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Keep It Simple
*How Banks Can Do
Less and Deliver More*



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EXECUTIVE SUMMARY

Banks have become overly complicated. Over the years, many financial institutions have grown rapidly through acquisition without fully integrating their new products, processes, and systems. This has resulted in complicated matrix organisations, as well as broad and sophisticated product offerings that are serviced by an array of incompatible IT systems. In addition, banks have made substantial investments in alternative distribution channels without significantly increasing value from branch networks.

This complexity has resulted in varying levels of customer service and inefficiency. From the customer's point of view, it is an unfortunate yet accepted fact of life that service from your bank can be less than ideal. In addition, over the past few years, the banking sector has not seen significant improvements in its cost-to-income ratio, despite cost-cutting efforts centred around consolidation, outsourcing, offshoring, and rationalising suppliers. Complexity has created inefficiencies which have eroded these benefits.

End-to-end simplification and a focus on activities that add value can help banks cut costs, enhance customer service, and improve customer retention. The benefits can be substantial.

IMPROVING PERFORMANCE BY REDUCING COMPLEXITY

Banks have significant opportunities to improve customer service and efficiency. Compared with productivity improvements in other industries, those in banking have been slow (*see Exhibit 1*). Over the last decade, productivity growth in the electronics industry grew by 182 percent; in the retail trade, it grew by 47 percent. In comparison, productivity in financial services grew by 14 percent. In addition, there is also a large variation in performance within the U.K. banking sector. Moving to best-in-class cost-income performance could result in up to 11 percent cost reduction across the U.K. banking sector (*see Exhibit 2*).

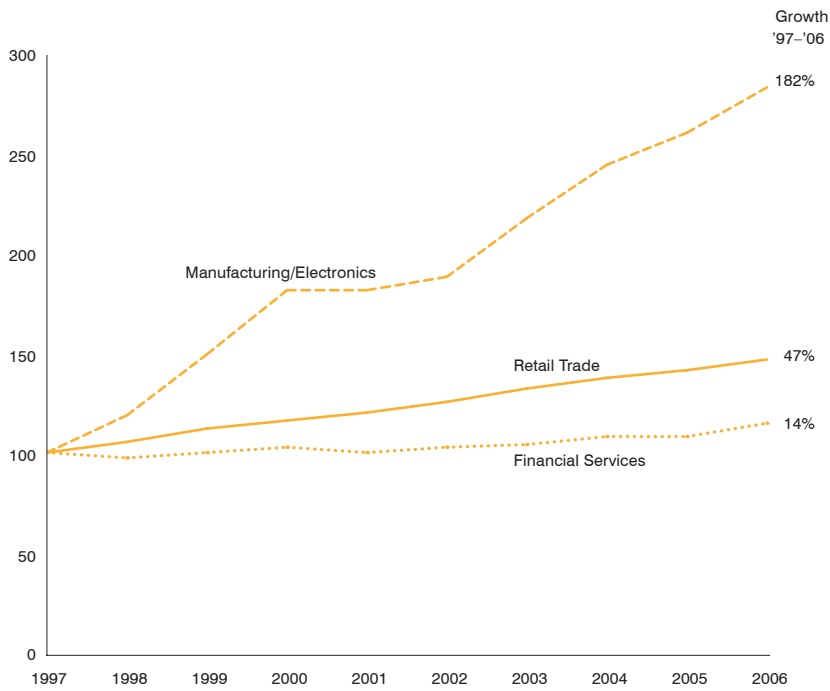
How can banks achieve this improvement? End-to-end simplification and a focus on value-adding activities help banks cut costs, enhance customer service, and improve customer retention. These measures also allow them to better position themselves for the wave of consolidation that is expected in the industry. Account opening will become a simpler process, for example. The simplification of IT and

back-office systems will enable front-end staff to get a holistic view of the customer and to focus on high-value customers to improve cross-selling and customer retention. With a simplified and flexible approach, banks can achieve more rapid, efficient, and sustainable growth.

There are four key areas of the value chain that are prime targets for simplification: product management, distribution, operations and IT, and organisational structure.

