

OPERATIONS

Winning at the Margin

A man who does not think and plan long ahead will find trouble right at his door.

Confucius

Operations is the delivery mechanism of the bank, providing the processing infrastructure that ensures execution of the product and service promise. It is the engine driving the back-office work by clearing transactions, reconciling balances, executing on transfers, tackling execution anomalies and dealing with peaks and valleys of demand. That engine depends on input from the frontline functions of the business—Branch Network, Sales, Marketing, and Finance.

In broad terms the Bank's Operations challenge is setting up efficient access points for customers that cut across workflows that have different operational / institutional standards. For example the highest level operational structures in the industry are the Payments Mechanism and the Securities Mechanism. They both involve a common goal: Same Day Settlement. Other operational structures such as the Checking and Funds Transfer are part of Cash Management services while Securities Clearance, Custody and Collateral Management have historically been associated with Trust Services. The common operational requirement being efficient execution balanced against the delivery or required performance standards.

Of all departments, Operations has dealt the longest with the competitive situation described in Tom Friedman's book *The World Is Flat*. Offshore and outsourced solutions and technology-enabled process excellence are part of the relentless drive for lower costs. After more than a decade of investment and continuous improvement initiatives, banks have achieved what major cost savings are possible. Managing and winning at the margins is the new competitive area for Operations.

Three critical barriers prevent Operations from working these margins to deliver the best possible performance:

Barrier 1: *The operational back end can't see where it's going without the frontline's vision*

Operations depends on accurate and constantly updated information on what is required by customers. If you don't have accurate information about the transaction demand (both volume and variety) in your pipeline, you stand to lose operational efficiency and margin. With better information, you can plan for an upsurge and up-resource accordingly to satisfy the unforeseen. System cut-off times for transaction processing can be better accommodated, and extra capacity can be scheduled. You can better match capacity with customer demand and limit the exposure to high incremental costs additions, for example salary overtime.

Barrier 2: *Process bottlenecks and downtime*

Operations continuously competes against time. Can this process be faster? Can workflow processes be re-engineered and simplified to gain time? The more steps between start and finish, the more bottlenecks and downtime risk may be hidden in them. The time to complete a series of process tasks is inflated by waiting periods. In some situations, actual process time can be as low as five to ten percent of the total time from start to finish. When only one-tenth of the time used is productive, reducing such waste is a worthy prize. You must identify and eliminate predictable process time-wasters. While many solutions may be internal—such as Internet banking, changes in loan application procedures and forms, or upgrades to IT infrastructure—you may decide the bank is better served by outsourcing to a specialist with technical and scale advantages.

Information sweet spots help generate continuous intelligence loops on the real cost of bottlenecks and downtime, showing you the benefits of increased automation or specialization.

Barrier 3: *In a fast-paced, increasingly specialized economy, cost averages disguise cost reality*

With the pressure to adapt to new and changing customer requirements and offer specialist solutions, the Operations workflow is regularly affected. It is no longer sufficient to use broad standard cost allocations when the activity drivers differ significantly. That approach may disguise significant variances in actual process performance costs. Customer segments or products and services that appear profitable on a standard transfer cost basis may not be in fact.

By breaking down work processes into discrete activities and measuring them with accurate activity indicators, you can achieve real-time costing. The best indicators will vary with the situation. Some will be based on labor time used to process a given activity, such as credit scoring. Others may directly measure the nature of the customer interaction, for example, electronic, fax, or telephone, used for a given transaction request, or the number of problem resolutions required for a given customer or product type. The more detailed this activity breakdown, the more accurate your understanding of actual costs. Understanding and analyzing the information sweet spots lets Operations identify process patterns and suggest cost savings.

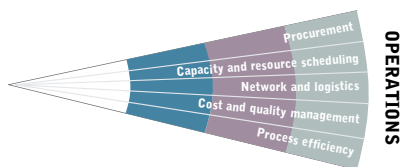
Based on more granular costing information, the business unit can better understand the segment profitability and decide how to position its proposition in the market. “Important” customers may still benefit freely from loss-generating services due to their high net worth. Less premium customers may be asked to pay for certain services. The key is being sure of the drivers of cost and that the underlying cost-allocation methodology is sound and is not driving business away from the bank. Using a broad-based cost transfer and allocation methodology will never highlight customer-specific cost realities. Information sweet spots that let you understand what drives the larger cost categories will have an immediate and sizable impact on managing actual costs.

