BETTER EVERYTHING

A Faster Path to Creating a Next-Stage Credit Operating Model
Traditional commercial banks have their sights set on loan growth. It makes sense. Economic agendas in some markets are spurring small- and medium-sized businesses and corporations to invest. Banks' success, however, depends on how well they can modernize to get and stay ahead of dynamic market drivers that test their dominance.

Externally, business customer expectations for convenience and speed are high; 56 percent are willing to leave their primary provider and go elsewhere for better service. Economic indicators—from rising interest rates and narrow credit spreads to a tighter labor market—suggest caution in managing risk. Alternative digital-based lenders, like OnDeck and Kabbage, are offering the fast, frictionless service business customers want. Internally, operational challenges—such as heavy administrative bureaucracy, long turn-around time on credit applications, channel overlap, excessive fulfillment handoffs, limited transparency across the lending process and outdated legacy technology—both tax the bank's workforce (limiting their ability to differentiate the bank) and gives disruptive models an advantage.

The fact is that the traditional operating model for most commercial banks is already under attack. The growth rate in commercial and industrial loans for most US commercial banks has been declining over the last three years, with 2017 seeing an anemic 1.2 percent year-over-year growth. This does not mean that the demand for credit from commercial and industrial clients is slowing. On the contrary, demand for credit in this sector has remained consistent over time. However, the source of funding for that demand has drastically changed. The first three quarters of 2017 saw a $412 billion growth in commercial and industrial credit; however, only $5 billion of that growth (less than 1.5 percent) went to the top 25 commercial banks while $34 billion (some eight percent) went to traditional commercial bank players. The vast majority of the growth in credit went to the capital markets and other non-traditional players. In essence, the large flow of credit activity is going elsewhere which is now causing shrinkage in banks' balance sheets. This could also spill over to banks' treasury and cash management business where credit is often used as an anchor.

This reality is compelling each bank to explore its next-stage operating model, one that is mature enough to suit the digital economy. It means that after years of under-investment, banks must move up the operations maturity curve to meet both client and employee expectations, and keep pace with non-traditional lenders (Figure 1). Banks recognize the reality of today's rather calm markets, giving them a short window to invest before M&A activity kicks up the competitive pressure and market and credit conditions change. Accenture forecasts that business lending units in North America will have spent

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**Figure 1. Four levels of operations maturity**

- **Basics**
  - Overlapping roles and responsibilities
  - Low visibility into key metrics with limited performance and regulatory reporting
  - Separate product-specific platforms lack integration, resulting in low productivity, manual handoffs and re-keying
  - Limited use of data

- **Transformation**
  - Simplification on the inside to reduce costs, improve cycle time and enable greater automation
  - Establish "single view of customer" for data, driving performance and regulatory reporting
  - Consolidation of sales, fulfillment and servicing systems move closer to straight-through processing

- **Optimization**
  - Clear delineation of roles and responsibilities organized around Deal Team philosophy
  - Optimized traditional distribution channels; entering digital marketplace
  - Segmented commercial portfolio to maximize revenue potential, cost-to-serve
  - Full end-to-end integration to achieve straight-through processing
  - Risk and Analytics Center of Excellence using standard set of data and analytics to monitor portfolio risk

- **Innovate**
  - Increased share of wallet and cross sell by tailoring specific offerings to each customer segment
  - High quality customer experience and increased lead generation through digital channels
  - Better underwriting decisioning and sales lead quality via advanced analytical and data capabilities
  - Low approved deal attrition due to high customer satisfaction, fast cycle-times and transparent processes
  - Automated, continuous, predictive monitoring of risk using all internal and external data

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$29.4 billion on IT-enabled improvements by the end of 2018. Those that do not invest to modernize their business model and capabilities are, in essence, forfeiting their future.

There are many viable model options a bank can choose to become a more mature, future-ready lender. Its choice will depend on the bank’s unique starting point, destination point, strategy, culture and capabilities. What will determine the bank’s success in shifting to its new model, however, is the path it takes to get there. For most commercial banks, it means fundamentally changing the way they think about their operating model.

YOUR WHY? BETTER EVERYTHING.

In shifting to a more mature and modern operating model, progressive commercial lenders aim to do more than just keep up with technology. Their ambitions are broader. They want to tap deeper into commercial markets to grow lending, and be ready for the evolving digital future with speed and agility by having their target operating model designed for people—empowering a more innovative workforce and offering clients a more compelling experience.

