

Outsourcing: It's Not Just About IT Anymore Why Cash Management is the Next Logical Step for Some Banks

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- A major U.S. financial institution wants to expand its lockbox network, but prefers to avoid significant capital expenditures.
- A regional cash management bank wants to expand its footprint in the U.S. and to broaden its offerings, but it can't afford the substantial investment required.
- A large international bank wants to offer cash management services in the U.S., but it lacks domestic infrastructure.

Left unchecked, these varied circumstances could generate potentially significant consequences — ranging from missed opportunities to deterioration of existing customer relationships.

Despite their divergent challenges, all three banks may consider the same solution: **private-label outsourcing**.

A concept most commonly associated with IT, outsourcing is becoming increasingly popular in other areas such as human resources, training and procurement. And more recently, “private-label” style outsourcing has been steadily gaining acceptance among banks that want to introduce or expand their cash management practices.

However, in many instances, the mere mention of outsourcing conjures feelings of uncertainty and discomfort as evaluators worry about its potential impacts on areas such as staffing and process control.

Private-label outsourcing is different.

When a bank pursues private-label outsourcing for cash management, in many cases, it wants to add completely new capabilities or supplement those it already possesses — not necessarily to outsource its treasury function entirely (although this is sometimes the case). So, the usual obstacles — loss of jobs, public perception and employee relations among others — may be of less concern in the decision-making process.

Also, the “private-label” aspect of the arrangement can make it all the more attractive to many financial institutions. They may choose to either actively market the expertise, resources and experience of their chosen outsourcer — or to keep the relationship transparent in the marketplace.

Its flexibility makes private labeling virtually a “one-size-fits-all” solution. It can meet the needs of well-established cash management providers who may prefer to market their enhanced capabilities under their own brands as well as smaller banks that want to leverage their relationship with a respected provider to attract new business.

Through BNY Mellon Enterprise Cash Management (Enterprise), which has provided private-label treasury services to nearly 70 financial institutions for more than a decade, The Bank of New York Mellon has learned a great deal about the factors that motivate banks to pursue outsourcing — and what hinders their participation. Herein, we examine a few of the many issues that senior bankers should consider when evaluating the potential to establish a private-label alliance.

What Makes Private-label Outsourcing Attractive to Banks?

Banks can achieve a new or more robust source of fee-based revenue. Nearly every financial institution that works with Enterprise, regardless of size and/or degree of cash management capabilities, agrees that increasing fee-based revenue is a — if not *the* — major factor in its decision to outsource. Whether they completely lack capabilities to begin with, or possess some basic or even advanced resources, nearly all aim to derive new or increased cash flow from customers who need cash management services.

Banks that offer cash management services can gain some reward for providing credit to business customers. One way that banks can grow their revenues is to enhance their returns associated with provision of credit. It is not uncommon for cash management banks that offer credit to their customers to be awarded business in return.

Banks can protect and grow current customer relationships — and attract new clients. If your bank lacks treasury capabilities to any extent, two factors are at play. First, your competitors always stand ready to take business away from you if you'll let them — and those with broader capabilities are more likely to succeed. Second, many companies like the simplicity inherent in consolidating relationships with fewer or even a single provider. And again, those equipped with more holistic financial solutions are the most formidable contenders.

Together, these two factors have led some Enterprise customers to introduce cash management services at least defensively to reduce the threat of having their valued customers wooed away. Some of these banks simply view cash management services as an insurance policy that they can use to thwart attempts to poach their business. And in many cases, it works.

Far more successful, however, are our customers who market these services proactively.

Banks find private-label outsourcing to be an affordable way to keep up with technology. More than ever, technology is crucial to quality cash management services — and the bar is raised each year. To meet market demand for advanced remittance processing capabilities, reliable fraud detection alternatives, image services and myriad other solutions, industry leaders invest millions of dollars annually in their infrastructure, expertise and development efforts just to keep pace. It's extremely difficult for some banks to compete in this environment. And, in view of volatile economic conditions, even larger institutions may need to delay expenditures on treasury capabilities so that they may support other core areas of their businesses.

