

change

Facing Change in Banking Today and Tomorrow *A View from 'Down Under'*

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by Bryan O'Connell

Banking over the last decade has been through a dramatic piece of history - perhaps a period of change and transformation, coupled with political and economic events, that will be seen as one of the most dramatic turning points in the industry as we know it.

Banks have been forced to think much differently about almost every aspect of their business and importantly, the external environment that we operate in. It has been an era in which banks have worked very hard at improving performance and core competencies; particularly credit quality, costs, information technology and related systems.

At the same time, it has been an extremely difficult period for banks to manage their businesses given the changes that banks have been forced to make and the uncertainty and volatility of world financial markets, corporate collapses and a number of global events, like the shock effect of September 11, the war in Iraq and SARs. These events have added to the complexity of the landscape and have implications for the future.

Many of the forces that have driven change over the last decade are still at work; technology, particularly the impact of the Internet and e-commerce; globalization; the need to create scale and growth through consolidation; increasing powers of customers and their changing needs; growth of regulation; ever increasing competitive forces; demands to find new sources of non interest income as a result of margin squeeze; the advent of wealth management in banking; increasing shareholder and market pressures on bank performance and growing social pressures on banks.

Challenges ahead

The new millennium is however showing that banks are facing a new set of challenges and horizons driven by some different forces coming into play on top of those still overhanging from the last decade.

Banks, having focused on their core competencies to substantially improve performance and make them more robust, are now finding that there is an increasing need to find new paths of growth and strategies as home markets mature, competition intensifies and more immediate consolidation opportunities evaporate.

In addition, banks are being forced to face making difficult choices about what type of business models best suit their needs and capabilities in terms of product manufacture, distribution and administration.

Many banks have cut costs to the point where this process is reaching its limits; other banks that have not been as successful at managing down their costs, still have the cost rationalization card to play. However, cost cutting your way to improving performance is no longer a viable strategy for a number of banks and may risk the ability to grow certain parts of the business or at worst, risk deterioration of the business. Major Australian bank cost /income ratios for instance have shifted from the mid 60s a number of years ago to the mid 40s for the best and at worst, the low 50s. That is not to say that cost containment and efficient cost management must be not be maintained - taking out cost inefficiencies will always be high on the agenda of any CEO.

There is a growing need to improve marketing, selling and distribution power in order to grow revenue, as well as a need to create more innovative product solutions for customers.

Competition is intensifying at a rapid rate. Some examples include banks looking to grab more local market share particularly in the small to medium size enterprise market where price and service issues make customers vulnerable to switching or extending their banking arrangements. In consumer banking, the credit card market is shaping up as another battleground based on price, loyalty awards and more new entrants. Non banks like the giant GE Capital are using their muscle to create a potential nightmare for banks in areas like consumer finance and linking their alliances with giant retailers. Global banks are either expanding their international operations through further acquisitions or are posing greater threats to local banks in established markets through niche product and service offerings where they can leverage their global scale and experience.

A new battle is looming in the customer service arena as banks desperately fight to retain loyalty of their customers, cross sell more product and create differentiation.

Risk management is moving to another level with Basel II ready to potentially give capital relief to some banks in the future, whilst for others it is creating major concerns that they will not be ready to comply adequately with the stringent requirements of the accord. At the same time, risk and capital management will increasingly become important in improving performance.

More and more pressure will be on people employed in banks to increase performance and

productivity, to be accountable, to shift their culture in line with the overall objectives of the organization and new forms of leadership are emerging.

In the end, banks are facing a more complex and far reaching set of challenges that is going to test the management capability of banks to deal with continuing change in the industry.

The following looks at some these issues in more detail.

Managing, dealing and anticipating change

From an internal bank perspective, one of the greatest challenges facing management is how you manage change and maximize the outcome of the change process.

The strategy needs to be continually reviewed and the adjustments clearly communicated within the bank. This has become a difficult and complex issue but one that will affect the overall positioning of a bank if it is to achieve its growth and performance objectives.

It may also become a distinctive competitive advantage if is implemented successfully.

A banks internal environment is facing more change and experiments through transformation of people, structures, culture and the use of technology than it has ever experienced. People management, which is dealt with separately, becomes the critical component of this process and a major determinant of how successful an organization will be at managing change.

