OLIVER WYMAN

ALL CHANGE

WHAT EUROPEAN BANKS NEED TO DO TO MAKE CHANGE HAPPEN

MARSH & McLENNAN COMPANIES

CONTENTS

INTRODUCTION

Plummeting returns and fading investor confidence are forcing transformation to the top of the agenda for European banks. Return on equity (ROE) stood at 4% in 2013 and with half of European banks trading below book value, the Financial Services sector still faces very challenging times ahead.

With narrowing regulatory uncertainty, much is now known about the new conditions under which European banks must attempt to survive, compete and thrive. A new shape of the industry is emerging, which we outline in chapter two of this report.

The programme of change required to close the gap between the status quo and the future industry is daunting and we have found that after six years of crisis and remediation, banks are struggling across the board to deliver transformation. Despite the enormous effort and progress on balance sheet remediation, overall many banks are in a cycle of missed targets on large-scale change initiatives.

Our research this year has focused on understanding why this is and what can be done about it. We have interviewed and surveyed those responsible for change delivery within the major banks throughout Europe, across different seniority levels. We have heard about a series of issues, common to most European banks irrespective of size, business model or region. We explore these in some depth in chapter three of the report.

New innovative techniques for overcoming these challenges are beginning to emerge, some borrowed from other industries, some being invented within banking to fit the purpose needed. In chapter four we highlight some of the most exciting practices that banks struggling with transformation can use to improve.

Much has been written already about the causes of the financial crisis. However, in time, the process of reform and sector reshaping in banking will form one of the most fascinating case studies on change management anywhere in business history. We hope our research contributes to the understanding of the challenges and indeed some of the innovative change management solutions that are emerging.

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1. EXECUTIVE SUMMARY

1.1. THE EUROPEAN BANKING CONTEXT

TWO PHASES OF REMEDIATION AFTER THE CRISIS: REGULATORY UNCERTAINTY NARROWING

Banks have been working through two phases of post-crisis recovery: a recapitalisation process followed by conduct remediation. The US was first to transition from the first to the second phase, followed by the UK. In the Eurozone a shift in phases is heralded by the end of the Comprehensive Assessment and the assumption of prudential oversight by the European Central Bank's (ECB) Single Supervisory Mechanism. Although some uncertainties remain in both areas, regulatory uncertainty is much reduced. Banks now know most of the regulatory constraints within which they will be doing business.

THE EMERGING SHAPE OF THE INDUSTRY: COMPETITIVE UNCERTAINTY WIDENING

With the regulatory environment stabilising, the new shape of the industry is coming into focus:

- More distinct business models: a clearer distinction between debt-like and equity-like earnings profiles. For example, by our assessment of public commentary from the 50 largest European banks in Europe, ~45% are focused on delivering in-market market share gains, high dividends, stable moderate returns and a low risk profile. By contrast, ~25% are targeting higher top line growth rates, access to international markets and higher risk-return. The remaining ~30% of firms have not clearly stated their strategic objectives
- High cost of resolvability driving strategic selection: legal entities matter – and the fabric of legal entities banks choose to organise around, and their funding, capital and operating models are now fundamental to the shape of banks' business models and set the bar for where they can compete
- Tighter financial resource constraints: leading to a transformation in the way banks operate, along two lines. First, banks must slash operating costs to compensate for the structural increase in capital costs. This is forcing the overhaul of infrastructure and branch footprints. Second, to avoid wasteful use of scarce and costly capital, financial resources need to be more dynamically micro-allocated
- More client-centric: this is not just to do the right thing; the relative economic value of driving up client penetration and share of wallet has rocketed given the know your customer (KYC) and anti-money laundering (AML) costs of acquiring new customers

Macro-environment aside, the competitive landscape has now emerged as the largest unknown for senior leaders, after a period of relative competitive stability. Challenger banks are making ground; banks are no longer advantaged in all parts of the value chain; and possibly disruptive non-bank competitors with deep pockets are lurking menacingly. Banks know the competition is going to get tougher, and potentially a lot tougher.

THE REPORT CARD FOR THE INDUSTRY ON MANAGING CHANGE

The industry shape described is largely uncontroversial and most large banks are working towards a version of this future. However, it will be a profound adjustment, demanding an enormous amount of transformation from almost all large European banks.

Our research suggests that this degree of transformation is proving extremely challenging. The most obvious indicator of this is the very low post-tax return on equity for the system at

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the aggregate level, which in 2013 wallowed at just 4% for European banks as a whole.