Consider that today’s technology can provide for an automated, integrated and transparent commercial lending process end-to-end that gives staff easy access to a single version of “true” data. It means that relationship managers no longer have to input the same data sets into multiple systems. According to a recent Greenwich Associates survey, banks where relationship managers spend above-average time on administrative activities finished in the lower quartile for relationship manager satisfaction ratings. It means that underwriters have the information they need as soon as a deal reaches them. Through tools that support employees, like mobility that enables people to complete tasks on the go, banks can add convenience to workforce jobs. Given that 55 percent of wholesale banks’ core function headcount is employed in repetitive processes (Figure 3), simplification and automation can free employees to focus on more value-adding activities. Such strategies make for lower costs, higher efficiency and happier employees that can turn the bank workforce experience into a competitive advantage.

Likewise, a client-centric operating model can enable banks to deliver the overall better experience—convenience, speed, ease, self-service, advisory services, back-office systems integration—that clients want. For example, a digital know-your-customer process with once-and-done data entry and automated filling of forms, validations, sanctions checking and other requirements can now be completed with minimal risk in under five minutes compared to the weeks and months of a manual process. Through such client experience strategies, banks can improve customer satisfaction and loyalty. The U.S. Federal Reserve’s 2016 Small Business Credit Survey report revealed that small business loan clients in the US are most satisfied with small bank providers (80 percent), followed by credit unions (78 percent) and community development financial institution (77 percent).

GIVE BANK EMPLOYEES A REASON TO SMILE

Commercial borrowers actually “buy” the banker, not the bank itself, so the well-being of bank employees matter. A common work complaint of relationship managers (RMs), core users of a bank’s operating model, is that it’s too hard to get things done. By including RMs in the transformation journey and tapping their digitizing sales and operations talent, banks can make work life easier for them and other users. For example, by collecting data from multiple sources and drawing on advanced analytics to extract cross-business intelligence around risk and profitability, banks can help RMs generate greater leads, better offers, higher conversion rates and more share of wallet.

An employee-centered, technology-enabled workforce offers banks two-fold benefits: happier staff and more satisfied clients. It helps staff to deliver a more compelling, efficient, information-rich client experience. Clients are able to work with the same RM throughout their banking relationship, making for a more trusted client relationship and higher client retention. Happier bankers mean lower RM turnover (which also reduces client attrition). Banks that focus on meeting people’s needs—employees and customers—through modern internal processes can create a magical workforce experience.
Dissatisfied applicants cited lack of transparency as their primary reason, followed by difficult application process and long wait for credit decision. Greenwich Associates research shows that lenders in the bottom half for “speed of response” during the credit process typically lag in application-to-closing cycle times; in turn, lenders that lag in cycle times are more likely to also finish in the bottom half for “likelihood a non-customer would add the lender as a provider.”

A future-ready operating model puts a bank in a much better position to create a differentiated and satisfied workforce, positioning employees to drive engagement, retention and productivity. The challenge, though, is getting there. A top-20 US commercial bank that transformed its operating model saw a step-change improvement in its average end-to-end loan cycle time (Figure 2), from underwriting to booking, and a drastic improvement in its booked loans.

Figure 2. Top-20 US commercial bank’s step-change improvement in cycle time
Large banks, typically less nimble than their small-bank peers and alternative lender counterparts, need an executable strategy for evolving its business to win in the digital economy. Such a strategy to direct the bank in erecting its new operating model and re-platforming its loan origination system technologies, often raises the question of which to tackle first. Increasingly, successful organizations are finding that the answer is “both.” They are opting to implement their chosen operating model and its enabling technology concurrently in an iterative, modular manner.

Historically, banks have used a sequential approach to change. In this approach, a bank first defines the entire model across process, people and technology. Like a marathon, it organizes the delivery lifecycle into sequential stages; for example, launching process improvements followed by cultural (people) change and, finally, technology within a big bang delivery. According to the Standish Group 2015 Chaos Report, 29 percent of IT projects using this traditional delivery approach failed; 60 percent were challenged; 11 percent were successful. More banks are painfully realizing the win rate scenario of the sequential approach and are migrating to an iterative approach.

An iterative software development approach, like Agile, DevOps or Design Thinking, uses cross-functional teams, rather than fixed hierarchies and functions, to improve IT delivery flexibility and speed. Every aspect of commercial banking operations—people, roles, policy, process, risk and technology—is engaged in an ongoing cyclical process of discover and evaluate, prioritize, build and operate, analyze…and repeat. Experimentation, collaboration, iteration and a focus on the employee and customer are key themes throughout this process. It is a faster, more flexible way for banks to reduce operational risks and speed time-to-market while staying ahead of the competition and embedding top talent into the business. Using a new iterative approach, realization of benefit could begin in a 12 to 15 months compared to 24 to 30 months through a sequential approach (Figure 3). The 2015 Chaos Report indicates that an iterative approach is nearly four times more successful than a sequential approach.

