



cutting through complexity

FINANCIAL SERVICES

# Optimizing banking operating models

From strategy to implementation

September 2012

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KPMG INTERNATIONAL





# Contents

|  |           |
|--|-----------|
| <b>Executive summary</b>   | <b>1</b>  |
| <b>The challenges facing the banking sector</b>  | <b>2</b>  |
| Regulations and regulators   | 2         |
| Economic environment   | 3         |
| Changing customers   | 3         |
| The march of technology  | 3         |
| <b>How will these changes affect the universal banking operating model?</b>              | <b>4</b>  |
| The end of universal banking   | 4         |
| Disintegration of the value chain  | 5         |
| Cost efficiency is key in developing new operating models                                | 6         |
| New IT architectures are essential   | 6         |
| <b>What banks need to do</b>   | <b>8</b>  |
| Seizing this once-in-a-life-time transformation opportunity                              | 8         |
| Developing an innovative operating model to overcome loss of scale and cost issues       | 9         |
| Implementing long-term sustainable cost reduction measures                               | 10        |
| Implementing an iterative and collaborative approach to a complex, multi-faceted problem | 11        |
| <b>Making it to the finish line</b>  | <b>13</b> |

# Executive summary

As the world emerges from what has been described as the greatest crisis in the history of finance capitalism, banks must adapt to radical new regulations, technologies, customer expectations and economic environments.

The current universal bank operating model is bordering on collapse and changes will be needed in three major areas to prepare for the challenges of the future:

1. Banks will become smaller, fragmented and decentralized.
2. Banks across the world must acclimatize to a negative or low growth environment in the developed world for the foreseeable future – compelling them to cut costs.
3. A complex IT architecture will be needed to accommodate these new operating models and handle greater demands for data.

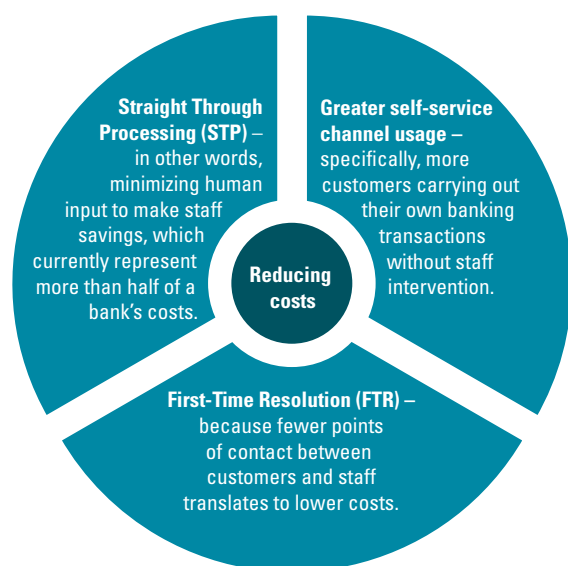
In this 'new normal', banks will not only have to worry about classic performance measures such as Return on Equity (RoE) and Earnings per Share (EPS). They will also have to focus on regulator driven measurements, such as delivering minimum capital and liquidity ratios and complying with new resolvability requirements.

Banks adapting quickly to these changes will emerge as winners in the marketplace. Solutions must be found which encompass new business models, operating models, customer demands and legislative constraints.

## Reducing costs

To overcome inevitable loss of scale and cost issues, banks must devise innovative operating models. An imaginative approach is needed to cut costs and control a disintegrated value chain. Innovation can be encouraged by lateral 'outside the box' thinking, based around preemptive rather than reactive processes. Furthermore, banks must introduce cost-reduction measures which are both long-term and sustainable.

**Three strategies in particular could have a high impact while being versatile and scalable and improving customer practice (more detail can be found on page 10).**



## Global challenges

Across the globe, the banking sector in different jurisdictions is grappling with the same challenges.

In the UK, the government has fully accepted the findings of the Independent Commission on Banking (ICB), set up to investigate the possibility of permanently separating retail from investment banking. Many banks have already begun the process of transforming their operating models by decentralizing operations, slashing costs and introducing more cost efficient processes and technologies.

In Asia-Pacific, authorities are developing a stricter regulatory approach and encouraging local banks to develop stronger standalone capabilities. With lower labor costs, the major focus for banks here is on process standardization and efficiency.

In the US, banks are repositioning their products and routes to market to replace lost revenues. Central to this is moving more low-value transactions to self-service channels such as ATMs, online banking and mobile. More flexible and user-friendly treasury management systems are also being introduced to support a renewed focus on corporate in place of retail banking.

Australia, meanwhile, has seen banks looking to customer-centric industries such as fast-moving consumer goods (FMCG), with beginning-to-end lines of responsibility. Staff must accept new skills, training, cultures and behaviors, otherwise it is the banks which will suffer.