Delivering on the Promise Made to the Customer

For Operations to win at the margins, every day and every process step, it must balance the need to reduce costs while staying agile enough to respond to new customer and product demands.

Operations has the responsibility to lead five core areas of the bank’s decision-making:

- **Procurement** → Ensuring timely and cost-effective input of resources and capacity
- **Capacity and resource scheduling** → Generating timely output in the face of uncertain demand, complicated processes, and variances in input
- **Network and logistics** → Achieving efficient logistic and network execution
- **Cost and quality management** → Balancing the need to reduce costs with the equal requirement to deliver quality output
- **Process efficiency** → Designing a process to monitor and analyze performance benchmarks to find opportunities for greater efficiency.



Purchasing and Procurement

The procurement decision area manages both input costs and supply requirements. Effectively managing them can bring savings directly to the bottom line. In addition to cost, the procurement personnel must ensure inputs arrive in a timely and effective manner. For example, an upgrade of the data service infrastructure within the branch network could cause unacceptable disruption if not planned carefully with the supplier and ensuring associated performance guarantees. Managers must balance cost savings with the performance standards while maintaining the focus on customer satisfaction.

There is also a balancing act in responding to short- and long-term situations. For example, is the procurement need related to a short-term or long-term service level agreement (SLA) contract?

Long-term decisions will tie the supplier directly to the bank, and its performance will become an extension of the bank’s performance. As such, they require a different degree of diligence in the supplier assessment and selection process.

How do you balance the savings and/or better quality or performance from exclusive supplier agreements against the risk of creating unacceptable dependencies? These decisions require information on specifications, procurement tenders, price quotations, and vendor performance assessments. You cannot make the necessary procurement trade-offs without access to information sweet spots. The better you understand the trade-offs, the more finely tuned your ability to win at the margins.

GOALS	METRICS	DIMENSIONS
Supplier Timeliness (%)	Purchase Order Cost (\$)	Fiscal Week
Purchase Price/Unit (\$)	Purchase Orders (#)	Year
Supplier Performance Rating	Supplier Credit Rating (#)	Quarter
	Contingency Tests (#)	Month
	Supplier Discount (\$)	Week
	Supplier Discount (%)	Suppliers
	Contract Remaining (#)	Supplier Type
	List Price/Unit (\$)	Supplier
	Supplier Testing Score (#)	Supplier Services
		Services Type
		Supplier Service
		Contingency Tests
		Contingency Type
		Contingency Test

FUNCTION	DECISION ROLES	PRIMARY WORK	CONTRIBUTORY	STATUS
Purchasing	Executives	•		
	Managers	•		
	Analysts	•		
	Professionals	•		
Audit	Executives			•
	Managers	•		
	Analysts	•		
IT / Systems	Executives			•
	Analysts	•		
	Professionals	•		
Operations / Production	Executives			•
	Managers		•	
	Analysts		•	
Customer Service	Managers		•	

Capacity and Resource Scheduling

Without an efficient and timely delivery process, there is no business. Accordingly, this decision area is the backbone of the business.

Capacity management depends on scheduling and fulfilling effectively the demand expectations of the front office and, more importantly, those of the customer. Ideally, you know the transaction demands well in advance to be able to plan capacity needs and fulfill process cycle standards in payments, remittance services, demand deposits, money transfers, etc. This minimizes bottlenecks, errors, and process re-runs. Changing a schedule, especially for an urgent requirement, means rearranging existing process schedules, resulting in extra system time, overtime, and lost transaction capacity. The bottom line? It reduces your ability to win at the margins.

As with any chain of interconnected links, changes in demand affect your process requirements. The domino effect of changes spreads across the whole Operations workflow, creating a series of costly capacity management responses. To counter this, you must communicate new information seamlessly, so that Operations can adjust its schedule and resource needs in the most effective manner. You must also communicate potential delays to Customer Service for resolution. Closely monitoring this ebb and flow of changing circumstances through production information sweet spots lets Operations maximize its capacity and resource scheduling.

