Enabling employees to drive bank effectiveness and efficiency

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Introduction

Banks' cost-to-income ratios have risen since the pandemic, reversing a downward trend. As banks renew their cost optimization efforts, employee productivity is a key battleground. In this article we discuss the performance of cost-efficient banks, and the levers available to reduce cost.

Cost transformation has been elevated to a new level since COVID-19. During the pandemic, there was an understandable shift away from cost reduction to supporting financially-stressed customers. Operational costs rose for a number of reasons — such as enabling work from home, as banks funded both telecoms and hardware for employees, while still bearing the fixed costs of often empty or underpopulated branches and offices.

According to the 200 bank executives surveyed in KPMG International's recent report New cost imperatives in banking, cost management is rated a "top concern", with 61 percent saying that cost reduction has become a higher strategic priority since the pandemic.

Even though two-thirds of respondents set a cost savings target of more than 10 percent of their cost base between 2021–2024, they also conceded that such aims may be hard to achieve; less than half felt their organizations had achieved previous cost goals.

To gain a clearer picture of how banks are tackling cost, KPMG carried out in-depth benchmarking of the cost performance of 60 large banks across the world between 2014–2021. We identify the drivers behind their performance, and discuss how banks can improve their productivity and boost their returns.

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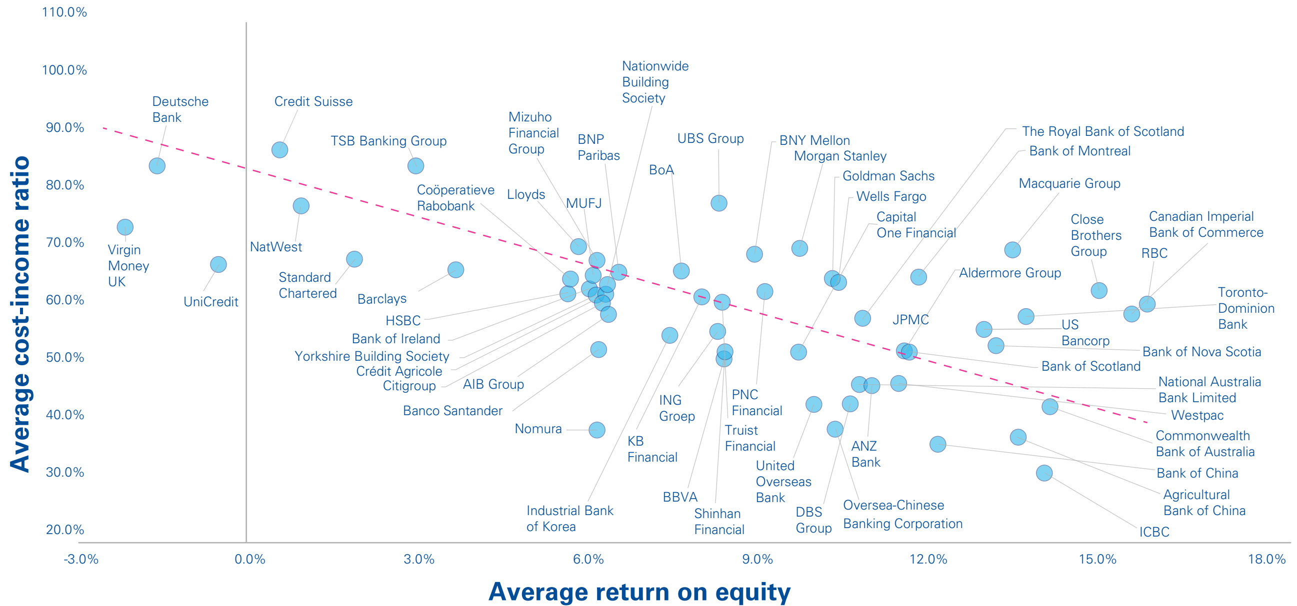
Cost efficiency performance

Our benchmarking findings (60 large banks across the world between 2014–2021) reinforce the importance of cost efficiency, finding a strong correlation between cost-to-income ratio (CIR) and return on equity (ROE) for this large sample.

