



OPERATIONAL EXCELLENCE: WHAT IS ALL THE HYPE ABOUT?

Instilling a culture of Operational Excellence and the discipline of process management to achieve consistency in customer experience in banking organisations

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1. BACKGROUND

The turbulence in global credit markets has added further pressure on financial institutions to derive constantly increasing profit contribution from their business operations. With a tightening of mortgage and other consumer lending revenues, added to higher funding and securitisation costs, significant margin attrition is expected in the foreseeable future. Hence there is an increased requirement for sustainable cost efficiencies, whilst nevertheless both maintaining (and growing) market position and managing ever more complex business, operating and regulatory risks.

These circumstances are neither new nor are they unique to any particular type of banking organisation. Many institutions confronted with these requirements have sought to address them by adopting practices that recognise core processes as real assets and by managing processes accordingly in order to obtain a higher return from them. This has often been described as achieving “more for less” or gaining “operating leverage”, and is delivered by achieving Operational Excellence as a result of “managing by process”.

Most, if not all, major financial institutions have formal process-related programmes in place. The leaders have adopted full business process management practices. Such programmes are not only driven by a desire for improved service delivery and cost efficiency, but also by a focus on improved risk mitigation and controls. Consequently, these institutions seek to achieve simultaneous consistency in service delivery, cost efficiency and the management of operating risk.

As a result of the tougher market conditions and the growing demands from all of the constituencies which financial institutions have to satisfy, there is an increasing use of the term “Excellence” in the statements, communications and actions of these organisations, causing a great deal of “hype” to be associated with it.

This paper explores the background to this phenomenon, and uses the rationale and experience from a recent engagement with a client bank to outline how the implementation of Operational Excellence can address the underlying requirements.

2. INTRODUCTION TO OPERATIONAL EXCELLENCE AND MANAGEMENT BY PROCESS

Operational Excellence

The achievement of Operational Excellence is a core component of an organisation’s strategy, designed to support and enable corporate business objectives in delighting customers whilst also serving the requirements of other stakeholders, such as shareholders, regulators and employees. In financial services, this invariably involves the consistent management of the inter-dependent, ever-changing, and often conflicting, requirements of service improvement, cost containment and risk management.



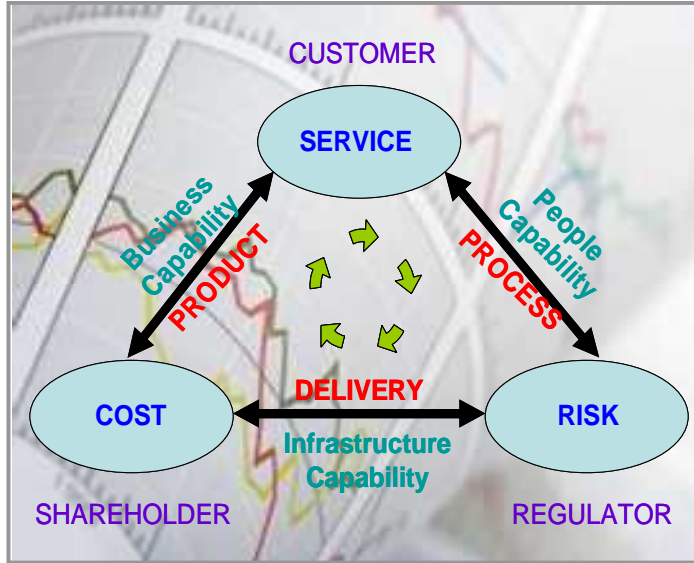


Figure 1. Operational Excellence in Banking

Operational Excellence is neither a discrete change programme nor a management initiative; it is a business-as-usual approach to instil a culture of effective business management on an ongoing basis across complex organisations. Where successful, it delivers exceptional service at optimal cost and with manageable risk.

Management by Process

An Operational Excellence Framework provides the means by which an institution “manages by process”, in the sense that it manages itself around process organisations in the same way as it may manage around customers, products or markets. It identifies the processes which are core to its business and directly manages these across the hierarchies and divisions of its organisation, to ensure that each process is discretely and transparently owned, controlled, and run as a business serving its respective stakeholders.

The individual key components of the framework establish principles, practices and procedures in the areas of leadership, knowledge and execution.