# The challenges facing the banking sector

The past two years have been a time of unprecedented pressure in the banking sector. Customers have become ever more demanding – and less forgiving; regulators' risk management expectations are more onerous than ever before; investment in new technology has become a business-critical decision; and new players, like Virgin Money, Metro Bank, Fidor Bank and Jibun Bank, are providing more options for customers.

There may have been national banking crises in the past that were more severe. The unfathomably complex transactional relationships between banks all over the world meant that the shocks to the financial system in 2008 reverberated across the globe, and the impact was not confined to the banking sector itself, but shook the international economy to its core.

The crisis has left the banking sector with a series of challenges:

## Regulations and regulators

Authorities around the world are determined to avoid a repeat scenario of the banking crisis, with the result that a whole slew of regulatory changes are in the offing, or have already started to be implemented, with a view to tightening up regulation and avoiding another 'too big to fail' situation.

In the EU, Basel III is already putting bank models under the spotlight, but the full impact of the ongoing regulatory revolution has yet to be felt. Similarly, at a global level, successive G20 summits will seek to redefine the boundaries of acceptable banking practice.

Reviews are under way in a number of jurisdictions which could forcibly break up banking institutions. In the UK, for

instance, the Coalition government has fully accepted the findings of the Independent Commission on Banking (ICB), set up to investigate the possibility of permanently separating retail from investment banking. In a similar vein, many countries are limiting the future size of banks to limit their danger to the economy if they fail. ING, for example, has been ordered to sell its global insurance operations, its investment management business and its US online bank.

In the US, the Dodd-Frank Wall Street Reform and Consumer Protection Act, or Dodd-Frank Act, is the most comprehensive financial regulatory reform measure since the Great Depression. Its specific impacts are still being defined, but the act is expected to herald major changes to systemic risk aversion and consumer protection, among other areas.

There's also the expected tightening up on capital reserves. In the UK, the ICB proposed that the biggest UK banks should have enough capital and loans to cope with losses equal to one-fifth of their global balance sheet. Although it looks likely that the proposal will be slightly watered down on implementation to cover only the UK balance sheet, it still represents a major change to banks' financial structures.

The Financial Stability Board (FSB) is pursuing a similar agenda for the 29 global systemically important financial institutions (GSIFIs), while in Asia-Pacific, Australia, China and Singapore are implementing faster and greater capital reforms than Basel III (although this is not necessarily the case elsewhere in the region).

Moreover, it is not only the regulations that are driving change, it is the approach of the regulators themselves. Facing a slew of new regulatory responsibilities, regulators are making ever more onerous demands on banks, for example in terms of transparency and risk management. For example, one major US-based global bank estimated it would cost £4.2 billion to comply with demands from the UK regulator to increase the transparency of its risk management.



Arguably the greatest crisis in the history of finance capitalism.

**The Turner Review, 2009**

## Economic environment

The global economy is entering its fourth year of reduced growth, if not downright recession in parts, due almost entirely to the aftershock of the banking crisis and ensuing financial chaos.

Operating successfully in such a shaky economic environment in itself requires a new approach from the banks. They are still reluctant to lend money, despite political calls to lend more freely, and this scenario is not expected to improve anytime soon. Currently, the low-interest environment has prevented more insolvencies from occurring during the recession. Once interest rates start to rise again, an increasing number of insolvencies could act as a further brake on lending.

Financially, the Eurozone is still in unprecedented crisis, too. If the US is dragged into the panic, a new world recession could follow. More banks will collapse sending shockwaves through markets, further tightening credit and triggering more defaults and insolvencies.

In developed economies, real income has not grown for six years. A consumer-led recovery is therefore highly unlikely. And as a further hindrance to growth, austerity measures in Western countries are depriving economies of massive levels of investment.

## Changing customers

In the aftermath of the economic meltdown, banks are finding customers behaving more warily towards them. As well as the public bail-out of the banks, four years of 'bank-bashing' in the media and changing perceptions about the banking industry in general, mean that banks' reputations have never been lower. Customers are less trusting, less forgiving and have higher expectations about how banks do business.

Adding to the skepticism is the mis-selling in many countries, including the UK and the US, of products such as payment protection insurance and consumer investment products. Customers will feel further disenfranchised by the additional fees many banks will expect them to pay to offset the squeeze on banking profits.

At the same time, cross-selling of products to existing customers remains the most effective way of increasing sales and retaining customers. Somehow, the trust lost during the global banking crisis must be won back, which could take four or five years.

## The march of technology

Finally, many banks are burdened with out-of-date IT systems. As competition heats up to win back customers and increase internal efficiency, systems will need upgrading across the board. Many banks are assessing core system upgrades to bring more flexibility and configurability to their product development and pricing capabilities.

Technology is further complicated by the rapid rate of change and the introduction of new channels and technologies, such as mobile banking and social media. The sheer pace of change suggests that IT architectures will require significant re-engineering to support a complete re-working of the traditional banking operating model.

