Refining Your Existing Staff Location Strategy

By Rashad Kurbanov and David Warfield
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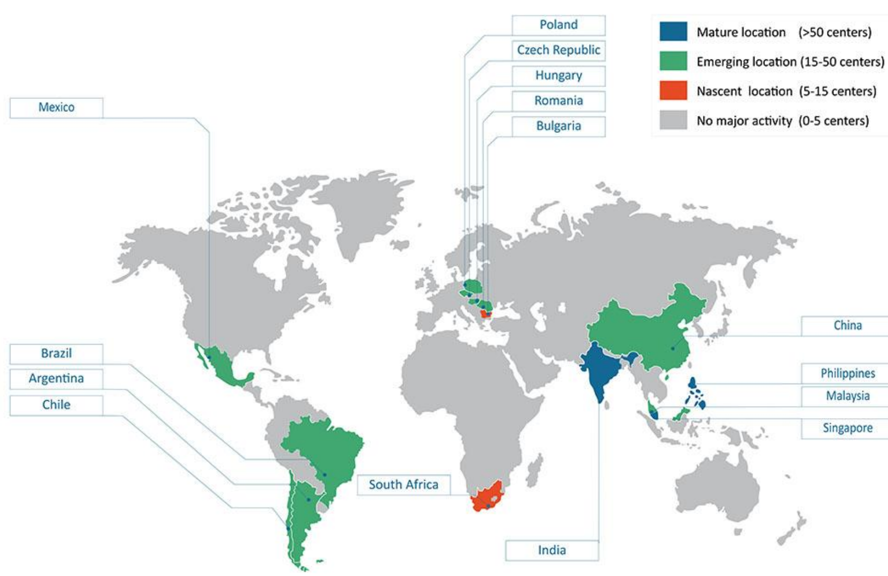
Difficult market conditions, increased regulatory obligations, and global competition are adding to the significant pressures on financial services firms to further reduce their operating costs. Over the past 10 years, many institutions have achieved substantial savings through outsourcing and/or offshoring some of their support functions. IT support, call centers, and transaction-intensive operational processes have been outsourced to large Business Process Outsourcing firms. Furthermore, most of the large banks have created their own captive centers in low-cost locations to maintain control and realize savings.

The savings from offshoring and outsourcing low complexity tasks have now been harvested. However, financial services firms still have a substantial support footprint and cost base representing close to 65% of the overall firms' headcount and 40% of the overall compensation costs.

While investments in better technology, business process optimization, and other similar initiatives offer opportunities to reduce the overall headcount, many firms are reluctant to pursue overly aggressive staff reductions in support functions fearing increased operational risk and regulatory scrutiny. In light of this, many firms are focusing on moving a portion of staff involved in more complex processes to locations outside of the major financial centers. This effort will reduce costs while maintaining the right staffing levels to support the business.

Figure 1: Hub locations outside UK and US providing support to financial markets firms



As Figure 1 highlights, the low-cost location option is still dominated by India. Alternatives include the Philippines and, at slightly higher cost, Eastern Europe. China is still in its infancy in terms of providing a high volume of support roles to financial services firms.

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Large financial services firms have traditionally focused on the latest low-cost location. The smaller institutions, which are often more constrained by their size, are focused on creating single, central hubs located onshore or near-shore. However, in light of political challenges even large financial services firms are now developing near-shore strategies to supplement their offshore deployments.

McLagan's recent study[1], *Workforce Deployment Analytics,* shows that location strategies differ depending on the size of the organization and business mix. Identifying the most appropriate locations and then obtaining access to low-cost, flexible, yet highly specialised expertise is becoming a key differentiator for firms that need to deliver the right balance of client service, for the right price, without increasing operational risk.

There are a number of factors involved in selecting the right location:

- **Time zone** – Must the location be in the same time zone as the onshore location? And, does the new location employ a "follow-the-sun" model? Many firms are blending operations in both near-shore and far-shore locations in order to service clients 24 hours per day. McLagan's *Operational Performance of Brokers* (OPB) and *Client Onboarding* surveys highlight the importance of a "follow the sun" model – with many buy-side firms pinpointing this as a business differentiator.

- **Language** – Some functions moving to a particular location require a certain level of language skills. Beyond language, some functions may require familiarity with cultural norms of the parent company's headquarters.

- **Ease of access** – Proximity to transportation hubs and ease of access are important determinants of the long-term value of a particular location. Access to and from the firm's regional hub is important for training, management oversight and control.

