

Enterprise wide Banking Cost Transformation – The old game is back in town

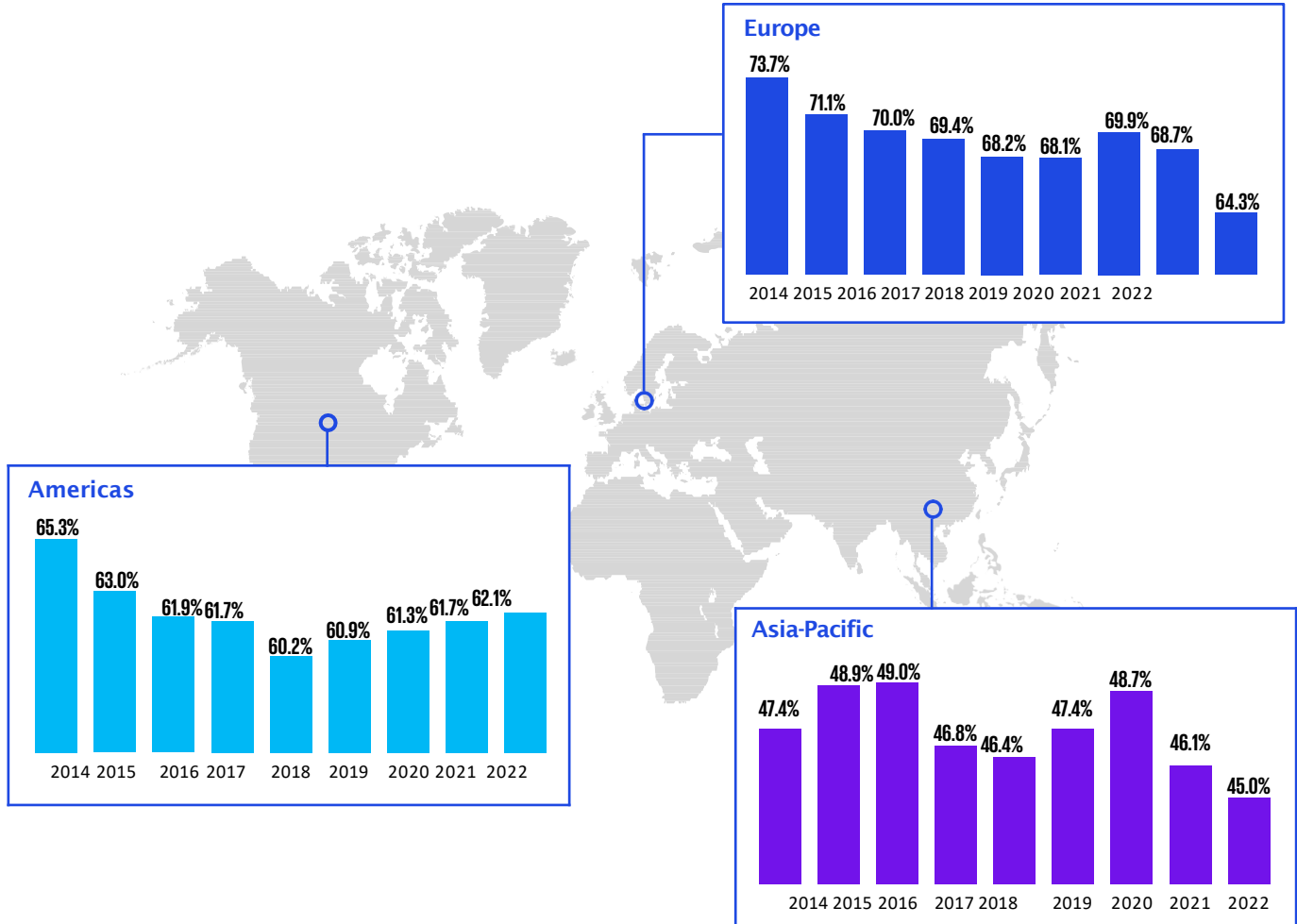
Banks are seeking to drive customer experience and reduce costs along customer value streams but when pivoting need to retain efficiencies of scale...

Banks are facing a more complex environment than perhaps ever before where the social and economic landscape has been radically reshaped while customer needs and expectations continue to dynamically evolve. Incumbent banks are being challenged from all sides for market share by a combination of neo banks and non-traditional participants and technology will continue to redefine the relationship between customers and banks.

What does this mean for Cost Efficiency?

Banks' cost-to-income ratio (CIR) fell slowly but consistently pre-COVID and following a period of COVID related increases in CIR from FY19 – 21 driven by increased in staff costs, technology costs and loan loss provisioning, we are only now starting to see some improvements in CIR again.