However, modernizing IT architectures will require vast levels of investment. While some banks understand the lead time and are making the appropriate level of investments, many banks are finding it difficult to support investments where the benefits may not accrue for many years and are often difficult to quantify. Their reluctance to drive forward a modernization agenda should not therefore be surprising. But this same reticence to internally invest will leave banks lumbered with patchwork IT compromises, rather than the efficient and integrated systems they need to thrive in the new banking reality.



# How will these changes affect the universal banking operating model?



Given the unprecedented challenges, it is not surprising that the universal banking model is teetering on the brink of collapse. We believe the changes revolutionizing the banking sector will impact traditional banking operating models in four fundamental areas, triggering a chain reaction which will leave its mark on every area of the current banking model.

## The end of universal banking

The financial crisis demonstrated that large, complex and interconnected financial institutions can generate disproportionate risks to financial stability (and tax payers' money). As a result, regulators and other policy makers have agreed that systemically important financial institutions (SIFIs)

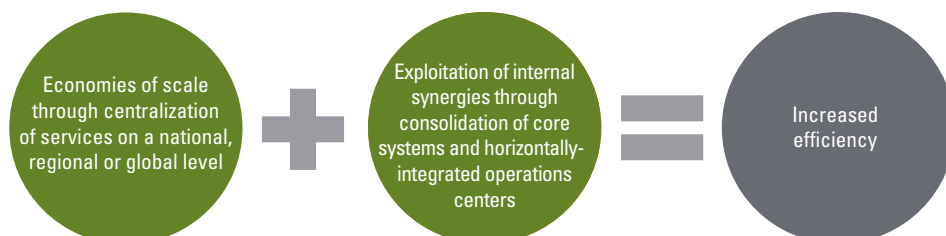
must accept a broader and more in-depth range of measures to mitigate these risks and avoid such wide-ranging impacts in the future.

One of the main tools to address this is to forcibly separate basic banking activities from more complex and more risky corporate and investment banking.

Although there are still some grey areas, especially in the realm of commercial/corporate banking, one thing is certain: this is just the beginning of a long and painful surgical operation to separate 'conjoined twins' who for decades have shared the same funding resources, liquidity and capital base.

## What will be the impact on operating models?

For the last two decades, universal banks have – almost without exception – pursued the same strategy:



We believe that the era of centralization and single-platform strategies is drawing to an end. Increasingly, shared services entities will be decentralized, either by disbanding them altogether, or by restructuring. One major SIFI in the UK is considering disbanding its central operations and putting the activities

back where they belong – into individual business units. Additionally, one US bank has recently disbanded a centralized IT group and installed mini-IT units within its lines of business.

Banks will also come under pressure to repatriate core activities from regional or global shared services to their respective

domestic jurisdictions. For instance, two Nordic banks trying to establish cross-border shared services have struggled to get a green light from regulators in their primary jurisdictions.

## Disintegration of the value chain

Splitting the universal banking model into retail and investment banking is not the end of the journey, however.

Banking regulators are keen to destroy the concept of banks 'being too big to fail'.

One way to achieve this is to divide ring-fenced banks into smaller components along product lines, spreading the risk between separate locally-resolvable entities. For example, in the UK, the FSA has identified 25 components, so-called economically critical functions, including retail deposits, payments and retail mortgages.

The aim is clear. If a bank gets into trouble, these components can be 'unplugged' and transferred to another entity. For example, if RBS encounters difficulties again, the regulator could take all its

current accounts and transfer them to Lloyds instead, or even protect them as a standalone entity. This could be done quickly, almost overnight if necessary, and customers themselves would suffer relatively little inconvenience. It would in essence be the same product, but with a different badge.

Such a system would require fundamental changes, not only in bank operating models but also in the way the industry operates. For example, it's likely that a sector-wide payments entity will be necessary (*see page 6*) and, by default, all customers would automatically be on the system. So if one bank failed, it wouldn't affect the whole payments system – their customers could simply be 'reassigned' on the central system. If a customer wanted to move banks, they could

be assigned to their new bank on the central system, rather than having to go through the current bureaucratic and time-consuming process of opening a new bank account.

