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FINANCIAL SERVICES

Embedding Productivity Disciplines:

Why financial services firms need a lifestyle change that lasts

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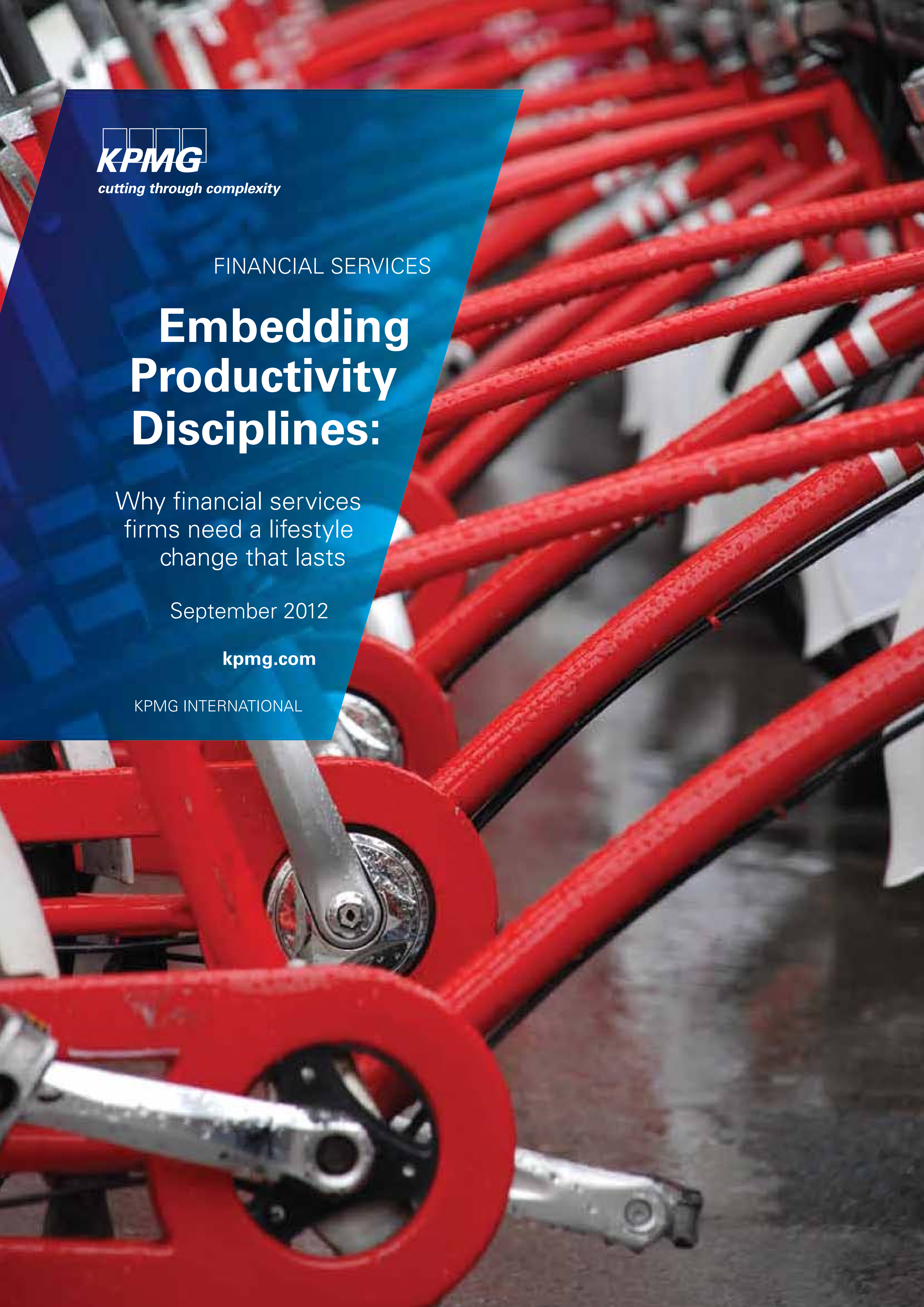

As any experienced weight watcher knows, crash diets do not work. Once you stop dieting, you just put the weight back on. It is much the same for organizations. Short-term cost cutting exercises rarely deliver long-term improvements. As Martin Blake, New South Wales Chairman and Partner, KPMG in Australia and Adrian Harkin, Partner, KPMG in the UK explain, it is much more important to focus on lifestyle.

By themselves, big programs of cost reduction rarely deliver sustainable improvements in efficiency. During the turmoil of the financial crisis, many financial services companies focused single-mindedly on cutting costs in an all-out effort to survive the recession. But, despite all this effort, costs are today rising again due to the increased cost of regulation, remediation of regulatory breaches and amortization of technology costs.

KPMG research into this cost boomerang has shown that there is a clear imperative for executives to re-examine their approach to cost-efficiency by turning their recession-induced crash diet into a sustainable lifestyle change.[1] This requires action in two areas. First, to keep the weight off, organizations have to maintain a tight focus on delivering ever-higher productivity, with excellence in continuous improvement being the key to maintaining the drive for productivity improvement. And second, in a business environment such as today's where revenue growth is constrained and everyone is working to reduce costs, smarter organizations are also focusing on the levers that can boost revenue by delivering the right business mix of higher margins and reduced capital intensity.