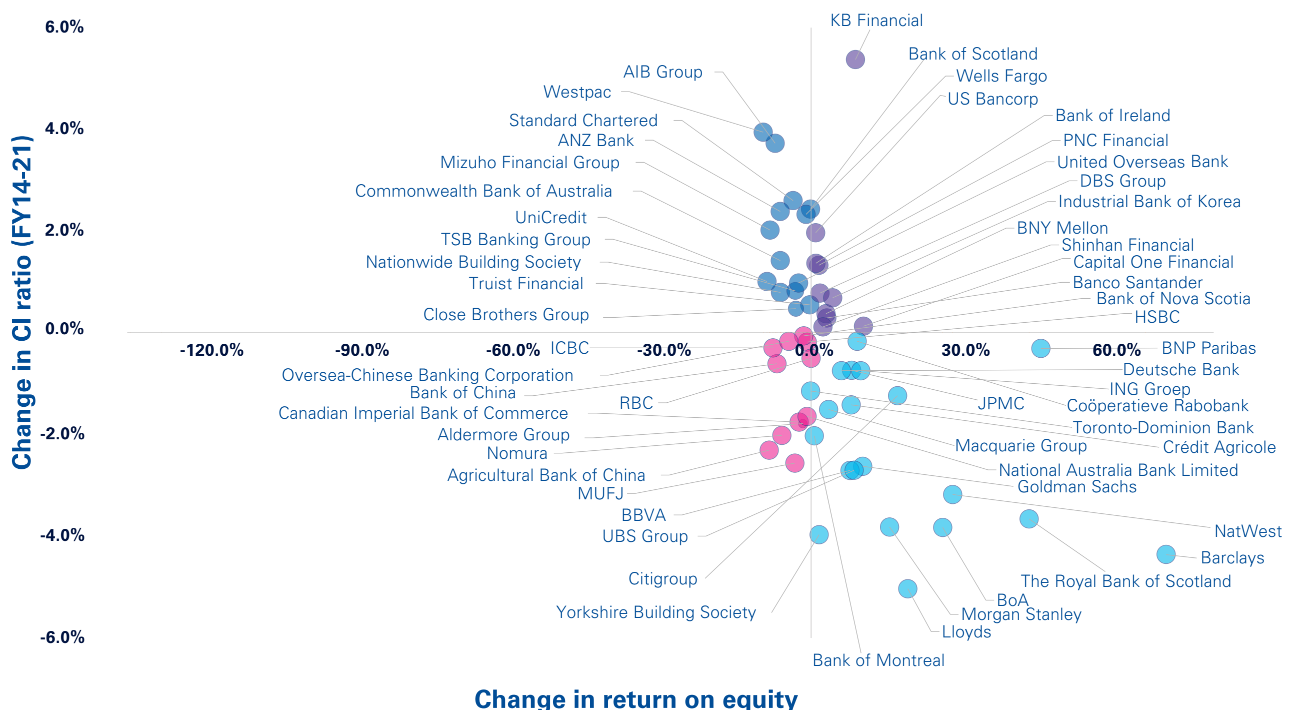
Cost-efficient banks deliver higher returns than their less-efficient competitors



Source: CapitalIQ database; KPMG analysis

It's therefore little surprise that banks who can improve cost efficiency typically enjoy a subsequent increase in ROE — while those whose CIR falls see a decline in equity returns.

