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Making the case for change

How to create a business case for core banking replacement

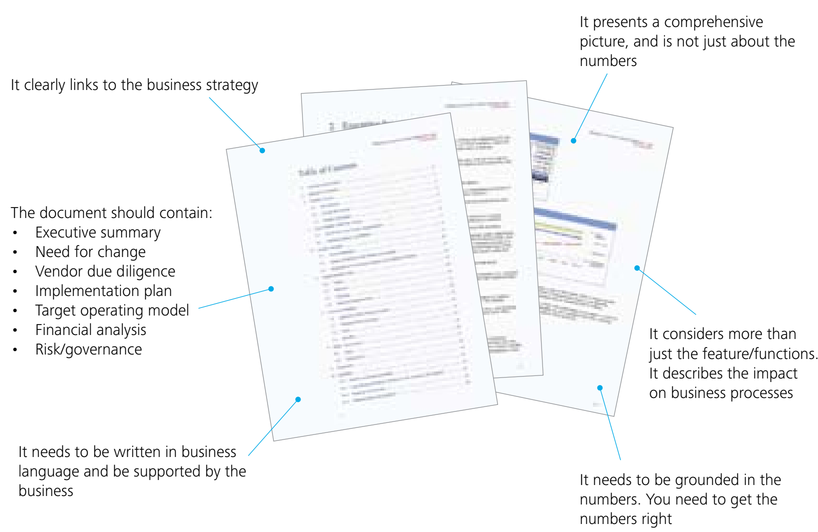
You can't put it off any longer – your bank's legacy core banking system needs replacing. Clearly your bank has reached a tipping point where the cost and risk of doing nothing outweighs the cost and risk of taking action[1].

So how do you go about convincing your business partners to invest such a significant amount for a core banking replacement in today's turbulent economy? There's plenty of talk around core banking replacement solutions, but relatively little discussion of the true benefits of taking on the risk, investment and upheaval of such a complex project.

The purpose of this document is to outline a pragmatic approach to building an effective business case so you can make a case for change.

Some attributes of an effective core banking business case:

Figure 1.1: Attributes of an effective core banking business case



One of the biggest hurdles to core banking replacement is making the business case. Too often banks do not have a clear idea of how to calculate the return on investment, or have an effective way to measure post implementation benefits.

Building the foundation

Closing the gaps

Quantifying the benefits of core banking replacement is difficult. Costs often need to be spread across multiple business units and the benefits can be difficult to identify. Business cases built only on technology costs and benefits are rarely, if ever, successful.

Therefore, establishing an effective dialogue between business and technology groups is critical to the success of a core banking replacement project. And yet achieving alignment is harder than it sounds. So often business and IT resemble fraternal members of the European Union – while aligned in matters of monetary policy, they work in different time zones, speak different languages and one is invariably richer than the other.

A recent study found that communication failures and cultural differences between IT departments and business units within leading banks are hampering the industry's strategic development and business effectiveness[2].

The road to a successful business case starts at the foundation and a joint understanding of what is at stake by all parties. There are often fundamental gaps in timing and communication that need to be addressed.

1. The gap in timing

While most banks have long-term strategies in place, the business' planning cycle can be largely driven by the budgeting process which works on an annual basis. The reality, however, is that major IT initiatives can consume most of that year in just planning and gathering requirements.

The big transformational IT initiatives, like replacing components of your legacy systems, can take three to five years to complete. Most long-term corporate strategies – even those that are clearly outlined and well communicated – do not provide the level of detail required to set the path for technology to take action. The fact that technology solutions generally outlast the business models they were designed to support (by a factor of several times) further magnifies the problem[3].

The business' shorter-term planning cycle leaves the technology group predisposed to dealing with the challenges of 'today' – implementing quick fixes and keeping up with application maintenance (i.e. 'keeping the lights on').

2. The gap in communications

The front and back office often bring very different perspectives to the table – they often define strategy in different terms and work at different levels of detail. The technical lexicon associated with scalability, capacity and availability will sound like "techno-speak" to a business partner focused on customer retention, revenue uplift and share of wallet. Add in the reality that the core system replacement will cross multiple lines of business and it often feels like people are speaking completely different languages.

Aligning IT to the business is a sequential process that starts with understanding the business context and strategy, followed by defining the capabilities and requirements necessary to support that strategy.