## What will be the impact on operating models?

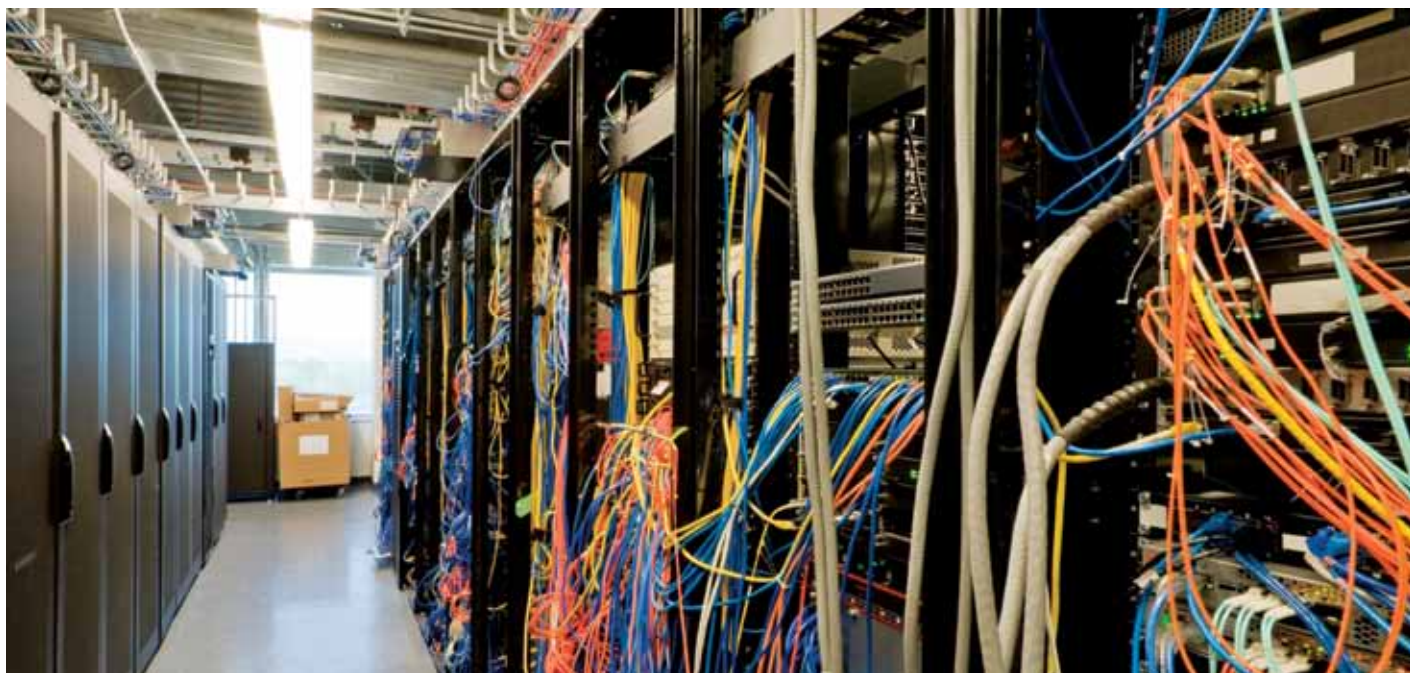
New operating models need to be flexible enough to function successfully in this new environment. Banks therefore need to consider componentized operating models supported by flexible and configurable architectures. Each component should be able to operate independently, or at least only loosely connected to other components and industry hubs.

This is a very long journey and will fundamentally define pacesetters and laggards in the new banking era.

**The FSA has identified 25 separate economic functions that a bank's services can be broken down into.**







**Is a new sector wide payments entity needed?** Similar to the ‘Mambo’ project that ran in Australia between 2007 and 2011, it will probably be a public sector organization servicing payments across the whole sector. This payments entity would process and route all incoming and outgoing money transfer orders via a Money Transferring Account (MTA). If a bank runs into trouble, its MTAs can be transferred to a new bank, and the routing platform can be programmed to reroute all incoming and outgoing transactions accordingly. If the scale of such a switch is problematic, the payments entity itself could even take over the payment services from the failing bank.

## Cost efficiency is key in developing new operating models

The consistent theme that underlines many of the challenges facing the universal banking model in the coming years is cost reduction.

However, traditional downsizing strategies are unlikely to be enough to deliver the cost base reductions needed. We believe that banks should start thinking about implementing longer-term sustainable cost reduction measures, such as straight-through processing, first-time resolution and self-service channels. There is some movement along these lines in the US, as banks strive to eliminate paper, automate processes and retire physical infrastructure to right size their operating environments.

## New IT architectures are essential

For the banking industry to achieve the necessary degree of separation and componentization, its underlying IT architecture must be capable of operating

in a similarly decentralized environment. These are significant challenges for banks, but they must be overcome.

Firstly, banks must recognize that existing tightly-integrated core platforms won’t be able to meet these new operating models. They should revisit Service Oriented Architecture (SOA) principles, including cloud computing, and try to identify the best roadmap for a componentized, service-oriented IT architecture.

Secondly, having a componentized value chain and corresponding IT architectures

will require industry-wide data standards. For example, customer data held by one bank must be held in a format that enables it to be processed simply and accurately by any other bank, as well as by any potential new structures, such as a central payments facilitator.

Thirdly, reporting requirements (mainly driven by the regulatory agenda) are already stretching banks’ IT resources. A disintegrated value chain and componentization will bring additional complexity into this picture which banks need to tackle swiftly.

