Beyond Cost-Cutting: Six Strategies for Improving Banks' Operating Efficiency

By Timothy J. Reimink

With the challenges that financial institutions are facing these days – and with the memories of the recession still painfully fresh in their minds – it's no wonder that a growing number of banking executives are focusing intently on cutting costs, trimming payrolls, and "right-sizing" their operations. But a relentless focus on cost-cutting alone is not a formula for long-term success. What's needed is a more balanced approach – one that enables an institution not only to improve operating efficiency but also to upgrade its capabilities to respond to market needs and prepare for the future.

Why Efficiency Matters

As with any business, banks must be vigilant about keeping down costs. Today, however, the financial services industry faces an unusual combination of circumstances that are giving special impetus to the drive for efficiency.

The long-running low-interest-rate, slow-growth environment of the past decade has contributed to significant rate competition, driving down margins in both loan and deposit operations. Meanwhile, the aftershocks of the recession, coupled with a generally slow-growing economy, are encouraging banks and their customers to move cautiously, which in turn leads to slow portfolio growth.

Equally significant are customers' dramatically changing interests and preferences in terms of banking products and services, particularly the channels they use to access these products. These changing preferences are generating a constant demand for new technological capabilities, which carry their own cost pressures. Banks must not only invest time, money, and resources into acquiring technology to provide better mobile access, they also must devote even more resources to address the significant security risks these new platforms introduce.

Added to all these pressures is the ever-rising cost of compliance with postrecession regulatory requirements. The combination of these factors has put exceptional pressure on financial institutions' operating budgets and generated an understandable appetite among executives for cost-cutting strategies.

Setting Targets for Improvement

Rather than asking whether efficiency and productivity can be improved, banks today are asking how – and how much – these can be improved. Every institution is unique, of course, so the size of the improvement opportunity will vary greatly from one bank to another. Industry experience suggests that a concentrated and carefully executed efficiency initiative should be able to achieve significant savings. Reasonable targets might include:

- Branch staffing reductions equivalent to one to two full-time equivalents (FTEs) per branch
- Savings in commercial, mortgage, and consumer lending functions equivalent to 0.25 to 0.75 FTE per lender
- Efficiency improvements in payment processing equivalent to two to four basis points
- Procurement and sourcing efficiencies enabling up to a 15 percent reduction in certain targeted spending categories

Again, every institution is unique, and there is no simple formula for estimating the size of an opportunity. Moreover, the outcomes are not always realized through direct cost reductions. Ideally, improved efficiency means that the bank's revenue stream and asset base are growing while overhead costs are growing at a significantly slower rate.

Six Strategies for Improving Efficiency

So how can a financial institution begin moving toward such outcomes? Across-the-board budget cuts inevitably are a recipe for disaster. The most successful efficiency initiatives follow a more analytic approach that reflects the specific challenges and opportunities facing each line of business and support function. Following are six strategic areas where many of today's industry leaders are focusing their efforts.

1. **Business realignment.** The basic premise of business realignment is to exit business lines that have high costs and low margins and move instead into lines that are inherently more cost-effective and profitable. Efficient institutions take a robust approach to strategic planning, assessing the minimum commitment of resources needed to compete in a particular line of business and identifying opportunities to differentiate themselves from competitors. In many instances, this means that traditional banks might choose to move into nontraditional businesses, such as specialty financing and payment processing – provided, of course, their analysis reveals they can compete effectively and efficiently.
2. **Channel optimization.** The goal of channel optimization is to assess the various ways customers interact with a bank in order to create a cost-effective combination that is adapted to each bank's specific customer base. This process is encouraging some fairly aggressive selling and buying of branches as banks adjust their geographic presence. Many institutions also are significantly reconfiguring duties and responsibilities within the branches and employing new metrics for analyzing branch performance and value. Other strategies include enhancing the operating hours and technical capabilities of call centers to meet customers' changing expectations.

Creating electronic images of documents early in a transaction helps the process move from step to step with minimal delay and virtually no added cost.