- Process Leadership establishes processes as an organisational imperative with specified strategies, tactics and accountabilities assigned within the leadership of the organisation
- Process Knowledge provides the organisation with the framework, skills and management systems with which to manage process assets on an ongoing business-as-usual basis





- Process Execution delivers the mechanisms and the organisational culture through which the organisation effects day-to-day management and continual improvement on a consistent and controlled, but also rapid and sustainable, basis

The adoption by financial services companies of such a framework is designed to instil a deeper culture of excellence and a common discipline of process management across the organisation. These are targeted to drive greater consistency in customer experience as well as in operating efficiency and effectiveness and in the management of risk.

Those institutions who successfully implement this type of framework stay ahead of their industry through consistent execution and thus exhibit the characteristics of an excellence-focussed company:

- Clear market leader - strives continuously for competitive differentiation
- Culture of genuine customer focus - passion for client experience is the primary business driver
- Organisational design around business-critical processes - manages across, rather than within, functions, departments and empires
- Scalable platform for growth - focuses consistently on creating operating leverage ("more for less")
- Single, but flexible, company-wide approach - invests in addressing only the important issues with a consistent discipline
- Best people empowered with the challenge of changing the business - leads from the front with the top stars of the company delivering improvements
- Managing by data, not gut-feel - decisions based on fact and empirical analysis, not made by simply relying on experience or history

3. OPERATIONAL EXCELLENCE IN THE BANKING INDUSTRY

Management by Process

Most, if not all, major financial institutions have formal process-related programmes in place, or are taking steps to launch one. The leaders in this respect have adopted full process management practices. Such programmes are not only driven by a desire for improved service delivery and cost efficiency, but also by a focus on improved risk mitigation and controls. Consequently, these institutions are stealing a march on their competitors in achieving unrivalled consistency simultaneously in service delivery, cost efficiency and the management of operating risk.

Less successful initiatives in the market have been focussed primarily on the process improvement element of a process managed model and/or have targeted only specific parts of the organisation rather than establishing group-wide management by process. Consequently, despite admirable efforts at an individual departmental level to improve





the performance of a process (or part of a process), these efforts do not deliver results with sufficiently significant impact organisationally to be either material or sustainable.

The leaders and early adopters of Operational Excellence in the mid to late 1990s were US-based institutions, followed in the early 2000s by some UK banks and others based in Europe. Currently, many Continental European-based banks are still in the early stages and take-up is now also evident in Asia. Those banks that continue to run discrete programmes in individual businesses without implementing a group-wide approach are producing, in general, suboptimal results. Many others are undertaking process-related initiatives on a limited scale with results which are not significant enough to discern at a group level.

The best results in the market have been enjoyed by those banks that have clear objectives for the programme linked directly to the businesses' strategic and financial targets. This rigour has been extended to individual processes, therefore providing strong focus and disciplines for the process teams to achieve meaningful objectives. In turn, as these results have been captured, the business is able to aggregate and publish them, creating a virtuous circle of results increasing awareness and buy-in that generates further results. Over time, as the banks have matured and these disciplines have become engrained, there has been a greater focus on the total process management results rather than on individual process improvement outcomes. In this sense, the banks have achieved "management by process".

Banks currently pursuing Operational Excellence

Venturehaus' 2008 annual market survey on the development of Operational Excellence in the top 20 European Banks, with a comparison to 15 of their global peers from the US and Asia, has indicated that virtually all of the banks have continued to increase their activities and focus on achieving Operational Excellence since the 2007 survey, and only 4 of the 35 institutions included in the study demonstrate little or no discernible evidence of major commitment in this area.

Of the 35 institutions studied, 4 are classified as Global Leaders, 6 as World Class, 16 as Professional, 5 as Aspirant, and 4 were Unrated. All 4 Global Leaders are US banks, as in 2007, as are 2 of the 6 World Class organisations, which this year also includes 2 European banks and 2 from the Asia Pacific region. Of the top 20 European banks, none are yet Global Leaders, and only 2 are World Class, with Royal Bank of Scotland Group making the leap up from Professional this year as a result of the further expansion of the "WorkOut" programme. However, 13 achieved the Professional classification and 2 have been accorded the Aspirant title. More significantly, many of those with the Professional classification are very close to attaining the World Class level and are likely to do so next time.

Almost every bank in the survey showed improvements within the Orientation and Maturity categories, as Operational Excellence begins to take a more tangible hold and achieve greater support within their wider organisations. Notable increases in overall scores have been recorded by many of the Europeans, for instance by BNP Paribas, Credit Suisse, Barclays, Deutsche Bank, HSBC, HBOS and UBS. Commerzbank and UniCredit have now also begun to feature in the rankings too.

