Survival through Target Operating Model (TOM)

Banks need to rethink their operating models to ensure survival in today’s marketplace.

Current versus target operating model

In the current environment of increased regulation, market uncertainty, fierce competition, tighter margins, reduced returns and changing client expectations, it is essential that banks continue to rethink and adapt their operating models.

Banks need to process a larger volume of information at a faster pace with ever-increasing demands relating to client, regulatory and financial data. Importance is placed on data, client information and reporting with zero tolerance for errors and delays. This, together with digitalisation and increasingly more sophisticated and demanding clients, has placed additional burdens on banks and means that they must look at innovative ways to differentiate themselves to successfully overcome obstacles. Some banks have already taken action while many others are still struggling with these questions. Consequently, banks now need to focus on new ways to stand out from the competition to achieve an operating and/or structural advantage.
Rationalisation, simplification, streamlining and automation are now common buzzwords used in banks’ business-as-usual and not only in strategic board meetings. After all, these ideas are a means for banks to deliver improvements that bring real economic value. For example, procurement spending reductions, process improvements and smaller-scale system enhancements all help to optimise the Current Operational Model (COM) and reduce costs. Banks can also re-assess their COM to pinpoint its structural advantage so that they can build and differentiate themselves from competitors by focussing on their core business strategy, sustained efficiency and long-term growth. Indeed, we have observed in the last decade that many banks have—and continue—to look at ways to divest non-core and capital-intensive assets to minimise costs. Near- or off-shoring for lower-cost operations, outsourcing to lower fixed costs, rethinking their customer value proposition by focussing on internet servicing of clients, rationalisation of products and customer segmentation, strategic acquisitions and system integration or enhancements are all options allowing banks to trim their balance sheets, concentrating limited resources where they can earn the best returns. After all, the underlying requirement is the need to do more for less, which invariably means that banks need to review and reconsider their current and target operating models.

This paper provides an overview of the changing business landscape, market pressure, increasing client demands and target operating model considerations that will be required to overcome these obstacles and how to make the successful transition to a more efficient operating model.

What does this mean?
The current operating models of most banks can no longer cope with these heightened business, client and regulatory demands. A patchwork of workarounds may be able to deliver in the short-term but, as we have seen in recent years, this is not a sustainable solution.

Some banks may have been reluctant to overhaul their operating model because of the investment this is likely to entail. However, rising pressures on prices and margins, regulations impacting fees that can be charged and greater demands from clients, together with numerous challenges resulting from digitalisation and globalisation, mean that banks are under pressure from a variety of forces and so must look at their COM and TOM to survive.

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Our experience shows that looking at COMs and TOMs is not simply an intellectual exercise, but essential to implementing a bank’s strategy. Moreover, a well-defined TOM is certainly worth the upfront investment. For example, in the past we have seen banks merge without integrating their IT platforms. Consequently, most of their processes were inefficiently set up and the organisation struggled with different legacy systems and a disjointed IT architecture. This led to huge inefficiencies, redundancies, time wasted and ultimately, costs. However, in recent years, we have seen increased investment in integrating IT platforms or finding alternative solutions to deal with the inefficiency of incompatible and outdated IT systems and infrastructure.

Another example is a study and transformation journey initiated by a major bank that decided to review and challenge its operating model in order to improve its performance, efficiency and ability to respond to new challenges. Our analysis highlighted that the bank’s COM presented a series of missed synergies between the various entities of the bank as regional hubs were managed locally, providing a limited range of services. This, coupled with an old legacy system, led to manual processes and operations, which in turn resulted in inefficiency and slow market responsiveness.

Simplification of back office activities and re-organisation from a hub to a product-focussed model became the key focus for the bank. However, designing a TOM was not a simple task as the team faced numerous challenges:

- How to avoid additional project costs connected with system alignment between the different entities and with the bank model while consolidating the model to optimise process rationalisation
- How to ensure strong programme governance and authority, with comprehensive enterprise architecture to avoid potential incompatibilities and inefficiencies
• How to enhance the existing change management framework to better prioritise and cope with change request processes and allocation of activities between front, middle and back-Offices
• How to ensure local agility (e.g. client and portfolio management, order initiation, credit approval, cheque collections, etc.) and the support requirement needs of each country

The team worked closely with the bank’s employees to design a TOM that would respond to all the challenges whilst ensuring a robust but agile operating model. The final TOM aimed to harmonise channels such as e-banking, relationship manager and client-facing solutions. Moreover, the TOM added specific functionalities, streamlined and standardised back-office operational activities and resulted in the implementation of a new core banking system that not only entailed significant cost savings for the bank at group level but also improved the bank’s ability to respond to the changing market. The new TOM meant that front-office activities and functions remained at a local level to support requirements specific to each country, ensuring local agility (e.g. client and portfolio management, order initiation, credit approval and cheque collections). Common and non-client-facing operations were managed at back-office level so that these could be pooled in a regional hub (e.g. order execution and settlement, trade finance transaction processing, client-side treasury back-to-back management, etc.).

