University of Southern Queensland

Prudential Regulatory Governance of the Risks Associated with IT Multi-Sourcing Strategies within the Australian Banking Sector

A Dissertation submitted by Brian Strong for the award of Master of Business Research
2014
Abstract

Concerns about the adequacy of the Australian Prudential Regulatory Authority (APRA) prudential standards to govern the risks associated with the Australian banks’ multi-sourcing IT service delivery strategies provided the motivation for conducting this study. Three research questions were developed to investigate prudential risk management in the banking sector of the Australian Financial Services Industry (AFSI). RQ1: Do the banks employ complex multi-sourcing solutions driven by business unit demands to deliver their IT services? RQ2: What are the risk and governance model/s used by the banks to manage risks associated with their IT services multi-sourcing strategy? RQ3: Is the AFSI IT operational risk exposure adequately covered by the current APRA risk framework and prudential standards?

The two largest Australian banks, Commonwealth Bank of Australia (CBA) and Westpac Banking Corporation (WBC) referred to as the ‘banks’ in this research are selected as the sample. CBA and WBC are the first and second largest banks when measured by capitalisation within the banking sector of the AFSI and represent 43 percent sample of the capitalisation value of the AFSI. Although profitable, the banks are under pressure from the market to reduce their cost-to-revenue ratio. One of the main strategies the banks employ to reduce IT costs is the outsourcing the delivery of IT services.

Over the past five years a trend has evolved with the banks using offshore-outsourcing to deliver IT services and gain further IT savings. However little empirical research has investigated what impact this trend has had on the risk profile of the banks and the Australian banking sector as a whole. This research identified and investigated the different IT services delivery models adopted by the banks by analysing on the relevant literature and documentation available in the public domain in relation to the AFSI. The findings of this research developed a picture of the IT delivery landscape within the banking sector of the AFSI. Findings of this research also demonstrates the complexity of the banks operational environment which can be attributed to the banks’ introduction of their IT multi-sourcing strategies. Finally the findings of this research raise some questions about whether the risks associated with an increasing reliance on IT multi-sourcing to deliver IT services is adequately managed by Australian banking sector and the regulatory framework of APRA.
Keywords

IT outsourcing, IT offshore-outsourcing, risk, governance, Australian banks, decision theories, Australian Prudential Regulatory Authority, BASEL, IT service delivery, multi-sourcing.
Certification of Dissertation

I hereby declare that this submission is my own work and to the best of my knowledge it contains no material previously published or written by another person, nor material which to a substantial extent has been accepted for the award of any other degree or diploma at University of Southern Queensland or any other educational institution, except where due acknowledgement is made in the dissertation. Any contribution made to the research by others, with whom I have worked at University of Southern Queensland or elsewhere, is explicitly acknowledged in the dissertation.

I also declare that the intellectual content of this dissertation is the product of my own work, except to the extent that assistance from others in the project’s design and conception or in style, presentation and linguistic expression is acknowledged.

During the course of the project, a research-in-progress paper was accepted for presentation as a poster at AMCIS and published in the conference proceedings: Strong, B, Cater-Steel, A & Lane, M 2014 ‘Prudential Risk Management of IT Sourcing Strategies: A Case Study of an Australian Bank’, 20th Americas Conference on Information Systems (AMCIS), Savannah, Georgia, USA.

Endorsed by:

Professor Aileen Cater-Steel, Principal Supervisor

Dr. Michael Lane, Associate Supervisor
Acknowledgement

My initial interest in this research topic was inspired by my experience in managing large IT outsourcing accounts for the largest global outsourcing providers. During my time delivering IT outsourcing solutions I saw ‘the good, the bad and the ugly’ from both the service provider as well as the customer’s side. Followed my twenty plus year career with service providers I moved into the customer side, some have referred to this as a ‘poacher turned gamekeeper’. I specialised in developing sourcing strategies, vendor selection processes and governance models for large companies. During this time I developed a multi-sourcing approach that involved mixing outsourcing and offshoring solutions depending on the services being purchased. Again during this time I saw ‘the good, the bad and the ugly’, and more importantly to this research, the downright dangerous approaches to solving business challenges.

Firstly I would like to provide my thanks to Professor Aileen Cater-Steel who from our first meeting in Sydney in November 2012 has always provided excellent counsel to a novice researcher. Aileen has that unique ability to guide a person so they deliver the best consistently. Without her support and mentorship I probably wouldn’t have even started on this path. Next I would like to extend my thanks to my associated supervisor Dr Michael Lane who provided the guidance I needed (not always wanted) to produce quality output with the most relevant materials that provided the needed foundation to my work. Finally I would like to thank Libby Collett who has great enthusiasm, but I am sure was bored while she proof read my dissertation.

