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Time to radically re-think bank productivity

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COVID-19 is presenting humanity with one of its greatest challenges of recent times. Thousands of health professionals are battling the virus, putting their own lives at risk. Solving the humanitarian challenge is, of course, the top priority. Much remains to be done globally to respond and recover, from counting the humanitarian costs of the virus, to supporting the victims and families, to developing a vaccine.

The crisis also presents major economic challenges, and every industry is affected. At the time of writing, banking has lost more value than almost any other industry (noting a wide variation between countries).

But while most banks have experience reducing costs, this time is different. The impact of COVID-19 has changed customer behaviours and working norms. This creates 7 new dynamics that require banks to adjust their traditional approach to cost reduction. Banks that work "with the grain" of these changes are more likely to emerge with better customer outcomes, more responsive decision making and lower cost.

		New dynamics	Renewed approach to productivity
Short term Cost control	1	A need to avoid short term redundancies	Reset third party spend through demand re-specification and supplier management
	2	Major changes in demand patterns	Systematically redeploy the workforce and reskill at scale
Mid-term Radically rethink the operating model	3	Changes in customer interaction preferences and behaviours	Accelerate shift to digital and create flexibility in re-opening of physical channels
	4	Uncertainty on what size of corporate centre is affordable post COVID	Move to "minimum viable" central functions with additional services only where they add value
	5	Expectation of accelerated technology delivery at a lower cost	Transform technology to digitise the bank while also reducing tech costs
	6	Potential for remote working to be the new norm	Keep a level of remote working and shrink the property footprint
	7	A new tempo for getting things done	Take an "MRI" of the crisis organisation to understand and harness the newfound decision making speed

PRODUCTIVITY: THE NEXT IMPERATIVE

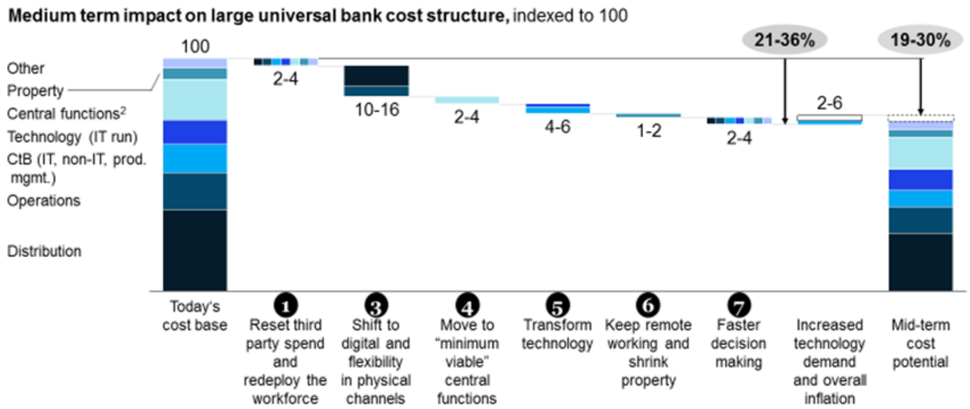
In likely economic scenarios, the global economy is heading into a recession that will require banks to reduce cost by 20 to 30% to reach pre-crisis profit levels. Most banking executives believe the global economy is headed for a "U shaped" recovery in which the virus recurs, long-term growth is slow, and global GDP contracts 13% in 2020, only returning to pre-crisis levels in Q3 2023[1]. Banks can expect a 20-30% reduction in revenue after risk when averaged over 2020 to 2023[2], driven by lower lending volumes (5-8%), lower interest and fee margins (1-2%) and increasing risk costs (14-20%) due to loan losses and increased costs as they support the economies in which they operate (e.g., loan repayment holidays).

Early estimates suggest banks could achieve this 20-30% net cost reduction if they apply the full range of levers. This would equate to 21-36% gross cost reduction, allowing for a modest level of reinvestment and baseline cost inflation.