Improving cost-to-income ratio (CIR) increases ROE — and vice versa



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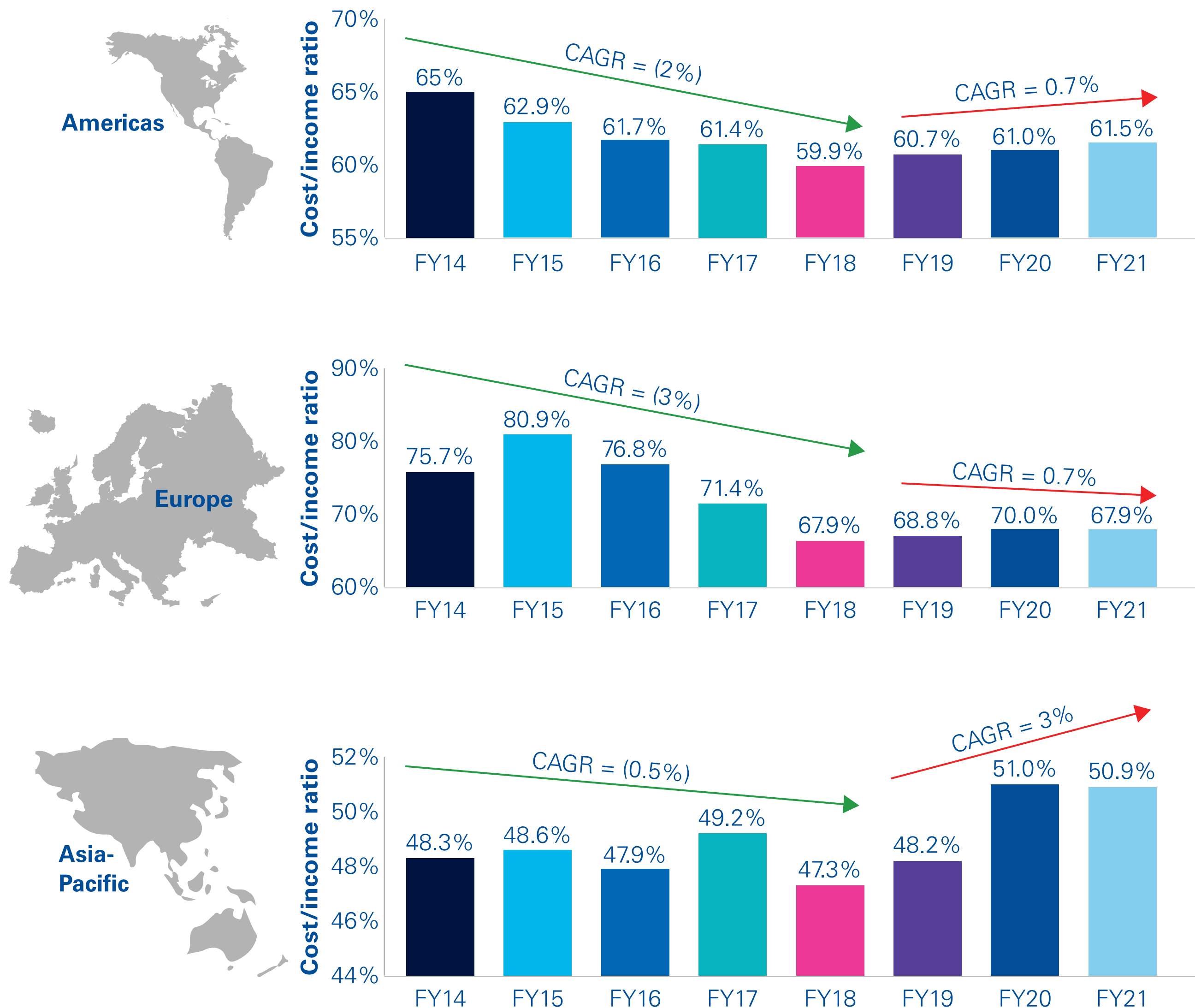
Given the importance of cost, the banking sector's pre-COVID performance could be described as moderately successful, with CIR falling from 64.9 percent to 60.8 percent between 2014-2019. Since the pandemic, however, costs have crept up again to 61.6 percent in 2021 — a trend observed across all regions. This primarily reflects higher staff costs (higher volumes of customer enquiries, higher absenteeism), increased technology costs (accelerated digital development, cost of telecoms and hardware to support working from home) and higher levels of loan loss provisioning.

