the present transaction costs to those under the possible solutions. That's where business mathematics comes in.

Business mathematics is a science that helps banks achieve operational excellence. Among other things, it can isolate large differences between transaction costs across different banks in different countries and across different processes within banks. ATM-transactions, for example, produce very few errors and, thus, few costs. The level of straight-through processing

tops 99.9%. Mortgages are much more prone to error, making them more expensive.

To judge backbone systems, key terms like 'standardisation', 'cost per transaction', 'run-through times' and 'error rates' have to appear. However, the back office cannot be considered as an undivided unit. It contains optical reading systems, fault-tracking systems, identifiers and automatic credit systems. Between the front and back offices is an intermediary system, translating the input into the right format to be used in back-office systems. Isolating different sub-processes makes them manageable and makes it easier to assess risks. The Dutch financial sector has progressed far in this respect.

Scale

Scale is one of the most important factors in achieving operational excellence. The payment division of Rabobank in the Netherlands, for example, has successfully built its internal processes on a cost based model, allowing it to process large numbers of transactions at relatively low cost.

□ Using international standards in front- and back-office systems is necessary to foster shopping around for the best and most cost-effective service provider □

Recently, the discussion about scale has found an international dimension. There is no reason why large banks or specialised service providers shouldn't compete cross-border to in-source the transaction activities from smaller competitors. According to a study by Gartner, only eight providers or banks on the global playing field will be able to survive transaction processing in the long run.

One of the important considerations in rationalising transaction processes is the choice of technical standards. The use of international standards in front- and back-office systems is necessary to foster shopping around for the best and most cost-effective service provider.

A partnership can be very useful for aligning

business lines and information technology. To measure the necessary business parameters, like transaction costs, information needs to be extracted from a number of mainframes, servers and other systems within the FI. A partner like CMG Finance integrates this information and transforms it into valuable business intelligence, and is able to in-source the processing of transactions and activities. Obviously, it takes knowledge of a bank's own cost structures to assess outsourcing offers.

Advantages

A partnership with CMG Finance can have more advantages. In the case of combining strengths between FIs nationally or internationally, CMG can locate the cooperating organisations in its extensive network. If necessary, it can initiate the exploratory talks and negotiations. In the past, CMG Finance has been actively involved in the restructuring of the Dutch banking market, where many FIs have been prompt in realigning their processes.

CMG Finance has been involved in outsourcing, in-sourcing and smart-sourcing projects. The

firm also manages many high-profile innovation projects. One of the main requirements in many projects is the development of an architecture that enables the FI to adjust its processes to future demands easily. For one client, CMG was asked to implement mobile banking, ensuring that transactions would be smoothly processed in the back office. An effective architecture allows new distribution channels or changes in transaction volumes.

In CMG Finance's view, a realignment of the transaction processes is inevitable for FIs in the years to come. Business mathematics, architecture design and other disciplines can help banks to ensure smart, flexible, cost-effective processes.

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About the author

Bert Kersten is principal consultant with CMG Finance and professor of business mathematics and computer science at the Free University Amsterdam.