Opportunities for Action in Financial Services

Transformation in Financial Services: How to Beat Team Ferrari

THE BOSTON CONSULTING GROUP

Transformation in Financial Services: How to Beat Team Ferrari

You don’t have to be an auto-racing fan to know what is happening on the Formula One circuit today. Every year, nine teams reengineer their cars, change drivers, and play with the regulations with one goal in mind—to catch and pass Michael Schumacher and his red Ferrari. Yet every year the Ferrari team seems to get better, moving farther away from the pack. It’s hard to see this situation changing without one of the other teams undertaking a major self-improvement program.

Things have not always been this way. Ferrari went through some tough times in the 1980s. But when Luca di Montezemolo returned as head of the team in 1991, having previously led Ferrari in the 1970s, he embarked on a long-term program to transform his outfit. In the ensuing years, he invested in new technologies and aerodynamics, tackled internal reorganization, and experimented with new driver teams that included a talented man named Schumacher.

The plan did not deliver immediate results, but di Montezemolo persevered. His aim was not just to win but to create a sustainable, unbeatable competitive advantage.

Since 2000, Schumacher and Ferrari have won the Formula One drivers’ and constructors’ titles every year. Ultimately, the team was able to achieve its goal—and redefine the basis of competition in the sport of auto racing itself—by taking a bold and comprehensive approach to transforming key elements of its technological, organizational, and human resource capabilities.

A similar story is being played out in today's financial-services industry. A few leading institutions in local and global markets are pulling farther ahead of the pack while the rest struggle to keep pace. Perhaps your organization is one that, following a period of general prosperity, now finds itself trailing the leaders and struggling to meet the high expectations of customers and shareholders. If that is the case, some of the following statements might apply to you:

- Your revenue projections never quite materialize, and your cost-reduction efforts don't get the traction they used to

- You don't know whom to hold accountable when things go wrong since responsibility for every initiative seems tangled among product, segment, or geographic units

- Customer and staff satisfaction levels are starting to slip

- Your executive team has lost its drive and spends more time on internal battles than on winning in the markets

- There is a widening gap between your total shareholder return (TSR) targets three to five years down the road and your current revenue and cost initiatives

In BCG's view, many financial-services providers today find themselves in the position of Ferrari's competitors. To be able to compete now and in the future, they must confront their malaise, move past stopgap measures, and explore a holistic transformation of their companies.

What exactly is transformation? It is a large-scale makeover of the principal elements of a business, aimed at overall performance enhancement that is renewable and sustainable. Moreover, although every transformation program is certainly unique in its own way, there are three imperatives that we have observed to be key ingredients for success: financial institutions must believe in the need for fundamental change, develop a bold agenda, and instill a winner's culture.

Believe in the Need for Fundamental Change

When many organizations talk about transformation, they tend to mean a relatively minor retooling of one or two parts of the business. Real transformation goes deeper than that. It is both about making dramatic changes that will reshape the way you do business and about creating new competitive capabilities at lower cost. Of course, transformation is not without risk: it requires a multiyear commitment, the ability to make tough decisions, and a lot of perseverance.

We have found that a careful diagnostic exercise involving three basic initiatives is central to creating belief in the need for transformation.

Identify the size and nature of the gap between performance aspirations and current cost and revenue initiatives designed to achieve them. Can your business plans achieve target TSR and other goals? Are your assumptions about industry growth and competitor activity realistic? By tackling such questions directly—which surprisingly few players do with any regularity—the size of the gap (often in billions of dollars) can be estimated under different revenue and cost

scenarios. We usually find this exercise to be highly enlightening for CEOs and executive teams, if not downright frightening.

Assess your relative competitive capabilities. Will the tried-and-true business model that has served you well in the past get you through the race three years down the road? Will you have the capabilities in customer relationships, distribution, product and pricing flexibility, cost efficiency, and business scalability to create an advantage over competitors under changing market conditions? Here, typically, is where the true reasons for competitive disparities between players are uncovered and where transformation priorities are determined.