GOALS	METRICS		DIMENSIONS
Capacity Utilization (%)	Transaction Value (\$)	Quality Score (#)	Fiscal Day
Systems Up Time (%)	Transactions per Employee (#)	Error Rate (%)	Year
Transaction Volume (#)	Cost per Transaction (\$)	Accuracy (%)	Quarter
	Transaction Activity Growth (%)	Avg. Reject Items (#/\$)	Month
	Accounts (#)	Avg. Reversals (#/\$)	Week
	Avg. Transactions per Business Day		Day
	Closed Accounts (#)		Customers
	Funds Transfers (#)		Customer Billing Account
	New Accounts (#)		System Transaction Account
	Overdrafts (#)		Transactions
	Payments (#)		Transaction Types
	Withdrawals (#)		Transaction
	Capacity Hours (#)		Messages
	Backlog Hours (#)		Message Types
			Message
			Counterparties
			Counterparty Types
			Counterparty
			Systems
			Application
			System

FUNCTION	DECISION ROLES	PRIMARY WORK	CONTRIBUTORY	STATUS
Operations / Production	Executives	•		
	Managers	•		
	Analysts	•		
	Professionals	•		
Audit	Managers	•		
	Professionals	•		
IT / Systems	Executives			•
	Analysts		•	
	Professionals	•		
Customer Service	Executives		•	
	Managers		•	
	Analysts		•	
Finance	Managers		•	
	Analysts		•	
	Professionals		•	
Sales	Executives			•
	Managers			•

Network and Logistics

This decision area looks into the operational support and infrastructure requirements of a branch network or indirect network. It also includes the management of local process performance standards, cost, and timeliness of execution and delivery. Examples could include security logistics, branch network systems, ATMs, or telecommunications needs, all to ensure that the support

functions offer the branch customers an efficient, convenient, and relationship-supportive service. The operations management will also scrutinize whether you can reduce costs, improve execution standards, and, ideally, exceed customer service expectations. The network infrastructure and logistics to deliver a given service are intricate and costly. Managing third-party providers to fulfill specialist support requirements also involves effective project management skills. Strategic third-party support can be an advantage either in cost or performance.

While outsourcing makes sense on many levels, it does mean you lose direct control and have to accept the risks that come with loss of control. Managing such risks requires negotiating and monitoring agreements with clear terms and performance guidelines.

GOALS	METRICS	DIMENSIONS	
Transaction Timeliness (%)	Avg. Transaction Volume	Processing Date	Systems
Efficiency Ratio (#)	Avg. Transaction Value (\$)	Fiscal Year	Application System
Account Growth (%)	Avg. Reject Items (#/\$)	Quarter	System
Infrastructure score (#)	Avg. Reversals (#/\$)	Month	Depositories
	Customers (#)	Week	Depository Time
	Accounts (#)	Day	Standards
	Branches (#)	Hour	Depository
	Teller Transactions per Month (#)	Customers	Transaction Processing Method
	Transactions per Customer (#)	Customer Billing Account	Processing Method
	Inquiries per Customer (#)	System Transaction Account	Funds Transfer Method
	Products/Accounts per Customer (#)	Transactions	Funds Transfer Method
	Revenue per Employee (\$)	Transaction Types	Method
	Net Income per Employee (\$)	Transaction	
	Infrastructure Expenditure (\$)	Messages	
	Infrastructure Expenditure per employee (\$)	Message Types	
	Infrastructure Expenditure per Account (\$)	Message	
	Infrastructure Expenditure Growth (%)	Counterparties	
	Supplier Performance Score (#)	Counterparty Types	
		Counterparty	

FUNCTION	DECISION ROLES	PRIMARY WORK	CONTRIBUTORY	STATUS
Operations / Production	Executives	•		
	Managers	•		
	Analysts	•		
	Professionals	•		
Audit	Managers	•		
	Professionals	•		
IT / Systems	Executives			•
	Managers		•	
	Analysts		•	
	Professionals	•		
Customer Service	Executives		•	
	Managers		•	
	Analysts		•	
Finance	Managers		•	
	Analysts		•	
	Professionals		•	
Sales	Executives			•
	Managers			•

Cost and Quality Management

In cost and quality management, you balance cost savings in one area against potential threats of reduced performance standards, increased errors, reconciliation monitoring, customer complaints, etc. A new, lower-cost call center may be attractive, but the impact on problem resolutions and customer satisfaction may be unacceptable. *What is best for the business?*

You need to understand cost variances and their impacts. By contrasting cost differences, you can benchmark performance, identify patterns, and understand the root causes of cost differences. You also need to understand and analyze the value and cost of preventative measures that ensure quality performance such as training, appraising workflow bottlenecks, and resource improvement. The more you examine measurable work activities and the more detailed your breakdown of costs, the more detailed your understanding will be of the root causes of variances in those costs. Measuring and monitoring must be integrated with quality expectations to understand the effect of changes.