Many banks find that outsourcing is the most affordable way to access the technology needed to support industry-leading solutions ongoing. This reduces the need for upfront investment (although there are still expenses related to startup, marketing, implementation, customer service, training, etc.) and it puts the onus for much of the continued maintenance, licenses and upgrades on the provider.

Banks can tap into specialized expertise. Like technology, expertise is essential to high quality cash management services. But many banks find that they can't attract highly qualified talent in the treasury field. Outsourcing to a specialist puts such expertise in reach for many small to midsized banks — and it can supplement the skills and knowledge of larger institutions that employ their own specialists.

Since the provider can allocate the expense it incurs for industry-leading expertise across its numerous customer relationships, the expense becomes more affordable for banks choosing to pursue private-label arrangements. And having access to a pool of experienced advisors can be very beneficial from a strategic point of view.

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Banks can better address ebbs and flows in customer demands. Banks that offer cash management services are often challenged by variations in transaction volumes, which are problematic for a few reasons. First, unless tiered pricing has been put in place at the onset of a customer relationship, declines in volumes will inevitably reduce revenue in proportion with any fluctuations. Simply stated, fewer items translate into lower customer charges. But fixed expenses for equipment, software licenses, real estate, salaries and benefits remain in place as you await the next peak period when your full resources will again be required.

When volumes diminish, outsourcing helps banks keep expenses in check by eliminating their fixed costs — all of which are borne by the provider and allocated across its many customer relationships.

Likewise if business picks up, some banks are challenged to keep pace with the associated upswing in processing requirements that may call for increases in staff, overtime pay and physical resources to get the job done. Again, fixed expenses remain but in this case variable expenses increase — sometimes significantly.

The advantage of outsourcing is that it may help banks address both sides of this delicate equation. When volumes diminish, outsourcing helps banks keep expenses in check by eliminating their fixed costs — all of which are borne by the provider and allocated across its many customer relationships. Thus, many concerns related to volume fluctuations may dissipate to a large extent.

And during peak processing periods, the outsourcer must deal with the need for increased resources for staffing and associated expenses. Thus, if you private label, and are aware of your pricing upfront, you may be able to eliminate surprises because your expenses are much more predictable based on volume.

Banks can redeploy resources to other key areas of their businesses. Like most organizations, your bank probably has limited resources — and competing priorities. So you are challenged to decide where to best apply your working capital to derive the most value. For banks that consider cash management to be a desirable offering, but need to focus first and foremost on other areas of their businesses where investment may generate higher returns or is otherwise necessary, outsourcing may be an attractive alternative.

Because it diminishes the upfront and ongoing investment that a bank must incur to operate a cash management practice, outsourcing largely alleviates concerns about resource consumption. Private labeling enables banks to channel their working capital into other key business areas as needed, while still delivering a top-quality treasury solution to their customers.

Banks can reduce / share risk.

There is risk associated with just about any investment that a bank makes these days. Changes in market conditions, regulatory impacts, and technological advances can be difficult to anticipate, let alone outpace.

To a large degree, outsourcing providers assume much of the investment risk on behalf of those they serve. This may help shield your bank from the uncertainties inherent in entering or expanding your cash management capabilities in a volatile and rapidly changing economy.

The “down side” of outsourcing

With so much good news, why aren't more banks taking advantage of private-label outsourcing? In talking with numerous banks, our Enterprise experts have learned that financial institutions often cite several concerns to overcome:

Fear of Losing Control Over Key Business Functions.

Some banks say that concerns about loss of control over the cash management function impedes their participation in outsourcing. While their rationale is clear, they may not realize that outsourcing doesn't have to be a pure "hand off" to an independent provider. Conversely, experienced outsourcers know that keeping the ties between their organizations and their bank customers constant, strong, and reliable is key to any successful relationship. Again, using Enterprise as an example, there are many mechanisms that can be put in place to help the bank maintain control over their cash management function — even when it is being delivered through an outsourcer:

