Knowledge Processing Outsourcing (KPO)

Transformation in the Operating Model for Fee-Earning Activities
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Summary

- Knowledge Process Outsourcing (KPO) is a form of outsourcing, in which knowledge-related and information-related work is carried out by workers in a different company or by a subsidiary of the same organisation, which may be in the same country or in an offshore location.

- KPO is now being used to transform the operating models for complex, judgement driven and fee-earning activities of a range of firms within Financial Services, Law and Pharmaceuticals.

- Growing maturity of KPO service providers is allowing firms to use KPO as an enabler of new operating models by securing access to alternative sources of talent, whilst addressing potential challenges of talent retention in their home location.

- India’s KPO market is forecast to grow by 25-30 per cent annually until 2013, driven by rising demand for professional services according to the global research firm Gartner.

An Introduction to KPO

A number of industry verticals are introducing the use of externally sourced KPO capabilities in their target operating models which can support fee-earning activities. This is in response to increasing pressure on financial performance and the need to maintain competitive positioning.

Leading organisations strive to retain their leadership role by constantly re-evaluating their strategy, performance and operating model. This is particularly true for highly competitive industries like Investment Banking, Insurance and the Law.

Investment banks were early adopters of new operating models which encompassed the use of externally provided services for their back office functions such as technology and operations. This change in the operating model was used to deliver cost savings, access to skilled resources and to offset the typical investment in training and retaining skilled staff. Investment banks also saw the potential to drive new operating models for other corporate-level functions by applying sourcing strategies to functions such as human resources, procurement and facilities management.

Insurance and Law verticals have also sought to change their operating models for group-wide functions by sourcing services from external service providers or developing captive shared service centres in low cost locations.
Early Adopters of KPO

Factors driving early adopters of KPO
The willingness of firms to embrace KPO was borne out of necessity to look beyond transactional support (business process outsourcing) and labour cost arbitrage when building a new operating model. Early adopters of KPO were driven by:

- Need for talent augmentation as competition for talent in home markets rose inexorably
- Requirement for a more flexible operating model to support global capability
- Extending the capacity and capability of the business to support client needs
- Addressing mounting cost pressures / margin erosion and talent retention

How the early adopters addressed key pressures
Initial adopters of KPO sought to address key pressures in their business model by looking to move more complex, judgement driven and information rich processes to off-shore locations. Banks set up captive centres in low cost centres to develop "super analyst" capabilities. This meant building capability in low cost centres (invariably India) by hiring high calibre graduates and then infusing this capacity with process knowledge and technical expertise from its onshore banking teams.

This provided incremental capacity to support the activities of the on-shore banking teams. This new approach enabled banks to unbundle complex quantitative and qualitative analysis often used to support trading and client coverage activity, to be selectively migrated to the low cost captive centres.

Developments of the early KPO model:
During the mid 2000’s some organisations began to pursue an alternative sourcing model for KPO services through the use of non-captive service providers. Leading European investment banks, encouraged by the success of being able to support complex knowledge intensive processes from off-shore locations, sought to drive greater value from this proposition through removing the management overhead of owning, managing and running the captive teams.
Multi KPO Sourcing Model

The Integration of KPO providers

The emergence of the KPO service provider universe was in response to the confidence of firms to re-engineer complex processes which embraced the use of third parties, and a growing maturity of firms in the KPO space in terms of their managerial, technical and delivery capabilities. Banks began to invest time, intellectual property and equity in supporting the development of the preferred companies in the KPO market place such as Copal Partners. The increase in the level of sophistication of work undertaken by KPO providers enables the recipient organisations to integrate the service providers’ staff and offering more fully into their day-to-day operations as increasing alignment of KPO resources became the norm.

The integration of KPO providers further into the value chain of clients enabled deep relationships to develop between the customer and the supplier. This enables the KPO service providers to gain deeper insights into their client’s needs, thereby allowing them the insights to refine their proposition. The success of the KPO space serving the financial services sector can be seen in the emergence and growth of companies such as Copal Partners, Evalueserve and Amba.

Figure 2: A selection of KPO providers
Growth of KPO Start-Ups

The success of KPO start-ups in attracting higher margin work from banking clients encouraged the entry of the larger, more established outsource providers to develop KPO propositions. Infosys, RR Donnelley and WNS amongst others tried to address the growing KPO market by developing competing competencies in the KPO space.

