CENTRAL BANK OF EGYPT
Egyptian Banking Institute

البنك المركزى المصرى
المعهد المصرفى المصرى

CURRENT TRENDS

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Cost Transformation New Imperatives in Banking

MOVING FORWARD WITH CONFIDENCE...

Background

Cost Transformation/optimization has been a priority on the agenda of most banks for many years. It is an ongoing tough process that must evolve over time, as market conditions, customer requirements and stakeholder expectations change. Banks' complexity and legacy may lead to different forms of cost inefficiencies. As banks grow and evolve, it is often normal to add new costs rather than remove existing ones.

In the wake of the COVID-19 pandemic, the cost agenda has been elevated to a new level of importance. A clear majority of banks are looking to significantly intensify and accelerate their cost transformation programs. This urgency derives from the downturn in bank profitability globally. In the current environment, banks need to reinvent their operating model and harness the agility, resilience and digital transformation they mobilized in their initial pandemic responses.

The COVID-19 pandemic pushed banks to find ways to aggressively cut costs. As ultralow interest rates and rising loan default rates continue to threaten revenues and profits, banks must find ways to stay solvent—ways that preserve their reputation and the sense of community they have fostered over the years. Banks used some cost-cutting measures during the financial crisis of 2008, closing thousands of branches and laying off many thousands of employees. Although these moves helped the bottom line, they greatly damaged employee morale and customer sentiment.

To reach sustainable cost optimization, an important focus of the cost strategy should be its customers and employees impact. A smart approach to cost reduction is to target activities that do not add customer value and to simplify and streamline existing activities and processes.

Additionally, we should recognize that there are new costs that are non- discretionary to cope with regulatory and societal (ESG) requirements.

Importance

Banks that redefine their cost transformation programs and rethink operating models are best positioned to strengthen profitability for the long term. Cost optimization solutions help banks to:

- Improve financial performance.
- Free up working and non-working capital for investment in growth.
- Gain competitive advantage by repositioning cost management and getting insight into fixed and variable costs.
- Enable agility and flexibility to respond to changing markets and demands.

- Understand spending patterns compared with the industry and the competitors.
- Create a culture of accountability and cost consciousness while maintaining high levels of productivity and output.
- Avoid non-value-added activities/expenses.
- Analyze the spending and map the total costs to value chain and determine which activities add value and which ones don't (good costs vs. bad costs), and select the right levers to influence the outcome and cost base.

Practices/Cost Transformation Levers:

The critical Important areas supporting banks' cost transformation plans post COVID 19 can be summarized as follow:

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.

1.3 Cost management focus: Drive a cost focus through strategy and accountability.

2- Optimizing procurement spending:

2.1 Property optimization/branch rationalization: Rationalization of operations between head offices and regions, adjustment of seat to desk ratio based on the changing needs. Reimagining workplace/branches through models such as community hubs/coffee stores. Over the long term, banks will recalibrate their physical presence through a mix of closing some branches and remodeling others for smart use and cost efficiency.

2.2 Optimize third party sourcing: Drive third-party spend down. Drive efficient and cost-effective sourcing practices to reduce or eliminate third party spend where not needed.

2.3 Deepen supplier relationships and review: Establish and maintain collaborative supplier relationships, consolidate the number of suppliers and identify alternative vendors.

2.4 Supplier tiering: Put suppliers in tiers on the basis of bank's needs and the vendor's capabilities.

2.5 Utilize vendor risk management: Practice robust and efficient vendor assessment, onboarding and management to identify and minimize third party and supply chain risk.

2.6 Bundling/Process Improvement: Coordinate purchasing across the entire bank and optimize purchasing processes across departments (Ex: Many departments may be purchasing similar items separately that will be much cheaper if bought in bulk)

2.7 Insourcing and outsourcing: Make insourcing & outsourcing decisions on the basis of internal capabilities and costs.

2.8 Specification rationalization: optimize and standardize specification across departments (Ex: A bank may be buying items with specifications far higher than what are actually needed and paying a premium as a result)

2.9 Demand Management: Reduce the quantities of purchases and the amount of spending that have low business impact. For Example: A bank analyzed the annual number of cash-transfer trips per ATM in relation to the ATM-specific cash stock balance. The analysis revealed a low-to-medium correlation between the number of trips and the cash balance. These findings allowed the bank to run simulations to find the optimal cash stock balance for every ATM cluster. The optimal ATM-specific balance reduced the amount of money in stock and the total number of shipments of cash to ATMs, resulting in 14 percent savings on cash-in-transit costs.