Of the top European banks which published quantitative performance targets in 2010 annual reports, just over half set targets for ROE in a defined future year. Of those, a staggering 80% missed their targets.

A lot of change has been achieved. In particular the greatest success for the industry has been in managing risk-weighted assets (RWA), and the recapitalisation process. Basel 3 effectively drove as-is risk-weighted assets for many banks up by a factor of two, and the industry has put an enormous effort behind managing the impact of this through improving measurement accuracy, rethinking how products and services are delivered to reduce the risk, and taking strategic action on parts of the portfolio that are no longer attractive under Basel 3. The results have been good: from analysis of public statements, we estimate ~50% of banks have hit their targets on RWA management and 30% of banks have exceeded targets.

The greatest failure for the industry has been on cost management. Approximately 60% of banks have missed their Cost : Income ratio targets over the last two years. Banking compares badly with other industries on cost management, both in terms of techniques used and in terms of the culture of performance.

In most other areas, the industry has found delivering change extremely challenging. Legal entity restructuring is proving very slow; the agenda around IT simplification and digital implementation has struggled to get off the ground; changing cultures and behaviours has proved extremely difficult, including the shift towards more client centricity which is also proving to be hard yards, without the explosive progress seen in other sectors. Finally, few banks believe they are getting value for their large investment portfolios and even fewer are yet spending their money where they see the biggest bang for their bucks.

1.2. WHAT IS BLOCKING EFFECTIVE CHANGE IN LARGE EUROPEAN BANKS?

The picture that emerges in our research this year is of an industry that knows where it needs to go but is struggling to get there. We asked them why. Over six months we interviewed relevant executives from over 30 banking groups. We set out to understand where the blockages were in large change programmes, what executives think is working and what is not. We identified problems across a number of areas. Some of the highlights include:

- **Purpose and culture**

After six years of crisis and remediation, many banks are tired organisations. Black humour and cynicism have set in among the middle ranks that are vital to change delivery. Re-energising the troops once again to set forth on another round of change requires leaders to articulate a clear vision and purpose and to create a culture and incentives that value great delivery of change

- **Organisational failures and poor prioritisation**

Many executives said the silo-mentality of their organisations blocks effective change. Delivering "transversal" programmes, such as cost reduction, requires hundreds or even thousands of people to work together across the boundaries of the organisation. Siloed thinking and incentives mean that many banks struggle to concentrate their scarce resources on the most critical change initiatives

- **Bandwidth bottlenecks**

Skilful change managers are in short supply at banks. The firm's ability to deliver change is often limited by the bandwidth of a handful of critical change agents – who they increasingly struggle to hire and keep

- **Execution**

Good intentions are too often unsupported by appropriate project management tools, processes and governance structures. Value is leaking through the delivery process and some change programmes fail entirely

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1.3. INNOVATIVE TECHNIQUES

Banking is changing, at some firms faster than at others. In the final chapter of the report we outline some of the most innovative techniques being used to counter the difficulties we heard about. To highlight a few examples:

- **Zero-based mentality**

In some ways, the lack of the same disruptive new digital competitive threats that have swept through industries like retail, telecoms, and media has not served banking well. The mindset that all bets are off, and that the business practices need to be rethought with a blank sheet of paper was a common thread among the institutions most consistently delivering effective change

- **Promoting innovation in leadership**

In today's environment of rapid evolution, in a banking sector that will no longer have the protections of incumbency, innovation becomes a core tenet of leadership. However, most institutions have seen two generations of leaders come and go since innovation was high on the agenda. We found a number of institutions have put innovation in change back at the heart of the leadership agenda

- **Network organisations**

Some institutions that are making strong progress are very deliberately setting themselves up as network organisations; in such an organisation, personnel group together in networks across siloes to deliver innovation and change, allowing transversal objectives to be achieved. Firms in other sectors, most notably technology and media already set themselves up as network organisations

- **Change skills and use of technology**

Delivering programmatic change is difficult. It requires a combination of go-get-em leadership, the ability to contend with complexity, and the programme management skills and serious staying power to grind out performance. The best institutions are recognising that these skills need to be found and invested in. We also found that the toolkit that great change agents use is evolving very rapidly in a digital world, including use of data, communication methods that suit networks, and ex-ante scenario planning

We hope that this report will be valuable to banks as they bridge the gap from the need for change to strong planning and successful delivery. In addition to our identification of the best practices emerging, we provide a user-friendly "health check" which will allow banks to conduct a self-assessment against cohorts of peers that have contributed to our benchmarking as part of the research for this report.

