Chapter XXVII
Outsourcing Non-Core Business Processes:
An Exploratory Study

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ABSTRACT

This study examines corporate performance effects when banks outsource noncore business processes. Additionally, the article proposes that knowledge management process plays a significant role in determining the outcomes of outsourcing. Drawing from resource theory and knowledge management literature, the authors develop the concept of managerial outsourcing competence and then propose a conceptual model. Also presented is an exploratory study of members of the North Carolina Bankers Association to assist in identifying the business processes they are currently outsourcing and their principal reasons for outsourcing.

INTRODUCTION

Outsourcing has been defined as a results-oriented relationship in which a business organization transfers ownership of a business process to an external service provider rather than perform the activity in house (Halvey & Melby, 2000). For some, the hint of outsourcing may be found as early as 1776, when, in *The Wealth of Nations,* Adam Smith wrote the following: "If a foreign country can supply us with a commodity cheaper than we can ourselves make it…" (Adam Smith Institute, 2007). This may have been one of the hints of the forthcoming principles related to outsourcing and later building on Adam Smith's ideas was British economist David Ricardo and

his principle of comparative advantage, where he hypothesized that each nation should specialize in what it does best and trade with others in order to best meet their needs (Ricardo, 2004).

Certainly, the issues of competitive pressures, customer demands, cost efficiency, and the ability to gain access to world-class capabilities are considerations that have all manifested themselves in the increased use of outsourced functions. When the choice is made to outsource, and the move involves a vendor located in a different nation, outsourcing then becomes offshoring.

Business process outsourcing is another type of outsoucing that also relates to the investment of physical resources while still attempting to maintain internal effectiveness. In fact, one of the most commonly cited reasons for outsourcing is that management expects that they can gain cost advantages by hiring outsiders to perform certain services and produce certain products (Loh & Venkatraman, 1992). Banking activities that are not inherently or typically part of a bank's core functions are therefore logical processes thought generally suitable by management for outsourcing. Additionally, the implementations of such activities in-house can be prohibitively costly to smaller institutions.

For years, the financial industry has relied on the outsourcing of services where banks could seek advanced technologies and greater economies of scale while still lowering costs. It should be expected that the use of outsourcing will only increase as banks expand their product lines (e.g., Check 21 processing). Check 21 was specifically designed to foster innovation in the payments system and to enhance its efficiency by reducing some of the legal impediments to check truncation. More specifically, the Check 21 law that was created in 2004 introduced the notion of a substitute check, which permitted banks to process check information electronically.

Other methods of electronic processing have also been introduced to handle electronic check transfers. As an example, Amar Gupta and a team of MIT researchers have developed a fully electronic check transfer that can read handwritten infomation in order to increase check processing efficiency and accuracy, which may be of interest to countries outside of the U.S., where powerful banks are in a position to better control their overall check processes ("Gupta Eyes," 2007). Within the current process, check processing is an expensive prospect for banks due to the high cost of the technology required, and thus makes Check 21 processing a logical process to be outsourced by community banks.

In his March 17th, 2004, satellite address before the Independent Community Bankers of America Convention, Alan Greenspan stated, "Over the past 5 years, for every four bank mergers that have been approved, three de novo bank charters have been granted" ("Technology Outsourcing," 2005). Additionally, he added that 90% of all start-up banks will choose to outsource and that, overall, it is expected that all banks will use some type of outsourced services.

Financial institutions have been outsourcing technology projects for more than 30 years in their desire to reduce costs, focus on their core business, obtain knowledge, and increase efficiency and productivity. In particular, and within the past 10 years, the competition for customers and the consolidation of banks has brought these aforementioned issues to the forefront, as well as the need to outsource, both on and offshore, these activities in order to achieve the desired results.

Starting in the 1970s, the outsourcing trend began mainly with banks outsourcing software development and maintenance (http://www. financetech.com/showArticle.jhtml?articleID =17500105). Projects ranged from straightforward tasks such as application maintenance to complex long-term projects. Today, outsourcing large, complex technology projects is making a comeback, as evinced by J. P. Morgan Chase's recent decision to outsource their technology infrastructure to IBM.

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