Product management—focus on core businesses and products. The aggressive acquisition and expansion strategies that banks have pursued over the last few years in a quest for growth have resulted in a wide range of business lines and a huge number of products. Management attention has been spread thinly, and focus on the core business has been diluted. Given the current market turmoil, it is more important than ever for banks to focus on the value-added activities in which they have a

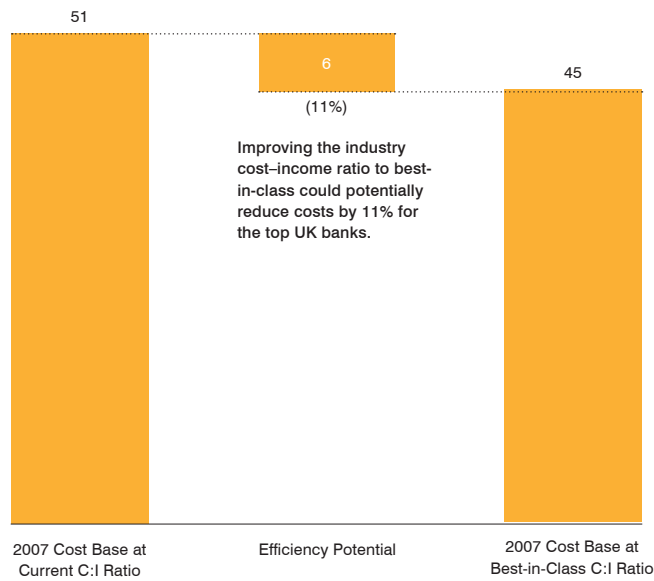
Exhibit 1
Labour Productivity Growth



Source: Bureau of Labor Statistics; Booz & Company analysis

Exhibit 2
U.K. Banks Can Move to Best-in-Class Cost-Income Performance

MAJOR UK BANK COSTS¹ AND REDUCTION POTENTIAL (IN BILLIONS OF POUNDS)



Average C:I ratio 50% 44%

¹ Includes HSBC, RBS, Barclays, and Lloyds
Source: Bloomberg; Booz & Company analysis; annual company reports; *The Banker*

competitive advantage. To do so, banks must do two things:

- **Cut out non-core business lines.**

Some banks have already begun the process of divesting non-core assets: RBS, for example, sold its stake in Tesco Personal Finance in the summer of 2008. In some cases, banks may have to discontinue poorly performing businesses they are unable to sell—just as HBOS did with The Mortgage Business.

- **Rationalise and simplify the product offering.**

One firm streamlined and modularised its product architecture, which led to simpler products which were easier to understand and sell. In addition, the company realised \$600 million in back-office cost savings.

Distribution—migrate low-value transactions to direct channels and focus on sales. Staff working in bank branches should not be spending their time cashing cheques for customers. The higher the number of simple, over-the-counter transactions branch employees are required to carry out, the lower the sales productivity of the branch (see Exhibit 3). Instead, banks should find ways to further shift the burden of routine transactional tasks away from branch staff and into lower-cost channels, such as call centres and the Internet. For instance, banks can create products

that influence customer behaviour, such as Internet-only or telephone-only accounts.

If the shift to direct channels is to be successful, banks should continue to improve self-service technology within branches and use employees to encourage customers to carry out simpler transactions themselves or through direct channels. Using these strategies, one leading retail bank increased its time spent on sales from 40 percent to 65 percent, leading to a 10 percent increase in sales (see Exhibit 4). Combining increased time spent on sales with simpler products can lead to an even larger increase in sales.

To improve the customer experience and help convert more leads, all sales channels should be integrated. This will ensure data is captured only once and that customers can be effectively and efficiently served through any channel. Although this can be difficult and costly to achieve, it should be the end goal. Customers want convenience and to be understood.

