GETTING FIT: AGGRESSIVE COST REDUCTION

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02

INVESTMENT BANKS HAVE FACED A CHALLENGING LANDSCAPE OVER THE PAST EIGHT YEARS, CHARACTERIZED BY DECLINING REVENUES, HIGH COSTS, DEVELOPMENTS IN DIGITAL AND REGULATORY PRESSURE.

A CHALLENGING LANDSCAPE

Returning to profitability in a shrinking revenue market

Looking at revenues of investment banks, average revenue was down across fixed income, currencies and commodities, equities, equity capital markets and debt capital markets in the first quarter of 2016; and aggregate investment bank revenue was down 16 percent year over year. Looking at the cost side, the industry's average cost-to-income ratio was 68 percent in the first quarter of 2016, up from 65 percent in the first quarter of 2015.

In addition, new market players are driving value chain disintermediation in the form of new information platforms, which are digitizing the role in counterparty discovery. Last but not least, regulatory initiatives like Basel III, Basel IV/FRTB will further tighten capital and liquidity requirements, and squeeze revenue pools.

QUICK FACTS

The industry's average cost-to-income ratio was

68%

IN Q1 2016

UP TO **11%**

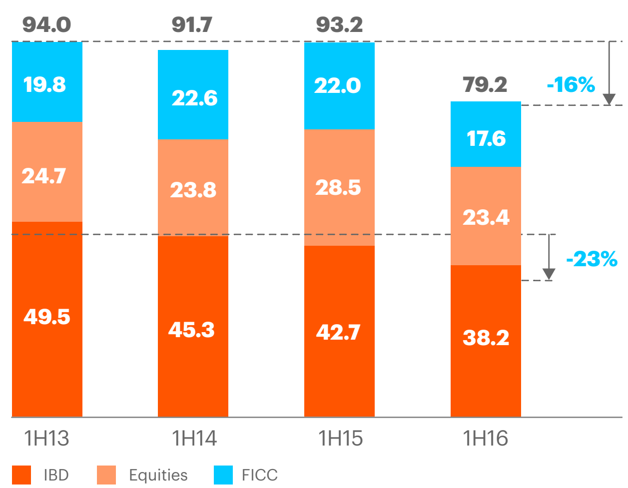
additional run-rate savings are possible with a public cloud model

Source: Accenture

At press time, several banks had released their third-quarter, calendar year results for 2016, posting significant improvements in returns. Does this mean that cost competitiveness and profitability have been conquered? That cost reduction is nothing to worry about any longer?

Our discussions with executives at investment banks around the world indicate otherwise. A resounding chorus of voices suggested that companies need to maintain a razor-sharp focus on cost reduction. Headlines continue to announce major cost-reduction initiatives at many companies as executives seek a sustainable equilibrium and, ultimately, profitability. Overall, banks should move beyond tactical cost reductions toward strategic initiatives inside and outside their organizations. In addition to potentially generating higher efficiencies and larger cost reductions, these kinds of initiatives could set banks up for sustainable growth in the future. The result would be companies that are not only efficient now, but also prepared to grow efficiently when the market grows again.

Figure 1: Investment banking revenue from primary businesses



Source: Accenture research based on Coalition IB Index, September 2016, Dealogic

It is clear that seeking to achieve truly meaningful and sustainable efficiency is a complex and mammoth task. “Reduce costs” is a common battle cry, but up to now rarely has it resulted in sustainable cost reduction that leads to highly efficient businesses. The fact that cost reduction has been a recurring theme in Accenture’s Top 10 Challenges series is therefore unsurprising.

A LOOK BACK AT PAST TOP 10 CHALLENGES

2012

In 2012, Challenge 10 reflected on the industry’s goal of sustainable cost reduction. Investment banks spoke about the need to avoid “boom-and-bust” cycles of cost management. Observing that managing labor costs means more than cutting head count, Accenture suggested that firms take a customer-centric approach to understand what clients value and will pay for, and adopt continuous efficiency methods to constantly fine tune and truly embed a permanent culture of cost consciousness.

2014

In 2014, Challenge 2 focused on restructuring investment banks through streamlining and rationalization. Changes in regulation and capital requirements resulted in changes to business models (e.g., a shift in focus to retail), rationalization of duplicative processes and structures, simplification of the technology stack and changes to operating models (e.g., the fledgling adoption of utilities).

2015

In 2015, Challenge 5 focused on simplifying complexity through rationalization and decommissioning. Challenge 6 focused on balancing shared IT and operations with business ownership, and Challenge 10 focused on the role of utilities. Each report tackled a different issue investment banks faced as they pursued their cost-reduction agendas.

2016

Last year, Challenge 5 looked at value-based cost reduction, explaining how investment banks were struggling to turn cost-reduction savings into growth opportunities, and how closed-loop and zero-based budgeting might address the cyclical failings of previous approaches.

