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Capability-led Transformation in Banking

A robust approach for today's banking challenges

Several quarters of consistent earnings performance and the recent, first-in-nearly-a-decade Federal Reserve rate hike are fuel for optimism among bank leaders. But even the most hopeful bankers tend to greet each day facing diverse and growing demands.

Many banks are stretching resources to attract new profitable customers while protecting existing market share against innovative nonbank competitors. Technology upstarts and retail giants alike are offering convenient, low-cost alternatives to bank services, including peer-to-peer payment methods and instore banking. Tech-infused Millennials have high and growing expectations for online and mobile banking, as well as individualized services and financial guidance. The emergence of blockchain technology signals a potentially monumental shift in the exchange of money, securities, and other assets.

Along with these market challenges, post-crisis regulatory scrutiny and oversight continue to grow not only for the largest institutions, but also midsized and smaller banks, with potentially grave financial and organization consequences. In addition, with cybersecurity risks escalating across the globe, financial services bears unwelcome distinction as the industry most targeted by crooks.

Together, these disparate forces are compelling bank leaders to make critical strategic, financial and operational decisions—choices that require a structured approach to capture the breadth of considerations involved. Certainly, banks are already addressing these challenges aggressively. In some cases, though, taking the traditional people / process / technology view of strategic planning and change simply may not be enough.

This paper offers a more robust alternative: a capability-led approach to transformation that considers six interrelated elements in assessing current conditions, developing target states, and charting courses of action. It's an approach that offers a different perspective on how to explore and address the pressures that banks and their leaders face today.

Deciding where to compete

As bank executives well know, the forces noted above reflect the changing expectations of both customers and regulators, as well as a rapidly changing competitive environment. Addressing these trends can be overwhelming to begin to plan and cost prohibitive to execute. In light of this, many banks are choosing among three different approaches in their efforts to respond:

Reactive imitators: Some banks are building capabilities to mimic more aggressive competitors or to meet the minimum expectations of regulators and customers. The first foray by a bank into offering check deposits over a mobile application led other large institutions to quickly implement some form of mobile remote deposit capture technology. When large fines first hit banks for anti-money laundering violations, many big institutions quickly ramped up their AML related capabilities.

Proactive opportunity seekers: Other banks are proactively building capabilities that differentiate them from competitors and help them gain a competitive advantage by serving customer needs in the evolving market. The natural gas fracking boom led a community bank to set up an oil and gas management team to help landowners navigate land rights sales. Institutions are partnering with large universities to capture the millennial market at the onset of their financial independence.

Innovative competitors: Some institutions are pushing the envelope further, building capabilities that are new to banks everywhere. Market leaders are offering digital and mobile-friendly products to technologically savvy customers that integrate savings and checking products with built-in budgeting and investment tools with an ease of use not seen before in this space.

Regardless of whether a bank intends to employ one or more of these marketplace approaches, formulating and executing strategy within a capability-led framework can help establish a comprehensive picture of the issues, uncertainties, and opportunities involved.

A look at the capability-led value chain

Figure 1 portrays an illustrative continuum of activities that together form the capability-led value chain. Built on a holistic view of the banking enterprise, this approach buckets capabilities into six customer lifecycle phases:

- **Develop**: Researching, designing, and launching new products
- **Market:** Planning and executing promotional and marketing campaigns to build awareness of new products and offerings
- **Sell:** Connecting with specific customers to sell specific products and offerings, working across channels
- **Account setup**: After the sale, executing the multiple steps to onboard customers and set up accounts and products
- **Service**: Servicing the products for specific customers, managing relationships and potentially expanding services over time
- **Portfolio management**: Working across product families and customer types, overall bank management of assets, liabilities and working capital

Different customer-facing channels and lines of business will have their respective versions underneath these six capability groups, emphasizing the need to tailor the framework to an individual bank's line of business structure, products, and priorities.