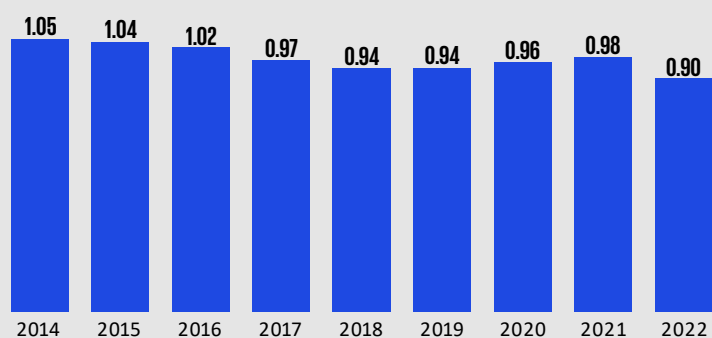
It is clear that the interest rate environment has changed for banks but with inflation becoming a key influencer on most major economies we see that cost transformation in banking has been elevated to a new level of importance.



Employee productivity should be a top priority for banks eager to improve cost efficiency

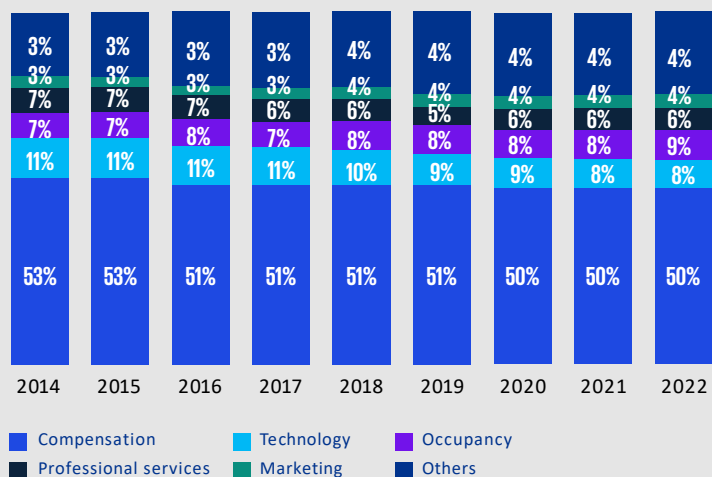
Our analysis indicates that although banks have made considerable progress in applying digitisation and automation across the value chain, compensation as a proportion of total costs has risen suggesting that digitisation and automation have yet to deliver the intended productivity benefits and that expenses have barely de-coupled from customer activity and income.

Cost to income relationship



The relationship between non-interest expenses and net interest income has been consistently linked.

Cost profile



Despite an increase in technology investment from 8% in FY14 to 11.3% in FY22, staff compensation as a proportion of total costs has also risen from 49.7% in FY14 to 53.1% in FY22.

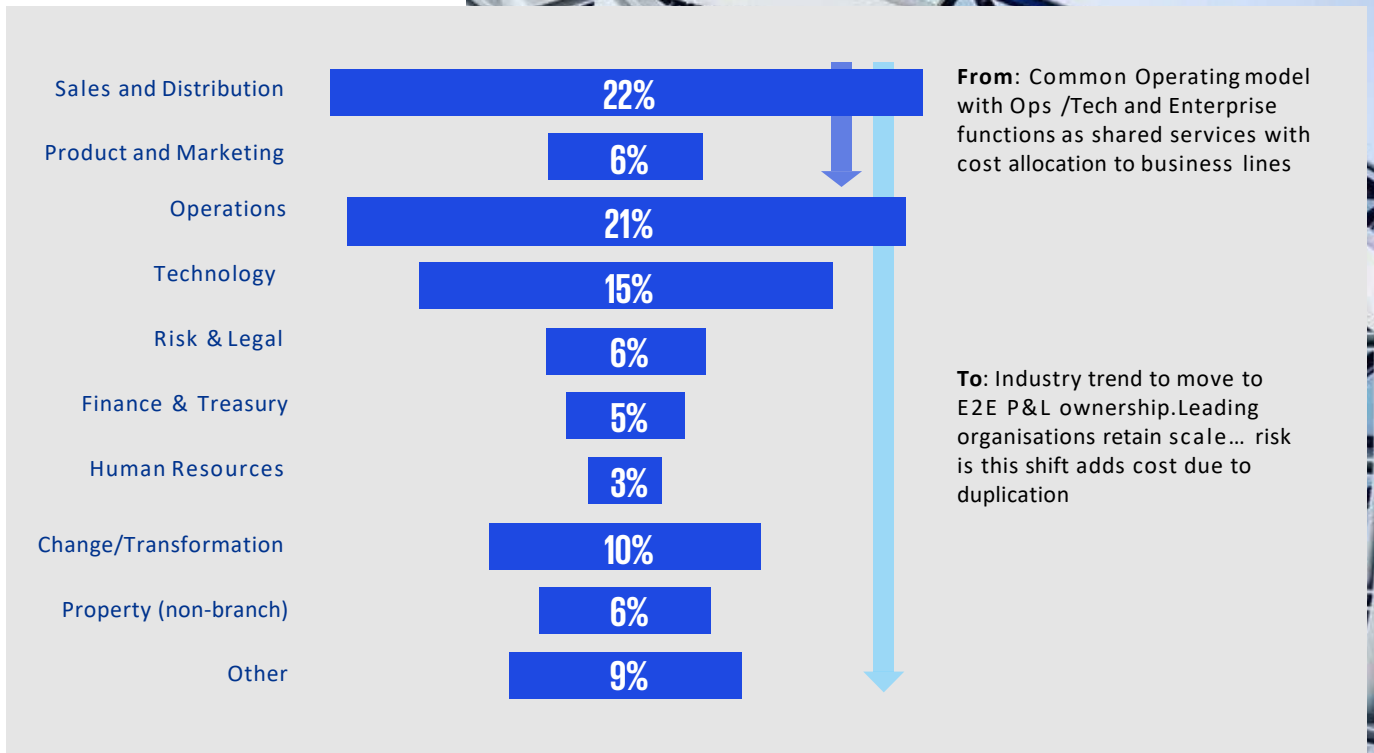
Turning strategy & ambition into commitment to transform the cost base and join up outcomes across functions