Ask your own executives to identify organizational inhibitors to better performance. Company executives are often acutely aware of the barriers that prevent their institution from achieving its potential. But they usually feel uncomfortable expressing such thoughts to the CEO for fear of implicating themselves in the problems or being labeled disloyal. Yet many will open up to a confidential third-party interviewer, and CEOs are often amazed at what comes to light when the content of these interviews is reported back anonymously.

Develop a Bold Agenda

What is a bold move? It is an action designed to reach goals beyond those the organization previously thought were achievable. A bold move puts initiatives in motion that dare to depart from business as usual, challenging the company to perform above entrenched, mediocre expectations. Such moves are needed to change a company's trajectory, and they

are not one-off exercises. Ferrari didn't make just one bold move but learned how to challenge itself consistently, year after year, to move the bar ever higher. Financial industry leaders must also challenge themselves to stay on top.

In our view, based on work with many financial institutions, bold moves capable of shaking up the status quo typically involve five initiatives.

Set stretch targets and establish accountability. When a CEO asks for slow, gradual revenue growth or cost reduction, that is generally the maximum performance he or she can expect. The typical result is mediocre. Yet audacious targets, provided they are clearly communicated and cascaded down through the organization so that each executive knows exactly his or her level of accountability, can light a fire under a company.

For example, one large bank in a mature market had been in a state of lethargy for a couple of years. As part of a far-reaching transformation initiative, the bank decided to set a goal of achieving top-quartile TSR performance within its market. But when the business-unit forecasts were added up, that goal looked unachievable. Then the CEO intervened and set a nonnegotiable overall target of 70 percent earnings growth within three years, assigning clear accountability to the head of each business unit. This step, in tandem with a new set of revenue and cost initiatives, helped spark motivation and a sense of mission within the institution, setting it on the path to recovery and renewed success.

In another instance, a leading bank's corporate-function costs had been growing faster than revenues for several years. Various cost-cutting measures had

slowed—but not stopped—the trend. The CEO then assigned all corporate functions to a single executive and mandated a 30 percent cost reduction. Such a stretch target was the only way, in the CEO's view, to drive fundamental change. Although the functions and the business units had been stuck in a permanent state of mutual dissatisfaction, the target helped ignite excitement and energy around forming a more dynamic partnership. The move helped the bank take large steps forward in its overall transformation program.

Align organizational structure with business strategy. Mismatches between organization and strategy represent a classic barrier to top performance. Aligning these elements is critical to transforming a business. Take the case of a large financial institution whose organization design led to overlapping distribution support for different products, missed opportunities owing to poor segmentation, and solutions that appeased competing factions but were ineffective. The bank was organized with a management committee at the top, which had not provided a clear sense of direction, and six product-centric, silo-like divisions underneath, which possessed little clarity when it came to decision making and accountability.

To try to achieve the strategic goal of boosting revenues by providing a better customer experience, the company adopted a new center function consisting of the CEO and a CEO team. The institution then reorganized the six product-centric units into three customer-centric units (retail domestic, retail international, and wholesale), with clearly defined goals, lines of authority, and accountabilities. This organizational step very quickly eradicated the "silo" thinking that had dominated the institution and delivered immediate, excellent results.

In another example, a financial services CEO believed strongly in focusing on key segments with a multi-product value proposition. But in the company's home market, there were three subsidiaries covering the retail space: banking, wealth, and insurance. The CEO combined the three business units into one that focused on retail financial services, with clear segment strategies and accountabilities. This move led to a significant improvement in results.

Simplify the product portfolio. One critical path to transformation in financial services is through the dramatic simplification and standardization of products (and their supporting systems) that over many years have had layer upon layer of complexity built into them. Such an initiative requires a bold reduction in the number of products and product variants, along with rationalizing their supporting systems and infrastructure.

One large bank drastically reduced its product range by restructuring its portfolio around a very small set of core lending products, using standard pricing, and bundling product features to create flexible customer offerings without adding business complexity. Not only did this move deliver significant cost savings in processing and core systems support, but there was also a surprising upstream effect: increased sales flowed both from products that were much easier for staff to understand and sell, and from greater flexibility to bundle and align offers with individual customer needs.

Streamline operations and IT. Operations and IT are often black boxes to senior executives. Costs creep up every year, and inflexible processes constrain growth. Action seems impossible, given the complexity of IT and operations and the way in which they are scat-

tered across companies. One solution is to set ambitious objectives and to make a single executive accountable for delivering simplification, improving performance, and reducing costs.