Defining TOM to fulfil strategic vision
New landscapes demand innovative responses to drive both efficiency and differentiation, rethinking operating models to deliver strategic vision but also ensuring that there is an integrated solution underpinned by people, processes and systems. Individual functions and departments cannot survive working in silos, but must now focus on integrated capabilities, solutions and competences, as well as standardisation of processes and practice to achieve operational excellence and cost leadership. In fact, configuring the different components to ensure they work together effectively and efficiently is one of the biggest challenges when redesigning a TOM. Generally speaking, a TOM needs to take all the different steps illustrated in Figure 1 into account.
As mentioned above, the first step in defining a TOM is to evaluate your Current Operating Model (COM). It is crucial that you understand where you are today before defining the vision and strategy going forward (i.e. your strategic vision and priorities for the next five to ten years) as this will help you develop a realistic roadmap for your business.

The answers to the following questions can act as a framework for the process:

- What is your business strategy?
- What markets, products/services, channels and segments will you compete in?
- What is your differentiated client value proposition?
- What resources do you need in terms of people, skills, organisation, data and technology?
- Which enabling technologies will you use to support your TOM?
Once aligned on the strategic vision, you will need to begin making critical decisions regarding the TOM. These choices will vary depending on the player, but typically they are centred on three main themes: people, processes and systems. For each of these areas, you will need to consider the following questions (among others):

**People**

- What are the resources and capabilities required for TOM?
- What is the impact on the current organisational structure and resources in terms of skills, capabilities and roles? Measure the cost of change in the organisation and the potential people change impact.
- How do both individual and departmental roles need to change?
- What level of coaching and training is needed to support the capabilities required by the new model?
- How does the leadership model motivate behaviour and to what degree are metrics and measurement systems (e.g. dashboards, KPIs) set up to reinforce TOM?

**Processes**

- In what way will the TOM impact the business and functional processes?
- To what extent can process improvement and automation enable the centralisation of tasks and better use of the back and middle office?
- Are there opportunities to streamline and standardise processes such as reporting across business units?
- Are there opportunities to create Shared Service Centres (SSCs) for key activities such as finance, IT and data analytics, for example?
- Are there any opportunities to leverage lower-cost locations for specific activities, and which capabilities are required? Are outsourcing or strategic partnerships a viable option?
- Are there any implication in terms of reporting and governance?

**Systems**

- Is a full overhaul of legacy systems feasible or desirable?
- What can be achieved by redesigning end-to-end processes without significant technology investment?
- Where can technology enhancements enable process improvements and add value to the client experience?
Once you have addressed the above questions and carefully considered each element outlined in Figure 1, you should be on the right track with a solid roadmap to achieve your vision. Moreover, the roadmap should include target client segments and sources of potential advantage such as product breadth, service models, price positioning, advisory capability, mobile functionality, etc. These should form the basis for your business case for additional investment or divergence from your current operating model. Critical to success for any TOM is having a clear strategy, executive buy-in and in-principle design decisions on key areas (e.g. in-house vs. outsourced model).

Creating a more effective operating model

Creating a more effective operating model requires broad changes across the organisation, impacting everything from organisational structure and governance to processes and systems. Defining an operating model capable of responding to the tougher business environment and regulatory requirements is clearly a huge challenge, which will be heightened by the sheer number of stakeholders, pressure on resources and the need to sustain core reporting responsibilities. Access to mid-management and in-house SMEs, utilising external benchmarks (within and outside the sector) and stable downstream decisions (i.e. executives not changing their mind within weeks/months of making a decision) are critical success factors in TOM implementation.

Conclusion

There is no one-size-fits-all solution; operating models are always evolving and although it is a challenge, it is nonetheless a requirement for ensuring the business is successful and is able to implement its vision while keeping shareholders happy and achieving a bottom line. Moreover, a documented operating model is a useful reference point for assessing the impact of any change, from strategic (e.g. M&A) to tactical (e.g. process change), and helps to ensure that your organisation remains agile and sufficiently equipped to keep abreast of the competition, the changing business landscape, market pressure and increasing client demands.