PROFIT RESOURCES INCORPORATED

In-House vs. Outsourced Core Implementation

Points for Consideration and Evaluation

by Mike Neale

Frequently, PRI gets questions about whether it is better to be in-house with your core or to outsource it to a service bureau.

The truth is it really depends on the organization. It's an important decision and as Henry Watkins of PRI frames the question, "Technology remains the platform for financial institutions' fundamental solutions – products, delivery, customer interface, operations and accounting. This manufacturing floor should never substitute anything for quality and accuracy. The growing dependence on a digital delivery solution coupled with the lack of available resources for internal development of changing product solutions is a mitigating factor for many to choose a cloud-based or outsourced platform." When evaluating core implementation strategies, there are a few key areas of consideration as you consider the pros and cons of in-sourcing vs. outsourcing.

Application Support (Human Capital)

In general, the key points to consider are the trade-offs between the investments in staff with the expertise to effectively manage the application(s) as well as support end users versus the cost-of-service fees. Regardless of implementation type, financial institutions that have a higher level of expertise in their core and ancillary applications tend to have higher overall financial performance. That said, not every organization can source the talent needed to manage and support an in-house implementation in a cost-effective way. As Tom McGill of PRI asks, "Do you need to spend money on higher cost IT staffing in your core when your digital channel is where the most innovation is being demanded?" The trade-off in cost of human capital tends to be in higher processing fees from the vendor.

Flexibility & Agility

Frequently, we see staff and management of financial institutions that have moved from an in-house to an outsourced implementation develop a sense of relative deprivation as it relates to control, flexibility, and agility to effect changes in their core application(s). Service provider divisions of core vendors tend to deliver more of a "one solution fits all" experience that limits the complexity and service delivery cost for the vendor. This flexibility extends to the update release schedule as well. In-house financial institutions tend to have more control over the schedule as it relates to updating the core software. This flexibility, however, comes at a cost. Greater emphasis must be made on testing and implementation of the updates when an FI is in-house. Flexibility always sounds like a great thing, but as above, it comes with a cost. Be sure that both your strategic business plan and organization culture will take advantage of the flexibility before committing to the expense.

Compliance & Governance

As prudence would demand, in-house implementations typically also come with a higher overhead associated with compliance and governance. Outsourced clients tend to enjoy the financial advantage of a simpler, less costly disaster recovery strategy as the cost of the core hot-site is carried by the vendor and spread across multiple clients. This typically includes the cost and effort associated with the annual testing of the Disaster Recovery and Business Continuity Plans. Likewise, an in-house implementation tends to drive higher audit and compliance costs. For in-house institutions, audit scope is typically expanded significantly. While overall, compliance costs in-house tend to be higher, it should be noted that a more mature vendor management program would be expected when implementing an outsource strategy.

Growth & Acquisition

Historically, in-house licensing structures have frequently allowed growth without incrementally increasing cost. With current trends in the industry including licensing structures and increasing ancillary integrations, that is a less dramatic difference than before, but bears consideration in proposal reviews.

Infrastructure & Telecom Costs

Depending on the hardware required to support an in-house implementation as well as the size of the financial institution, the cost of infrastructure can be a significant component of the overall implementation cost. As it relates to telecommunication costs, each case can vary as to whether there is a significant advantage for either approach to implementation.

Vendor Pricing & Availability

In the current market, with vendors generally focused on recurring revenue, the historically lower licensing cost is becoming more and more a thing of the past. That said, properly negotiated, there does still tend to be a lower cost of software in an in-house implementation. Separate from the traditional core providers, there are a limited number of cloud native (read "outsourced only") core providers that do not even offer an in-house option. If the feature functionality and other key considerations of one of these providers leads you to select them, the implementation decision has already been made.

To the right is a summary matrix of the points above. While the matrix would generally appear to favor the in-house implementation strategy, it is important to consider that one of the most significant investments in an in-house strategy is human capital. With employee costs being one of the largest on virtually any general ledger, it should be duly considered in the matrix.

	In–House	Out–Source
Application Management HR Costs	Con	Pro
Audit Costs	Con	Pro
DR/BCP	Con	Pro
Compliance	Con	Pro
Release Flexibility	Pro	Con
Testing & Implementation	Con	Pro
Flexibility of Configuration	Pro	Con
Organizational Agility & Control	Pro	Con
Licensing Costs	Pro	Con
Infrastructure Costs	Con	Pro
Telecommunication Costs	Pro	Con

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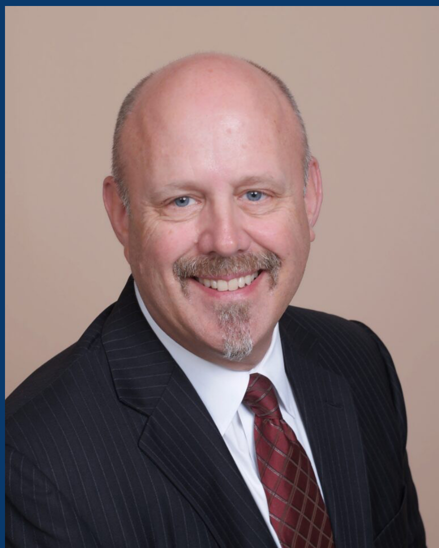
Summary

While an in-house implementation strategy does tend to provide greater flexibility, the payload for that flexibility continues to increase in parallel with regulatory burden, increasing labor costs and a greater desire by vendors to create recurring revenue. Twenty to twenty-five year ago, it was economically practical for a small community institution to utilize an in-house deployment. With the advent of digital banking channels as well as greater regulatory burden following 9/11, the asset threshold to make an in-house deployment economically feasible has risen. This has been a long-term trend and there is little evidence that it will change. While industry statistics are scarce, a 2014 Finextra article on automation indicates that 55% of small financial institutions utilize an outsourced deployment, with new sales for processing exceeding 77% for an outsource model.

As we think about the impacts of human capital when it comes to decisions about the type of deployment, be sure to think through where you want to make your investment. For the most part, many bank, save de novo banks, have already made a decision on this topic, so the context of the decision is change. If you are considering changing from outsourced to in-house, be sure you have access to talent with the expertise to do it well. If you are in-house and are considering outsourcing delivery of your core application, be sure that you've thought through redeployment or right sizing of staff.

Because of the gravity of the decision, it can be very helpful to engage resources outside the organization to objectively step through the process. With a broader view of the industry and expertise in what works and doesn't, these resources can be invaluable in identifying the strengths and weaknesses of either approach for your financial institution.



About Mike Neale

Mike is a management professional with more than 25 years of experience in organizational transformation and acceleration, specializing in financial technology and operations. He has served as CIO for multiple financial institutions and financial technology companies. In these roles, Mike regularly developed and lead execution of strategic business and technology plans including infrastructure design as well as assessment, selection, and negotiation of core and ancillary solutions. Throughout Mike's career, he has been effective at communicating strategic, tactical and operational planning from the board room to the server room and operational floors to meet organizational objectives.

About Profit Resources, Inc

Profit Resources Incorporated (PRI) strengthens financial institutions by improving profitability and efficiency, so that they can best serve customers, employees, and shareholders. By taking a hands-on approach to consulting, the PRI team of seasoned banking professionals makes a measurable impact on the bottom line through income enhancement and expense reduction. Established in 1990, PRI's expertise covers most areas of the financial institution including:

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