GOALS	METRICS	DIMENSIONS	
Transaction Reconciliation (\$/%)	Avg. Balance (\$)	Processing Date	Counterparties
	Negative Net Free Equity (#/\$)	Fiscal Year	Counterparty Types
Cost per Transaction (\$)	Avg. Reject Items (#/\$)	Quarter	Counterparty
	Avg. Reversals (#/\$)	Month	Systems
	Transactions per Employee (#)	Week	Application System
	Avg. Overdraft (#/\$)	Day	System
	Transaction Activity Growth (%)	Hour	Depositories
	Accounts per Employee (#)	Customers	Depository Time Standards
	Customers per Employee (#)	Customer Billing Account	Standards
	Quality Score (#)	System Transaction Account	Depository
	Error Rate (%)	Transactions	Reconciliation Method
	Accuracy (%)	Transaction Types	Reconciliation Method
Reconciliation Cost (\$)	Transaction		
Avg. Reject Items (#/\$)	Messages		
Avg. Reversals (#/\$)	Message Types		
	Message		

FUNCTION	DECISION ROLES	PRIMARY WORK	CONTRIBUTORY	STATUS
Operations / Production	Executives	*		
	Managers	*		
	Analysts	*		
	Professionals	*		
Audit	Executives			*
	Managers	*		
	Professionals	*		
Product Management	Executives			*
	Managers		*	
	Analysts		*	
	Professionals		*	
Customer Service	Executives			*
	Analysts		*	
Finance	Executives			*
	Analysts		*	
Marketing	Executives			*
	Analysts		*	
Purchasing	Executives			*
	Analysts		*	
Sales	Executives			*
	Analysts		*	
IT / Systems	Analysts		*	

Process Efficiency

Process efficiency management looks at ways to improve operational and work process activities. This means looking for performance outliers and understanding why they occur. There are three areas where well-designed comparative performance metrics can make the difference between an industry follower and a leader:

- Internal operational processes
- External developments and trends
- Competitive benchmarking.

Your internal operational processes are most familiar to you, and the easiest to analyze. For example, if “cost per transaction” is a benchmark, then an unusual increase in this index may indicate two things. Either short-term transaction costs have increased or transaction volume has decreased. You must determine whether the efficiency has gone down or if revenues have slumped. Another possible benchmark

is “number of mortgage applications per loan.” If this metric is decreasing, it can indicate that the business is filling more mortgage applications for the same numbers of loans. This may mean that the bank is less competitive in mortgage pricing and/or that it is attracting less credit-worthy customers who are failing the credit-scoring process—but it may also indicate that you need to re-engineer the mortgage evaluation process to make it quicker and more convenient for the customer.

Taking advantage of external developments and trends requires looking outside your organization. Should you shift to low-labor-cost economies for services such as call centers? Are there new IT systems, hardware, and third-party providers that can introduce dramatic efficiencies?

Failing to follow up on these external efficiency developments may jeopardize your competitive position. Beyond this focus, many leading banks extend their monitoring activities to their competitors. Simple comparative benchmarks such as net income per employee, cost per employee, cost per account/deposit, and others will help identify performance differences. With these identified, you can determine the actions you need to take.

GOALS	METRICS	DIMENSIONS
Operational Failures (#)	Capacity Utilization (%)	Fiscal Month
Process Cost (\$)	Systems Up Time (%)	Year
Process Value-Add (\$)	Transaction Volume (#)	Quarter
	Process Steps (#)	Month
	System Downtime Cost (\$)	Manufacturing Product Component
	System Failures (#)	Product Line
	Transactions per Employee (#)	SKU
	Cost per Transaction (\$)	Component
		Product SKU
		Product Line
		Brand
		SKU
		Production Process
		Production Process
		Work Function

FUNCTION	DECISION ROLES	PRIMARY WORK	CONTRIBUTORY	STATUS
Production	Executives	•		
	Analysts	•		
	Managers	•		
	Professionals	•		
Finance	Executives			•
	Analysts		•	
IT / Systems	Executives			•
	Analysts		•	
Purchasing	Executives			•
	Analysts		•	
Customer Service	Analysts		•	
Sales	Analysts		•	