CIR fell consistently pre-COVID but has since risen slightly

CI ratio, interest income, non-interest income and expenses, FY14–21, by regions



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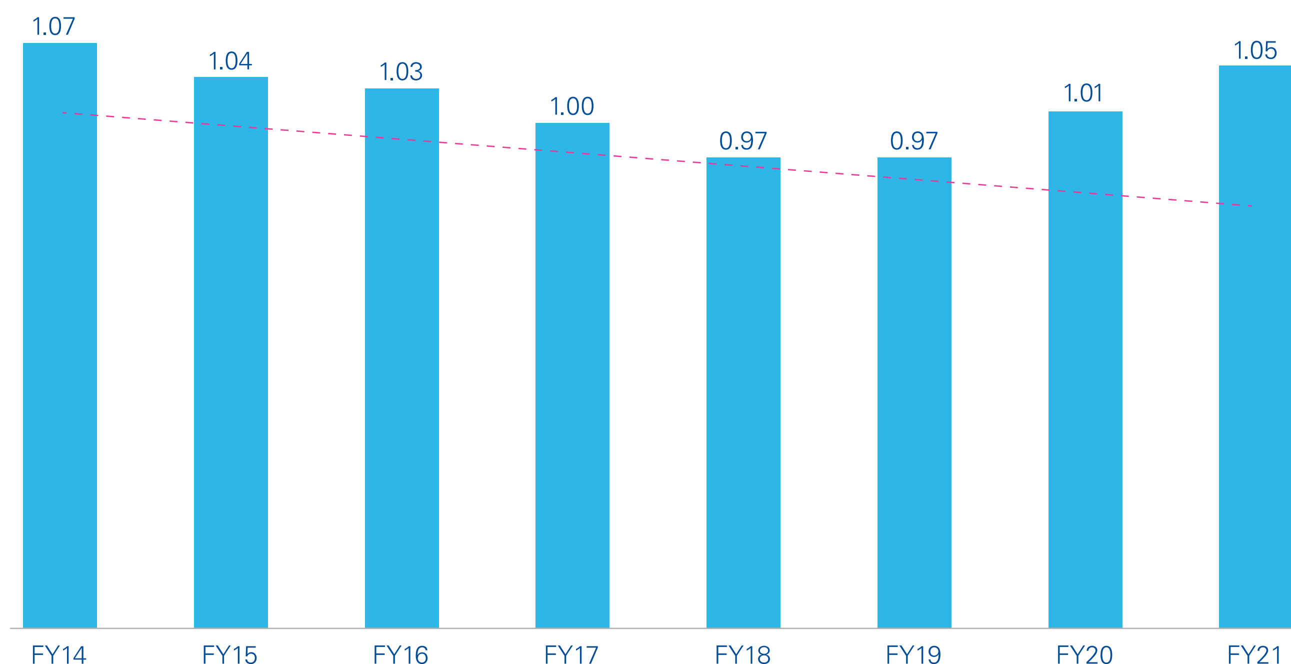
Drivers of cost efficiency

During periods of growth and decline, the ratio between operating costs (non-interest expenses) and income has remained remarkably consistent for our large global sample of banks. Our analysis focuses on net interest income as a good proxy for underlying levels of customer activity. Such a metric is useful given the global trend to reduce or remove fees in retail banking, and because market volatility can otherwise be a big driver of financial markets' income.

With the huge investment in digitization, one might have expected expenses to have become more de-coupled from income, as automated and scalable platforms should deliver relatively stable costs regardless of the number of customers or transactions. So, why are banks struggling to contain costs?

Operating costs closely track net interest income

Non-interest expenses/net interest income ratio during FY14–21, globally



Source: CapitalIQ database; KPMG analysis

One of the main reasons is the continued rise of employee costs, despite a significant reduction in the number of full-time employees (FTEs). While the 60 banks studied decreased their total headcount by 50,000 between 2014–2021, total compensation went up by 12.5 percent, with average costs rising from US$91,800 to US$104,500 per employee. This increase reflects the bargaining power of in-demand technology and risk professionals, along with broader wage inflation.

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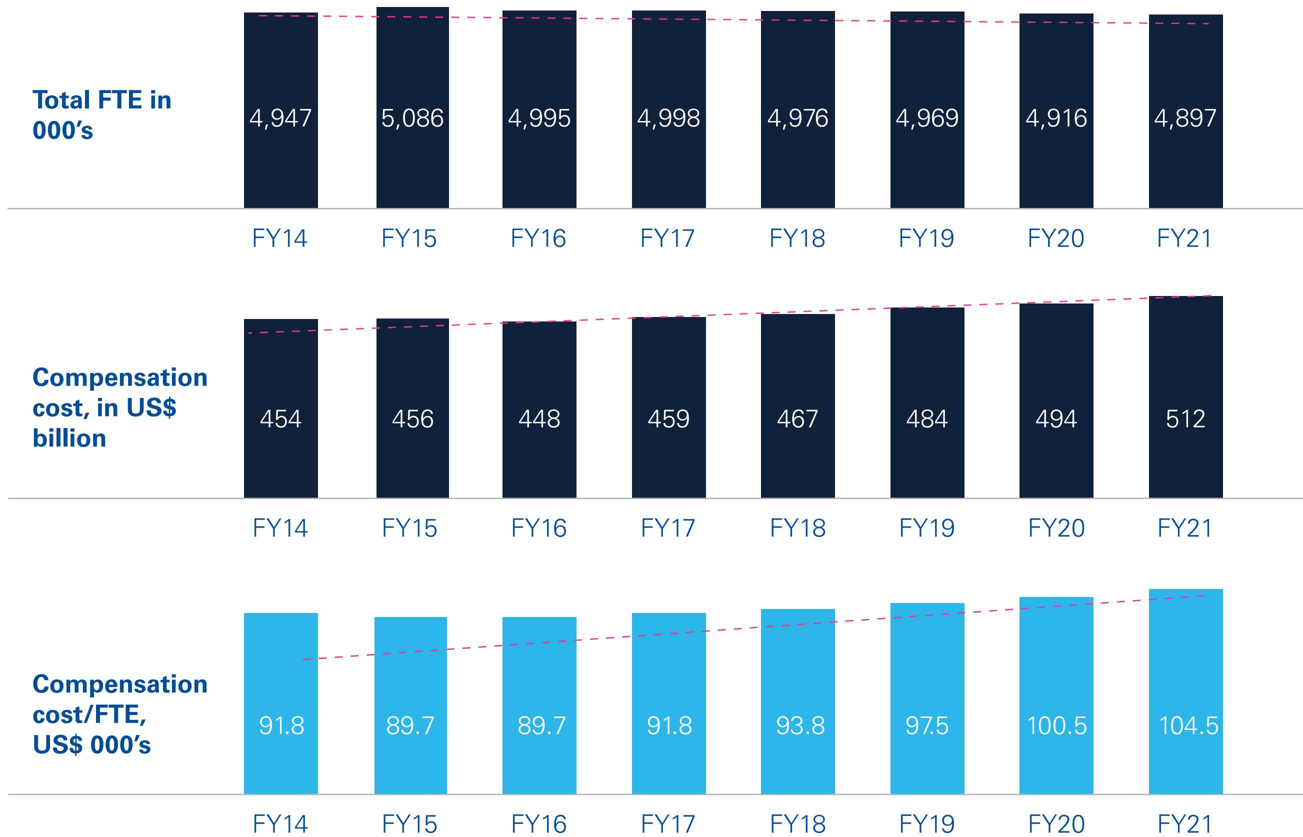
Total staff remuneration costs rise despite employee numbers falling significantly