For example, one major financial-services player possessed a complex IT landscape. Various cost-reduction campaigns had produced mixed results, and performance was mediocre. Then, as part of a sweeping transformation initiative, the CEO charged his CIO and IT organization with bold, long-term objectives. Within several years, 6 core product systems were reduced to 2, 12 IT networks were merged into 1, and 8 computer platforms were consolidated into 3. The cost savings were impressive, and managers could focus on managing the business—not just the IT complexity.

In another case, a major financial institution introduced what it called a "process-centric, shared-services" structure and operating model. The model's purpose was to overcome cost inefficiency and accountability barriers between business divisions, which owned their own operations platforms, and the centrally run IT organization. Ultimately, by putting the operations and IT function under one authority at the product/service delivery level—and by creating eight "hubs of processing excellence" with clear end-to-end accountability—the institution was able to cut its operations and IT cost base by more than 20 percent. This model leveraged internal scale and best practices to deliver quality and timely services. The bank was also able to implement accountability and governance measures—at the enterprise level—that simultaneously focused on revenue growth and operational efficiency.

Revitalize the corporate center and support functions. Corporate centers can often find themselves at odds

with business units and can be perceived as a hindrance rather than a crucial contributor to the success of an enterprise. Transformation programs don't work unless this problem is addressed. We have found that real change is enabled if CEOs and CEO teams redefine and revitalize the role of the center and take a tough-minded inventory of how it should operate in three critical areas: establishing governance standards, developing and monitoring strategy, and managing performance against objectives.

In one instance, a bank created an office of transformation led by a member of the CEO team and supported by members of various business-unit leadership teams. This move set the stage for monthly performance-management meetings where key questions could be addressed:

- How many of the bank's top projects are on track with agreed milestones?

- Does the bank have enough high-impact projects in the pipeline to achieve its financial targets three years down the road?

- Are the portfolio of initiatives and the investment budget aligned with strategic priorities?

The bank's multiyear implementation plan is now being managed proactively, enabling managers to intervene when things go wrong and allowing actual results to be figured into budgets and financial forecasts.

Indeed, strong program management is the glue that holds major transformation efforts together. The program should be led by a very senior executive who is trusted not just by the CEO but also by the wider organization. We have found that the

development of high-level program-management skills is a common challenge for banks. Many have superb project-management abilities, but far fewer have the enterprise program-management capacity to oversee their change initiatives as a portfolio. Numerous institutions also lack the capacity to gauge the future impact of their projects and are thus forced to rely on highly uncertain financial forecasts for each business unit. Moreover, a clear majority of major banks have difficulty identifying off-track projects early, which often results in bad news surfacing when it is too late to act.

Strong program management enables visibility into the enterprise pipeline of projects at an early stage, based on facts and objective information. This in turn permits proactive monitoring of projects—which lowers the probability of bad news surfacing late in the game—and improved forecasting of financial consequences two to three years down the road.

Instill a Winner's Culture

The hardest part of transforming your team is getting your people to think like winners. This piece of the puzzle is never achieved by exhortation alone.

In one case, a large universal bank developed a series of major cost-reduction and market-share initiatives but realized that unless some deep-rooted management behaviors changed, the rest of the organization would not buy into the program fast enough to make a difference. So senior management—including the CEO team, business-unit heads, and initiative teams—identified the behaviors that they knew, individually, should be "stopped" and "started," and chose to lead the transformation by personal example. Targeted

“stop” behaviors included making a decision and then going back on it, saying you agree when you really don’t agree, seeing only “why nots” and never coming up with a solution, and avoiding telling difficult truths. The power of this change in behavior resonated throughout the company, and the CEO team continues to take a disciplined, quarterly inventory of how well the company is doing against its behavioral commitments.

Or take the case of a sizable insurance company whose performance had long been deteriorating. The institution lacked clear aspirations or objectives, and this condition was mirrored by the attitude of its employees. Poor performers were tolerated. The lines of communication between departments and all levels of staff had become almost entirely dysfunctional. The entire business was at risk.