Approach to business and IT alignment

The earlier IT and the business engage each other, the better. Deloitte's approach to business and IT alignment is founded in creating a simple mechanism that allows the business and technology groups to engage each other in a constructive dialogue to close or significantly reduce the gaps. It is founded on two basic principles:

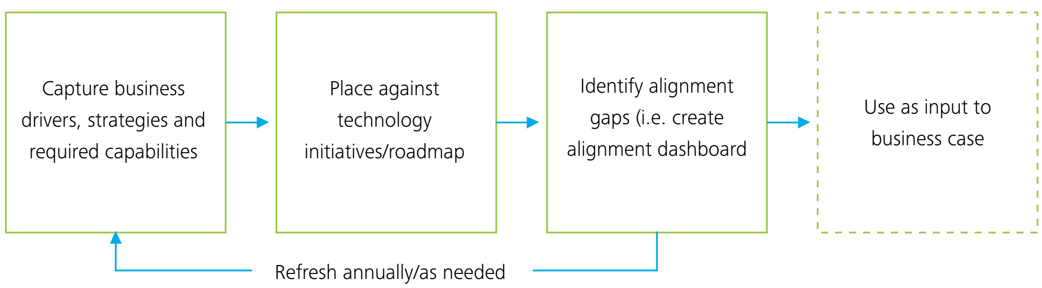
1. Create a straight-forward, ongoing alignment process for regular engagement
2. Develop a simple framework to drive structured, results-driven conversations when the groups meet

Next, it's the technology group's responsibility to map those capabilities against a technology roadmap and to manage expectations in terms of what capabilities will be delivered and when.

Finally, the business and technology groups should meet to discuss and agree on any alignment gaps.

Building support for the business case to replace the core should be a natural extension of this process. Engaging the business early and often will help frame and socialize the case for change in terms that will resonate.

Figure 2.1: Alignment Process



Within each step of the alignment process, clear objectives and outcomes (i.e. framework) should be communicated in advance. This ensures an efficient results-driven process.

It starts with the fundamentals, which is an understanding of the business drivers.

This understanding is used as the backdrop to then engage the business in a dialogue, identifying the strategies in place to cope with these drivers within the context of a three to five year planning horizon.

Once the strategy is confirmed, you can start to look at the capabilities required to make the strategies work. It's at the capabilities level where the rubber starts to hit the road. Capabilities are not about features and functionality, but are the high-level business requirements needed to allow the business to achieve its strategic goals and completes the statement "in order to realize the strategy, I need to be able to…".

Probing questions to consider

- Is the existing business limited by what technology can support?
- How are anticipated business needs constrained by technology?
- Are regulatory and operational risk concerns being properly addressed?

The case for change

Actually building out the business case for a core banking system replacement is not a task for the faint of heart. Effective core banking business cases take these points into consideration:

1. **The decision to replace a core banking system is not simply a financial one.** Comprehensive core banking replacement business cases are not built on financial benefits (i.e. ROI) alone
2. **The benefits need to tie in to your organization's overall business strategy.** Technical drivers for change (such as technology currency, system availability, etc.) are not compelling if they do not clearly support the overarching business need
3. **Consider all dimensions of your business when structuring your business case.** Assess the benefits in terms of how it helps to CHANGE the business, RUN the business, and MANAGE the business.

The decision is not simply a financial one

A business case built solely on financial benefits fails to account for value that extends beyond the basic numbers. In fact, strong business cases can be developed even with negative ROIs.

In addition to the 'hard' benefits (i.e. benefits that are easily quantifiable in a business case), there are several important 'soft' benefits that need to be articulated thorough qualitative analysis to tell the whole story. Soft benefits are qualitative and are not as easily quantified in a business case. However, these benefits are real and include:

- **Operational efficiency** – Replacing a set of existing, disparate modules with an integrated core banking solution will improve operational efficiencies through improved STP (straight-through processing) and business process alignment. Simplification of the technology environment improves business agility and long-term sustainability.
- **Strengthened controls** – Opportunity to strengthen business process controls and general system controls by replacing stand-alone applications and spreadsheets. This reduces the need for manual controls with multiple inputs across different sources (which regulators typically frown upon). Today's core banking solutions enable enhanced, centralized security controls (via single sign-on, access controls, etc.).
- **Enhanced financial audit capabilities** – Modern core banking solutions offer full audit trails for every transaction via online inquiry and on-demand reports, improving transparency and traceability.
- **Improved sales and service capacity** – An integrated core banking platform, combined with improved analytics, optimized processes and supporting HR models, will improve cross-sell/up-sell opportunities and increase the ability to acquire new customers. More agile core banking solutions allow for faster time to market with new and innovative products or services.
- **Enhanced regulatory and risk management** – A robust, well-designed solution will help to avoid business disruptions caused by system downtime. A solution that has been localized for the geographies that the organization operates in will address regulatory changes in a timely manner.

Tie benefits to the overall strategy

Where most core banking replacement business cases fall short, is the focus on the technical imperatives for change without linking the benefits to the overall business strategy.