1 McKinsey Economic Scenarios, in partnership with Oxford Economics (scenario A1)

2 MGI, McKinsey PFIC – Global Banking Pools, Annual Reports

Formula for 20-30% productivity gain



SHORT TERM CHANGES TO CONTROL COSTS

The impact of COVID-19 has created an acute need for some banks to consider immediate productivity, whilst protecting the workforce value and jobs. Banks are already committing to minimize any short-term redundancies: as at April 2020, 11 global banking CEOs had announced that they would not cut FTE in the coming months[3]. Therefore, banks are turning to new ways of reducing their third party spend and re-deploying their people to meet the changing needs of the bank.

1. Reset third party spend through demand re-specification and supplier management

Many expense lines have become volatile, presenting choices to reset third party spend. For categories where demand has increased (e.g., telecoms) banks can establish tiering and rationing policies to ensure the extra spend is justifiable, and some are seeking volume discounts. For categories where demand has reduced (e.g., travel and events) banks can use policies to ensure demand reduces to appropriate levels, and some are seeking reduced fixed costs.

Leading banks are industrializing this approach by setting up spend control towers to manage demand, negotiation factory teams to manage suppliers, and clean sheeting to understand supplier margins. Banks can also use automated data processing and advanced analytics to create invoice-level spend cubes and to spot opportunities such as contractors whose day rates are out of line with the norm, or branches where maintenance costs are abnormally high.

Banks could consider reducing or re-deploying resources committed in their investment portfolio, which typically represents 10-15% of total operating costs and is usually dominated by third party spend. Regulatory programs, for example, tend to comprise more than half of the investment portfolio, and are being rescoped or re-sequenced by some banks working closely with regulators.

2. Systematically redeploy the workforce and reskill at scale

In the short term, the impact of COVID-19 has changed the workload for specific job families (e.g., creating much higher demand for roles like credit analysts and contact centre agents). And in the mid-term, the demand on the workforce is likely to shift to higher skill roles.

CHROs can manage this shift by setting up a reskilling hub that works across business units to act as a single point of talent assessment, retraining and redeployment. The hub forecasts supply and demand for job families and then acts as an academy to reskill and redeploy staff into high demand areas.

In the near term, this approach enables banks to redeploy operational staff into adjacent roles to respond to the changing customer demand (e.g., reskilling branch tellers to become web chat agents). This is

[3] Press search, as at 14 April 2020

particularly true for the 50-60% of the talent pool that focuses on standardised rules based processes [4]. In the mid term, this approach allows banks to build the workforce of the future, for example by reskilling analysts into data scientists and reskilling project managers into product owners.

MID-TERM CHANGES TO RADICALLY RETHINK THE OPERATING MODEL

In the medium term, banks may need to fundamentally reimagine their business model to meet the needs of a "next normal" and sustain a 20-30% net lower cost base than today.

3. Accelerate shift to digital and create flexibility in re-opening of physical channels

Since the crisis started, banks globally have temporarily closed 20-35% of their branch networks[5]. At the same time, customer interest in digital has jumped by more than 25%[6] - equivalent to about three years of evolution pre COVID-19. Up to 40% of consumers report a significant reduction in cash usage (less in markets where cashless penetration is already high)[6].

While there is uncertainty about how consumers will behave in the long term, banks have an opportunity to meet and shape customer preferences. Digital could become the default channel for simple sales and service. Contact centres and remote advisory could focus on complex needs. And branches could evolve to focus on complex guidance and service. Industry utilities could also play a role to further reduce the cost base through shared branches and retail partnerships.

However, capturing productivity gains is not a case of bluntly reducing the branch network. Banks are likely to need to sustain the shift to digital, accommodate cash needs, support high emotion interactions, and maintain optionality to adjust as customer needs evolve.

As they re-open, banks can consider five actions.