Operations and IT—capitalise on scale. Most banks have fragmented, non-standardised back-office processes, with different systems supporting different products and multiple small teams carrying out identical tasks on different sites. To create process utilities and capture scale benefits, banks need to simplify, consolidate,

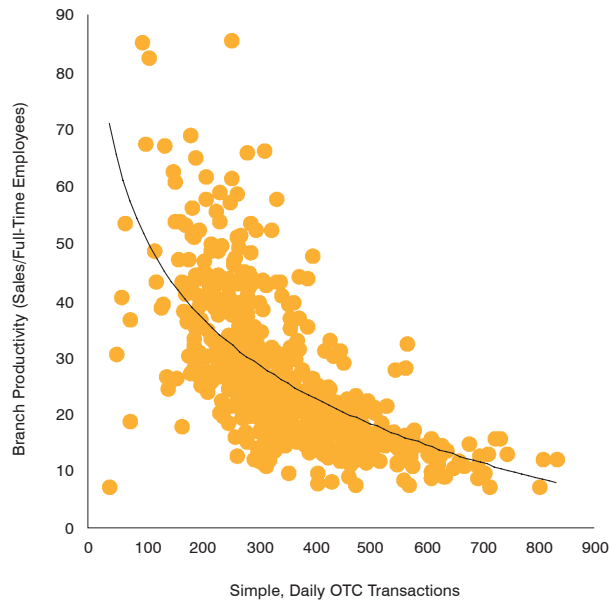
and automate core processes, such as account opening, within and across geographies.

This will not only cut costs but also reduce risk, improve turnaround time, minimise errors, and significantly improve customer service. For example, customers will be able to resolve many queries and account changes within a single call, and new product approval times will be much shorter.

IT systems must also be simplified and consolidated. Banks can create global shared services based on a global enterprise architecture and common policies and standards. The increased use of open systems, common applications, and a simplified application architecture will also reduce the complexity of the IT operating model.

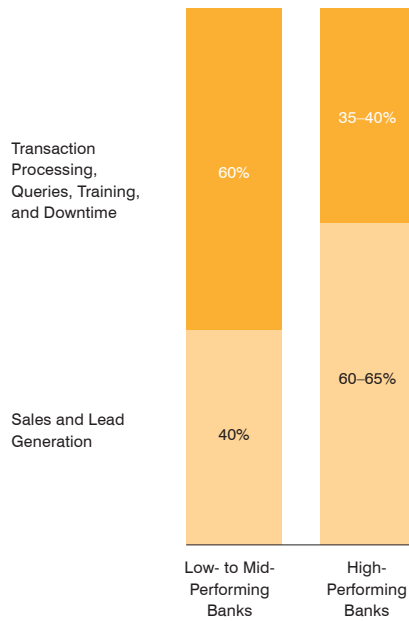
Finally, banks must look at rationalising projects: eliminating those discretionary projects which do not add a great deal of value, are not fully aligned with corporate or strategic objectives, and are poorly defined. The remaining projects should then be reprioritised, taking into account change and system capacity. This will allow the bank to focus more intensively on high-value projects. A streamlined approach to projects and project management will also build the capabilities needed for successful consolidation should the need arise.

Exhibit 3
Simple Transactions Performed Over the Counter vs. Sales Productivity



Source: Booz & Company

Exhibit 4
Branch Agent Sales Time



Source: Booz & Company

Organisational structure—clarify roles and accountabilities. In many cases, banks do not have a clear view of what their overall operating model is or should be—whether it should be centralised or decentralised. Nor do they have a clear view of the philosophy of the overall bank: For example, is it operationally involved in each of the business units, or does it operate as a holding company? In addition, banks have often oscillated between models over the years, and, as a consequence, are left with models which are unclear in the minds of their staff. Both centralised

and decentralised models can work well, provided the choice and guiding principals are clear, consistent, and well communicated. It all depends on the business and customer proposition. The overarching principle should be to keep it simple, with crystal-clear accountabilities.