CEOs, along with their senior executives, need be bold, be different and prepared to try more inno-

vative approaches to maximize and harness the total infrastructure and resources of the bank so that it can respond to and adapt to the forces of change that have been discussed above.

Today's environment is not only one of fast reaction; there is a need to anticipate and have alternate plans and strategies for lines of business and opportunities where changes in economic cycles, interest rates and competitive forces threaten or impact major lines of business and income.

There can be no better example of this in Australia and other major financial markets around the world in relation to the rapid growth retail credit - in particular, the housing boom which has been fueled by an unprecedented period of low interest rates enabling borrowers to substantially increase their borrowings and create for banks a river of unprecedented income from this source.

It is inevitable that this cycle will come to an end and that banks need to have alternate strategies in place to shore up potential lost income when the interest rates head north or other factors negatively affect investor and residential buying sentiment.

Added to this, we have seen a much more volatile external environment which poses many new challenges for the future. The business needs to be managed knowing that there is more uncertainty about what can be expected. No one anticipated the speed at which some major corporate collapses occurred in the past and scandals that took place. This has not only created major losses for banks, but also has impacted on the approach to corporate governance, rules of compliance and how to deal with conflicts of interest.

Banks need to be more prepared for volatility in financial markets and for the possibility of major shocks to the external environment given the events of September 11, SARS, the ongoing risk that terrorism poses and the reality of other environment risk e.g. massive power failures.

The banking industry can no longer assume future stability and safety. It must be continually looking at contingency strategies and resource and factor in the cost as a price to protect assets and the ongoing business of the bank.

Increasing performance through people and leadership

There is mounting pressure for major improvements to be made to every individual's performance within a banking organization. This ultimately means that a bank's focus must be on how each person within an organization adds to performance and the key strategies of the bank either directly or indirectly.

A part of this strategy will be on creating greater productive culture in line with increasing growth. Banks are looking to set targets that stretch individuals, increase performance and motivate people. At the same time, banks are keen to ensure that staff have high levels of satisfaction.

Some banks are driving this very hard. The cultural focus at some banks has shifted to driving more accountability, achievement, customer focus and general continuous improvement whilst maintaining cost reductions and shareholder value. Importantly, what many banks are trying to drive out is bureaucracy, hierarchy, command and control and short term focus.

An important goal, but difficult to achieve in larger organizations like banks, is the focus on engendering innovation - diversity, creating a difference, new ideas and new perspectives. In order to achieve this, banks have already started to and will continue to bring in executives and other managers from different backgrounds and experiences to help break down the old cultural barriers. The aim is to bring new leadership input, different perspectives and sharper focus.

Whilst productivity is a key focus, there is also the need to recognize that the skill base required in banking is changing and that for the future, banks will consider how they need to attract new talent. The demands of banking and the changing environment mean that not only do you need to have specialist skills, but it is becoming important that bankers have an understanding of economics, are effective communicators, understand technology and can be good marketers. On going training and improving skills levels will be vitally important - no one can run the risk of standing still. As the industry changes and the complexities of the industry increase, the most successful banks will be those that can attract this talent.

A major precondition to achieving this transformation of culture revolves around having new forms of leadership and management. The new style will be focused on working with and managing change, bringing the best out in people, harnessing their energies and capturing the value that they can bring.

Customer service - the new battle

A new battle is emerging between banks on substantially improving customer service. Banks not only want to retain their customers, they want greater wallet share. Creating superior and consistent service is a precondition to making greater

inroads to selling more product and services to customers.

Today, more than ever before, customers have more power, choice and information; their needs are more complex; the quality of advice they require has risen; they are more savvy; they do not like to wait and are no longer are prepared to tolerate bad service.

Increasingly, many more customers need access to high quality financial planning advice. The focus on the creation of wealth and self support in retirement has created a boom in banks moving into funds management. Australian banks, for instance, have spent billions of dollars in acquiring funds management companies and now dominate the funds management business. However, one of the major challenges for these banks is not only to have the products that customers require, but also the ability to offer "independent" and high quality advice across all geographic locations.

The process of attacking service levels means that banks must look at every aspect of service delivery. From people capability, training to infrastructure support. Each and every point of contact, system delivery and process must be working as one to produce a seamless and high quality experience for the customer.