### IT architectures must be capable of operating in a decentralized environment

| Problem   |   | Solution   |
|---|---|--|
| Tightly-integrated core platforms won’t meet new operating models | ➔ | Revisit Service Orientated Architecture (SOA) principles |
| Each bank must be able to manage and process data in the same way | ➔ | Industry wide standards                                  |
| Componentization will inevitably lead to more complex reporting.  | ➔ | Redesign of management info.                             |



## US: Chasing lost revenues



Operational efficiency. Cost reduction. Regulatory impact. Revenue replacement: the four engines driving change in the US banking sector.

Many US banks are already rationalizing their IT expenditure; trying to do more with less. They recognize that to succeed in the new banking environment, they need more flexible IT architectures and more agile operating models.

At the same time, banks are repackaging their products and their routes to market to try and replace revenue lost through regulatory changes, such as FATCA and Dodd-Frank.

One of the aims is to move high volume, lower value transactions away from branches and into lower cost self-service channels, such as ATMs, online banking and mobile. In theory, customers that use a self-service ATM, or access their account over the internet, where costs are lower, will access a different set of services than if they go into a branch and talk to an advisor in person.

Banks like PNC, Bank of America and Chase are currently grappling with the challenge of turning theory into practice, however, not least in terms of the implications for technology, data and the operating model itself. How do you identify the right customers for a particular channel?

How do you advertise a particular channel to a particular audience? What happens if a customer in a branch wants to conduct a low value transaction with a teller rather than an ATM – how you recoup that cost?

Another key strategy is the renewed focus on corporate banking, rather than retail. With revenue growth on the retail side at a standstill, banks are refocusing their investment into the modernization of corporate platforms and portals to enhance processing capabilities and increase agility and transparency of transactions across the Treasury Management and lending functions.

## Asia Pacific: Ramping up the regional focus



In light of the regulation coming out of the UK and the US around capital, transparency, structure and business resilience, authorities in Asia Pacific are also beginning to develop a more robust regulatory approach.

One aspect being considered is the impact on a local bank if its US or UK counterpart fails. This is leading to some regulators wanting a more intra-Asia focus on operations, which could have a big impact on the structure and operations of banks.

Increasingly, it is no longer about having the right mandatory documentation (such as agreements and service levels), but about how banks can maintain standalone operations regionally, rather than just focusing on the global picture. Banks are looking at their operating models (people and structure, process, technology) and trying to understand how this regulation could actually impact on their day to day operations. They are reviewing how they are

structured locally, such as the level of autonomy they have and their ability to make investment decisions, to enable themselves to be more reactive to the local and regional market.

The result is more regional consolidation, with many banks overhauling their sourcing and outsourcing strategies to reduce costs, and a more pragmatic approach to entering or exiting markets. For example, a number of global banks in Asia have identified that it is too expensive to maintain a banking license in certain markets and so will exit.

There is not the same regulatory pressure to restructure, for example by decentralizing, as the size and scale of local banks (except for China) is not comparable to those in more mature markets. However, local regulators do want to make sure that from a governance and accountability perspective, banks do not stretch themselves too thinly.

In terms of changing customer needs, the biggest focus for banks is their ability to process payments from various and emerging channels, such as mobile payments. It is an area where local and domestic banks have a slight advantage, as they have been using this technology for some time through necessity. For example, emerging countries like Vietnam, the Philippines and Indonesia have been using mobile payments for some time as the local infrastructure has not been in place to enable the effective use of more traditional channels.

Cost efficiency is still a big factor, but given the relatively low labor costs in Asia Pacific, the real focus is process standardization and efficiency – the ability to build critical mass and scale quickly. The market in China, for example, has over 1.3 billion people. To really make a dent in this market banks need to be able to scale up fast.



# What banks **need to do**

The severity of the banking crisis has to be matched by the severity of the response. It is not simply a case of fixing the banks and then getting back to business as usual. The repercussions have been so wide and so deep that banking as we know it – or have known it for the past half a century – will change dramatically.

**N**ew business and operating models will emerge; banking value chains will be disintegrated; new industry structures will arise. Classical performance measures, such as RoE or EPS will no longer be the only measure of success. And shareholders will not be the only stakeholders to which boards are accountable – they will be responsible to taxpayers, too.

In this 'new normal', banks should not only optimize RoE and EPS. They must also focus on regulator-driven strategies, such as delivering minimum capital and liquidity ratios and increasing their flexibility to comply with resolvability requirements. Indeed, it may be the first time that regulators have taken an active part in the formulation of new business strategies. We believe such strategies may include:

## **Seizing this once-in-a-life-time transformation opportunity**

We believe that the new regulations are here to stay and they will change the sector for good. Banks that adapt quickly to this shift – those that see challenges as opportunities and can transform their business and operating models accordingly – will emerge as winners.

Banks should mobilize all parts of the business (sales, marketing, products, operations, risk, finance, IT, compliance and more) to make this transformation the number one priority on everyone's agenda, starting from the members of the board.