Progress among the banks from the Asia Pacific region, with the exception of the Australasian banks, continues to lag the US and Europe, but some institutions (for example in China and India) are joining their Western counterparts in launching





initiatives and programmes to begin to embed Operational Excellence into their organisations and their business approaches.

Evolution in the industry

The pursuit of Operational Excellence is a long-term undertaking, with arguably the ultimate goal always remaining just beyond reach. Banking institutions do not therefore suddenly appear on the Operational Excellence radar overnight. Instead, constant and consistent progress over several years is generally necessary before it becomes evident that a particular bank is genuinely dedicated to this pursuit.

For a long time the classifications have been lead by the US institutions, followed, primarily, by banks from other English-speaking regions (e.g. UK, Australia). These positions are, however, now clearly being coveted by European banks, with banks in Asia also beginning the chase. It is likely that next year the Global Leader class will also include European banks, and that European banks will become the new examples to follow.

Operational Excellence may have first grabbed the headlines in the US (e.g. with GE and Bank of America) but it has progressively travelled East and continues to do so, from the UK (Lloyds TSB, RBS, ...) through Continental Europe (BNP Paribas, Credit Suisse, ...) and now to Asia Pacific (Overseas Chinese Banking Corp, National Australia Bank, ...). In this way, perhaps, the focus on Operational Excellence is taking a similar route to many other long-term evolutionary developments in international banking.

4. IMPLEMENTING AN OPERATIONAL EXCELLENCE FRAMEWORK

Development of an Operational Excellence Framework

The key design principles of this framework are that it applies rigorous common minimum standards across each of the prerequisite components in order to deliver group-wide business results, and that it also allows a degree of flexibility in its specific application in order to accommodate the existing operating models.

The core components of the framework adopt industry best practices in order to address each of the (9) critical elements proven consistently to deliver excellence through structured process management disciplines.



