

Cost effectiveness

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SPIRALLING COSTS

However you view the wealth of reports that predict either economic catastrophe or salvation, as a senior decision maker in a financial institution, trading carefully is really the only option. Counterparties and capital are likely to be in flux for some time and until certainty returns it is better to remain flexible with both.

Simple tactics are needed that will not fix the future path for a financial institution too firmly in stone, but will reduce the overall profile of risk for each organization leaving it flexible to react according to circumstance. Relationships, whether clients or partners, must be limited to reduce the additional costs driven by a large network and to make financing initiatives more profitable for your own bank and for partners. Fimatrix has produced a number of studies about interbank relationships indicate that the number of bank-to-bank relationships are reducing, and this should be embraced as it offers an opportunity to reduce the complexity and costs created where systems and relationships are duplicated.

OPERATIONAL AREAS

Reducing headcount and multiple systems will be a straightforward operational choice, as both offer real advantages to the business and can be implemented with a limited amount of risk. There is always the temptation to outsource the most difficult parts of the business to manage or to outsource the most costly non-core areas, but it's important to take a careful, although decisive approach.

Where headcount is being reduced, the cost per employee, weighed against the value returned must take into account the levels of risk that are reduced through their labour. In some cases automation will allow a reduction of risk as there are likely to be fewer errors involved than in manual processing. There are risks involved in this however, as when errors do occur they may not be picked up by an automated system. When industrializing a particular business process a bank must consider the full front-to-back office workflow, avoiding switching between systems or between manual and technology based processes. By

switching data between formats of any sort, there is increased risk of translation error, reducing the efficiency gains that can be realized. If possible it is sensible to look at ensuring the architecture of your systems is componentized, although obviously not if this incurs greater costs. The advantages are that it allows systems in non-core businesses to be detached - if those units are sold off or consolidated – but the impact on the rest of the bank is minimal. The danger of a rigid architecture is that the technology is tied directly to the processes – much like an exoskeleton being built around a crab – and so any changes will require the entire technological shell to be shed and regrown.

STANDARDIZE TO ACCLIMATIZE

An area that should be followed closely by heads of technology is that of standards. For many years the normal complaint about the concept of standards has been that there are too many standards, making the concept redundant. However the current crisis has had a lot of its causes attributed to concerns over data, and the lack of standards within it. In February of 2009, Jean-Claude Trichet, president of the European Central Bank announced that the ECB would now start to address this problem; “We very much welcome the current dialogue between the ECB and CESR on the possibility of creating a standard for reference data on securities and issuers, with the aim of making such data available to policy-makers, regulators and the financial industry through an international public infrastructure. Such an infrastructure would enable all interested parties to produce more timely analysis of increasingly complex financial markets, especially in times of turbulence.” The ECB is in dialogue with regulators in the US and elsewhere to try and make these global standards. As market fragmentation in Europe has raised concerns over price data as well, it is likely that data standards will be in for an overhaul in the near future.

By waiting for these standards to be agreed before any securities trading or processing systems are developed, the costs of re-engineering the systems will be saved. On top of that, the translation of data between systems thought expensive middleware will be reduced, offering a chance to redevelop the existing architecture on a lower cost basis.

Adoption of standardized protocols also promotes the development of shared service facilities. One clear lesson from the credit derivatives market is that having an automated back office increases position management and decreases risk. Sharing data with other partners reassures them of your stability and you of theirs. When building for third party connectivity it is imperative to consider how interfaces or middleware can be constructed in an adaptable manner, allowing them to connect with more partners or to be upgraded if necessary.

NON-CORE IS OUT

The risks of outsourcing have been raised somewhat, as economic uncertainty can introduce normally unlikely prospect of a failing partner. For some that makes outsourcing an unlikely option, however if done correctly it can offer flexible cost base for FIs that cannot afford to maintain current operations. Business process or information technology processing provides good options for the manager with a good grip on their business. But crucially the most costly operations are often the most complex, and it can be that complexity isn't being properly managed that is creating the cost.

A common dilemma with outsourcing surrounds this issue of 'outsourcing a mess'. A reasonable question to ask is that, if you can't clean up the mess, how can you get any sort of decent measurements for benchmarking the process with a partner, and how can you create metrics that will persuade the CFO to agree to the project? However if you have the requisite skills necessary to clean the mess up, there may not be the need outsource in the first place. In a market in which cost and security are issues, it is not worth the possibility of increasing either. For that reason, outsourcing opportunities should be identified during the process of paring back operations, and should be factored in as an option for particular business units. This allows the bank to consider which parts of business are core and which are non-core, therefore mentally separating the business prior to any decision being made. That in turn allows clearer decisions to be made.

As the current credit crisis has taken on considerable political weight, the possibility of outsourcing – or at least offshoring – may seem limited. It is unlikely that banks that have had government intervention, for example Royal Bank of Scotland in the UK, would consider taking jobs to other countries given the level of public ownership. That doesn't prevent it from outsourcing functions however. It is worth investigating outsourcing arrangements in your own bank's locality as well as those offered overseas. Finding an organization expert in its field will often mean you find the potential for cost reduction through its scale.

COST EFFECTIVE, NOT REDUCTIVE

Ultimately the strategies that are reducing a bank's costs must still be led by a view to growth, even if it is only in the longer term. By streamlining and reducing operations the bank must be looking to maximize the returns it sees from its core businesses even while cutting back on the non-core activities. Where architecture is re-engineered it should be used as an opportunity to better understand customers through business intelligence programmes.

If credit card operations are outsourced there is a chance to drive sales of lower rate consolidated loan facilities, increasing the banks grip on the total debt of a customer and decreasing their own repayments in times of hardship.

The banks stakeholders – whether shareholders or governments – will be looking for returns from their investments and this must come from the top line. Cost cutting targets can be achieved through increasingly flexible cost bases or simply through selling off assets and businesses but the bank must be fully functioning after the event. Strong internal systems will allow senior management to identify commercial opportunities, to identify their strongest customers and strongest partners.

In summary then: standardize, componentized and rationalize your operations. Don't be sentimental about what is core but be realistic; partnering is more speed dating and less marriage at the moment. Without wanting to stretch an analogy too far that means you should be wearing dancing shoes, not concrete blocks. The world of finance is likely to keep changing for some time and committing your capital too firmly is quite simply a risk.



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