First, consider how to make the new digital behaviours stick through consumer education, having great propositions and proactive nudging. Even before the crisis, leading banks in developed markets had achieved 25% fewer branch staff per customer than their peers by migrating payments, transfers, and cash transactions to self-service and digital channels[7]. A further 10-15%[6] of customers will be unlikely to use a branch after the crisis, further enhancing the opportunity.

Second, consider how to re-wire footprint models based on new customer behaviours, and accelerate the shift to guidance and away from cash. Traditional transactions and onboarding will decrease, while high emotion interactions such as financial difficulty will increase. Industry utilities for basic services like KYC and cash can offer a further 15% in distribution cost saving.

Third, consider how to create more flexibility in the workforce to adjust to the potential change in what branches are used for. This means considering a universal banker model and using branches flexibly for capacity of contact centres and remote advisory.

Fourth, consider how to build flexibility in as branches re-open, in order to learn. As banks reopen, they could perform "A/B testing" in comparable micro markets to experiment with different approaches to coverage, hours, roles and branch activities. One bank is experimenting with keeping some branches closed and measuring displacement and customer satisfaction to provide real-world data on the impact of keeping the branch permanently closed before committing.

Fifth, consider transforming contact centres to leverage automation of simple needs, focusing human agents on complex needs. Leading banks are increasing IVR and chatbot containment rates, introducing "click to call" functionality to avoid manual identification/verification steps, and using AI for live coaching of agents and checking script compliance.

4 Findings from a European bank in an assessment, April 2020

5 Finalta Pulse Survey 2020

6 McKinsey M&S Consumer Pulse Survey, 6-20 April, 2020

7 Based on a survey of global banks

As banks move to more digital channels they can build their capabilities in digital sales and marketing to maximize productivity. This includes digital marketing, conversion rate optimization, media optimization, personalization at scale and dynamic pricing. Banks who have done this well have achieved 3-7% revenue uplift, 30-40% media spend savings, and 2-3x improvement in customer satisfaction.

The changes in customer behaviours also may present banks with opportunities to enact changes to the regulatory environment to better suit the shift to digital. For example, allowing wet signatures.

The move to more digital channels also allows banks to automate more of their operations. Many banks have already started measuring operations and distribution unit costs at a customer journey level (e.g., the cost of opening a current account, or originating a mortgage). This approach surfaces the full end-to-end costs, and the full set of automation levers for optimising those costs. Banks who have already made the pivot to a customer journey view are now applying the same approach to central functions (e.g., looking at the end to end hiring process in HR, or the full cost of report production in Finance).

4. Move to “minimum viable” central functions

With a focus on customers, some banks may need to accelerate simplification of their support functions (HR, Risk, Finance, Legal, Marketing). Banks can zero base these functions by designing the “no frills” version that fulfils the most basic services, and then carefully adding choices to improve service, speed and quality. Where banks add functionality above the zero-base, they could do so in the most efficient way, using automation, digital servicing and standardisation. This approach delivers two productivity opportunities: stopping unaffordable services; and finding new ways to deliver support at lower costs.

In HR and Finance, many banks are already on a path to achieving up to 30% productivity gains through standardising and centralising, reducing demand, moving to standard software-as-a-service and digitising common requests and reports.

By contrast, the control functions like Risk and Compliance have grown in line with the volume of regulation. Banks that are willing to take a fresh look at these functions find substantial opportunities. For example in anti money laundering (AML) processes, the best banks are achieving 15-25% productivity gains and more effective risk management by creating a simpler process for low risk customers, allowing KYC passporting across geographic borders, automating the process for low risk customers, and removing duplication between first and second line teams.

5. Radical technology transformation to serve increasing demand at lower cost

Historically bank CIOs have kept costs flat[8] by making modest savings that offset increasing demand. But going forward CIOs may need to deliver net cost savings, rather than just keep costs flat. At the same time they may experience far greater demand than before as banks invest in further digitisation.

This calls for a radical technology productivity effort. Leading banks have already shown that this can reduce technology costs by more than 25%[9], allowing a level of reinvestment in new capabilities while still making a modest overall saving.