- **Labor market** – Staff with experience and an understanding of the relevant markets and products are often in short supply. It can be difficult to find the right person for the job if a region is immature or underdeveloped. In evaluating locations, institutions need to assess whether the local labor market has the required levels of experience and skill.

- **Competition** – The presence of many players in some markets may increase the competition for talent. Attrition levels keep recruitment at a continuous pace. One of the key questions to focus on is whether there are any other peer financial services firms entrenched in a particular location. If yes, then trained resources are likely to be available, alleviating the need to train new hires. However, financial services firms in these types of locations are likely to see higher attrition rates.

- **Long term viability** – Wage inflation and compensation dynamics in traditional low-cost locations may make them much less attractive in a relatively short time frame. Indeed, with some low-cost locations experiencing 10%+ annual compensation increases, financial services firms must now consider whether the required investment to deploy there will be recouped through long-term labor cost arbitrage. Firms must also consider the potential of productivity decreases from using staff in low-cost locations.

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[1] *Workforce Deployment Analytics* collects full time and affiliate (outsourcing and contracting) headcount to show various metrics including the proportion of staff in high / medium / low-cost locations.

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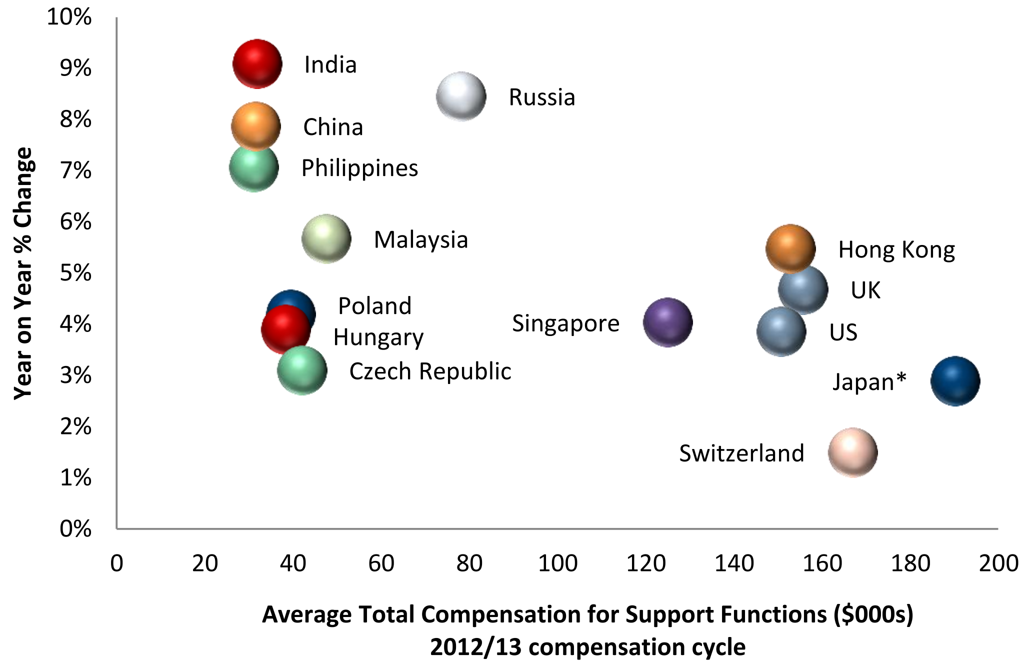
Figure 2: McLagan Year-on-Year Total Compensation by Country (Financial services)



* Note: Japan figures may be influenced by relative seniority of the grade pyramid

Once the initial deployment is complete, a common challenge still facing managers is the 8% – 10% compensation increase which must be factored into their overall cost reduction plans.

In light of the challenges above, many financial services firms are significantly expanding use of near-shore locations to supplement their long established offshore centers. For example, in the U.S. many firms are moving substantial parts of their operations to the Southeast and Midwest, while in Europe firms are looking to Eastern Europe for near-shore operations, focusing on Prague, Budapest or Warsaw. Many of these locations are in more convenient time zones, offer deep pools of talent, and experience significantly lower levels of wage inflation.

Progress is not uniform across the industry. McLagan's *Workforce Deployment Analytics* study found a wide range of deployment profiles. Having analysed the data from ten global banks, McLagan found a marked difference across firms in their use of low /medium cost locations:

- On average, financial services firms have deployed close to 40% of the full-time staff to low and medium cost locations.