Broadly speaking banks have deployed four key strategies to tackle the cost base/ employee productivity challenge over the last five to ten years; demand management and process redesign, automation, data-driven processes and workforce optimisation. This approach has no doubt led to cost reductions within functions and in particular where banks have been able to build scale through GBS transformation. However we now see most banks struggling to deliver the next step change in cost outcomes within functional silos.

The answer to this from leading banks globally has been to start to shift their operating models towards value stream and P&L ownership.

We believe that as banks look to drive faster and more value for money interactions for their customers, taking control at the business line level is clearly the leading strategy.

This shift to value streams enables key factors like customer experience, cost optimisation, technology, and control environment to be fully understood end to end and allows joined up execution of change with a high-degree of accountability and transparency on ROI. The Strategy is set by E2E P&L owners in combination with functions and delivered together.



Getting this balance between E2E ownership and the benefits of functional scale right will be the key going forward and mistakes are already emerging

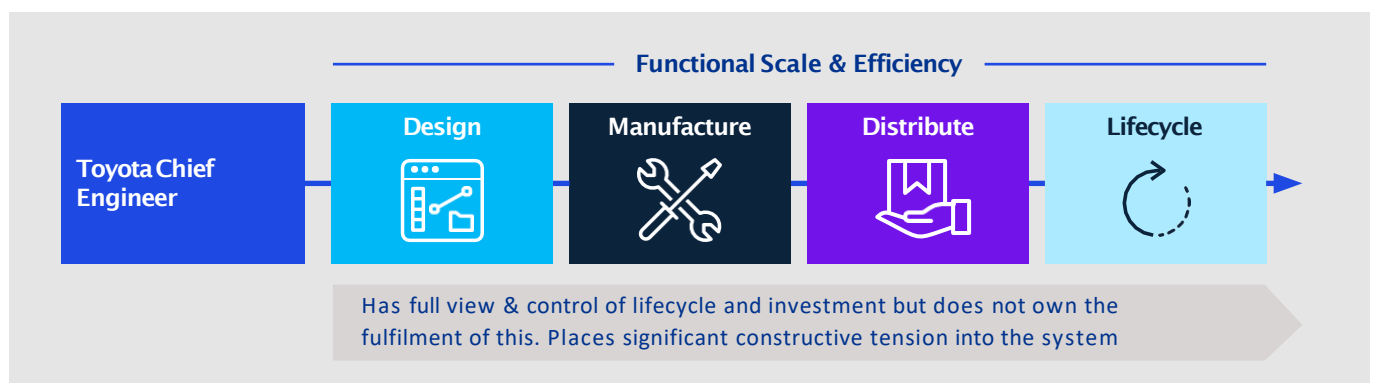
Banks have developed agile tribes & squads to drive people, process and technology change across E2E value streams, however, the danger here is the risk of duplication and undoing of the efficiencies gained through GBS transformation over the past decade.

Lessons from manufacturing can be learnt with Toyota's Chief Engineer role being a good example of retaining control and accountability without the need to own all of the resources.

The banks that will succeed with cost optimisation over the medium term will taking a multi-layered approach from strategy through to execution to transform customer outcomes, employee productivity and the risk and control environment.



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<p>Distribution</p> <p>Operations</p> <p>Technology</p> <p>Ent. Functions</p> <p>Other</p>	<ul style="list-style-type: none"> • Expansion of digital capabilities • Consolidate (+FTE), Transform & Optimise (FTE) • Increased investment in new, outsource legacy • Many banks have not addressed increased costs • Reduction in costs such as property footprint
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<p>Key Trends in Cost Base over the past 3 years:</p> <ul style="list-style-type: none"> • Transition of cost /FTE out of distribution /other into Operations (or often called Customer Services) where processes can be scaled and efficiency levers applied • Investment in technology cost to enable transformation, many banks looking to shift away from legacy infrastructure and to tackle technical debt to provide more modern and agile technology platforms 	<p>Key Trends in Cost Base for the next cycle:</p> <ul style="list-style-type: none"> • Shifting towards a matrix structure providing P&L owners with greater accountability for their E2E costs • The key caution here is not to increase cost base by undoing the benefits of scale that have already been achieved
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