## Developing an innovative operating model to overcome loss of scale and cost issues

Existing approaches to the development of operating models are based on traditional, linear problem solving techniques. This type of approach can be very effective when uncertainty and complexity are low and when the new design doesn't need to be radically different than the current one. However, they can not address the needs of the current highly fluid, uncertain environment, where banks need to radically change their operating models in order to survive.

All the traditional levers, such as economies of scale, single platforms and shared services, must be cut back, or at least can't be exploited as before. So, banks really need to find new ways of

reducing costs, coping with a complex and disintegrated value chain and addressing new data requirements, while at the same time delivering excellent customer service. We believe therefore that a new approach is needed for designing innovative operating models to address all these challenges.

One way of doing this is to look at the field of design, and borrow proven practices to foster innovation and creativity. This approach should encourage creators of new operating models to think laterally – and to accelerate the process, crucial to the new world in which we find ourselves.



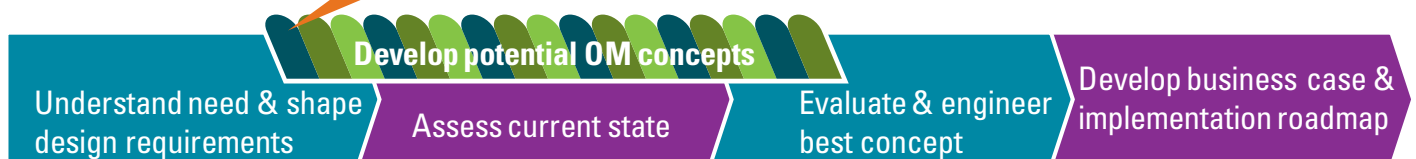
Iterative approach



Where design is done

### KPMG Rapid Target Operating Model (TOM) Design Approach

Design process starts right from the beginning





## Implementing long-term sustainable cost reduction measures

We believe banks should find new ways of reducing costs while increasing the quality of their customer service. We have identified three cost reduction strategies that can also make bank operating models more scalable while dramatically improving customer service.

### a. Straight Through Processing (STP)

On average, more than 50 percent of banks' costs relate to staffing – the sheer number of people necessary to process customer transactions. This is mainly due to a lack of complete automation of the service processes.

STP, therefore, is about paring back to an absolute minimum the human input required to process transactions. For example, if a customer creates a standing order online, with STP the whole process is automated from start to finish and no human input is required. Banks should identify their STP throughput rates and try to dramatically increase them.

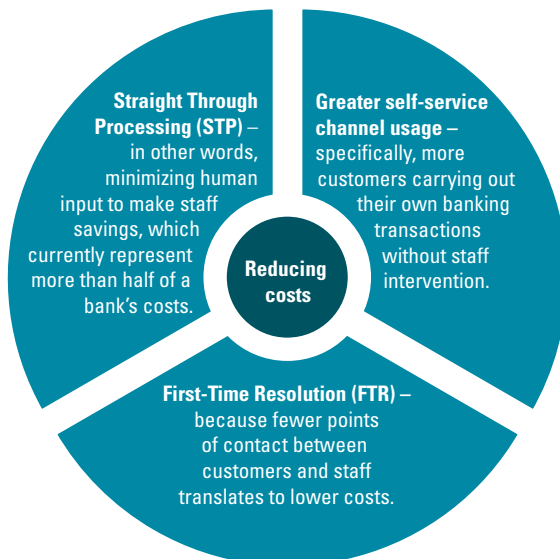
### b. Self-service channel usage

By giving customers more power and responsibility for carrying out their own banking activities, there will be less need for human input from the bank, with obvious cost implications. However, banks should remember that moving a process to a self-service channel without adequate planning risks inadvertently increasing the cost. Inviting customers to bank online increases the number of transactions carried out. If you don't automate these processes, eventually you will need more people simply to handle the increased number of transactions.

### c. First-time resolution (FTR)

This means that processes are resolved immediately at the first point of contact with the customer, whether it is a branch or a contact center. For example, if a customer wants to open an account, they are able to do it there and then in one go, without needing multiple contacts with a bank employee or contact center to complete the transaction. This contrasts with the current centralized model, where the vast majority of transactions end up in central operations. Again, FTR will only work effectively if the underlying transactions abide to STP principles. Otherwise, the same strategy can increase costs.

By pursuing these three strategies, the need for shared centers will fall. Middle and back-offices will handle only exceptions, fewer people will be needed, customer service levels will increase, and costs will dramatically drop.



## The five lenses of transformation.

### Strategic

- What will your business model look like in the new world and how does this fit with your strategic goals?
  - Understanding the impact on customers and changes to the way in which you do business with them in the future.
  - Assessing the extent to which regulatory change presents new strategic opportunities that can be exploited and where it leaves you versus your competitors.