Global: Compensation cost/FTE analysis of banks



Source: CapitalIQ database; KPMG analysis

Remarkably, employee costs as a proportion of total costs have risen in recent years — suggesting that digitalization and automation has yet to deliver the intended cost efficiencies. This analysis shows that banks' investments in automation have not had the desired cost-efficiency effect, despite achieving the intended reduction in staff numbers — because improvements in people productivity have failed to keep pace with remuneration growth. Employee productivity should, therefore, be a top priority for banks eager to improve ROE by increasing cost efficiency.

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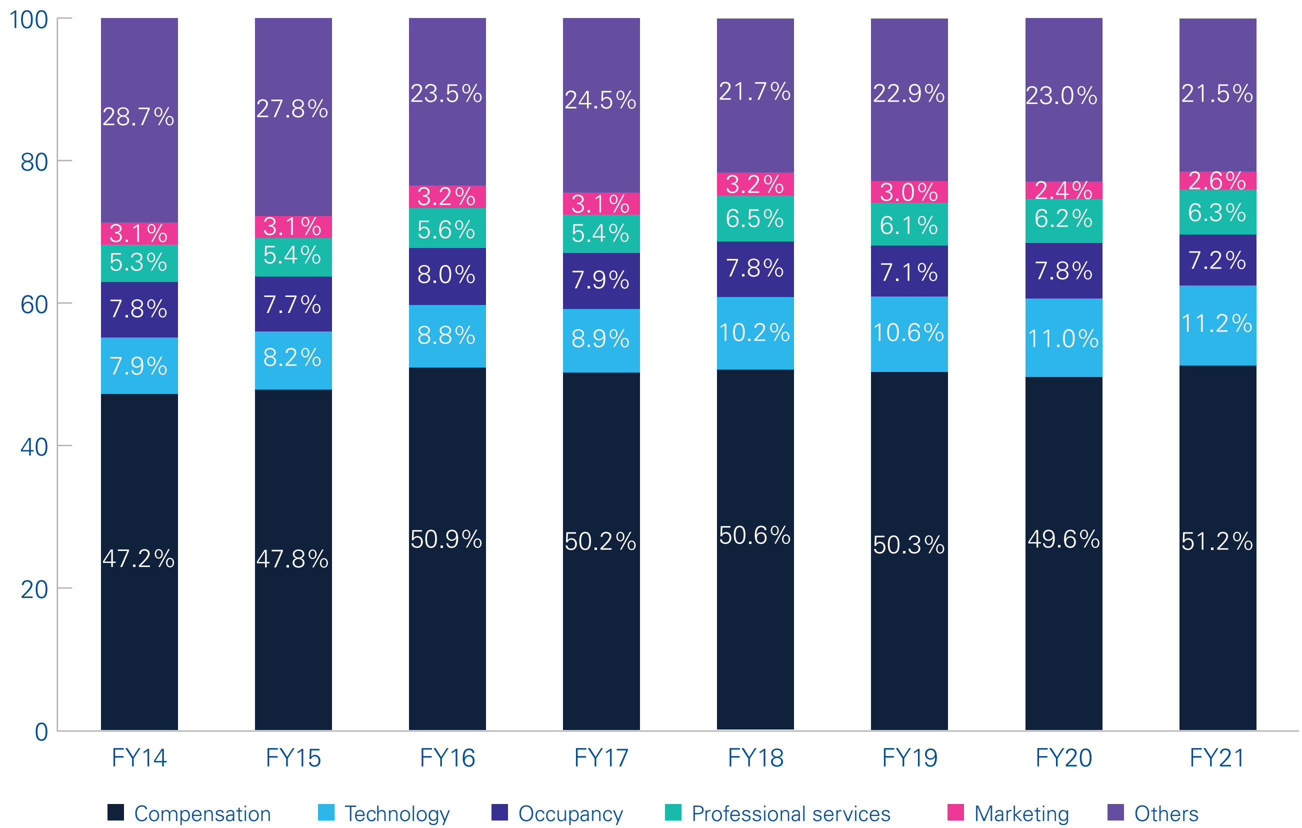
In spite of technology investment, staff compensation as a proportion of total costs has risen