- The range of deployment outside of high-cost locations is wide, spanning from 15% to 50%. Given that outsourcing is traditionally delivered from low-cost locations, results that include outsourced staff improve the picture. Since outsourcing is typically delivered from low-cost locations, the percentage of staff deployed outside high-cost locations rises from 38% to 45% when outsourced staff are included in the calculation.

Firms can choose to manage the resources in low-cost locations either directly or via a 3rd party. Only 3 out of 10 firms in the study use a 50/50 approach.

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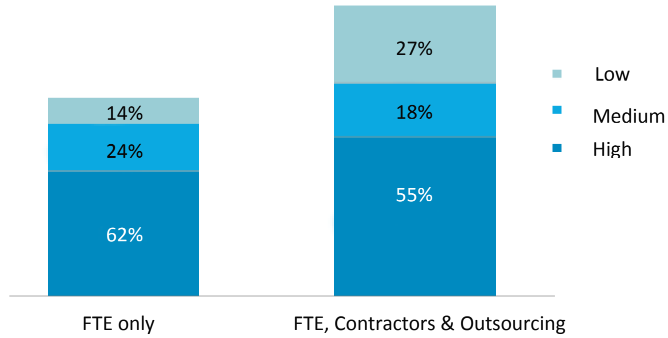
Figure 3: Proportion of Support Function Staff Working in High, Medium, or Low-Cost Locations



Targeting a 5 percentage point reduction of staff in high-cost locations (e.g., from 55% to 50%) and moving these roles to low and medium cost locations can make a difference without requiring a wholesale change to the business processes. The compensation savings are attractive on paper and represent as much as $40m - $50m annual reduction in compensation costs for a larger firm.

There are clearly benefits to be realized from deploying staff outside of high-cost locations:

- The largest savings can be realized by moving non-officer populations to low and medium cost locations. Specifically, non-officers compensation levels are 68% less in low-cost locations compared to high-cost locations.
- VP/Director level compensation differentials offer substantial savings with a 40% differential between low and high-cost locations, and 15% differential between medium and high-cost locations.
- Certain functions have even larger differentials. For example, Finance VP/Directors compensation levels are 20% lower in medium cost locations compared to traditional hubs .

A firm's ability to realize these benefits depends on its approach and commitment to leveraging hubs outside of the traditional financial centers. This is often expressed by the percentage of officers located outside of the high-cost locations. Furthermore, organizations need to assess which functions can be deployed outside of the traditional, high-cost locations.

Financial services firms may consider similar strategies for their front office staff. Despite a significant number of announcements and discussions about location, front office staff remains concentrated in high-cost hub locations. On average, firms have 81% of their front office staff in high-cost locations, 14% in medium cost locations and 5% in low-cost locations. There are clearly opportunities to be realized by identifying specific functional areas that can be deployed outside of traditional hubs (e.g., some elements of research, trading, etc.). Firms with a robust footprint in low and medium cost locations will have the required infrastructure to make this transition more seamlessly. Another important metric for the front office is productivity of headcount by location. This is discussed in detail in another McLagan paper, *Regional Performance and Rightsizing the Front Office*.

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Conclusion

Support functions are a key focus area for financial services firms aiming to realize further efficiencies and cost savings. Geographic redeployment is an attractive tool for achieving desired results while mitigating the operational risks that can stem from suboptimal levels of headcount. A large part of the challenge is to ensure appropriate levels of training for the staff deployed to new locations.

In pursuing benefits from deployment optimization, firms should focus on:

- Identifying attractive locations with deep labor pools, limited competition, and good infrastructure;
- Selecting the right mix of skill and experience level by evaluating how peer firms have set up their grade pyramids in the target location;
- Performing an annual position audit to measure the proportion of staff in high/medium/low-cost locations and gauge how these metrics are changing versus peers;
- Evaluating optimal Target Operating Models and assessing benefits/drawbacks of the centralization of those functions operating within a shared service center;
- Designing compensation packages to attract and retain qualified staff in desired locations;
- Quantifying the target savings levels to be realized from location optimization. This analysis should take into account specific migration paths, as well as location-specific analysis of compensation trends.

Ensuring that the right people are in the right locations is part of every firm's strategy. McLagan is in a unique position to use its market leading headcount, cost and compensation information to help firms execute their location strategies with a focus on maximizing the financial benefits and future opportunities.

McLagan is the leading Performance / Reward consulting and benchmarking firm for the financial services industry. Aon Hewitt is one of the leading compensation consulting firms, helping clients ensure their pay strategy is designed and executed to meet business needs, while focusing employees on what they need to do to help the company meet its goals.

GLOBAL CONTACTS

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