Figure 3. Agile implementation approach - illustrative

Old Approach

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New Approach

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Governance

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GETTING IT DONE

An iterative software development approach offers a new way to get IT design and build done right and quickly.

Design for humans

A first step toward an effective transformation is designing the model and approach around the employee experience as a key component of the customer experience. It means examining key pain points (such as where relationship managers may struggle to get a client deal across the finish line), and identifying intended outcomes and how they support the overall bank strategy. For example, by organizing processes around clients and their priorities (Figure 4), commercial banks can better clarify staff roles in effecting seamless customer relationship management. Then through the modular delivery approach, design can rapidly turn to business requirements that are configured on the fly.

Also critical is the creation of “bundles” of initiatives across process, people and IT that must be delivered and integrated to effect intended outcomes. These bundles should be formulated jointly between business and IT stakeholders, with considerations to the operating model and technology solution, respectively. The combination of joint accountability, achievable scope and aggressive timelines help create a project culture of “mutually-assured collaboration.” Without a convergence of operating model and technology, banks can sub-optimize the project’s benefits and very easily revert to a sequential, highly customized, big bang IT approach that does not work. The convergence also allows for a more flexible, adaptable and robust operating model implementation with real-time enhancements, ongoing improvements, continuous engagement and buy-in from the field, and the ability to fund some of the transformation from the delivered benefits.

Figure 4. Commercial lending organized around the client
Build on innovation

The flexibility of innovative technology is a core piece to quickly enable the design. By combining revolutionary technologies, banks can modularize platform delivery and bring on line what they need to optimize the process and people components of a particular “bundle”. Chief among these technologies are predictive analytics, APIs, cloud, integrated workflow end-to-end, robotic process automation, back-office digitization and blockchain, as shown in Figure 5.

79% of bank operations leaders say their organization’s existence could be threatened if they don’t update technology to be more flexible and capable of supporting rapid innovation.

Figure 5. Emerging technologies in commercial lending
Key enablers of speed, flexibility and efficiency

- **Predictive Analytics**
  - Data-driven insights help to accurately evaluate credit worthiness, driving profitable loans and lowering costs

- **Robotic Process Automation**
  - Intelligent automation provides for faster speed to market, transaction transparency and lower costs

- **APIs**
  - Integration that enables partnerships with fintechs and others to improve business processes

- **Back-Office Digitization**
  - Paper-free and digital back-office processes make for more efficient operations

- **Hybrid Cloud / Agile & Open Architecture**
  - Open systems support flexibility, interoperability and partnerships with third parties

- **Blockchain**
  - Distributed ledger-based technologies reduce cost, inefficiency and friction in moving money around the world

- **Integrated Workflow End-to-End**
  - Transparent, integrated and real-time digital workflows enhance customer experience

Predictive analytics, for example, embedded into account portfolios can enable early warning signals as part of the bank’s detrimental credit defense. Cloud-based solutions offer a flexibility and speed of delivery that remove technology as a bottleneck, and place the onus on the business to drive the pace of change. The “as a service” nature of cloud solutions ensure that continuous innovation is built into the new operating model and the workforce, as new releases and features are regularly deployed into the solution.
TAKE IT FROM US: GET THIS RIGHT

Based on our experience helping banks transform their operating model through an iterative approach, there are five key things to get right:

01 Build strong target-state vision as the underlying process foundation
02 Limit customizations across lines of business and avoid reinventing the “new version” of the existing customer relationship management and origination platform or tools
03 Confirm the data governance/ownership strategy early in the process to avoid rework in design sessions
04 Manage compliance, regulatory, operational and credit risk, and set requirements and expectations for the control environment upfront
05 Involve stakeholders and project team members early in the project to allow sufficient time to understand and support the changes

READY YOUR LENDING FOUNDATION FOR THE FUTURE, SOONER RATHER THAN LATER

It’s no longer a question of whether traditional commercial banks will need new operating models to succeed in delivering relevant lending experiences in the digital future. They will. The questions are around when and how to make it happen.

By taking an iterative approach to transformation, a bank can be modular in the way it creates its to-be model and adapts its employees. Once their future-ready foundation is set, banks can expand from that core to align their people, processes and technology in harmony to make the change complete. It means joint collaboration between business and IT to deliver the new operating model design and re-platform systems quickly, efficiently and effectively. It means zeroing in on changes that improve both the customer experience and the employee experience—the sweet spot to increase revenue and lower costs. It can be done right, quickly and with intended results.
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