Again, there is no one-size-fits-all approach. Some banks assertively promote electronic account openings, remote deposit capture via smart devices, and accounts that are designed to be virtually paperless. Other banks – often those with large commercial customers – pursue a fundamentally different approach, focusing on personal service with a relationship manager and support team assigned to each qualifying account. The analysis of such institutions has revealed that the high-value business generated by this approach can more than offset the added costs.

3. **Process costs.** The opportunity to improve process costs often is underappreciated in financial institutions, in part because it involves taking a somewhat nontraditional view of business processes. The goal is to reduce the unit cost-to-value ratio of each activity or transaction – such as the cost of opening an account, creating a loan document package, or handling a specific type of transaction. Improvement in this area involves continual performance monitoring and often comes about as a result of analyzing, mapping, benchmarking, and ultimately rethinking back-office processes. Important trends (discussed in more detail later) include greater reliance on automated routing and processing, as well as more efficient use of imaging technology.
4. **Staff productivity.** In addition to reducing process costs, automation tools can help improve staff productivity, enabling banks to handle more transactions and greater volumes of activity with the same number of personnel. But productivity improvement is not dependent on technology alone. Some of the most significant opportunities involve using established performance management techniques, such as clearly defined expectations and scorecards, improved motivation and rewards systems, and better training and supervision.

   Other useful tools include visible metrics and performance charts along with "line-of-sight" incentives – such as bonuses that are directly related to individual performance and practices, not just institutional performance. Many institutions also find success in redefining job roles, experimenting with more flexible work arrangements, and outsourcing more specialized activities.
5. **Technology and automation.** The role of technology has been mentioned several times already, but because of its broad, enterprisewide impact, the use of technology and automation also merits individual attention as part of the overall efficiency improvement effort. The overarching goal is twofold: 1) to use technology to reduce the time that's spent in finding information and 2) to use automated business rules to move work through the institution more quickly and efficiently.

   For example, automated workflow processing gives managers greater visibility into the activities being performed, allowing them to monitor work queues, identify bottlenecks or problems, and reallocate work to respond to changing conditions. One increasingly important practice is to engage in electronic imaging of documents as early as possible in a transaction rather than using electronic images as a final step for document storage after the transaction.

   Electronic documents can move from step to step with minimal delay and virtually no added cost. Even more important, electronic imaging allows parallel processing of documents so that several steps in a transaction's progress can be completed

Contact Information

Tim Reimink is a director with Crowe and can be reached at +1 616 774 6711 or timothy.reimink@crowe.com.

simultaneously. In many instances, of course, the use of signature pads and online processes can eliminate the paper form altogether – thus taking one more step out of the process.

Beyond helping to automate core processes, technology also has an obvious role to play in a bank's channel optimization efforts. It affects not only how customers interact with the bank but also how banks communicate important information internally and how they manage their sales and customer relationship activities.

6. **Vendor relationships.** Improved vendor management does not mean simply pressuring vendors to lower their prices. Rather, it is a focused effort designed to derive the greatest possible value from a vendor relationship. Important tools include using service-level agreements and vendor scorecards to monitor performance issues, such as system availability and response times, in addition to direct expenditures. Such tools help provide a more complete view of the vendor relationship.

   Other basic cost-cutting techniques include consolidating vendors and benchmarking costs against comparable services in the market. Bear in mind as well that vendor relationships can have an effect on regulators' view of the institution's risk profile.

Instilling a Culture That Values Efficiency

Looking beyond the six specific cost-saving strategies discussed here, it's important to recognize that long-term efficiency is impossible to achieve without a corporate culture that supports and values it. This requires a visible commitment from top management to balance value and cost, reduce unnecessary expenditures, and implement metrics and accountability that encourage individual attention to cost reduction and efficiency.

Ultimately, organizational success and improved financial performance require more than just cutting costs. A successful organization must be able to provide customers with value and service at a cost that allows it to be competitive while still generating an acceptable return.

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