- **Communication is key.** You should expect your outsourcer to be in near constant contact with your bank to keep you informed not only about day-to-day issues related to provision of services, but also about progress related to their product development, training and other support services. You need this information in order to respond to your customers quickly and knowledgeably and to support your marketing and business development efforts.
- **Dedicated support resources are desirable.** Your outsourcer should also be willing to provide you with dedicated resources that will enable you to tap into and influence their organization ongoing. Enterprise assigns each private-label bank a dedicated team of liaisons that is responsible for overseeing various aspects of the relationship with our customer. The team always includes a dedicated client support officers who helps resolve day-to-day issues; an implementation manager who helps with customer setup and related tasks; and a relationship officer who serves as a point of contact for broader issues that need to be addressed during the course of our customer relationship. Having established and accountable contacts in place provides the private-label bank with a reliable and accessible way to obtain information, voice concerns and opinions, and provide input into the outsourcing organization's processes.

- **Technology facilitates interactions between business customers and their banks.** As with just about any facet of today's business environment, technology plays an important role in giving banks more control over their outsourced services. Again using Enterprise as an example, these tools include:

- an automated feed into the bank's Account Analysis system, enabling each individual financial institution to construct and issue its own customer invoices and to control its pricing;
- Internet-based customer service tools that enable banks to track and actually view their business customers' cash management activity. Using these Web resources, our private-label banks can track and resolve customer inquiries on their own and actually log on to walk their business customers through processes where they may be having difficulty; and
- additional Internet tools such as Web-based forms that enable banks to prefill some basic but important information for repeat usage, thus eliminating the need for manual rekeying and thus saving time and effort over the long run for tasks such as addition of new services, service implementation and customer service requests.

In effect, customer relationships are always under the control of the bank, not of the private-label provider. As such, customer service, training, relationship management and other client duties remain with the bank, unless a special situation dictates otherwise.

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Some banks don't fully comprehend the private-label aspect of outsourcing. This is particularly true among marketplace leaders who would like to supplement their already considerable capabilities (in most cases for remittance processing) but are concerned that their reliance on another provider may diminish their reputations. What they fail to grasp is that, if they choose the right provider, it is they who control their customers' perception of how services are being delivered. In fact, many Enterprise customers choose not to reveal their relationship with our organization to their customers at all.

Instead they market the additional capabilities that we provide under their own brand. And, Enterprise often works to support those banks by providing them with materials such as demos, Web interfaces and brochureware that can be customized to support their marketing efforts. As a result, their Enterprise relationship is virtually transparent in the marketplace.

Some banks worry about quality. Again, these fears can be overcome. Clearly, banks considering a private-label arrangement need to thoroughly investigate potential providers. The providers should be able to supply evidence of industry leadership and ongoing quality performance, as well as customer references. Much of this information can be obtained via independent sources such as the Bank Leader Survey, the Phoenix-Hecht® Quality Index™ and individual bank's own customer satisfaction surveys (if they are independently conducted).

In spite of transparency issues, Enterprise has often found that its customers are willing to share their outsourcing experiences with other banks ready to make the leap.

Under certain circumstances, some outsourcing providers may be willing to establish service level agreements (SLAs). SLAs provide a mechanism whereby the outsourcer and its bank customers can agree upon and document acceptable performance levels and associated penalties/rewards that will be imposed based upon the quality results achieved by the provider. These

provisions included in the SLA can filter down to the bank business customer relationship, adding value and confidence to this relationship.

Some banks wonder if outsourcing is really worth the effort and associated expense. Based on the results we've seen many of our own customers achieve, Enterprise can unequivocally answer: yes, it can be worth it.

Banks that achieved the highest growth rates appeared to embrace a set of common business practices that contributed to their success. These included viewing cash management as a "strategic product" instead of a defensive one; classifying cash management as a "profit center"; establishing a dedicated sales force; and using credit as their lead product.

In addition, few customers jump off the outsourcing bandwagon once they have signed on — which indicates that they concur on the value of a private-label approach.