Since the industry’s difficulty with realizing sustainable cost efficiency is surely not due to lack of awareness or methodology, one could ask what the barrier is? It may seem like an “old chestnut,” but good governance, strong leadership and a long-term view are essential for achieving the outcomes the industry requires. Companies also need to have a fundamental “performance anatomy” in place. Where this exists, there is a foundation that cost-cutting initiatives could lead to sustained results.

GOVERNANCE, LEADERSHIP AND CULTURE

The performance anatomy for sustainable change

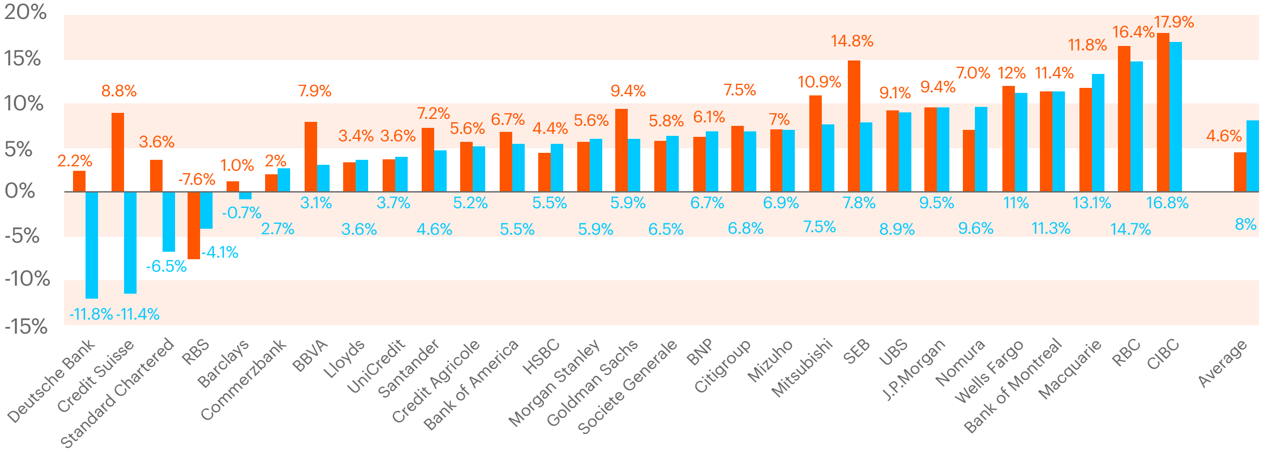
Leadership matters. After careful examination of the cultural and institutional personas of successful and unsuccessful initiatives, it’s clear that the prerequisites for success should include:

- **A top-down mandate** capable of crossing business and operating silos, and enforcing a “bank first” view rather than a desk or product orientation.
- **A truly front-to-back process** to help verify that costs are truly understood, solutions address root causes and downstream effects are minimized.
- **An understanding of costs and cost drivers.** Too often, target cost reductions on departmental operating budgets are established with insufficient understanding of the total cost details.
- **A re-examination of what is important to own and what customers will pay for.** Many bank IT organizations continue to make a case for custom development and on-premise capabilities—even when those solutions are truly non-differentiating or inferior to alternatives already available in the marketplace. Accenture estimates that these expenditures account for up to 40 percent of IT and operational costs.
- **A plan for the savings generated**—whether that’s offsetting costs or generating new revenue.

Any future cost reduction initiative in the industry should as well be seen as a journey that increasingly begins with acknowledgment of a simple belief: technology (and digital) could help organizations to be both high-value providers and efficiency mavens. Disruptive digital technologies are raising the bar for cost reduction. Banks need to focus less on historical benchmarks and more on what is possible with a new cost model enabled by digital technologies.

“BANKS NEED TO FOCUS LESS ON HISTORICAL BENCHMARKS AND MORE ON WHAT IS POSSIBLE WITH A NEW COST MODEL ENABLED BY DIGITAL TECHNOLOGIES.”

Figure 2: Global fixed-income e-trading (industry ROE)



2Q15 ROE 2Q16 ROE Source: Accenture

Figure 3: How masters of client experience play to win

Digital, new consumer expectations and increased scrutiny are disrupting an already complex world	Redefining the terms and boundaries of competitiveness	Competitive agility is defined as winning simultaneously across three dimensions
VOLATILITY UNCERTAINTY COMPLEXITY AMBIGUITY	DISRUPTIVE SPEED NEW CONTESTABLE MARKETS RADICAL TRANSPARENCY	GROWTH AND CUSTOMER PROFITABILITY SUSTAINABILITY AND TRUST

Source: Accenture

Figure 4: Investment bank cost reduction over the next 7+ years

WHAT

0-3 YEARS

Deliver value today, transform and grow the core

- Rationalization and simplification
- Automation (e.g. RPA)
- Strategic exit of select businesses
- Data led business and culture (analytics)
- Hybrid cloud enabled / infrastructure migration