### Operational

- How will you continue to drive operational efficiency whilst meeting regulatory requirements?
  - Developing an operating model through which you are able to demonstrate certainty of continuity of support during periods of stress.
  - Building compartmentalization into new legal entity structures whilst maintaining economies of scale.

### Regulatory

- How do you align your approach with the broader regulatory agenda?
  - Determining a best-fit solution in the context of the continually evolving and multi-jurisdictional regulatory agenda.
  - Ensuring the right balance between maximizing the regulatory dividend (i.e. reducing regulatory capital surcharges) and extent to which the firm crosses the regulatory threshold.

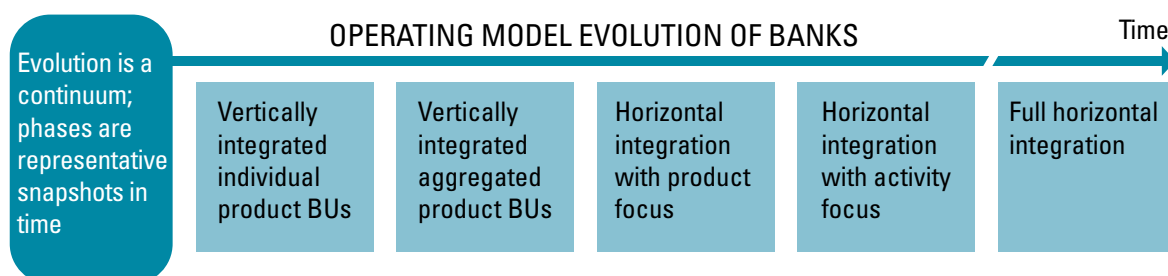
## Implementing an iterative and collaborative approach to a complex, multi-faceted problem

The transformation of universal banks into banks fit for this new environment involves new business models, new operating models, new legal structures, regulatory constraints and new financial and non-financial measures. Changing one without considering its impact on others may result in ineffective solutions or unforeseen consequences elsewhere in the business.

Many of the leading banks have already started along this transformational path, beginning the gradual process of restructuring their operational models to suit the 'new normal'. The vertically integrated model that until very recently held sway across the industry was developed around individual product business units, such as mortgages, banking,

savings, investments and insurance, largely due to legacy product-centric IT platforms. Each business unit was responsible for its own activities, such as sales, marketing, servicing and support.

Faced with the new environment they operate in, banks are now restructuring their operations around a horizontally-integrated model based on common services and activities, rather than products. So the model would be based on service-led business units responsible for a particular part of the value chain across the whole product range (where possible), such as customer proposition management, product development, strategic marketing, or distribution, with non-core products, such as investment products, being outsourced.



Few clients have ever undertaken transformation projects on such a scale. Understandably, many experience challenges in coordinating their activities and delivering real value. Banks should transform themselves by simultaneously redesigning their business models, operating models and legal structures. Each element needs to be considered through five distinct 'lenses':

strategy, operations, legal entities, regulatory constraints and financial outcomes, with all parts of the puzzle being addressed simultaneously. The advantage of this approach is that it unites all parties and drafts a holistic roadmap for progress. They can start their journey by asking a series of strategic questions through the five lenses.

### Structural

- How will you balance the need for structural separation with the commercial need for an integrated and efficient global group?
  - Working out whether or not the 'Group' or 'Center' has any future role in the business.
  - Establishing where synergies in the various interactions across the Group exist currently and which may disappear.

### Financial

- How do you build a financial model that supports regulatory requirements whilst delivering a compelling equity story?
  - Determining how to create an acceptable return for investors.
  - Maintaining an efficient tax profile throughout the changes to the business's structure and financial arrangements.

## Australia: View from down under



Like many other banking markets, in Australia the traditional, pre-crash driver of bank growth was credit growth. People were borrowing more and more each year, generating ever increasing revenue for retail financial services providers. Similarly, the effectiveness of sales teams and the operating model to support them was never tested as a ready supply of willing consumers always existed. But those days are gone. In the mid-2000s credit growth in Australia was about 20 percent a year. Today the figure is around 3.5 percent, leading to huge pressures on bank incomes and shining a spotlight on the need to drastically reduce costs.

The Australian regulatory environment is also testing. Banks are having to comply with around six times as much regulation as they did seven or eight years ago, both global and local, including anti-money laundering, various credit reforms, APS210 and changes to liquidity and capital rules, not to mention various local regulatory changes.

Australian banks are looking strategically at their cost base and operating models as they adjust to the 'new normal' levels of income growth. Many banks are looking to further consolidate functions that are duplicated across the group (often as a result of historic acquisitions) and develop 'centers of excellence' for key

functions leveraging Lean and other customer centric interventions. The formation of 'centers of excellence' also provides opportunities to baseline performance targets against better practice that is currently achievable within the bank, rather than entering into lengthy debates as to what is 'theoretically' possible as tends to occur when peer benchmarks are used. In this journey, banks are dealing with the tradeoff between the holistic autonomy of brands and entities and the need to drive efficiency and genuine customer value.