Achieving simultaneous success in these two areas depends on an organization's fitness and capabilities in a number of critical productivity disciplines.

[1] *The Cost Boomerang: How organisations can embed sustainable cost efficiency to drive competitive advantage*, KPMG 2011. Find out more: http://www.kpmg.com/uk/en/issuesandinsights/articlespublications/pages/the-cost-boomerang-1.aspx

Productivity Disciplines

As an adviser to many of the world's top financial services organizations, KPMG has been in a unique position to observe closely a wide range of productivity and cost-efficiency initiatives and understand why some succeed in delivering sustainable improvements, but many fail. Through the experience of working in the front-line, and with the benefit of extensive discussions with executives from over 40 of the leading financial services firms globally, we have worked hard over the past 3 years to understand and articulate the factors underlying the success or failure of these initiatives.

From all this experience and research, our conclusion is that, just as an Olympic athlete is unlikely to win gold without effective training and preparation, enterprises wanting to commit valuable capital and human resources to run in the productivity race should first look to their state of readiness in a number of key disciplines before they even approach the starting line. These productivity disciplines are:

Productivity strategy

This is all about the role productivity plays in delivering corporate strategy. Is the firm focusing on productivity as a key source of competitive advantage? Does revenue maximization remain the explicit (or implicit) goal? Does the firm regard productivity as a synonym for cost-reduction or does it recognize the importance of end-to-end efficiency and revenue generation?

Transparency of revenue and cost drivers

How well does the organization – and all its people – understand what drives revenues and costs? How well are these drivers embedded in performance management and management information systems? Alignment with people's performance measures is critical. If you grab people by their measures, their hearts and souls will follow.

Customer value-creation

How well do management and staff understand what the customer sees as value? Does the organization systematically deliver value to customers and eliminate those activities that are not value-adding – i.e. waste? Are operational performance metrics aligned to customer value, end-to-end across functional boundaries? In KPMG's experience, good customer service is actually 25 percent cheaper to deliver than poor customer service. But there needs to be a political appetite at the top of the organization to recognize the benefits and institutionalize change.

Continuous improvement

Most cost reduction programs are relatively ineffective over the medium- to long-term because they do not reduce the amount of work required per unit of output, so costs tend to grow back over time. Indeed, some short-term cost-out initiatives, such as project deferrals, actually detract from the medium-term performance of the business. Clearly, operating model change programs can create sustainable productivity improvements – for example, through removing duplication of functions, outsourcing and offshoring. But they are inevitably periodic in nature. By contrast, continuous improvement is an approach to running the day-to-day business, not an initiative. In our experience, leading organizations keep driving productivity improvement through a combination of sustained executive focus and support for team-led change through closed-loop learning and improvement cycles.

Investment management

How is investment funding allocated within your organization? Is it effectively a divisional/bottom-up bidding process with limited challenge? Are funding decisions fixed or are they able to change as circumstances change throughout the year?

Leading organizations use their understanding of revenue and cost drivers to create a line of sight between strategy, investment spend and benefits across the organization, so that investment decisions are based on, and aimed at delivering, the desired future operating model.

Tools and techniques

The key issue here is whether the organization has built up a way of doing things that informs and enables its people to understand customer value, to gain insight into the state of core processes, and to identify, evaluate and deliver opportunities for improvement. This means putting relevant financial and operational information in the hands of people who can interpret and draw insight from it in order to drive learning and improvement cycles.

Culture

A consistent theme of our research is that if people believe that 'nothing I can do will make a difference' or 'if we change, I may lose my job', then the effectiveness of any productivity strategy will be seriously challenged. People in the organization have to believe they will be supported and recognized if they come up with and implement ideas to reduce waste. Of all the productivity disciplines, the trust and willing engagement of staff is the most important. From our research, it is also the first to be sacrificed.

Driving customer value and productivity through continuous improvement

Dealing with the cost dilemma involves both innovation and a true and deep understanding of customers' needs and behaviors. Cost reduction exercises that pay little more than lip service to understanding customer needs are likely to be a dead-end, because unless we can identify where value lies, we cannot see what is waste. Once we can distinguish the waste, we can find ways to eliminate it without harming the customer experience. In fact, because wasted effort tends to slow cycle times, increase redundancies and create unnecessary customer contact, by eliminating waste organizations almost always improves the customer experience.

So what are the key elements of customer value in financial services? Our research suggests customers value:

- cheaper, faster services that respect customers' time and effort
- a secure and trustworthy relationship
- relevant, quality advice and support when it is really needed.

Financial services firms often fail to understand what prevents them from delivering the value customers expect. Yet it is possible to win customers at the same time as reducing costs by eliminating anything that is not directly satisfying their true needs - such as unnecessary form filling and extraneous customer interactions – while responding to customer requests right the first time, every time.