Although technology currency, system supportability and improved system architectures are valid benefits, they in themselves do little to motivate the business to approve multi-million dollar projects to overhaul the organization's core banking systems.

It is important then to show how core banking system replacement drives business benefits through increased functionality, optimized business processes and improved technology.

The increased functionality provided by a replacement system enables new products and services to be offered. Better business process alignment, automation and optimization with a replacement system increases both operating efficiency and effectiveness (quality of service). Further, enhanced technology helps to 'future-proof' the investment, providing a flexible and extensible platform that is able to support changing business needs and dynamic environments.

As discussed in the last section, we strongly recommend that you spend the time to understand the overall business strategy (e.g. Will growth be organic or via M&A? What are the competitive pressures? What is your product roadmap?). You need to be able to demonstrate how the benefits (hard or soft) align with, and support, the stated business strategy.

Structure your business case

A proven and effective way to structure your business case (including both hard and soft benefits) is to consider the following three dimensions:

1. **CHANGE the business** – Refers to external stress a financial institution faces that may result in the need to change the way business is done (e.g. introduction of new innovative products, changes in the competitive landscape, planned organic/inorganic growth, targeting of new customer segments or markets, etc).

2. **RUN the business** – Refers to demands on the operations of the financial institution generated through its day-to-day business (e.g. process improvement, cost reductions, etc). Focus should be on both the cost/efficiency and the capacity/effectiveness of the operations.

3. **MANAGE the business** – Refers to the comprehensive set of risks a financial institution needs to manage (e.g. regulatory risks, operational risks, market risks, security risks, etc).

Table 3.1: Core system replacement drivers-benefits framework

Benefit	Description	Sample indicators/metrics
CHANGE the business		
Growth	Assets under management; top-line revenue; number of customers	• New revenues • Deposit base
Customer/brand	Customer experience; quality of service; external brand; customer insights and analytics	• Net promoter score • Share of wallet
Business agility	Business changes and innovation; M&A activities; major project delivery; future flexibility and extensibility	• Time to market • Project success rate
RUN the business		
Cost/efficiency	Efficiency of ongoing operations (ability to do more with less); run-time costs; application portfolio complexity; straight-through processing	• Operational costs • Efficiency ratio (NIX) • Application/hardware rationalization
Capacity/effectiveness	Capacity and effectiveness of the bank to deliver technology-enabled solutions	• # Changes supported • # Major incidents/downtime • # FTEs required
MANAGE the business		
Regulatory risk	Ability to adhere to changes in laws or regulations (e.g., BASEL, SoX, AML, SEPA, etc.)	• Regulatory compliance costs
Credit and operational risk	Ability to manage credit (e.g. loan losses, receivables) and operational risks (e.g. fraud, information security, etc.)	• Loan loss provisions • Traceability and transparency • # Security breaches

Recognizing the core of the matter

Core system replacement alone will not always address all the business needs. In some cases, business needs can be met only when systems surrounding the new core 'turn on' or are able to leverage capabilities provided by the new core.

Examples of this include global treasury capabilities such as advanced account analytics and harmonization. While core system replacement enables the offering of such services, it does not provide the services directly. Instead, development in the surrounding systems (in this case, the cash management and treasury systems) is required for the business to be able to offer the services to clients.

When building a core system replacement business case, it is important to differentiate between the benefits that will be achieved directly with core replacement alone, versus benefits that will still require changes to surrounding systems.

A well-defined boundary between core versus surrounding on both the costs and benefits sides of the equation, is important. That is, if you exclude the costs of implementing changes to surrounding systems from the business case, you must also exclude the benefits that require those changes to be realized otherwise the integrity of the business case is diminished.

Deloitte's POV on core banking replacement, "When Legacy Is Not Enough", provides a clear, industry-recognized definition of what is included in the core system versus what is included in the surrounding systems.

'When legacy is not enough'

Deloitte's point of view on the high stakes game of replacing a bank's core systems.

Available at www.deloitte.com

Making the case

There are eight key steps on the path towards building an effective business case. Executing against them is as much an art as it is a science. These steps will help you to ask the right questions and follow the right path.

Figure 4.1: The journey to a successful business case

Turn-by-turn business case itinerary

1. **Assemble the right team.** Ensure there is a balance between business and technology representation on your core banking business case development team. Teams comprised of individuals reflecting diverse points of view will challenge each other and while they may take longer to arrive at a consensus than uniform teams, chances are they will arrive at a better answer.

2. **Understand the enterprise direction.** The right solution will depend on where the organization wants to be in the future (i.e. the overall business strategy, as discussed in Section 3). In order to understand that direction, the right decision makers and stakeholders in the organization need to be engaged early in the process. These thought-leaders will help focus on where the benefits of your business case may reside.