To respond to the problem, the insurer, as part of an overall transformation program, redefined accountabilities to focus on a culture of leadership and on delivering results. The company implemented a stringent performance-management process that included tough but attainable metrics, and it jump-started collaboration through programs in which performance feedback was given and received by all levels of staff. Rigorous grading systems were introduced, and poor performers were managed out. A crucial motivational factor was the renewed collaboration, which led to a feeling of being “all-in-this-together” and a collective sense of purpose to put things right.

Ultimately, it was the combination of adopting both disciplines and motivators—within a framework that BCG calls *engaging for results*—that helped the insurer turn the corner. Within three years, profits doubled. Also, in this case—as in many others we have ob-

served—the confident, can-do culture was driven through the organization by the CEO, as well as by the CFO and other members of the corporate center's inner circle.

Rev Your Engines

Financial institutions can always adopt quick-hit strategies to address this or that performance shortcoming. And companies can try to improve staff morale in many ways. But when bold moves are made both in the way a company conducts its day-to-day business and in the way it actually perceives itself—all within the context of an acknowledged need to enhance performance significantly in a sustainable way—then a true and comprehensive transformation can take hold.

Of course, large-scale transformation programs are not to be taken lightly. They are not universal panaceas, can cause a lot of friction within companies, and can be extremely wearing. They require a large investment of time and resources with no guarantee of success. Yet not to explore the possibilities of large-scale transformation would be, in our view, a gamble that relatively few financial institutions can afford to make—especially as regional and global market leaders seem to be putting more and more distance between themselves and the also-rans.

If you have a desire to beat the Team Ferraris of your market and to deliver a better institution for your shareholders, customers, and employees, then don't wait until your oil is dangerously low—and your engine is in jeopardy of seizing up. A familiar path of stopgap measures might buy you time but will never let you catch the dominators.

Above all, forward-thinking financial institutions should know that large-scale transformation, although potentially risky, can bring enormous long-term benefits when successful. And it *can* be achieved. Why shouldn't your institution be the one to get the checkered flag?

Jürgen E. Schwarz
Danny Dale
Michael Shanahan
Keith Halliday

Jürgen E. Schwarz is a senior vice president and director, and Keith Halliday a manager, in the Toronto office of The Boston Consulting Group. Danny Dale is a senior vice president and director in the firm's Melbourne office. Michael Shanahan is a vice president and director in BCG's Boston office.

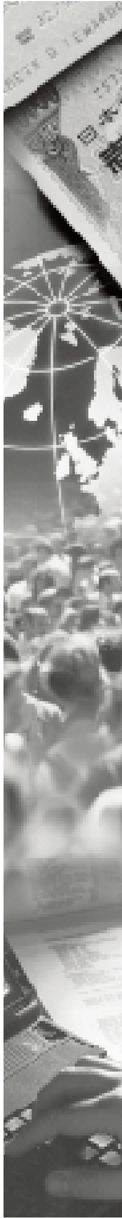
You may contact the authors by e-mail at:
schwarz.juergen@bcg.com
dale.danny@bcg.com
shanahan.michael@bcg.com
halliday.keith@bcg.com

To receive future publications in electronic form about this topic or others, please visit our subscription Web site at www.bcg.com/subscribe.

© The Boston Consulting Group, Inc. 2005. All rights reserved.

The Boston Consulting Group

Amsterdam
Athens
Atlanta
Auckland
Bangkok
Barcelona
Beijing
Berlin
Boston
Brussels
Budapest
Buenos Aires
Chicago
Cologne
Copenhagen
Dallas
Düsseldorf
Frankfurt
Hamburg
Helsinki
Hong Kong
Houston
Istanbul
Jakarta
Kuala Lumpur
Lisbon
London
Los Angeles
Madrid
Melbourne
Mexico City
Miami
Milan
Monterrey
Moscow
Mumbai
Munich
Nagoya
New Delhi
New York
Oslo
Paris
Prague
Rome
San Francisco
Santiago
São Paulo
Seoul
Shanghai
Singapore
Stockholm
Stuttgart
Sydney
Taipei
Tokyo
Toronto
Vienna
Warsaw
Washington
Zürich



BCG
www.bcg.com
4/05