Figure 1. Capabilities value chain

Develop	Market	Sell	Account Set-up	Service	Portfolio Management
Researching designing, and launching new products	Planning and executing promotional and marketing campaigns to build awareness of new products and offerings	Connecting with specific customers to sell specific products and offerings, working across channels	After the sale, executing the multiple steps to onboard customers and set up accounts and products	Servicing the products for specific customers, managing relationships and potentially expanding services over time	Working across product families and customer types, overall bank management of assets, liabilities and working capital

Six interrelated elements define each of the capabilities under the value chain at this level or the next level down with specific line of business or product group capabilities:

- **Mission:** The purpose of a capability, how it will operate, and what value it can deliver. The mission is derived directly from and supports the company's strategy
- **Insights:** The decision flow, information, and analytics that drive more informed and timely decision making
- **Process:** An integrated and efficient set of processes and activities designed to achieve a desired outcome
- **Technology:** The technologies (software and hardware) and tools required to enable the capability
- **Talent:** The competencies, skills, talent infrastructure and workforce planning that enable an optimal talent base to execute the capability
- **Integration:** Clear roles, decision rights, and policies that facilitate integration within and across other capabilities, functions and partnerships

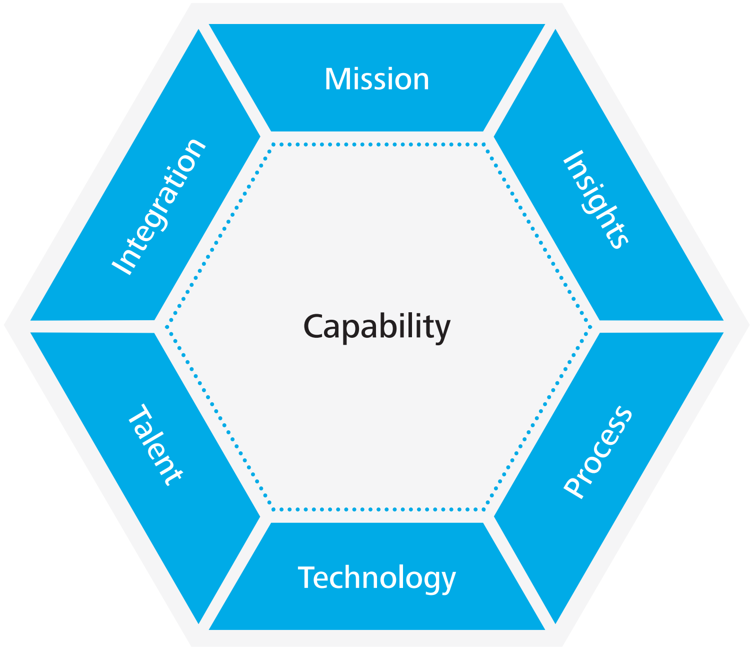
Each of these six elements plays a part in defining each capability, and should be used both to assess the current state and define the target state capability (Figure 2).

Not all six elements will be equally important in every capability, and "more" may not always be better; sometimes it is just more expensive. While challenges in one element may not impede a bank in executing, such limitations may prevent it from leveraging the capability in an efficient or differentiating manner.

For example, an inability to articulate the mission may lead to employees questioning why the bank is working to develop or deliver the capability. Consequently, they may not understand the need to deliver services using the prescribed method. This can result in inconsistent delivery and diminished customer experience or just delays in getting things done that may not show up on management reports.

Further, having limited insights associated with a capability may lengthen decision-making processes, potentially undermining efficiency, agility or competitiveness, or even preventing a bank from capitalizing on a market opportunity. Finally, misalignment of talent can impede execution because people don't have the required skills or training to deliver the bank's brand promise or don't sufficiently anticipate an upcoming change in talent needs.

