P E R S P E C T I V E

Banking Efficiency Beyond Cost Cutting

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It may only be a slight exaggeration to say that the financial crisis has divided the corporate world into two groups - companies that have gone belly-up and others that are striving to survive. For over a year now, business news has featured little else besides organizations' attempts to trim costs - through lay-offs, cutbacks, downsizing and other means.

For the banking industry, which finds itself in the eye of the storm, the need to raise efficiency has perhaps never been more crucial. Although cost cutting is the first thing that comes to mind, impulsive slashing of expenditure across the board could actually do more harm than good. While there are several ways to trim the fat, not all of them are appropriate for all banks. Banking institutions need to realize that there is no one size-fits-all solution to cost cutting; they need to do a great deal of analysis to arrive at the one that works best for them.

A successful banking efficiency optimization plan must look beyond mere cost cutting and draw upon a combination of the following strategies:

Raise cost consciousness:

Cost consciousness cannot be driven by the bean counters alone; rather, the entire banking organization needs to orient itself towards this goal. It is also time that banks looked beyond cutting costs in isolated pockets; for the needle to move, the philosophy of cost consciousness must pervade all activities at all levels. Top management must play a lead role in securing the buy-in of other employees, who must be encouraged to come up with innovative cost cutting possibilities in their sphere of work.

Increase process efficiency:

In recent years, Business Process Re-engineering (BPR) has been a choice mantra of banks seeking to transform themselves. Since banking is so process driven, the slightest inefficiency in processes can seriously dent the bottom-line. Therefore, banking institutions need to get their processes right. Unfortunately, a number of banks continue to struggle with legacy processes – designed at a time when markets were less competitive and customers less demanding – which are simply not efficient enough in the current context. These banks may need to consider a comprehensive transformation strategy to re-examine their processes, from design to orchestration, and overhaul them if necessary.

That being said, even non-legacy banks can find several avenues to improve process efficiency. The reduction of error incidence is an obvious target. Efficiency also increases when processes are rendered capable and robust enough to handle very large volumes of transactions without breaking down. Exception handling must be separated from routine processes in order to avoid operational bottlenecks.

Over time, cost inefficiencies may creep into banking processes by way of excessive overheads. An example is the use of the maker-checker principle, wherein one person is hired to perform an operation, and another to verify or authorize it. While this is justified for operations highly susceptible to security risk, when extended to routine or non-core processes, it only serves to drain resources. A key point is that excessive service level targets could also create process overheads. If customers are not to be kept waiting, the bank needs to maintain a larger service staff. During slack times, the overheads can begin to hurt. However, it is a tough call for banks to lower service levels in order to improve cost efficiency, since that runs a high risk of alienating customers.

Automation of processes can reduce both errors and overheads. An efficient process design tries to minimize manual intervention and enable Straight Through Processing (STP). Besides needing to employ fewer people to perform the same operations, banks can save time and reduce wastage.

Unfortunately, a number of banks defer or abandon their IT investment plans when faced with tough market conditions. This is detrimental in the long run, when most judicious technology investments start to pay back by way of higher cost savings.

Improve productivity:

Being colossal entities, banks need a huge amount of resources to keep them going. On the flip side, there are many opportunities to chop and trim – ranging from staffing to marketing to procurement.

The first port of call in the journey of productivity improvement is the utilization of human resources, since staffing costs form a large part of operating expenses. Large scale layoffs are not the only answer; banks can consider improving staff utilization by allocating cross-functional tasks or pursuing a flexible hiring policy.

Marketing budgets are usually the earliest casualty during tough times. Rather than do away with the activity altogether, banks can restrict their promotion to low cost media such as email or SMS. The use of social media, powered by Web 2.0 technology, is another inexpensive option for banks to interact closely with their customers.

The centralization of the procurement function can bring higher cost efficiency through better negotiated prices and rationalized order quantities. The use of cheaper alternatives is also worthy of consideration.