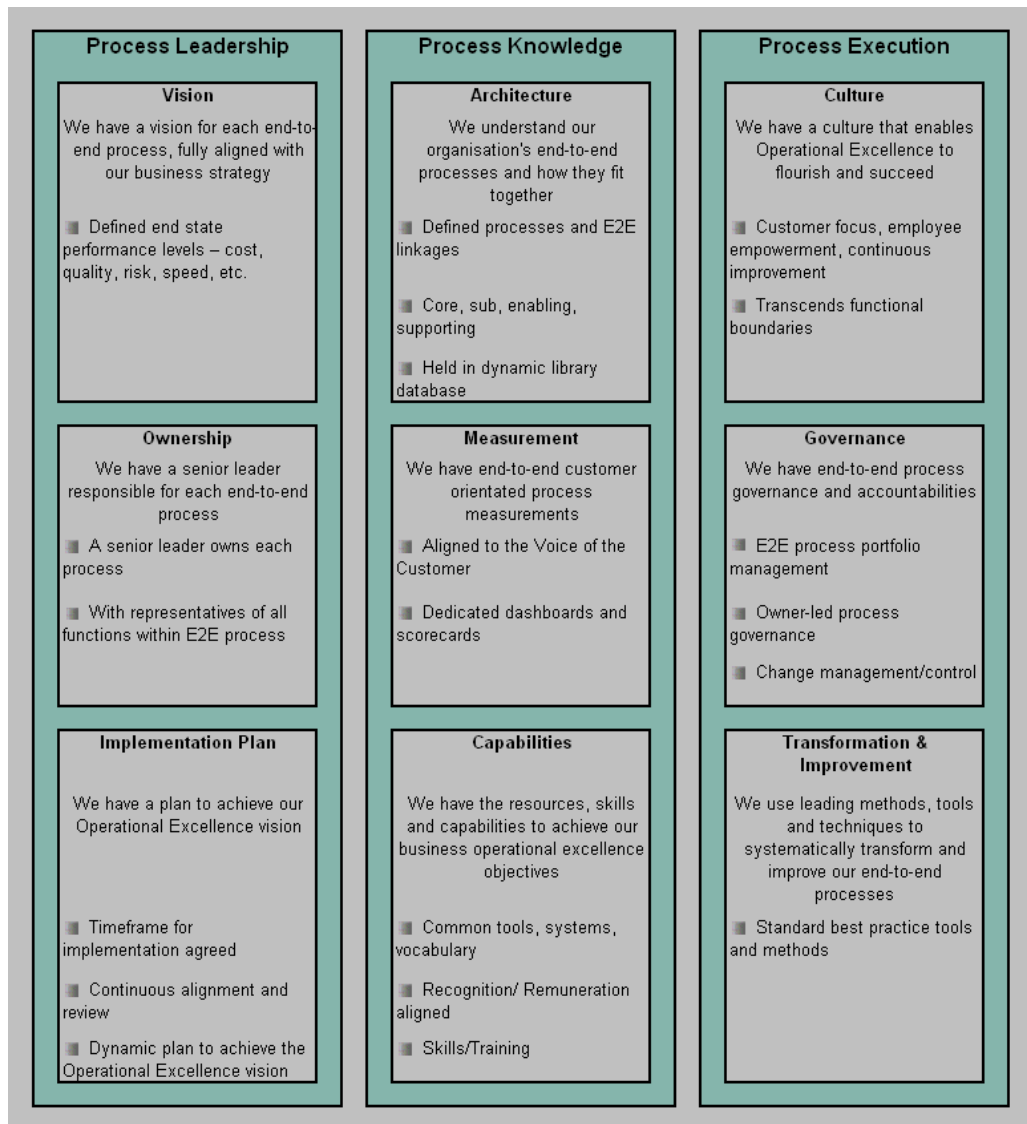


Figure 2. Operational Excellence Framework – Key Components

Implementation of the Framework

The framework does not require a “big-bang” simultaneous implementation everywhere in the organisation, but can be rolled out sequentially across each Division, provided that this is effected to the established common standard.

Full implementation of the framework will require significant behavioural change across the whole organisation, and will involve representatives throughout the company, in order to achieve the desired common approach. This will therefore require full sponsorship at an appropriate senior level of executive management, governance through a Steering Group with representatives from each division, and ownership by a small central team.





Before this occurs, full proof of the concept should be undertaken by means of a controlled pilot implementation in one business area in order to ensure that the designed framework, versions of which have been successful in many financial institutions, is nevertheless completely fit for purpose within the organisation. Upon successful completion of the pilot, the wider roll-out of the framework across the rest of the division in which the pilot occurs can begin, moving on to programme deployment across the other divisions, in order to achieve a single approach and tangible business benefits.

Proof of Concept through a Controlled Pilot Implementation

Although the above Operational Excellence Framework has been instrumental in achieving significant business benefits in other institutions, it would be prudent to test its effectiveness within the specific environment on a trial basis before moving to full implementation. The pilot environment needs to exhibit specific characteristics that will effectively prove the concept and thus be representative of a wider context. Key selection criteria (amongst others) are that the process area must:

- Be business critical
- Impact directly on the external customers' experience
- Involve various different parts of the organisation in delivering to the customers
- Represent a current significant problem area
- Demonstrate clear opportunity for improvement in service delivery, operational efficiency and/or risk management
- Be addressable within the proposed limited timeframe of the pilot

The success of the pilot should be measured by demonstrating that the implemented Operational Excellence Framework has allowed the chosen business area to achieve specific and tangible benefits in business performance which have not been possible in the past and/or would not have been achievable to the same extent without its implementation.

Full Implementation and roll-out

Once the results of the pilot are known, full implementation can occur by division, starting with wider roll-out after the pilot and allowing for implementation within each other division in a sequence and timeframe to be agreed with them in order for this initiative to tie in with other activities. Finally, Operational Excellence can be fully established and each division can be managing by process not only within division but also across the organisation using the common approach, language, organisational behaviour and techniques.





5. RISKS AND CHALLENGES

The risks of doing nothing

The risk of not progressing with a dedicated Operational Excellence Framework manifests itself in two ways. Firstly, the likelihood of falling behind major competitors and losing market share, as it becomes increasingly difficult to compete on differentiated service levels with banks that have invested in process and service excellence. Secondly, and perhaps more importantly, there is a growing risk of regulatory and/or market breaches as a direct consequence of the lack of process ownership, accountability, transparency and discipline.

Prevailing dismissive attitude to Process

The prevailing attitude to 'Process' within any organisation is a key issue. Process discipline has often been regarded as stifling and, for this reason, operational industry best practices such as group-wide standardisation and centralisation can be seen in a negative light. The Operational Excellence Framework offers a means by which a company can foster its cultural differentiators whilst managing its processes and risks with uncompromising professionalism. Having built a solid platform of process and operational excellence, the organisation would be better placed to leverage its capabilities in delivering customer intimacy and product innovation.