1-5 YEARS

Pivot and grow the new

- Clarity of business model
- Client, not product-led
- Utility creation and adoption
- Strong network of alliances/ecosystem
- Industrialized innovation capability (Fintech led from PoC to production)

3-7+ YEARS

Master the new long term

- Eliminate legacy scale
- All services on shared digital infrastructure
- Self-service product and service provisioning
- Less human intervention for processing
- Fully digital product set
- Blockchain dominant infrastructure

HOW

Changed mindset: Strategy change investment needs to be focused on longer term ROI rather than in-year, short term profit performance

Fund the future: Use benefits from delivery of nearer term technology projects like RPA to free up cash to invest in the next wave of transformation

Find the balance: Leverage multi-speed IT to effectively manage legacy and innovation technologies side by side

Consider greenfield: In some scenarios, the availability of as a service solutions from the digital ecosystem could justify a greenfield approach

Source: Accenture

OPTIMIZATION AND COST-REDUCTION INITIATIVES: BUILDING BLOCKS FOR CHANGE

If the past few years have taught us anything, it's that many banks still may need to rethink their business models by:

- **Simplifying.**
- **Establishing alliances with fintechs, other banks and other industries.**
- **Redefining the role of the bank and tapping into the wider ecosystem.**
- **Embracing utilities.**

They also may need to rethink the operating models and legacy IT systems that support the business, using techniques like zero-based programs to identify, eliminate and prevent unproductive expenses. And they could migrate infrastructure and platforms to Infrastructure-as-a-Service (IaaS), Platform-as-a-Service (PaaS) and Software-as-a-Service (SaaS). Or look at new technologies (see Challenge 3 "Turning Automation Into Intelligence") and start working on IT application map rationalization (see 2015 Challenge 5).

For example, Accenture has assisted a major investment bank in saving over $100M per annum in applications support and platform hosting costs and, more importantly, breaking the "log jam" of IT streamlining and renewal by moving to a public cloud model. That represents an additional 8 to 11 percent in run-rate savings compared to a private model.

Cloud-based services and the increasingly pervasive "everything-as-a-service" model could also influence how banks approach their operating models and IT systems. By identifying opportunities to purchase services and/or work within the fintech ecosystem, organizations can discover new ways to provide IT and operational services.

THE NEW DIGITAL ECOSYSTEM

The new, emerging digital ecosystem could offer many opportunities to help reduce costs and generate new revenues—but this requires a strategic approach to technology investments (see Challenge 8 "Getting Innovation Right"). Specifically, companies could focus on:

- **Fintech partnerships** to supplement their offerings and increase efficiency.
- **Big data and predictive analytics** to enable greater customer insight and responsiveness.
- **Artificial intelligence** to automate complex tasks that involve non-structured data and require learning algorithms.
- **Distributed ledger technology** to deliver efficiency in areas such as cross-border payments, liquidity management, collateral management, syndicated loans, trade finance and securities settlements.

Above all, investment banks will also need—from an overall business perspective—to strike a balance between enhancing the existing core today and investing in what is new.

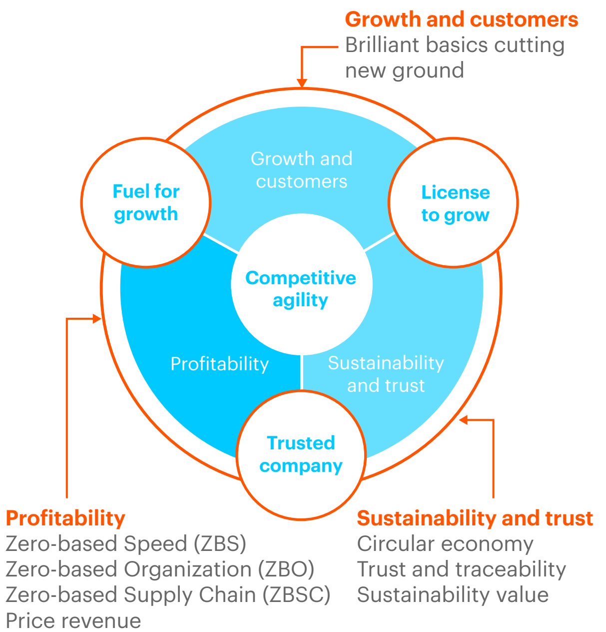
THINK ABOUT IT

While cost reduction is a key challenge for many investment banks, it does not mean that banks cannot be successful at it. We believe that banks should consider:

- Adopting a new performance anatomy that addresses historical barriers to change.
- Understanding and leveraging rapidly maturing digital technologies to drive efficiency gains instead of using backward-looking benchmarks that underestimate the need for—and potential value of—change.
- Adopting an approach to cost reduction that balances all three dimensions of competitive agility (see figure 5).

This could help industry players to lay the basis for a successful future.

Figure 5: Comprehensive approach (GPS)



Source: Accenture

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