

Commercializing the Back Office at Lloyds of London: Outsourcing and Strategic Partnerships Revisited

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With the recent global recession, senior executives are desperate to cut costs from back office functions like information technology, human resource management, finance and accounting. Outsourcing these functions has been the primary cost reduction strategy for the past decade, and remains a viable option. But some innovative companies actually see the potential to participate as a *supplier* in the outsourcing space. Companies such as Lloyds of London, Bank of America, Barclays Bank, and BAE Systems have transformed high-cost, low-performing back office functions into commercial enterprises by partnering with key suppliers. The suppliers typically centralize, standardize, and web-enable the customer's back office processes, retrain, empower, and motivate transitioned back office staff, and leverage the assets to attract external customers. The results are impressive: lower costs, better service, and revenue generation. Of course, such radical transformation is never pain-free. We aim to help senior executives assess the viability of commercialization of their own back offices and offer eight lessons derived from one customer's experiences.

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Introduction

To many senior executives, back office functions such as human resources, information technology, indirect procurement, finance, and accounting are often perceived as costing too much, providing too little, and responding too slowly. Yet, their back office managers reply that these functions are, or could be, key contributors to competitive advantage. After all, human resources attracts and develops intellectual capabilities; information technology is critically ubiquitous in every business process; indirect procurement — which represents up to 80 per cent of a business' costs — must be aggressively managed to protect profitability; and of course recent events at Enron, WorldCom, Tyco, and others has taught us that finance and accounting are essential capabilities. What if senior management devoted substantial attention and resources to these back offices? Might their true strategic potential be realized? Could they even be commercialized to generate revenue?

In this paper, we discuss how innovative companies like BAE Systems, Bank of America, Barclays Bank, and Lloyds of London have actually transformed their back offices into commercial enterprises. Although the idea of commercializing a non-core function seems counterintuitive — if not downright absurd — it is hard to argue with results: these organizations reduced their back office costs,

improved their services, and generate external revenues through third party sales.

Commercialization of back office functions is viable because of the increasing market for back office services, also known as business process outsourcing (BPO). The Gartner Group, for example, estimated that the BPO market was \$119.4 billion in 2000 and projects the market to grow to \$234 billion by 2005 in the areas of human resources, payment services, supply, customer care, and finance and accounting (Scholl, 2002). Of course the market for IT services warrants its own numbers — an estimated \$250 billion market each year. Other research predicts even larger size of market figures¹. While many senior executives reading this article are, or will probably become, *customers* in this market, some might actually become *suppliers*. In this paper, we describe how several companies have commercialized their back offices through strategic partnerships, with special focus on the Lloyds of London/Xchanging deal. Senior managers will learn to assess the viability of commercialization, how to select a strategic partner, and what it takes to achieve commercialization. But even if readers ultimately reject the idea of commercialization, the paper offers many insights for reducing costs and improving back office services.

Examples of Back Office Commercialization

Some famous examples of commercialization include American Airlines' spin off of its reservation system through the Sabre Group in 1996 and General Motors spin off of its information technology capability, Electronic Data Systems, also in 1996. These success stories have been well documented² and are generally seen as examples of functions that were high-performing before commercialization. But recent examples of back office commercialization are intriguing because the companies' back offices were not world class; On the contrary, they suffered from high costs and poor service due to lack of investment, lack of leadership, outdated technologies, and duplicate and inefficient processes. These companies cleaned up their back offices *and* commercialized them by partnering with a supplier.

Consider, for example, Bank of America. During the past decade, the bank grew by acquisitions (Thomke, 2003), which resulted in over-staffed, idiosyncratic, duplicate, and incompatible back offices. In HR, management believed they could achieve significant savings through centralization, standardization, and downsizing. They chose to transform their HR operations through partnering with start-up company, Exult. The bank took an equity stake in Exult in exchange for guaranteed cost savings and significant

improvement in HR services, largely enabled by Exult's proprietary eHR platform. Bank of America was confident that their investment in this commercial enterprise would be successful because the market for HR services is strong. The Gartner Group, for example, predicts that the HR services market will be \$68 billion by 2005 in North America & Europe. The Bank of America/Exult deal, worth about \$1.1 billion over 10 years, provides Bank of America with shares in Exult's revenues from external customers. Thus far, Exult has won significant contracts beyond Bank of America, including a \$700 million deal with Prudential Financial and a \$600 million deal with International Paper (Cagle and Campbell, 2002).

BAE Systems provides another example. BAE Systems wanted to harness its massive indirect spend of over £900 million per year. BAE Systems sought to reduce spend through consolidating their buying power across its own 70 sites. Initially making inroads into this area, BAE Systems recognized that indirect spend could only be radically reduced if buying power was increased across organizations outside BAE Systems. What if they commercialized their back office? Certainly, the market seemed viable given that 60–80 per cent of the \$18 trillion business-to-business procurement market is indirect spend (Neef, 2001). Rather than commercializing themselves, they created a 50–50 partnership with Xchanging called Xchanging Procurement Services in 2001. During XPS' first year of operations, XPS already delivered the following benefits to BAE Systems: 12 per cent reduction across all categories of spend transacted, improved service, including user desktop ordering from a newly developed sourcing web portal, and shared revenues from new external customers, including such as Heywood Williams and Novar, the latter worth over £250 million (Lacity *et al.*, 2003).

Barclays Bank had a problem with one of its back office functions, namely, check processing. Check processing was in desperate need of new technology, but capital spending could not be justified because check processing volumes were declining due to increased uses of debit and credit cards. But the check processing business would never completely disappear, so something had to be done to revitalize the service. Senior executives at Barclays reasoned that other banks must be facing the same issue. Thus, there must be a viable market for shared check processing services. Barclays decided to commercialize their back office, but wanted a partner to help with the upfront investment and commercialization process. Barclays eventually selected two partners — Lloyds of London and Unisys. The three partners formed a new company called Intelligent Processing Solutions Ltd (IPSL), in December 2000. Unisys received 51 per cent of the shares, with the two banks initially owning 24.5 per cent each. The commercial enterprise was profitable the first year and currently has 67 per cent of the UK market³.

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