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The growing maturity of offerings from the KPO providers enabled banks to develop their KPO sourcing strategy to include multiple vendors and multiple geographies. The same war for talent which drove companies to source skills from off-shore locations eventually led to KPO firms having to establish new locations outside of their traditional low cost centres in India. KPO providers established a presence in countries such as Sri Lanka, China and Central America in an attempt to address the growing demands of their clients for talent, capacity and same time zone presence.

Much of growth in the use of KPO has taken place against the backdrop of a Financial Service sector boom. The subsequent turmoil in the financial markets since 2008 changed the demand for KPO services. The period since late 2008 has seen a retrenchment of some banks from multiple sourcing of KPO services. The lower levels of profitability arising from a more uncertain and highly regulated market place may yet cause a re-assessment of the appetite for KPO sourcing.
Case Studies
Using Sourcing to Deliver a New Operating Model

Global Investment Bank
The operating model for Corporate Finance client coverage teams typically consists of industry or product aligned groups of resources. The coverage team is responsible for creating client collateral to secure or execute client mandates. Each coverage team is provided with access to support functions who provide generic information sourcing and document production capabilities to assist the bankers in preparing client-specific materials.

The demanding nature of the role often leads to high levels of staff attrition which is both costly to the organisation and disruptive to the work effort. In order to address these financial and operational constraints, the operating model for the coverage teams was reviewed to understand the capabilities/deliverables of the team and whether these could be sourced from outside of the Bank.

The result of this analysis was a strategy to source the quantitative and qualitative skills from specialist knowledge process outsourcers, whose output was integrated into the daily workflow of bankers based in the on-shore location. The benefit of change to the operating model was an increase in the coverage and execution capacity of the banking team, the potential to reduce onshore team sizes and the enrichment of onshore roles by enabling more time to be allocated to client-facing activities.

Figure 3: A high level target operating model
Global Law Firm

Significant pressure on fees made it important for law firms to look at their underlying cost base to see how they could protect billing rates and margins. Due to the growth in capability of specialist knowledge process outsourcing providers for law firms, any review of the operating model for law firms can now be extended beyond the development of captive off-shore or near-shore operations to deliver group shared functions such as IT support, finance and HR activities. This includes support for fee earning activities such as the discovery process, litigation support and contract management. All of these can now be supported at a distance from the lawyers who are interacting with their clients.

Specialty Insurance Company

The process of determining an underwriting fee typically involves a complex set of interactions between underwriters, actuaries, catastrophe modellers and, depending on the nature of the risk, specialist risk engineers. The typical operating model for this activity would be to co-locate these resources, often at significant cost due to the need to provide ready access for brokers to meet with underwriters.

A specialty insurance business reviewed the growth strategy for the firm and made the decision to adopt a new operating model which involved locating the specialist non-underwriting skills in an alternative, lower cost location. To support this change in the operating model, a captive shared service centre was developed in an off-shore location. Specialist skill sets were then hired in the local market place and the workload was integrated into the work of the on-shore based underwriting teams.

![Figure 4: Key KPO Segments. Source: www.sourcingnotes.com](https://www.sourcingnotes.com)
The Future
KPO’s Role in Supporting Future Target Operating Models

Leveraging the insights and experience can help firms to accelerate the adoption of KPO into their new operating models

Innovative firms continually seek to exploit new business models and ways of working in order to achieve their strategic objectives. Developing new Target Operating Models which use KPO providers represents an opportunity for these firms to re-engineer a firm’s performance by addressing strategic issues around organisational flexibility (capability and capacity), improving cost performance and addressing challenges around access to appropriate skills. The challenge for many firms going forward is how best to take advantage of the opportunity to re-engineer their back and front office operating models through embracing the use of KPO.

Selecting a consulting partner who can support an organisation through the definition of a new operating model which embraces the use of KPO, and who can develop a complimentary sourcing strategy to source those capabilities, are critical decisions for any firm looking to change its front office operating model.
About Elix-IRR:

Elix-IRR is a strategic advisory firm specialising in all forms of transformation, change, operating models and sourcing strategies. It is comprised of senior professionals from consulting and services firms such as McKinsey, Deloitte, IBM and Accenture, as well as experienced practitioners from industry.

We provide practical, pragmatic advice that leads to real results.

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