Some banks are concerned that the private-label outsourcer could compete against them. It's possible — but if the outsourcer is serious about remaining in the business, it won't. The reputation risk is significant. Regardless, you need to carefully select your outsourcer; here are some important points to consider:

- **The outsourcer's target markets.** Enterprise, for instance, is part of The Bank of New York Mellon Treasury Services, which focuses exclusively on the large corporate marketplace. Therefore, for banks that concentrate on the middle market, there is little to be concerned about from a competitive standpoint. We want our Enterprise banks to be successful in garnering business at the mid-sized corporate level because that is how we tap into that marketplace.
- **How the outsourcer's business is structured to promote confidentiality.** Some banks are worried about privacy, thinking that the information they provide to their outsourcer may end up being used to the outsourcer's advantage in a competitive situation. If you find that your outsourcer is indeed

competing for the same markets as your bank — but you still need its capabilities to supplement your own — it is important to understand how the outsourcer addresses such situations.

In Enterprise’s case, several precautions have been put in place. The private-label outsourcing business, for instance, operates as a separate unit within The Bank of New York Mellon Treasury Services. It has its own dedicated staff and operates behind a firewall in terms of its business development efforts. Separate bid meetings are held to “partition” the distribution of information and separate databases to store associated data.

In this way, opportunities where any potential conflict of interest could arise are carefully segregated between our corporate business and our private-label business so that no information of consequence is shared between those bidding on behalf of The Bank of New York Mellon Treasury Services and those assisting an Enterprise bank in its development efforts.

Additionally, as an added level of protection, The Bank of New York Mellon Treasury Services routinely provides contractual agreements that address confidentiality concerns.

- **The provider’s position on credit.** Enterprise banks find added assurance in the fact that The Bank of New York Mellon Treasury Services does not focus on the provision of credit to its cash management customers. This factor alone is significant in that it diminishes the odds of conflicts in terms of business development.

While working with non-bank outsourcers can also alleviate concerns about credit, this arrangement may not provide the advantages inherent in working with a financial services provider who possesses significant expertise in treasury and can thereby serve as more than a conduit for technology.

Find Out if Private-label Outsourcing Is an Option for Your Bank

If you are interested in introducing or supplementing your cash management services, ask yourself a few questions:

- Can we do it cheaper on our own and still achieve our desired level of quality?
- Can we control the costs for technology and distribution over time?
- Is this where we should invest working capital or are there other areas of the business where it would make more sense from a strategic standpoint?

Based on your answers, you will know whether pursuing a private-label arrangement may make good business sense for your bank.

To further facilitate your evaluation, we offer a series of whitepapers on private-label outsourcing issues. Each paper explores a different facet of outsourcing such as vendor selection, measuring the effectiveness of your outsourcing arrangement, tips for increasing your success and more. We hope you will find these publications to be useful.

Additional information can be obtained by calling us at **1 800 424-3004** (Option2) or by sending your inquiry to ecm@bnymellon.com.

About BNY Mellon Enterprise Cash Management

BNY Mellon Enterprise Cash Management is a business unit of The Bank of New York Mellon Treasury Services. For nearly two decades, Enterprise has provided cash management services to financial institutions of all sizes under a convenient private-label arrangement that provides access to leading B2B receivables, disbursement, information reporting and data exchange services. Whatever your organization's size, business goals or level of current treasury capabilities, Enterprise Cash Management can help you.

Enterprise's goal is to help your bank implement and/or expand its cash management offerings to:

- strengthen relationships with your business customers;
- increase fee-based revenues; and
- diversify income.

At your discretion, you can choose to actively market the cash management expertise, resources and capabilities you gain via your Enterprise relationship. Or you can take full advantage of our private-label capabilities through an arrangement that is transparent to the marketplace.

In either case, our leading treasury capabilities are supplemented by a full range of support services, including training, marketing support and skilled implementation management services.

Our full suite of cash management services includes top quality offerings for:

- B2B and B2C receivables collection
- Disbursements
- Data exchange
- Web-based information reporting and transaction initiation

Unlike other outsourcing providers that are not affiliated with a financial services provider, Enterprise combines the strength, reputation and resources of industry leader The Bank of New York Mellon, hands-on financial outsourcing expertise and access to today's leading technologies.

Find out more about BNY Mellon Enterprise Cash Management at www.bnymellon.com/ecm or by calling **1 800 424 3004** (Option 2).

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