At the same time, banks are having to work harder to attract and retain customers. Generation Y will make up around 33 percent of the Australian workforce by the end of the decade, and they have very different transacting behaviors to traditional bank customers: For example, they are much higher users of online banking and mobile banking; less frequent users of branches; and much less likely to use a branch for traditional low value, high volume transactions.

Some leading banks are taking ideas from markets with a much stronger customer-centric approach – such as fast moving consumer goods – and applying them to banking. For example, rather than a fragmented structure common in most banks, whereby different departments look after

different parts of the value stream, such as product development, operations, technology, risk management, forward-thinking banks are implementing a more holistic approach, with a single owner taking end-to-end responsibility for a particular value stream, such as deposits or small business banking. It is a similar idea to the 'brand manager' approach of common in FMCG markets, where a very customer-centric brand manager has responsibility for a brand right the way through R&D, manufacturing, distribution, and sales and marketing.

It is not only about customers, though. Bank employees themselves are on the front line of this revolution. Rethinking delivery models and channel usage will require new skills, training and behaviors for bank staff. A branch-based bank teller carrying out high volume, low value transactions is a very different role to an informal 'drop-in' environment, where the emphasis is on sales and after-sales service more than actually carrying out transactions on behalf of customers.

Like their peers all around the globe, Australian banks that cannot rethink their strategy to address these fundamental changes risk becoming commercial dinosaurs.



# Making it to the finish line

Developing a new operating model will not, in itself, position a bank to succeed in the new market. The operating model is only part of the challenge. No matter how robust or sophisticated the operating model may be, if the implementation process does not have an effective governance framework, driven by strong, central design authority, the operating model will never fully achieve what it was designed for. The real test is in how effectively the operating model is implemented – and this is an area where KPMG can add substantial value. KPMG's target operating model methodology has effective, coherent implementation at its heart.

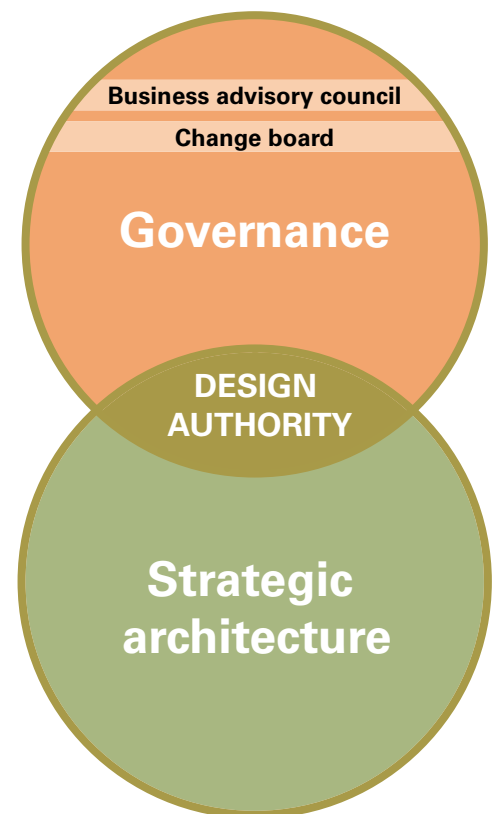
Implementing a new operating model might mean introducing a new technology infrastructure, moving towards new processes, or changing the operational structure of the business – major changes that need to be pushed through the organization effectively, without compromising the objectives of the operating model.

To help achieve this, KPMG's approach is to work with clients right from the design stage through to implementation.

It does this by co-opting senior members of the operating model design team – from the business, from the technology side, from the TOM design team at KPMG – onto a central design authority. The role of the design authority is to oversee not only the governance framework, but the practical implementation of the operating model.

All changes are reported back to the design authority. It reviews what is being implemented at each stage to verify it is in line the new operating model – is this implementing what the design specifies, or has it changed? If it has changed, was there a good reason? The main objective of this method is to not be a policing authority but be a guiding light that drives towards 'zero defect' during implementation.

This consistent, end-to-end approach is what makes KPMG different. Our involvement does not stop with the design of a new operating model. We work alongside the client on the governance and, crucially, the implementation, capitalizing on our specialist knowledge and industry insights to ensure the theory is actually translated into practice.



It would be unwise to underestimate the impact of the banking crisis on the industry. It would be equally short-sighted to underestimate the necessary response. It is not simply a case of finding a quick fix then returning to business as normal. The face of banking has changed forever. New business and operating models will be needed, and indeed should be embraced. Traditional value chains will disintegrate. New industry structures will emerge.

How quickly will banks adapt to this new landscape? And how effectively will these new models then be implemented? How readily will they adopt new business and operating models? These questions will determine which banks emerge from the current crisis as winners, and which fall to the wayside, unable or unwilling to adapt to the new reality.

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