There will inevitably be difficult issues about investment spend to infrastructures and systems that are required but provide no immediate or tangible revenue gains in the short term e.g. call centres, ATM networks, internet and web based services and improvements in back office processing. However, without having optimal infrastructure capability, a bank will run the risk of falling short on service delivery in meeting a customer's expectations.

Whilst CRM raises a hot debate, it is clear that the more integrated and complete a customer's data profile is at every point of contact based on real time data, the better the service will be.

If technology is being used as the face of the bank to service many millions of customers as it currently does, then the technology must be robust and highly reliable. Any shut down or failure of technology will present major risks to banks in terms of customer service and at worst, loss of good customers.

With the highly developed multi channels that banks offer, it is imperative that they offer a consistent and best of breed business experience for the their customers across every channel.

This embraces transforming the branch and maximizing its potential to interact and provide advice for customers. Banks have, after closing branches, turned full circle and are now looking to open branches again and encouraging customers to come back; not for transactional business, but to offer more relationship development and product offerings.

The role of call centres is starting to receive much more focus and attention by senior management of banks. There is a growing recognition that a call centre is the prime source of direct customer contact for a significant proportion of customers and its role is critical in improving customer service. In order to achieve this, banks need to focus on technology enhancements, improve people skills, increase training and focus on customer delivery. Call centers will ultimately deliver greater value to banks when they can not only deliver high levels of service, but provide real sales capability and positive income results.

The boom of internet banking has been a major bonus for channel strategy. It has given a low cost basis to service customers who may have otherwise used more expensive channels, including the branch. The cost savings that banks have made are significant and customers have warmed to the convenience of the net. The volume of transactions being made over the Internet continues to increase and for many banks now out strips the use of telephone banking.

The next phase of the development will however need to focus on enhancing the customer experience and making it more interactive. If successfully implemented, it may provide a major bonus to banks looking to enhance their relationship building with customers, improve service quality and marketing capability.

The Importance of Marketing Power

Growth is inevitably dependent on how many products and services customers buy from a bank. Thus in any strategy to raise retail income, banks need to be able to market and improve their cross sell rates to customers.

The number of customers is not the problem. Banks generally have shifted away from focusing on acquiring more customers which can be expensive, in favor of implementing strategies to retain them, particularly highly valued ones.

The challenge is for banks is to have to have the necessary fire power and people with the appropriate skills to market and sell the brand, product and services of the bank across the organization and into the markets that they are focused on.

Whilst banks have been more focused on this, it is difficult to achieve major change and results without making some fundamental changes to people and the skills that they have. Bankers employed in the high street and trading banks have been traditionally trained at the front line to process and provide a high level of service based on that function. It is in many ways it is unfair and difficult for people who have not traditionally had the experience or the training, to expect that they can be easily transformed into marketing gurus. Even with training, some people will find it difficult to make the transformation.

Inevitably, if a major shift of marketing capability is to be made, then banks will need to put in place the appropriate balance of skills required not only at the front line, but also throughout the organisation where marketing power and capability is needed and can be substantially increased.

Risk management

In terms of developments, there is little doubt that risk management has evolved as one the hot buttons at the CEO office. It has evolved into its own separate and distinct discipline and today is emerging as a critical strategic tool in not only protecting the business but also improving performance.

There have been major improvements to risk management techniques, tools and the way banks are structuring themselves to deal more effectively with risk management issues and challenges. A number of banks are now more inclined to have an executive at the top level that specialises in risk management rather than have it as part of another role.

Banks have will continue to make improvements to

credit practices, make operating risk a major priority, improve data quality and collection, decision making, change people behavior, create greater compliance with laws and regulation and increase training.

At the same time, the practice of risk managers is being driven by a desire to transform their roles purely as policemen to that of being a partner and strategic advisor to the business.

Fundamentally we have seen not only a desire of banks to protect themselves from balance sheet deterioration, but equally there is a push for improved performance by better managing risks and capital - reducing credit costs, losses and lazy capital.

With banks now more constrained with what they can do with increasing revenue and reducing expenses, more focus and attention is being made as to how risk strategy, better security, related technology and capital management can help the bottom line.

The smart banks will use Basel II to lift the bar with their risk management strategies and compliance regimes. These banks see it as an opportunity to make their infrastructures more robust, increase data availability, quality and storage, increase their precision around predictive capability and enhances performance by the prospect of capital relief.

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