Recovery Tips

The True Cost Of Build Vs. Buy

Many companies are struggling again with decisions to build, buy or outsource regulatory compliance solutions, which go beyond federal to state, agency and investor.

By Camillo Melchiorre

As we think about the modern age of mortgage lending, the age old question to build or to buy technology solutions seems to be more prominent and perplexing in the modern mortgage banking age than in past. Once the digital revolution found its way into mortgage finance – despite valiant opposition – it has pushed technology strategy to the top of the agenda at board meetings.

Concerns run the gamut from seeking competitive advantage to regulatory compliance and everything in between. Then add the desire to improve the consumer's experience.

Therefore, it is no surprise that technology budgets are the fastest growing component of mortgage bankers' expense profile during the last two years.

While much has been written about this classic dilemma, and even more money has been spent on consultants to assist in the decision-making process, there is no hard-and-fast template to guarantee the correct decision.

There are, however, some guidelines beyond the standard template that may be worth considering to ease the pain of the process and at least help management ask the right questions.

Five Stages of Decision Making

In a recent conversation with the COO of a top 50 residential mortgage lender, he likened the decision making process of whether to develop proprietary technology for pre-funding QA and post-closing QC to the five stages of grief; denial, anger, bargaining, depression and acceptance. His honesty was as refreshing as it was revealing as he concluded, "Since we are now in the acceptance stage, you may expect an RFP in three months."

It was a tortuous process to first recognize a technology solution was needed and then to finally conclude that for their particular situation, buy, not build, was the answer.

The COO went on to explain that one of the lessons he has learned over time regarding technology strategies is that changes in the business environment are often misinterpreted as temporary instead of longer-term solutions, Band-Aids are applied. For example, when the Dodd-Frank legislation passed in 2010, many companies did not appreciate the gravity of the change in federal regulatory oversight. In turn, these companies did not realize the need for technology from a strategic perspective to help with the implementation of Dodd-Frank rules as they should have.

So, while some people may argue that exigency forced Excel spreadsheets, Access databases and other end-user programs to be deployed, their salve was temporary. The solution was temporary because it delayed a more strategic decision like purchasing software specifically designed for compliance.

Now, even eight years later, many companies are struggling again with decisions to build, buy or outsource regulatory compliance solutions, which go beyond federal to state, agency and investor.

Few of us with any experience in the industry have not been involved in these herculean struggles regarding the choice of a technology solution. And haven't we all enjoyed providing evidence for the axiom that the time to make a decision is inversely proportional to the desired implementation timeline?

"Hurry up and wait" and "It must be in production by yesterday" are often-heard during group commiseration time.

We all have seen the various formulaic approaches to the buy/build question, which are a necessary part of a complete analysis: ROI, TCO and other metrics that live and die by the assumption.

So where is the edge? What could be done differently in addition to the normal analyses and decision making that will increase the probability of success?

In the end, no matter where you land in determining whether to buy or build your technology, your final decision will only be as good as the questions you ask the vendors that you talk to.

What's Mine is Mine and What's Yours is Mine?

Notwithstanding the ROI on building proprietary solutions, a frequent variable that may get overvalued is retaining intellectual property and its corollary, establishing a competitive advantage. However, when it comes to cost in direct expenses and time associated with such an undertaking, companies have historically, and wildly, underestimated these projections.

Many times the build decision is driven by CTO zeal and not the discipline and self-awareness needed to make the best decision. Sometimes it simply comes down to an identity crisis: are we a technology company or a lender?

The CEO of a large correspondent lender explained the issue in the context of retaining and enhancing a legacy LOS or seeking an outside solution. "We have a stellar tech team that is capable of developing just about anything and if given the budget, they will."

Outside of analytics that everyone uses, these leadership decisions are probably the most critical. It is incumbent upon business leadership to force the issue and really determine the need for proprietary compared to off-the shelf solutions despite the sometimes strong push from internal IT to build.

While IQ (intelligent quotient) is indispensable; EQ (emotional quotient) may be the final differentiator between a boondoggle and a successful initiative.

Key Considerations: Pluses and Minuses

Here are some key factors to consider when developing a strategy to implement new technology:

Third-Party Tech Solution

Plus: These systems are typically written by the vendor with domain expertise in the product they have built.

Plus: Release updates allows all uses to take advantage of ideas from other customers that would be beneficial to all.

Plus: Spread the costs of regulatory items across the entire customer base.

Plus: With multiple customers using the same core package, there is a better chance of one customer finding a bug (not all systems have bugs) that can be fixed.

Plus: Typically, there is a dedicated budget to enhance the system.

Minus: Could be a challenge getting your secret sauce request prioritized because the company must consider its entire customer base for prioritization of enhancements.

Minus: Once installed, the vendor could raise prices, and it could sometimes be difficult to change the application if your company has other pressing needs.

Home Grown

Plus: Typically, any enhancements can be implemented faster

Plus: Your great ideas can remain proprietary to your company and not shared across the industry; however, this is a factor that is only valuable for true differentiators. For example, there is no advantage to having the best bankruptcy solution because the same laws/process apply to everyone.

Minus: If in a highly regulated environment, the company must spend money to stay current with regulations and do so without the help from a third party.

Minus: As organization change occurs, budget allocations can change overtime and if a company does not invest in its homegrown application, it can become an inhibitor over time.

Another common approach to turn the dichotomy into a trichotomy is to consider using multiple technology providers to deliver a solution. In the end, no matter where you land in determining whether to buy or build, your decision will only be as good as the questions you ask and the leadership strength you exert to coax out the best result. ❖

Camillo Melchiorre is President at IndiSoft. Columbia, Md.-based IndiSoft, LLC develops collaborative technology solutions for the financial services industry. Its flagship products, RxOffice Compliance and RxOffice Vendor Management, enhance risk-based assessment and help companies, including servicers and sub-servicers with increased regulatory concerns. The company provides efficient, reliable and scalable solutions.