Implementation
An art, not a science

Crucially, any approach to embedding the productivity disciplines has to recognize that all organizations are different – with different legacy systems, operating models, governance arrangements, skill sets and cultures. This is why implementation is an art, rather than a science.

All the necessary productivity improvement tools exist and are well known – from LEAN to Six Sigma, from Zero Based Budgeting to Activity Based Costing/Activity Based Management, and from Listening to the Customer to End-to-End Value. But there can never be a straightforward manual that explains how this plethora of tools should be applied in any particular organization. Certainly it is logical to begin with a Gap analysis to understand the current initiatives already in place and to decide which of them are contributing to reaching the firm's strategic goals and target operating model, which are distractions, and what is missing. Thereafter, however, the skill lies in prioritizing the discipline areas and identifying which productivity improvement activities can be run simultaneously and which require a step-wise approach, taking account of any potential impacts in areas such as customer service and risk.

Of course, the emphasis on overall productivity inevitably involves trade-offs between costs and income and between different groups in the organization. This is why a culture of trust and willing engagement with the long-term interests of the enterprise as a whole is so important. But equally important is the ability to stand back, conduct end-to-end analysis that identifies how the organization really works, take fact-based, clinical decisions about how to move forward and then align everyone behind the new customer-focused, productivity-led approach. In this respect, change management skills are key.

Time to move to a sustainable lifestyle

Our research suggests it is time for the financial services industry to move beyond one-off initiatives and adopt a lifestyle change that lasts. This means a leaner and more customer-focused way of doing business in which learning and continuous improvement becomes the new norm, adding customer value becomes everyone's primary goal and directs investment, and tight cost control works together with innovative revenue generation to improve productivity.

This may seem daunting, but there is no realistic alternative. To survive, those organizations that do not have a system for doing more with less year after year will have to deliver significantly higher revenue growth than those that do – and such growth may be unachievable. In a low growth, capital-constrained business environment, continuous improvement in productivity is not an option, it is a strategic necessity.

Case study

Nationwide

Nationwide is the world's largest building society, with a relationship with one in four households in the UK. Given reduced interest margins, increasing costs and an above-average cost to income ratio, the firm wanted to improve its financial performance.

A combined client and KPMG in the UK team delivered cost savings of 15 percent while driving up customer satisfaction by 4 percent and staff engagement by 25 percent. As a result, KPMG won an award in 2012 from the UK Management Consultancies Association.

A structured framework and guide culture

Embedding Productivity Management Disciplines

		BASIC	FOUNDATION
Productivity strategy	**Focus on cost take-out initiatives**	Cost take-out and revenue maximization initiatives occur. There is limited resource prioritization process	Cost key to deliver organizational strategy, clear view of cost across organization
Transparency	**Disparate views of revenues and costs**	No clear responsibility for budget management, or approach to manage revenue or cost drivers	Cost information reconciled centrally, finance seen as owners of costs
Culture	**Bureaucratic and process-centric**	Rule driven behaviors, organizational units operating in isolation	Vision and strategy provide direction, but limited behavioral change
Customer value creation	**Limited, silo-based**	No systematic focus on, or understanding of, customer value creation	Focus on customer value adopted in some areas but not part of culture and not across the value-stream
Tools and techniques	**Basic financial management and data**	Basic levels of management information, cost management reactive, no clarity on approval processes	Clear management information, though not linked to performance drivers, basic planning tools employed
Continuous improvement	**Ad hoc approach to improvement**	Periodic, top-down driven programs to meet a cost reduction task, benefits often not sustained	Active operations management in use, focus on procurement and sourcing
Investment management	**Decentralized and uncoordinated**	Bottom-up initiatives driven through business units, limited challenge to investment decision	Top-down targets and challenges, synergies considered between investments that are identified as linked

to assess current capabilities change initiatives

COMPETENT	ADVANCED	
Clear cost management strategies and reporting of performance	Focus on better than peer cost to income performance – focus on top and bottom line performance and voice of the customer	**Superior productivity is a competitive advantage**
Rigorous budget setting aligned to strategy, effective process for assessing profitability	Accountability and reporting for cost and revenue drivers	**Understanding of revenue and cost drivers**
Increasing behavioral change but constraints remain in management systems and middle-manager attitudes	We earn our customers' business and value staff initiative to improve customer advocacy	**Empowered and customer-centric**
Value delivered across a few major value streams, aligning activity to the voice of the customer, and eliminating waste	Systematic approach to customer value is part of how we think and act; successive change cycles achieved across value streams	**Driven by voice of the customer, across the value-stream**
Integrated management information/financial reporting, clear view of group programs, lean/economic value added/ return on risk-adjusted capital regularly deployed	Internal and external benchmarking drives improvement; well-established and accepted methodology	**Leading edge techniques driving decisions**
Increasing focus on distribution productivity, overall effort remains periodic, silo-based	End-to-end improvement cycles driven by greater insight into revenue and cost drivers	**Closed-loop learning cycle institutionalized**
Group-wide clarity of vision and strategy, business case development aligned to investment strategy	Effective financial scenario planning, strategic investment decisions based on future operating model	**Integrated, robust assessment and decision-making**

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