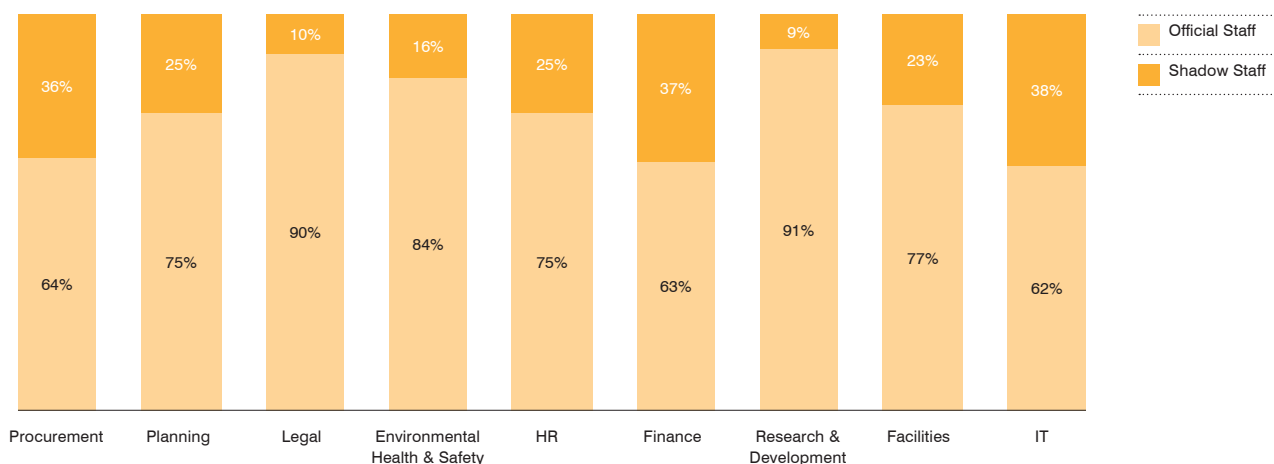
Organisational complexity has created ‘shadow staff’ that exist in most large businesses: the people who perform tasks which are duplicated elsewhere in the organisation. They perform a backup role, which leads to ineffectiveness and inefficiency by increasing

support head count. Another reason shadow staff are prevalent is that business units often show a lack of trust and respect for functions that they do not directly control. In banking, shadow staff can represent an additional 23 percent of support staff. In some functions, such as IT and procurement, they can represent well over 30 percent of official staff (*see Exhibit 5*).

To successfully reduce the number of shadow staff, banks need to address the underlying reason for their existence: In many cases, shadow staff

Exhibit 5
Shadow Staff Impact on Organisational Complexity

SAMPLE SHARE OF SERVICE STAFF: SHADOW VS. OFFICIAL



Source: Booz & Company

exist as workarounds for failed or inadequate processes in the service delivery model. If the problems within these processes can be addressed, the need for shadow staff disappears relatively quickly. In addition, spans and layers should be optimised to best-in-class levels. A retail bank reduced its human resources head count by 30 percent by centralising activities, eliminating tasks that didn't add value, and optimising spans and layers. One-third of the people identified as redundant left the bank within six months, a move which has not only increased efficiency but signifi-

cantly improved the service delivered to internal clients.

A key principle is to understand which activities require customer and business intimacy and which benefit from scale and consistency.

Business units often show a lack of trust and respect for functions that they do not directly control.

EMBEDDING THE CHANGES

There is always a danger that complexity will return and banks will need to keep doing one-off exercises. For example, one company cut head count at the corporate centre by 25 percent, only to have it to reappear in the business units. It is important to embed the changes within the company's culture and make simplification the *modus operandi*. In addition, senior oversight is required on a continuous basis to monitor results. This is an executive/director-level issue that must be led from the top.

To ensure the changes stick, banks must take several steps:

- Create excitement for the change and ensure support from top leaders.
- Communicate openly and frequently and reinforce messages and direction.
- Define clear accountabilities for driving and delivering the change.

- Implement the required governance structures to ensure swift decision making.
- Monitor and track progress against plan and escalate issues to senior management; ensure a clear feedback loop.
- Create role models who act as symbols for what the successful change has delivered and promote the change through measures such as newsletters and prizes for reaching targets.
- Reward success: Incentivise staff to adjust the way they work using development plans and remuneration.

Simplifying across the value chain has never been more important. Banks with clear business models and focus, along with simpler, transparent processes and systems, will be best positioned for future success. If in doubt, cut it out!

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