To the most important people in my personal life, to my wife Trish for her support and encouragement during this journey. On the days when I wanted to pack it all in and return to my previous life she provided the encouragement I needed to keep going. To my daughter Ceara who although didn’t have to suffer my daily ups and downs did provide me with phone and text support. Finally I need to thanks those that provided informal mentoring support, David, Deirdre and Sharon. They probably don’t realise the support they provided but I thank them for their support.

Brian Strong

University of Southern Queensland
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**Abbreviations**

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>ADI</td>
<td>Authorised Deposit-taking Institutions, defined in the Banking Act 1959</td>
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<td>ADM</td>
<td>Application Development and Maintenance</td>
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<tr>
<td>AFSI</td>
<td>Australian Financial Service Industry</td>
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<tr>
<td>AMA</td>
<td>Advanced Measurement approach used to calculate the capital allocation for risk under the APRA and Basel risk framework</td>
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<td>APS</td>
<td>Australian Prudential Standard, standard used by APRA to govern all ADIs</td>
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<td>APS 115</td>
<td>Standard used by APRA to provide the framework and requirements for ADIs to meet the regulatory capital requirements when using Advanced Measurement Approaches (AMA) to operational risk management</td>
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<tr>
<td>APS 231</td>
<td>Standard used by APRA to govern who use or intend to use outsourcing as a mean of delivering services from a service provider to the ADI</td>
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<tr>
<td>APS 232</td>
<td>Standard used by APRA to govern ADI ability to meet its business continuity management function, also used in conjunction with APS 231 outsourcing</td>
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<tr>
<td>BCBS</td>
<td>Basel Committee on Banking Supervision</td>
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<tr>
<td>BCM</td>
<td>Business Continuity Management</td>
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<tr>
<td>BASEL</td>
<td>The committee responsible banking supervision and is part of the Bank of International Settlements based in Basel Switzerland</td>
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<td>BASEL I, BASEL II, BASEL III</td>
<td>Revisions of the accords developed by the BCBS to provide bank supervisory bodies with a framework to manage risk and capital and liquidity of individual banks</td>
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<tr>
<td>Captive</td>
<td>This is an industry term referring to where a customer sets up a centre in an offshore location and retains full ownership and utilises the customer brand</td>
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<td>CTB</td>
<td>Change The Bank, commonly used term within the banking industry, defined as application and bespoke IT solution used to provide innovation and transformational solution to the banks</td>
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<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
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<tr>
<td>GFC</td>
<td>Global Financial Crisis</td>
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<td>IP</td>
<td>Intellectual Property</td>
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<tr>
<td>KBT or KBV</td>
<td>Knowledge-based theory or view of the firm – Theory</td>
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<tr>
<td>Acronym</td>
<td>Description</td>
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<tr>
<td>KPI</td>
<td>Key Performance Indicators</td>
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<tr>
<td>MSA</td>
<td>Master Service Agreement, a legal and commercial group of instruments that defines how the engagement between the customer and service provider are governed and managed</td>
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<tr>
<td>NAB</td>
<td>National Australia Bank Limited (<a href="http://www.nab.com.au/">http://www.nab.com.au/</a>)</td>
</tr>
<tr>
<td>RBA</td>
<td>Reserve Bank of Australia (<a href="http://www.rba.gov.au/">http://www.rba.gov.au/</a>)</td>
</tr>
<tr>
<td>RBT or RBV</td>
<td>The resource-based view of the firm – Theory</td>
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<tr>
<td>RTB</td>
<td>Run The Bank, commonly used term within the banking industry, defined as infrastructure, core systems and support functions that are required to keep the bank running.</td>
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<tr>
<td>SIP</td>
<td>Strategic Improvement Priority</td>
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<td>SLA</td>
<td>Service Level Agreement</td>
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<td>SoW</td>
<td>Statement of Work</td>
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<tr>
<td>TCE</td>
<td>Transaction cost economics – Theory</td>
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<tr>
<td>UNCTAD</td>
<td>United Nations Conference on Trade and Development</td>
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<tr>
<td>WBC</td>
<td>Westpac Banking Corporation (<a href="http://www.westpac.com.au/">http://www.westpac.com.au/</a>)</td>
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