Average proportion of non-interest expenses components during FY14–21, globally



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Identifying and implementing productivity improvements

Although banks have made considerable progress in applying digitization and automation across the value chain, there are ample opportunities to improve cost efficiency through the use of technology. For instance, the technology estate for higher skilled, middle-office teams such as Risk, Finance and HR can often be modernized to lift productivity.

KPMG's New cost imperatives in banking report recommends that a focused cost agenda looks at activity through three key lenses:

Strategy: Defining the long-term vision and plan for the bank; including the markets, products and business models that deliver customer relevance and shareholder value.

Simplicity: Ensuring the bank's organizational, accountability and governance arrangements enable fast decision-making and operational agility, to drive both 'change the bank' and 'run the bank' cost efficiency.

Engineering: How banks deliver services to their clients, including channels to market, use of technology, and roles and capabilities of people.

Within this approach we've identified 12 cost transformation levers. In light of the high people costs associated with banks, employee productivity should be high on the agenda, enabled by technology investment. Areas for improvement include continued operational efficiency through process automation and digitization; efficient, platform-driven distribution models encompassing retail branches, relationship managers, contact centers and digital channels; and data-enabled functional support services such as Risk and Finance across the bank.

12 Levers of Cost Transformation

Macro cost lens	12 levers of cost reduction	Example opportunities
1. Strategy	1.1 Geographies, markets, products	Reduce presence in low performing customer segments and product areas
	1.2 Operating model & balance sheet	Reduce the cost of funding by optimizing the balance sheet
2. Simplicity	2.1 Organizational model	Reduce organizational complexity, including management and governance layers
	2.2 Transformation optimization	Create a core organizational capability around transformation
	2.3 Cost management focus	Drive a cost focus through strategy and accountability
3. Engineering	3.1 Digitization & operational efficiency	Digitize work from front to back office and drive enterprise wide automation
	3.2 Channel optimization	Digital shift with interventions to drive behavioral change
	3.3 Organization design and People	Drive the simplification of the organizational model throughout the bank, focus on spans and layers, realignment of pay and rewards
	3.4 Technology optimization	Accelerate the migration of critical environments to the cloud, decommissioning of obsolete applications and the removal of the data centres
	3.5 Property optimization	Rationalization of operations between head offices and regions
	3.6 Sourcing & Supplier Management	Drive 3rd party spend down through challenge of integrated supply and demand
	3.7 Tax & Legal optimization	Optimization of tax and legal structures

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Key levers of cost efficiency

Digging deeper, here are some examples of the key levers for achieving lower cost through higher productivity:

