



TARP Participation and Rising Unemployment: Implications for Outsourcing and Offshoring in the Global Economy

By Paul Duckham, Director, TPI

With more and more U.S.-based corporations receiving investments from the United States government, and with domestic U.S. unemployment approaching 10 percent, many companies are asking whether they should continue to leverage the global marketplace as part of their resourcing strategy.

WHAT IS TARP?

The Troubled Asset Relief Program (TARP) is a US\$700 billion United States government program designed to address the subprime mortgage crisis and strengthen the financial sector by purchasing assets and equity from financial institutions.

What are the implications of TARP for the outsourcing and offshoring aspects of sourcing in the global economy? The “*written rules*” for TARP recipients are clearly aimed at areas outside the bounds of outsourcing and offshoring. TPI finds that the unwritten rules and recent history provide the most clues as to how the global sourcing industry may evolve in response to TARP.

Although it is too early to provide a definitive answer as to how TARP will impact the future use of offshoring — in particular offshore outsourcing — initial indications are that many firms have cut back on both new and existing offshore initiatives. The power of political influence and public disdain for initiatives that exacerbate the domestic U.S. unemployment situation is significant.

We believe that domestic outsourcing will play a significant and increasingly important role in Financial Services firms’ service delivery models. At a minimum, the tenor of strategic

decision making is decidedly more balanced in considering the merits of offshore versus domestic work locations.

Buyers and providers of outsourcing services that currently or potentially have an offshore component are advised to seek regular updates from TPI as the TARP saga continues to play out on the global stage. Fact-based sourcing strategies that weigh the merits of offshore, nearshore, and onshore alternatives are available.

THE UNWRITTEN RULES OF TARP MAY SIGNAL THE FUTURE OF OFFSHORING

Once an institution has accepted TARP money (or is even discussing participation), a new level of public scrutiny begins at multiple levels. In addition to the potentially negative publicity TARP recipients may need to contend with, a new set of implicit, non-statutory rules appear to be evolving outside the public domain.

For instance, TPI has observed that many recipients of TARP funding have slowed down or stopped offshoring initiatives.

More recent news hints that there may be further pressure to reduce the use of offshoring. On February 5, 2009, the United States Senate approved changes to TARP that prohibit firms receiving TARP funds from paying bonuses to their highest-paid employees until after the government has been repaid. Then, on April 2, the related Pay for Performance Act of 2009 was passed by the United States House of Representatives. These two developments have stirred speculation that the Treasury Department will attempt to implement either explicit or implicit rules to encourage TARP recipients to invest in

the domestic economy and to discourage offshoring.

Finally, there have been several potential indicators at the U.S. executive level. The stimulus bill recently signed by President Obama initially had a strong “buy American” component that was subsequently watered down, due in part to concerns about potential conflicts with the World Trade Organization. (Language such as “consistent with U.S. international obligations” was inserted.) Then there are President Obama’s oft-repeated words to Congress indicating that he would like to “restore a sense of fairness and balance to our tax code by finally ending the tax breaks for corporations that ship our jobs overseas.”

Whether these citations of unwritten rules will translate into a movement away from utilization of global capabilities by U.S. firms remains to be seen. It is similarly unclear where the boundaries of a global corporation truly lie. The largest companies in the world, many headquartered in the U.S., are among the most prolific adopters of outsourcing and offshoring. These companies consider the world as their marketplace and find protectionist policies of individual countries misaligned with their global business models.

THE ROLE OF OUTSOURCING AND OFFSHORING IN GLOBAL FINANCIAL SERVICES

The Financial Services sector has a long history of outsourcing and offshoring. Today, leveraging the global marketplace is a key component of many firms’ technology and operations service delivery models. Currently there are extensive domestic outsourcing operations providing data center services, credit card processing, 401(k) administration, check processing and many other functions. Financial institutions routinely outsource to each other, “white label” products, and seek to find the optimal balance of internal and external resources to meet business needs.

Globalization has been driven by financial institutions seeking to acquire the appropriate capability and capacity at the right cost for their business models. Many of the larger financial service firms were pioneers at leveraging the global marketplace, establishing their own wholly owned overseas operations. Still more have leveraged third parties, initially for technology services and more recently for business process services.

How will TARP affect the prevailing model? Despite the current evidence that future offshoring initiatives may be discouraged, at least one TARP recipient is moving forward with globalization. JPMorganChase, who received US\$25 billion in funds, publicly disclosed plans to increase outsourcing to India by 25 percent. An article in The Economic Times (“JP Morgan told to explain India outsourcing plan” [March 20, 2009]) reported that 43 members of Congress had written the company requesting an explanation of its plans to increase outsourcing to India. In a letter addressed to JPMorganChase CEO Jamie Dimon, the Congressional members asked, “How should these American workers, many of them your consumers, be expected to have hope for a better future when the very companies they contributed to through TARP outsource the jobs they desperately need?”

It remains to be seen how this public scrutiny will affect JPMorganChase’s ultimate plans.