Initiative fatigue

Any attempt to change an institution behaviourally as well as organisationally incurs risk. It is recognised that most financial organisations already suffer from "initiative fatigue". Therefore this new framework and modus operandi will need to demonstrate immediate results in order to overcome any latent cynicism within the organisation. A pilot implementation should therefore be designed to deliver early, significant, and tangible benefits through the application of industry best practice, as a result of which the readiness of the organisation at large to accept this more rigorous and sophisticated approach to process management will be enhanced.

6. OBJECTIVES AND BENEFITS

Management of Service, Cost and Risk

At the highest level, a common Operational Excellence Framework across an organisation based on industry best practice will deliver three core benefits:

- Greater consistency in client experience leading to improved customer service and retention
 - measured by independent customer satisfaction and market share ratings





- Improved cost efficiency end-to-end for product and service delivery
 - measured by tangible, audited financial results
- Increased transparency, understanding and awareness across processes, leading to an improvement in risk mitigation and control
 - measured by reduced incidence of complaints, operating losses and regulatory breaches

Additional benefits will accrue, such as:

- A culture of enhanced ownership and accountability across processes
- Improved management decisions based on facts rather than gut feel and assumption
- Reduced complexity and duplication across products and services
- A culture of continuous improvement
- An improved capability to integrate acquisitions

Ultimately, however, this strategy plans to drive greater operating leverage across an organisation, with a company-wide implementation of a standard approach for achieving Operational Excellence. There is no necessity to compromise quality for cost. It is possible to deliver service improvements, greater operational capacity and tighter risk controls across an organisation's end-to-end processes at the same time as reducing (or not increasing) operating expense, thus providing a scalable platform for growth.

With full implementation, it is possible to achieve the following outcomes:

Front Office and Customer Service

- Finding and winning more customers
 - Improved customer retention, driving longer term profit growth
 - Elimination of loss making lines of business and unprofitable products/clients
 - Greater effectiveness and value from the front line sales force

Back Office and Operational Cost Efficiency

- Operations refinancing itself through productivity
 - Significantly reduced hiring per year
 - Exponential growth in operating capacity on an incrementally growing cost base
 - Increased service quality and customer satisfaction
 - Reduced sourcing costs

Risk and Control

- Better decision-making across the organisation
 - Relevant and useful metrics for all business processes
 - Assigned ownership and accountability for all core processes end-to-end
 - Greater process transparency, leading to mitigation of operating losses and improved controls
 - Improved skills in risk and fraud analysis
 - Full compliance with market and regulatory requirements without expensive bureaucracy
 - Free up wasted capital for improved liquidity/solvency





7. CONCLUSION

The implementation of a company-wide Operational Excellence Framework enables an organisation to drive consistency in the direct management of its core business processes, in addition to its existing management of customer segments, products and services, and other business resources. The key design principles of this framework are that it applies rigorous common minimum standards across each of the prerequisite components in order to deliver group-wide business results, and that it also allows a degree of flexibility in its specific application.

In adopting this framework, an organisation puts itself in a position simultaneously to address its ongoing service delivery, cost efficiency, and risk management requirements. This is achieved by assigning clear leadership and accountability for each core process, and by implementing proven best practices to run, control and continuously enhance business processes in a business-as-usual and sustainable manner. By the time the implementation completes, this transformation will have delivered market-leading levels of service effectiveness, operational efficiency and risk management.

With committed executive-level sponsorship, thorough implementation and dedicated ongoing management, the aggregate potential value of Operational Excellence across a financial services organisation should not be underestimated. Major institutions, particularly in the US, have achieved financial benefits in the 10-15% range of total expenses at the outset of implementing process management. Some are achieving considerably more than this in targeted situations.

It is therefore not surprising that the world's global, international and domestic financial institutions are talking a lot about "excellence" and "process". Given the recent extraordinary markets, rigour and discipline in cost, service and risk management have become even more critical to success than beforehand. An Operational Excellence Framework provides a proven foundation for actually delivering what all this hype is about.





ABOUT THE AUTHOR

Alan Noble is Managing Director of Venturehaus, the leading management consultancy for Operational Excellence in the financial services industry. Alan has over 29 years' experience of business development and transformation in financial services. During the last few years he has brought this to bear by advising senior financial services executives at a strategic level in deploying their business improvement initiatives, in training and coaching managers to execute these strategies, and in leading successful major change programmes in their businesses. Prior to founding Venturehaus in 2002, Alan led the creation of a banking practice for IBM Business Consulting Services, specialising in business strategy, business transformation, and organisational change. Before this, Alan enjoyed a long and successful banking career of over 20 years with Citibank in multiple different businesses, markets and countries, and in all areas of their banking and securities activities.

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