2.10 Telecommunications spending: Consolidating all telecom spending with one vendor (mobile, internet, and analog phone lines) may be an efficient good way to reduce costs.

2.11 Legal spending: Banks should optimize the mix between in-house counsel and external laws firms to meet their legal requirements. As a general rule, most routine matters should be handled in-house, while complex, nonroutine matters can be outsourced. This is in addition to harmonizing the hourly rates for external law firms by firm tier, the position of each person who performs work for the bank, and the type of matter being handled.

2.12 Implement digital procurement: Drive automation, advanced analytics, and data driven optimization to streamline processes and tools.

2.13 Smart working and travel costs reduction: There is a real opportunity of savings and compression of expenses in the area of staffs travel based on the smart digital working new approaches.

2.14 Mail and courier services expenses cut: Banks can use a zero-based demand approach along with new analytical tools to determine the right level of demand. For instance, banks could perform a bottom-up assessment of internal courier services to determine the actual need for these services at headquarters and at each branch.

3. Simplicity and organizational efficiency:

3.1 Organizational model: Reduce organizational complexity by adopting a business governance approach that embeds cost-management best practices in budgeting, reporting, decision-making and control processes.

3.2 Transformation optimization: Create a core organizational culture and capability around transformation.

3.3 Organization design and people: Drive the simplification of the organizational design throughout the bank, focus on spans and layers and realignment of pay and rewards.

3.4 Simplified line of business: Focus on core activities. Repurposing of workforce (cross training) to work across functions.

4. Digitization and Intelligent IT:

4.1 Digitization & operational efficiency: Digitize work from front to back office and drive enterprise-wide automation to replace inefficient manual processes.

4.2 Channel optimization: Digital shift with interventions to drive behavioral change. Smooth migration to digital channels can not only improve the customer experience, but also lower costs in the medium and long term. Channel digitization should be considered primarily in the context of customer needs and preferences.

4.3 Technology optimization/ simplified intelligent IT: Accelerate the migration of critical environments to the cloud, decommissioning of the obsolete applications and removal of data centers, use of digital paperless processes and big data analytics, intelligent engagement with startups for the future.

4.4 Headcount optimization: Digitization also provides a route to reduce labor-intensive paper-based processes freeing up staff to focus on more valuable client-centric tasks.

4.5 Data transparency: banks can use Advanced Analytics (AA) to combine fragmented data sets related to building maintenance—including tens of thousands of maintenance tickets, vendor data, and contract data—into a single data set. With this “master spend data set,” the bank used machine-learning techniques to rapidly identify anomalies and patterns that would trigger “warnings”; for example, they could flag maintenance ticket clusters with high chance of overpricing, allowing them to streamline and consolidate those clusters. The results and analysis enabled the bank to identify opportunities for renegotiation, as well as mitigate risks of future price increases.

Challenges

The main challenges to achieve cost optimization may include the following:

- The length of cost initiatives and the time needed
- The management turnover
- The management prioritizing 'easy' costs over systemic problem areas
- The lack of accountability
- The executive focus on revenue growth rather than cost reduction
- The varied management interpretation of cost reduction strategy
- Physical Channels Costs: Reducing physical channels costs remains challenging in large part due to fixed costs. Furthermore, banks have an ongoing responsibility towards vulnerable customers to continue to offer access through traditional physical channels and services.

Cases and interested links

- DBS adopted ABPP Mobile OCR to offer quick credit, a mobile app that allows DBS customers to apply for loans on the go. The relevant fields (names, financial details, etc) are filled-in automatically based on documents preloaded by the customers. The app allows DBS to verify and dispense loans within minutes, which augments decisions making while cost effectively enhance CX.

https://images.abbyy.com/Partner%20News/december15/7417e_SS_DBS_Bank.pdf

- JP Morgan's contract intelligence (COiN) chatbot analyzes legal documents and extract essential data points and clauses. The bot reviews 12,000 annual commercial credit agreements in a matter of seconds, which previously required 36, 000 manual hours.

https://www.chatbotguide.org/jpmorgan-bot

- In the US, capital one launched coffee shop banks, where customers sip coffee while conducting banking activities. Similarly, in Spain, Caixabank launched imagincafe.

https://www.capitalone.com/local/boston-northshore

https://www.caixabank.com/comunicacion/noticia/caixabank-launches-imagincafe-a-major-cultural-space-for-millennials_en.html?id=40581

HOTLINE
15200
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Headquarters – Nasr City
22 A, Dr. Anwar El Mofty St., Tiba 2000
P.O.Box: 8164 Nasr City, Cairo, Egypt

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