The levers are already well known: agile at scale; automation of provisioning and testing; reducing non-engineering roles; moving to highly standardised cloud infrastructure. But many banks have only scratched the surface. In leading banks more than 75% of IT staff in change teams actually write code, whereas for laggard banks it can be as low as 20%. Similarly, in leading banks more than 75% of changes are deployed through automated tooling whereas in laggard banks it can be as low as 25%.

CIOs may benefit from a bolder aspiration and faster pace. They can also sequence the transformation to balance structural mid-term initiatives with rapid payback actions such as setting up contract teardown factories to assess opportunities in third party spend. Those that move quickly are more likely to emerge with a lower cost technology function that is also faster, more responsive and more resilient.

[8] McKinsey Digital 20/20

[9] One Asian bank reduced technology run costs by 40% over 3 years

6. Keep a level of remote working and shrink the property footprint

The move to working from home in response to COVID-19 has created an immense challenge for banks and their people. However, now that new remote working models are in place, many banks see the opportunity to permanently shift the way people work to be more flexible.

A recent survey[10] found that ~50% of CFOs expected at least 10% of their workforce to stay permanently remote. 6% expected that to be greater than 50%. In China, where the crisis is more advanced, 20% of all work is expected to be done remotely[11] post-COVID.

In the short term, FTEs per desk will likely reduce to maintain social distancing, depending on the exact local authority guidance. But in the mid-term, when social distancing measures are eased, retaining a level of remote working could increase a bank's desk ratio from 1.2 FTEs per desk today up as far as 1.6-1.8, freeing up 25-40% of the office capacity.

7. Take a "MRI" of the organisation to harness the newfound decision making speed

During the first weeks of the COVID-19 crisis, banks changed the way management operated. They aligned quickly on priorities and desired outcomes, they made decisions rapidly, empowered line leaders to execute, communicated frequently, and reassigned their best people to work on the most important issues. Decisions and performance were transparent, and individuals were held accountable.

It is not sustainable to run in crisis mode for long periods, but banks can "distil" the best of these execution practices and keep elements of this streamlined decision-making. Banks can do this by conducting a "MRI" of the crisis organisation to identify "vital organs" of the management structure that have been working much faster, and the "connective tissue" roles that execute these decisions. The "MRI" uses advanced analytics to review calendar and email data as well as employee surveys. Based on this understanding, banks can strengthen these critical functions to be more resilient and sustainable. In parallel, they can move to leaner, flatter management structures by reducing layers, optimising spans, removing duplicate functions and realigning spend to the functions that provide greatest value.

NEXT STEPS: HOW TO GET STARTED

Banks are in different starting positions on their journeys to the next normal. For some, this is a new discipline; for others, this has been going on for a while. Regardless of starting point, we suggest three steps to accelerate and embolden efforts:

1. *Raise the ambition.* Form a view quickly on what the bank will *need* to do, versus what it needs to *be ready* for. Setting a bold ambition will send a signal to the organisation that this is about fundamentally re-setting to the next normal.
2. *Size the major interventions*. While a productivity programme might ultimately have over a thousand initiatives, it is important to start by sizing the 5-10 major productivity levers and surface the tough choices. This is best done through a small group of "challenger" executives.
3. *Set up the execution engine*. A higher aspiration and pace requires a stronger execution machinery with three components. First, a transformation office that empowers line leaders, creates accountability for delivery and transparency on how ideas are moving from concept to bottom line impact. Second, controls and policies to ensure costs do not "come back". Lastly, measurement of productivity at the level of 50-100 units across the bank, to surface challenges and direction.

As banks enter a new era in banking, they should consider radical changes to their operating model that can help them emerge stronger. Those that act boldly and quickly are more likely to thrive.

[10] Gartner Survey, March 2020, Sample size 317 CFOs

[11] South China (南方日报)', http://epaper.southcn.com/nfdaily/html/2020-04/03/content_7876452.htm) ,03.04.2020