PROBABLE REGULATORY CHANGES WILL INCREASE DRIVE FOR MORE EFFICIENT OPERATIONS

Regardless of the future language of written and unwritten TARP edicts, a restructuring and expansion of the rules and regulations governing Financial Services is clearly on the way. It is likely that the overhaul of the regulatory framework will be significant, perhaps even radical. Within this context, it is reasonable to expect that some rationalization in currently overlapping jurisdictions will occur (state vs.

federal; banks vs. thrifts vs. credit unions vs. mortgage companies, etc.). Furthermore, it is quite possible that the scope of regulation will also increase, perhaps encompassing additional functions (insurance), entities (hedge funds), and instruments (derivatives).

Bank holding companies are likely to be the first subjected to a new regulatory environment. We foresee that regulations will become more onerous, and they will focus on risk and control related specifically to lending. Changes in regulations that restrict leverage and require more rigor in lending oversight will likely increase operating costs and reduce margins. This comes at a time when the government is also seeking to lower interest rates in order to stimulate the economy. These potentially conflicting imperatives will increase the need for firms to be efficient, which in turn will increase the focus on achieving the lowest-cost operating environments in order to remain competitive.

TPI POINT OF VIEW

There have been seismic shifts in the economic, political and risk environments facing U.S. financial institutions that should materially affect firms' business strategy, as well as the way they conduct all aspects of their business. In the long term, though, we deem it unlikely that this will alter the reliance of the Financial Services sector on outsourcing as a fundamental component of their service delivery models. We furthermore believe that the long-term trend is toward more globalization rather than less.

Given the evolutionary nature of the U.S. government's response to the financial crisis, it is likely that there will be a period of uncertainty as to the appropriateness of offshoring projects — whether offshoring to internally owned captive operations or to third parties. That situation presents an opportunity to reevaluate domestic alternatives and to revisit the solutions that have been implemented over the past years.

Firms should address these critical questions:

- Does the business case that supported past offshoring initiatives still make sense given the changes in risks that have occurred over the past few months?
- Has the decline in transaction activity and demand for new products and services reduced the need for offshore services to a point where the incremental overhead represents a material degradation of the labor arbitrage savings?
- Has a business or technology process been automated and reengineered offshore in such a way that it could now be repatriated at a materially different cost point than it operated at before offshoring?

The answers to these and other similar questions are what will determine forward-looking outsourcing strategies. This is the time to reconsider, rethink and react to the changes in business context that have disrupted the status quo. Firms that move quickly will be able to position themselves for the coming recovery and for growth.

LOOKING FOR A STRATEGIC PARTNER?

TPI's Financial Services experts can help you achieve your organization's goals through objective advice, knowledge of your industry and experience with arrangements from simple to complex.

Looking for a strategic partner? Contact **Brian Smith**, Partner & Managing Director, FSO Services, TPI, at +1 201 233 2384 or brian.smith@tpi.net.



ABOUT THE AUTHOR:

Paul Duckham, a member of TPI's Financial Services team, brings more than 20 years of practical outsourcing and offshoring experience to clients, from strategy development through transaction execution to ongoing management. Prior to joining the team he assisted a large automotive company with a huge outsourcing project from RFI to implementation. He then supported a large financial divestiture, which required numerous IT contracts to be restructured. Another project required Paul to recommend a governance structure for a business process outsourcing (BPO) contract for a large regional bank and then help create the key job descriptions. Most recently, he has led projects to outsource financial services back-office functions in retail and commercial lending, as well as customer service, to offshore BPO providers in India and the Philippines.

Prior to joining TPI, Paul spent more than 25 years with EDS, where he specialized in the financial industry, both domestically and internationally, including leadership roles in EDS Strategic Banking System, GMAC's Future System, and American Express Banks Global Banking System. Much of his career at EDS was spent on large development or implementation projects, where the risk of cost and schedule overruns was high. His assignments took him to Iran, New Zealand and Australia, plus many Asian and European nations.

Paul has a Bachelor of Arts degree in English from the University of Leicester, an HNC in Computer Studies from NE London Polytechnic and a Master of Science degree in Finance from the University of Texas at Dallas. He is also a certified Project Management Professional and earned an ITIL Foundation certificate.

ABOUT TPI: TPI, an Information Services Group company (NASDAQ:III), is the founder and innovator of the sourcing advisory industry, and the largest sourcing data and advisory firm in the world. We are expert at a broad range of business support functions and related research methodologies. Utilizing deep functional domain expertise and extensive practical experience, our accomplished industry experts collaborate with organizations to help them advance their business operations through the best combination of business process improvement, shared services, outsourcing and offshoring. For additional information, visit www.tpi.net.

Americas

Stephen Kopp
Partner & Managing Director
CFO Services
+1 804 513 1222
stephen.kopp@tpi.net

EMEA

Denise Colgan
Marketing Director, EMEA
+44 (0) 1737 371523
denise.colgan@tpi.net

India

Sid Pai
Partner & Managing Director
TPI India
+91 (98800) 77339
sid.pai@tpi.net

Asia Pacific

Arno Franz
Partner & Regional President
Asia Pacific
+61 0(2) 9006 1610
arno.franz@tpi.net