Productivity improvement can also be brought about through elimination of redundancy and smarter inventory management in less obvious areas. For example, many banks use a plethora of IT applications, performing similar functions, but working in silos. Banks don't just end up paying big money to maintain several applications – they need to spend even more to integrate and support them. An integrated universal banking solution can help banks overcome these and several other issues. In addition to pursuing low cost deposits to reduce interest expenses, banks can generate huge savings by managing their cash smartly. The reduction of cash inventory at branches and ATMs, and automation of cash handling are a couple of ways to do so.

The flow of information can also be made more productive by enabling self-help and automation, and consequently lowering the need for manual support. Tools such as information repositories, FAQ registers and process documentation can be used to make information more accessible to employees, whereas unassisted channels such as kiosks and Internet banking help customers become more self-reliant.

Although the sales team brings home the bacon, they too must do so at reasonable cost. Unqualified leads and lengthy sales closure add significantly to the cost of doing business. Clearly, sales activities must be underpinned by process excellence in order to yield maximum value.

Banks must also maximize customer productivity. While it is recognized that the top 20 percent customers contribute 80 percent of profits, what is less known is that the bottom 30 percent eat into the same. If productivity is to be maximized, banks must have a strategy to retire their nonpaying customers.

Migrate transactions to electronic channels:

Branches are banks' most resource draining channel, and hence, their capacity must be reserved for processing complex, high value transactions. Routine activities such as funds transfer, cash withdrawal or account opening are best handled online or at an ATM. Customers must be encouraged to transact on unassisted channels as far as possible. Given the savings that could accrue through the migration of transactions to alternative channels, the provision of incentives in the form of reward points or better rates to customers is also justified.

Once again, banks must train their eyes on channel productivity, and do away with redundant or non-performing channel elements.

Right-source:

The outsourcing of non-core processes to third party vendors can deliver the twin benefits of lower employee overheads and higher productivity among bank employees who can now focus their energies on the core business. Banks with smaller operations can also go down the shared services route.

Clearly, banks have found value in this approach. Two years ago, a study of 50 retail banks worldwide revealed that over three-fourths of the banks outsourced at least one function related to IT, support or back office. The study also showed that outsourcing of back office processes was most intensive in the payments, life insurance and mortgage segments.

Banks can also leverage the opportunity to outsource some processes to their sales and service partners. Agents that sell mortgage or insurance can be prevailed upon to complete some of the routine data entry or due diligence requirements, which are currently being processed at the bank. The creation of partner portals – which allow secure access to specific areas where partners can find updated information on their prospects or customers and the status of their transactions – can streamline this activity.

Outsourcing of IT operations, maintenance and development is another source of cost saving for banks. Although there is a preference among large banks to build their own applications, a shift towards off the shelf applications is predicted in the future. An interesting development is the emergence of the Software-as-a-Service (SaaS) model – in future, more and more IT applications could be delivered over a cloud, thereby reducing banks' outright investment towards software licenses.

Rationalize product portfolio:

Under pressure to attract or retain customers, banks have enlarged their product and service portfolio to appeal to a variety of segments. However, the sales of marginal products do not justify the considerable investment that must be made towards maintenance, promotion and support. Rather than build and own such products, banks can enter into smart alliances with other banks to promote their products for a fee. The success of Bancassurance is a good example of a win-win arrangement of this kind.

Explore low cost business models:

By employing a direct banking strategy to enter new markets, banks can defer the cost of establishing physical infrastructure until they are done "testing the waters". That apart, a direct banking model could potentially yield huge cost savings on a sustained basis, and hence, is worth trying out in other markets as well.

Summation

Important as it may be during good times, the improvement of banking efficiency assumes paramount significance during bad. However, this calls for more than cost cutting – an indiscriminate slash and burn approach will not provide the right answers. 80 percent of cost savings can come from 20 percent of expense items; therefore, banks need to do some careful analysis before arriving at those that present the best opportunity. That apart, they must institute a host of measures to ensure all-round productivity.

Needless to say, for any such drive to be successful, it must have the full support of the organization. It is the responsibility of the top management to inculcate a sense of accountability among their subordinates. More than ever, the buck stops here!

Reference:

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