- **Reducing excess management reporting:** simplifying decision-making, as well as zero-based design of reporting services, to reduce the burden in terms of granularity, frequency, format and associated discussion meetings for management reporting. This should significantly lift the productivity of the professionals tasked with upwards reporting. Such a move is especially relevant for support functions such as Finance and Risk, who typically face large, onerous reporting requirements.
- **Automating transformation dashboards:** producing real-time dashboards for all transformation projects within the bank, allowing project teams to spend more time on transformation, and less time on status reporting. Given that all initiatives should share common and standard key performance indicators, a dashboard approach can prove both appropriate and efficient.
- **Optimizing distribution platforms:** using customer segmentation, customer journey design and sales and service process digitization to optimize legacy distribution models. Better use of technology creates assisted distribution platforms that make better use of the unique skills of the humans in the field, branches and contact centers. The optimized use of digital channels and self-service frees up frontline staff to focus their efforts on the highest value customers and customer interactions.
- **Automating and digitizing back-office processes:** in many banks there has been a slowing down of results from process efficiency improvements, after early efficiency wins from workflow automation, robotic process automation and digitization. However, in areas such as customer due diligence and credit, many highly manual processes remain, with unnecessary reliance on bank staff for standardized inputs and intervention. In addition, growing use of machine learning and artificial intelligence increases the scope of processes that can be re-designed to lift productivity.
- **Rationalizing and automating risk controls:** reducing manual risk controls by lowering the number of controls and increasing the use of smart technology. As risk professionals are scarce and come at a premium, they should be used by banks where they are most needed and can add greatest value. As many risk controls are standardized and repetitive by nature, human intervention should be optimized.
- **Simplifying 'run the bank' infrastructure:** with an aim to reduce IT costs. Standardization of technology estates, and better interoperability of technology components, widens the scope for more efficient (out) sourcing of infrastructure. Similarly the move to cloud reduces the need for on-premise IT infrastructure and associated technology staff.

Three phases to embed productivity and efficiency

Although most or all banks are actioning the above levers to some degree, the failure to significantly improve operating costs suggests that more could be done to optimize the impact of transformation initiatives — notably with regard to employee productivity. We propose that banks adopt a three-phase approach for a permanent operational and culture shift towards greater cost efficiency:

Phase 1: Qualify

Faced with a host of cost-reduction initiatives, CFOs need a robust, standardized qualification process that assesses initiatives' objectives, feasibility and measurable key results. This enables like-for-like comparisons. In particular, transformation business cases need to be outcome-based, with clear efficiency and productivity targets supporting funding requests.

Phase 2: Prioritize

Priority should be given to initiatives that can deliver significant, ongoing cost efficiencies (including staff productivity), are achievable within agreed time frames, and are aligned with strategy. Banks can then compare business cases and prioritize those with the biggest impact. Importantly, initiatives should fit within the change and investment capacity of the bank, as new and in-flight projects compete for scarce transformation capabilities.

Phase 3: Manage

Like a car navigation system that re-routes when traffic occurs, the ability to alter direction is essential, to overcome barriers and adapt to changing circumstances. This transformation agility needs to be underpinned by accurate and real-time performance reporting. Only through a genuine understanding of the budget, performance and delivery status of their transformation initiatives can banks manage these programs in a timely fashion.

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Key insights

KPMG's benchmarking highlighted that cost efficiency is a major contributor to banks' ROE, as well as that banks globally have struggled to fundamentally improve their cost performance. As employee remuneration is the largest and growing component of bank costs, it makes sense to focus on employee productivity as the biggest driver of bank cost performance. This recommendation is supported by the finding that employee costs have continued to rise in importance despite increasing technology expenditure: recent investments in technology have failed to improve employee productivity.

Banks should identify which cost levers they have available to improve employee productivity, both through simplification and through technology investments. There are a large number of strategy, simplicity and engineering cost levers to improve productivity. Existing or planned initiatives that are not resulting in a employee productivity uplift should be re-evaluated, as they will further add to the bank's cost base.

In planning for and implementing these transformation initiatives, banks should adopt a strict three-phase approach:

- Qualify initiatives rigorously to enable comparison
- Prioritize initiatives based on their impact
- Manage transformation continuously based on real-time reporting

Banks that improve employee productivity through a deliberate transformation program, will be rewarded with better cost efficiency and higher returns.

