Converting cost to growth: Why strategic cost reduction matters in banking
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The growth gap

Despite a first wave of cost reduction initiatives and competitive moves to meet the new “digital normal”, shareholders continue to be underwhelmed by the banking industry’s performance.

From announcements of consecutive losses to flatlining returns on equity and fluctuating cost-income ratios, banks are under pressure to reclaim profitability. Yet the road to success is risky and execution is difficult.

Banks aim to thrive, not merely survive—Accenture Strategy research found that banks are aiming for a return on equity of 11 percent and between 35 and 45 percent of cost-income ratio. While many other industries are taking advantage of a more competitive market to generate revenue and grow, banks’ efforts are often frustrated. Competitiveness brings its own complexities. The regulatory environment is impacting banks in two ways; first, in many countries recent regulations have lowered barriers to entry and opened the door to new digital competition. Second, banks are incurring unprecedented costs, whether capital-related, such as repairing balance sheets, or due to the cost of regulatory compliance.

Digital disruption is forcing legacy “brick-and-mortar” banks to make fundamental changes—to their operating models and their business models, affecting how they make money in the future. Consumers are in control, driving the relationship with their bank and influencing its role and the market with their preferences and the needs of their everyday lives. New digital entrants, banks that challenge the traditional model and industry convergence, introduce diverse competition. To manage these challenges and meet ever-changing consumer demands, banking leaders must accept that the need for greater efficiencies and investment has never been more critical. By embracing strategic cost reduction, banks can fund new streams of growth, restructuring their operations to reach new levels of business competitiveness.
Battle-hardened banks

For a service-based industry, disruptive change is often best managed in a series of discrete steps. Many banks have already undergone several waves of transformation, whether as a result of mergers and acquisitions, divestitures or due to simplification or efficiency programs. Yet, while banks may be battle-hardened, the banking industry is proving to be a laggard when it comes to achieving strategic, sustainable cost reduction.

Accenture Strategy research reveals that banks are facing three cost-related challenges:

Banking executives must link cost reduction and value creation to succeed

Although banks have shown a willingness to undertake cost reduction initiatives, many have been disappointed by the returns. Accenture Strategy research found that many banks lack the visibility or the ability to create a strong link ongoing between where to reduce costs and where to invest. Without “connecting the dots” between cost reduction and the activities, processes and resources within their organizations that create value for the business, banks have been prevented from taking a holistic approach toward tackling their cost base or reinvesting savings in further value-creation initiatives. Our research reveals that less than one-third of banks (30 percent) prioritize the reinvestment of cost savings in alignment with strategy and faster return on investment. And less than one-quarter of banks (24 percent) have a clear intent to funnel cost savings into growth initiatives and have an enterprise-wide strategy to achieve this. By undertaking strategic cost reduction initiatives, banks can scrutinize their profitability and better understand where the greatest value can be realized.
Banking executives must be aligned around cost and growth initiatives

Competing priorities prevent banking leadership from aligning initiatives that bring about an aggressive cost-conscious culture and create value, in turn, putting top-line growth and profitability at risk. Our research found that only 26 percent of banks are confident that their leadership has the right initiatives in place to achieve cost reduction targets. Less than one-fifth (18 percent) of banking executives have utmost confidence that their leadership team has the right investment and growth initiatives in progress to achieve their business goals.

Making the right investment decisions depends on banks’ leaders being fully aware of the “big picture”—64 percent of surveyed banking executives said end-to-end business diagnostics are very relevant and applicable, by far the most effective cost management and business performance improvement technique. Such diagnostics not only identify and link cost and value creation initiatives, but also align leadership with the overall strategic direction of the business.

Banking executives must secure the right capabilities for sustainable gains

Banks are actively progressing cost reduction—but may not succeed. New, digital and agile entrants can outpace traditional incumbents by executing cost reduction swiftly and for the long term. Banks need a digital strategy that counteracts the rise of nimble FinTechs. Global investment in FinTechs tripled to US$12.21 billion in 2014, clearly driving a proliferation of new-entrants in the financial sector.² Such players are armed with the right capabilities and powerful transformational tools—as our surveyed banking executives note, with 42 percent of them strongly agreeing that digital strategies (insights-based, real-time, customized and scalable) are an enabler of advanced operating models.
Agility is key, but our research found that only 28 percent of banks have flexible operating models that consistently adapt to deliver on strategy and execute initiatives that drive value for the organization. To sustain gains, a capability must be in place that not only formally reviews but also reacts to the ongoing success of those transformations—yet only half of the banks we surveyed (52 percent) said they undertake a formal review of investment success.

Three ways to win

To drive profitable, sustainable growth, companies must proactively seek out value, take out non-value adding costs and reinvest those savings into growth and sustainability initiatives that can aid competitiveness.

Such activities are not an either/or scenario and must be baked in to company culture. It is a lesson that other industries have learned well. For instance, one global food company designed and built a new operating model to increase the company's efficiency and agility. This global business services platform is delivering key functions including supply chain, finance, human resources and IT. The value generated through the program—an expected US$100 million in recurring savings—will enable the company to fuel its growth strategies.³
Banks must consider the following actions:

**Maintain a holistic approach:**
Be aggressive in tackling the cost base. Develop a cost-conscious culture by embracing spend visibility and cost category ownership. Directly address the drivers of consumption in your bank, primarily related to the organization (that is, the staff), spend on IT or infrastructure and other general administrative costs, as well as price. Adopting a zero-based budgeting approach can help banks to drive bottom-line results. Some industries, such as consumer goods and retail, are already using zero-based budgeting to outperform their industry peers—increasing revenues by 28 percent, compared to 22 percent in the peer group and increasing EBITDA by 50 percent, compared to 39 percent among the peer group.⁴

**Connect cost reduction and investment decisions:**
Reinvest cost savings in initiatives that drive value creation and fuel new growth. Undertake an end-to-end assessment of the bank's enterprise across its front-, middle- and back-office functions. See the "big picture" of the organization from customer, value and cost perspectives to target, prioritize and connect both cost and growth interventions. Build the roadmap and chart the course for transformation once all initiatives are clearly linked to the success of the bank's strategic investment portfolio.

**Adopt a digital, agile operating model:**
Adopt digital to support new business and operating models, addressing costs throughout the entire bank's operations. Define a future state that recognizes a different approach to cost, such as reducing IT budgets in line with the growing reliance on cloud technologies. Design and embed the right digital capabilities across robotics process automation, cognitive computing, cloud and next-generation outsourcing to execute with pace and certainty, and achieve sustainability in an era of digital disruption.

Banks do not have a moment to lose. Banking executives must adopt a fundamentally different approach to strategic cost reduction now to reclaim profitability.
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Notes

1. Accenture Strategy analysis
3. The broken link: Why cost reduction efforts fail to fuel growth, Accenture 2016
4. Fueling growth through zero-based budgeting: how winners know where to place big bets, Accenture 2016