Figure 2. Capability elements



Quick capability assessment

Understanding the six-element definition of a capability, bank executives can take a first step toward adopting a capability-led approach to transformation: assessing the current state of the organization's own capabilities. While such an assessment can be approached in several ways, applying a competitive lens as part of the analysis can help achieve an outcome that factors in the organization's capabilities relative to peer performance. Incorporating this competitive information, capabilities can be categorized in one of three groups:

- Foundational: The organization needs to have mastered the basics for this group of capabilities to meet industry bare minimums—table-stakes required for the organization to participate in the industry. Expectations of the organization's foundational capabilities may change over time, as customers or regulators increase their expectations
- Competitive: These are capabilities mature enough to help the bank maintain competitive parity with peers and thus retain customers. These capabilities are those that customers may compare across banks when selecting banks or specific products
- Distinctive: This set of capabilities presents an opportunity to deliver superior value in the market. These strategically differentiating capabilities can help a bank compete and win in the marketplace, tipping the scale in a competitive situation with customers. They create a source of advantage over peers in terms of cost control, revenue generation opportunities, customer attraction and loyalty, or risk mitigation and management

After categorizing the organization's capabilities into one of the three groups, bank leaders can decide which capabilities should evolve and whether new capabilities may be required to meet strategic imperatives. In responding to external forces such as market developments, management may focus on enhancing capabilities considered to be competitive, or in more dire circumstances, developing foundational capabilities in areas where the bank currently falls short.

An organization possessing solid foundational and competitive capabilities may choose to invest in building or enhancing a distinctive capability as a means to differentiate itself from competitors. Once the capabilities that need to change are identified, executives can craft visions for which elements of those capabilities need to change and why (and not focus on people, process, technology separately, as is frequently the case).

Approach options: Outside in or inside out

The capability-led framework requires commitment, and it may seem overwhelming at first. But everything doesn't need to be done at once. The process of adopting this approach can progress through a few other easy steps.

An "outside-in" assessment is a good way to respond to and build on market conditions and opportunities to drive actions. An "inside-out" approach may be more appropriate if there is a particular capability or group of capabilities within the bank that are high priority. In either case, the approach should be manageable for the organization and address a timely issue while incorporating these steps:

"Outside-in": Change triggered by external trends:

1. Trends: Choose a key trend or pressure impacting the organization; brainstorm within the executive team to explore how the trend is affecting the company or competitors by identifying specific capabilities
2. Current state: Assess the current state of each of the six dimensions of the identified capabilities within the organization; categorize the capabilities as foundational, competitive, or distinctive
3. Target state: Identify the capabilities needed for the target state and determine how robust they will need to be (foundational, competitive, or distinctive) to effectively address trends and pressures; note gaps uncovered in the current state assessment
4. Plan to close gaps: Articulate a collective executive vision for the target state of the identified capabilities on each of the six capability dimensions; identify in-flight initiatives that are adding components; define investments required or changes needed to close the newly identified gaps
5. Drive change: Identify an executive sponsor to see the transformation through to its conclusion; develop a roadmap and high level business case for the required investment and design an ongoing method to review capabilities' current and target states

"Inside-out": Change focused on internally selected capabilities:

1. Capabilities: Assemble the executive team and choose a capability or group of capabilities to focus on
2. Corporate priorities: Identify the priorities likely to affect the capability in the short, medium, and long term; discuss the potential impact that external trends or the expectations of outside parties such as regulators and customers may have for the selected capability, and how those expectations may evolve
3. Target requirements: Assess what needs to be in place for each of the six capability dimensions to meet or exceed those expectations; note where gaps may exist
4. Executive vision: Articulate a collective executive vision for the target state of the identified capabilities on the six capability dimensions; define related current initiatives, investments required, or changes needed to close newly identified gaps
5. Drive change: Identify an executive sponsor to see the transformation through to its conclusion; develop a roadmap and high level business case for the required investment and design an ongoing method to review capabilities' current and target states

A new and potent way to drive strategic change and competitive leadership

Customer demands, market forces, regulatory requirements, and growing security concerns will likely continue to create a challenging environment for banks. But it doesn't have to be overwhelming. Whether focusing on one capability for a specific purpose or taking the first step of a larger transformation, the capability-led approach can be instituted a step at a time. And, it can be undertaken with confidence that the institution is proceeding with a broad-based view of needs, opportunities, and important considerations for the journey.

Contacts

Deron Weston
Principal, Deloitte Consulting LLP
dweston@deloitte.com

James M. Baker
Principal, Deloitte Consulting LLP
jamesbaker@deloitte.com

Michael S. Schaffer
Manager, Deloitte Consulting LLP
mischaffer@deloitte.com

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