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Appendix: 1

Banks	Return on equity	CI ratio	Revenue
AIB Group	6.1%	56.3%	3,146
Aldermore Group	11.7%	52.8%	326
Bank of Scotland	11.8%	52.6%	8,428
Barclays	3.6%	68.1%	26,715
Co-Operative Bank Holdings	-9.2%	171.9%	524
HSBC	5.7%	62.9%	50,623
Lloyds	5.9%	71.0%	22,016
Nationwide Building Society	6.4%	64.3%	4,137
NatWest	1.0%	77.9%	17,185
Banco Santander	6.2%	53.0%	42,288
Standard Chartered	2.0%	69.5%	13,337
The Royal Bank of Scotland	11.0%	57.8%	1,218
TSB Banking Group	3.0%	84.8%	1,260
Virgin Money UK	-2.1%	74.3%	1,503
Yorkshire Building Society	6.2%	62.5%	710
BoA	7.7%	66.9%	83,562
Capital One Financial	9.8%	52.6%	21,446
Citigroup	6.3%	61.3%	66,984
JPMC	11.7%	58.4%	1,01,797
Morgan Stanley	9.8%	70.6%	35,524
BNY Mellon	9.0%	69.6%	15,764
Goldman Sachs	10.4%	65.4%	34,619
PNC Financial	9.2%	63.1%	15,782
Truist Financial	8.4%	61.1%	13,197
US Bancorp	12.9%	55.7%	20,097
Wells Fargo	10.5%	64.7%	81,164
Bank of Montreal	11.9%	65.8%	16,986
Canadian Imperial Bank of Commerce	15.7%	59.2%	12,216
RBC	16.0%	61.0%	31,438
Bank of Nova Scotia	13.3%	53.7%	19,662
Toronto-Dominion Bank	13.8%	58.8%	27,088
ANZ Bank	11.1%	46.8%	13,627
Commonwealth Bank of Australia	14.3%	43.1%	17,256
Macquarie Group	13.6%	70.4%	8,055
National Australia Bank Limited	10.9%	47.0%	12,729
Westpac	11.6%	47.1%	14,986

Banks	Return on equity	CI ratio	Revenue
Agricultural Bank of China	13.7%	37.8%	71,846
Bank of China	12.3%	36.5%	64,792
ICBC	14.2%	31.6%	94,077
BNP Paribas	6.6%	66.5%	45,652
Crédit Agricole	6.4%	62.7%	19,824
Deutsche Bank	-1.6%	85.0%	30,374
UniCredit	-0.5%	67.8%	15,997
MUFJ	6.2%	66.0%	37,470
Mizuho Financial Group	6.2%	68.5%	23,647
Nomura	6.2%	39.0%	10,120
Coöperatieve Rabobank	5.7%	65.3%	12,945
ING Groep	8.4%	56.2%	18,829
DBS Group	10.7%	43.6%	8,455
Oversea-Chinese Banking Corporation	10.5%	39.2%	6,438
United Overseas Bank	10.1%	43.5%	5,933
Industrial Bank of Korea	7.5%	55.5%	5,290
KB Financial	8.1%	62.1%	13,555
Shinhan Financial	8.5%	52.6%	8,792
BBVA	8.5%	51.3%	20,875
Credit Suisse	0.6%	87.7%	23,802
UBS Group	8.4%	78.6%	30,564
Bank of Ireland	6.1%	63.6%	3,062
Close Brothers Group	15.1%	63.3%	1,028

Source: CapitalIQ database; KPMG analysis

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Appendix: 2

Banks	Change in return on equity	Change in CI ratio (FY14–21)	Revenue
AIB Group	-7.1%	3.7%	3,146
Aldermore Group	-1.6%	-1.8%	326
Bank of Scotland	-0.1%	2.4%	8,428
Barclays	66.5%	-4.0%	26,715
HSBC	-0.8%	-0.2%	50,623
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Yorkshire Building Society	1.6%	-4.0%	710
BoA	26.2%	-3.8%	83,562
Capital One Financial	10.4%	0.1%	21,446
Citigroup	17.2%	-1.2%	66,984
JPMC	8.1%	-0.7%	1,01,797
Morgan Stanley	15.6%	-3.8%	35,524
BNY Mellon	3.0%	0.4%	15,764
Goldman Sachs	10.3%	-2.6%	34,619
PNC Financial	1.5%	1.3%	15,782
Truist Financial	-0.3%	0.6%	13,197
US Bancorp	0.9%	2.0%	20,097
Wells Fargo	-1.0%	2.3%	81,164
Bank of Montreal	0.6%	-2.0%	16,986
Canadian Imperial Bank of Commerce	-2.4%	-1.8%	12,216
RBC	0.0%	-0.5%	31,438
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How KPMG can help

KPMG has an international team of cost transformation professionals that works with the world's leading global, regional and local banks. We can help you assess potential earnings improvements, define functional cost-saving strategies, and develop an execution plan tailored to your organization. We have experience helping clients drive value by creating integrated digital strategies, improving M&A integration and organizational alignment, and restructuring operating models. We dig deep into the root causes of inefficiencies and provide holistic insights that can help make your entire bank more responsive, more cost-efficient and more effective in the face of change.

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