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# Offshoring Payments Processing: Payments Experts Only Need Apply

By Jay Mehaffey and Bob Olson



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As the offshoring debate rages on many fronts, often lost in the rhetoric is the main rule of offshoring: *You should offshore only those functions that can be done better, faster, more cheaply and without unmanageable risk. All other functions, you should hold on to tightly.*

The corollary is: *You had better be certain precisely which functions are which. That sounds easy enough.*

As some philistine supposedly said of Michelangelo: “He had it easy — all he had to do was take a block of marble and carve away everything that didn’t look like David.”

And all your offshoring partner needs to do is to know as much as you do about your payments business, then carve away everything that does not need to stay. Simple, yes, but not easy.

Which takes us to the heart of what really troubles many bankers when they are approached by the leading outsourcers about their payments processing: “Do they really know my business?”

It is true that payments offshoring is eminently feasible. Columnist Tom Friedman in *The New York Times* (March 4, 2004) nets out the reasons for the rapid globalization represented by offshoring:

First is the massive installation of undersea fiber-optic cable and bandwidth... that have made it possible to globally transmit and store huge amounts of data for almost nothing. Second is the diffusion of PC’s around the world. And third... is the convergence of a variety of software applications... that, when combined with all those PC’s and bandwidth, made it possible to create global “work-flow platforms.”

These work-flow platforms can chop up any service job — accounting, radiology, consulting, software engineering — into different functions and then, thanks to scanning and digitization, outsource each function to teams of skilled knowledge workers around the globe, based on which team can do each function with the highest skill at the lowest price. Then the project is reassembled back at headquarters into a finished product.

Add to that the “around-the-clock” advantage of globalization, and payments offshoring takes on enough added appeal that many offshoring companies with little banking experience are setting their sights on the busy, increasingly automated and digitized back office operations of banks.

**...What really troubles many bankers when they are approached about outsourcing their payments processing: “Do they really know my business?”**



But offshoring of payments functions is a fairly new proposition for most U.S. banks. And like most new propositions, most of the pros and cons are still emerging, and it is easy to hype the pros. Offshorers new to payments processing can find it tempting to conflate the relative ease of IT outsourcing with apparent parallels in payments offshoring.

For example, it is not unusual for us to hear from our bank clients that one or another of the general offshorers has assured them something along the lines of, “You have 250 people in your Adjustments department? Consider them gone. We’ll take all that off your hands and save you 30% in labor arbitrage.”

Those who really know payments processing will find such a promise rash and unrealistic. Adjustments, like most other payments processes, is not a clump of simple, single-stroke, rote activities, but a linked set of serial functions ranging from the highly complex and sensitive to the simple and safe.

If your prospective offshorers don’t know the difference, they will see a block of marble with David all set to pop out from their aggressive chiseling. Pioneering may be an admirable stance for some innovations, but you do not want to be the practice partner of an offshorer new to the payments world.

Since we began helping U.S. banks with their payments offshoring opportunities, we have developed detailed business cases for sixteen large banks. We have focused mainly on six functions in the bank “back office”: Adjustments, Image, Proof of Deposit, Remittance (Retail and Wholesale Lockbox), Return Items (Incoming) and Exceptions.

Those are the large categories, but we do not build our clients’ business cases at the large-function level. In Adjustments, for example, we usually break out at least eight sub-functions (see table) before we estimate the offshoring business case.

Adjustments								
Sub-Functions								
Onshore/Offshore Considerations	Receive	Route	Research	Replenish	Reconcile	Respond	Recover	Report
IT Security Point of Entry								
Hardware Dependency								
Customer Interaction								
Privacy Concerns								
Vulnerability to Fraud								

Sub-Functions Table

...Pioneering may be an admirable stance for some innovations, but you do not want to be the practice partner of an offshorer new to the payments world.



Then we look first for reasons not to offshore. For example:

- Like many payment processing functions, Adjustments cases begin with what we call a Receive sub-function — the receipt of a paper or electronic file and its assignment to a caseworker with the appropriate knowledge, skills, access, clearance, and so on. Since point of receipt represents an entry into the bank, would offshoring Receive pose an undue IT security risk? If you wish to reserve judgment on whether some cases might be better off handled onshore, then you would keep the assignment activity onshore.
- Does the Routing activity (where pertinent records are sought and attached to the adjustment case for review by the caseworkers) potentially expose customer information to privacy concerns if offshored?
- Where do your main customer interactions occur? Which of those do you wish to reserve for your own in-bank personnel?
- As a case nears resolution, in the Respond and Recover activity, caseworkers need to make physical financial entries and balance to general ledger accounts. What does your experience say about vulnerability to fraud here? Are those sub-functions better performed physically within the bank, or does the offshorer have sufficient knowledge to institute appropriate safeguards?

And so on right through the entire function of Adjustments. Ultimately, if you are working with a knowledgeable offshorer, you may agree that about half of your Adjustments sub-functions are best left onshore — at least for the time being — while the others appear to be highly viable candidates for offshoring. That can, of course, vary somewhat by bank, so at every stage of your offshoring analysis there is always a sizeable premium on knowing the business intimately.

But for many offshorers, especially those who earned their spurs by offshoring software development or call centers, those fine distinctions are simply not visible enough from their macro-function perspective. It can be tempting for them to sweep aside those highly specific security issues and customer concerns in search of big savings in what appears to be just another largely codified, labor-intensive function.

After we look for reasons *not* to offshore, we help banks look for the opposite: Why would this be better offshored? We urge them to ask themselves these questions:

1. If I were setting up my bank back office today, is this a function I would create inhouse?
2. Would other companies hire me to do this function for them?

**It can be tempting for non-experts to sweep aside those highly specific security issues and customer concerns in search of big savings in what appears to be just another largely codified, labor-intensive function.**



3. Would the CEO of our bank be likely to emerge from the management of this department?

If they answer “No” to any one of the questions, offshoring is probably the right outcome for that function.

Building detailed business cases teaches a powerful lesson: In offshoring very little can be assumed from related experiences. You must know the bank, the business, and the function. It is true that our offshoring business cases at sixteen large banks across several payments functions are generally consistent: labor savings of a minimum of 30% and overall variable cost savings (including labor) as high as 67%. But unless you build from the bottom up — discrete sub-function by sub-function, you are, like the man who tried to walk across a lake with an average depth of three feet, in for some offshore surprises.



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