3. **Ask the right questions.** A business case can only be constructed for a defined state. Drawing the right boundaries requires the organization to ask a number of questions:

- Which geographies, functions, or business lines should be considered?
- What is the right implementation approach and target operating model?
- Which vendor is most strategically aligned with organizational goals?
- Which systems are being replaced?
- How are core processes impacted?

4. **Discover available data.** One of the greatest challenges relates to availability of cost and benefits data. Across the enterprise, there are often different formats and different interpretations of information. Understanding where gaps exist and how they may be filled is a key challenge. In order to make this process possible, the appropriate subject matter experts and business representatives will need to be engaged.

5. **Make decisions and define assumptions.** Pending available data, it is important to explore the questions posed earlier. Where possible, decisions should be made. Otherwise, assumptions should be formed and documented.

6. **Structure the case.** Ultimately, the case will need to present a story outlining the reasons the organization feels a replacement core banking system is the right solution. This often involves a discussion on some key topics, as illustrated in the table of contents.

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7. **Build the financial model.** The business case needs to present an analysis that is easily understood by a diverse audience. Including the option to run multiple scenarios, incorporating detailed source and analysis information and breaking out costs and benefits into standard categories (e.g. one time vs. recurring) will enhance the usability of the analysis and support the results.

Figure 4.2: Sample financial model summary

A 25% cost contigency allows you to anticipate additional costs and timeline overruns

Estimated increase in `share of wallet'

Àverage revenue per customer

Current `run the business' costs that are no longer applicable with a new system

Costs	Year 1	Year 2	Year 3	Year…
One Time Costs				
Software and licencing costs	A	A		
Hardware	B	B		
Implementation / migration costs	C	C		
Expenses and training	D	D		
One time cost contingencies (%)	25%	25%		
Total One Time Costs	sum(A:D)	sum(A:D)		
Recurring Costs				
Software maintenance	E	E	E	E
Hardware maintenance	F	F	F	F
One time cost contingencies (%)	25%	25%	25%	25%
Total Recurring Costs	sum(E:F)	sum(E:F)	sum(E:F)	sum(E:F)
Total Costs	sum(Costs)	sum(Costs)	sum(Costs)	sum(Costs)
Benefits	**Year 1**	**Year 2**	**Year 3**	**Year…**
Quantifiable Benefts				
Cross sell revenues	G	G	G	G
Customer acquisition	H	H	H	H
Recued downtime	I	I	I	I
Cost avoidance	J	J	J	J
Application rationalization gains	K	K	K	K
Operational efficiencies	L	L	L	L
Hardware consolidation	M	M	M	M
Total Quantifable Benefits	sum(G:M)	sum(G:M)	sum(G:M)	sum(G:M)
Total Benefits	sum(Benefits)	sum(Benefits)	sum(Benefits)	sum(Benefits)
Net Impact (benefits costs)				
NPV (net impact, wacc)				

Both internal and external implementation costs need to be considered

Average revenue uplift from cross selling

Estimated downtime and impact on revenue

Improved process efficiencies (e.g., STP)

8. **Socialize and validate the results.** It is important to validate interim and final results with the groups or individuals who were in involved at any stage, ensuring there is support for the analysis that was undertaken, and the assumptions that were made, with the information provided.

Insights from the field

- **Build support early.** Engage your business partners and key executives sooner rather than later. Having them along for the journey is key to reaching your destination.

- **Get the vendors to help.** Vendors are highly motivated to help. Call on them (formally via RFIs/ RFQs or informally) to get insight into what risks you may face and what things may cost.

- **Talk to other banks.** There are more and more core replacement projects either underway or already completed; insights from these real-life experiences will help you.

- **Make the process transparent.** Help people understand how you are approaching the problem, the analysis and the decision-making process.

- **Document your assumptions and the rationales behind them.** Invariably, at some point, at least a few of your assumptions will be questioned.

- **Account for both 'green' and 'brown' dollars.** Consider both the internal (i.e. 'brown') and external (i.e. 'green') effort required, not only in terms of cost, but the impact on your organization.

- **Ensure adequate contingency.** Core banking system replacement projects are large and complex and it is unlikely that all cost drivers will be known from day one so we recommend at least a 25% contingency above estimated costs.

- **Look beyond the usual business case time horizon.** The cost and complexity of deploying a replacement core system typically pushes the breakeven point of the business case beyond conventional decision thresholds (time horizons), therefore a longer outlook should be considered.

Conclusion

Building a case for a core banking replacement business is not an easy task – there are alignments to be built, 'hard' and 'soft' benefits to be considered and a link to the overall business strategy to be made. Laying the right foundation, understanding the case for change and taking a thorough approach to the development of the business case will go a long way to ensuring the project is given a stamp of approval.

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