

CUTTING COSTS, WITHOUT CUTTING OUT YOUR BANK'S FUTURE

Overzealous or misguided chopping does damage

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Efficiency programs, restructuring, right-sizing--no matter what euphemism is used, cutting costs was a challenge for banks long before the global financial crisis and the Eurozone crisis and all the other challenges banks are or will be facing.

However, as profits are squeezed by declining revenues and rising expenses, banks are now forced to embark on a much more rapid and fundamental reshaping of their businesses. For many, marginal cuts are not enough; some banks are looking to reduce costs by 20% to 30% or more.

But cutting costs doesn't come without a cost.

Banks must consider the cost of cutting costs--particularly those not captured by the restructuring line on the accounts.

Banks that believe they are robust enough to withstand such significant change without plans to mitigate problems will face expensive disillusionment.

Dangers of getting it wrong

Many banks made staffing cuts in response to the crisis, then rehired as the global economy began to recover, only to cut again as the Eurozone crisis has threatened the recovery. In addition to reducing headcount, institutions are continuing to turn toward outsourcing, off-shoring, and short-term contractors. The cut-hire-cut cycle, the influx of nontraditional hires, and the threat of further layoffs are damaging morale.

In an industry traditionally known for competing fiercely for top talent, uncertainty is a catalyst for increased attrition--and is driving the best out first.

This attrition often causes a near-complete turnover in many departments within just a few years, creating a severe loss of institutional memory and culture.

On the other hand, where it's a case of "last in, first out," some institutional knowledge is protected--but the next generation of managers and leaders are disappearing through the front doors.

Moreover, lines of responsibility are becoming unclear as banks transition to new models and fill resource gaps that emerge through staff departures or skill mismatches.

When your customer feels your pain ...

This volatile environment puts an entire organization, and its reputation, at great risk. Reducing headcount without planning to mitigate latent problems can lead to customer-service issues:

- • Customer care suffers. Faced with more product homogeneity, banks must differentiate themselves through their people and the service they provide to customers. Layoffs and outsourcing can put stress on customer relationships.

- • Mistakes hurt customers. Even worse, new staff members or contractors who lack experience or familiarity with systems and processes are more likely to make mistakes, further angering customers.

- • The buck stops, where? Even if front-office staff is spared, layoffs in other parts of the business (operations and technology) can cause problems. Banks may struggle to ensure a consistent approach to and level of customer service in the middle and back office.

Effective risk management is also being affected, particularly in banks where a common understanding of risk appetite is crucial. Banks need to rely on human judgment as well as systems to deal with current risks and anticipate new ones.

Easing the blow

There is no simple or single response to minimizing and mitigating the impact of these issues. But here are several areas in which to focus to alleviate potential problems:

Technology: Banks are already examining how to upgrade systems to satisfy increasingly challenging reporting requirements from regulators. Some are also working towards the harmonization of legacy systems that are still operational following previous M&A activity. Make use of such opportunities. Organizations can use these major redesigns to improve connectivity across the bank and further "industrialize" processes, reducing the effects of human error and the reliance on manual "workarounds."

Knowledge transfer: Working with longstanding employees to capture and transfer institutional knowledge is key. Training sessions during transition periods are a short-term solution. But developing and implementing a knowledge management hub--a set of written documents or a database--will provide the bank with a more robust proxy for the memory of individuals.

Organizational culture: Change and disruption can affect employee behavior and, over time, alter the culture of a bank. From the boardroom down, banks need to have a clear view of what they expect from their people, both specific behaviors and the values that guide employees as they exercise their judgment. These expectations must be communicated through multiple channels to reinforce their importance and to minimize misinterpretation as they cascade through the organization.

Employee development: Investing in group learning and development sessions--particularly in departments that have experienced significant change or have become geographically dispersed--will help to instill the right values in employees and ensure the right behavior. Specific programs to target high-risk and customer-facing areas will also help to protect and enhance the bank's reputation.

Getting it right jumps you ahead

Cutting costs is not cost-free. As many organizations reshape their business models, there is an opportunity for banks that recognize this reality and plan properly for cost reductions.

The banks that are best able to do more with less over the long term can potentially leapfrog their competition and be better positioned to maintain and grow market share as economic conditions inevitably improve.

* The views expressed herein are those of the authors and do not necessarily reflect the views of Ernst & Young LLP.