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2. THE CURRENT CONTEXT IN EUROPEAN BANKING

2.1. TWO PHASES OF REMEDIATION AFTER THE CRISIS: REGULATORY UNCERTAINTY NARROWING

Banks around the world have been wading through two phases of post-crisis remediation since 2008. Phase one was recapitalisation. Banks have rebuilt capital and restructured their debt funding, either supported or instructed by regulators. The second phase is conduct remediation, paying for the sins of the past, and overhauling ways of doing business.

The US was the first region to shift decisively from phase one into phase two. Post-crisis balance sheet repair has been quickly followed by a period of severe intervention by regulators and the Department of Justice (DoJ).

The UK has followed suit, establishing the Financial Conduct Authority (FCA), which is dedicated to supervising bank conduct. In the Eurozone, the Comprehensive Assessment (of capital adequacy) has been completed and the ECB's new Single Supervisory Mechanism has taken oversight of prudential supervision. The focus of national supervisors within the Eurozone on conduct is likely to increase.

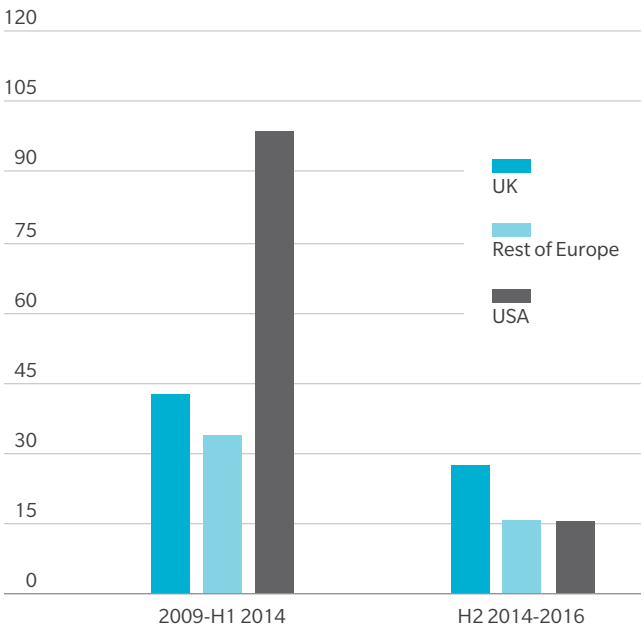
"We are in many ways in the second phase of the financial crisis. The first phase was a prudential one, while the second phase has revealed past misconduct. Fixing the financial system requires more than just fixing capital and liquidity standards. Standards of governance, conduct and the right incentives structures are all extremely important" – Andrew Bailey, Lord Mayor's Banquet, October 2014

1 ECB's Aggregate Report on the Comprehensive Assessment, October 2014

Recapitalisation has been slower in Europe than in the US and UK but now has strong momentum. Between 2008 and 2013 European banks raised €200bn of capital, and another €60bn has been raised during 2014. The Comprehensive Assessment has identified the need for €25bn across the 25 banks that failed to meet its standards, some of which remains to be raised[1].

As for conduct remediation, European banks have collectively paid €76bn in fines and litigation fees since 2009, which is a massive sum though less than the €98bn paid by US banks. Although future costs are difficult to estimate with certainty, indicators suggest there is still some way to go.

EXHIBIT 1: FINES AND LITIGATION FEES, EUR BN, BY REGION, 2009-H1 2014 AND FORECAST



Source: Morgan Stanley, US & European Banks: Bank litigation: $220bn so far; how will it impact capital plans & divis from here?, September 2014. Original data in USD; exchange rate of 0.78998 used

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The cost of conduct remediation cannot be counted in fines alone. We estimate a significant further reduction in industry earnings from services and products that have been discontinued since the crisis due to conduct concerns. Banks are bearing much higher compliance and risk management costs. Conduct authorities are increasingly insisting that all business plans be assessed against the potential to create bad conduct incentives, and dampening growth ambitions where there are concerns.

Regulatory remediation still contains notable uncertainties. For example, within the prudential regulatory framework, loss-absorbing capital, leverage costs and the rules on subsidiarity are yet to be fully finalised. However, that uncertainty has substantially narrowed and the regulatory regime under which European banks must operate is now, for the most part, well understood. The new shape of the European banking industry is emerging.

2.2. THE EMERGING SHAPE OF THE INDUSTRY: COMPETITIVE UNCERTAINTY WIDENING

What does this new shape look like? Several key themes have emerged and are now becoming largely accepted:

MORE DIFFERENTIATED BUSINESS MODELS

The distinction between banks seeking debt-like earnings and those seeking equity-like earnings is becoming clearer. By analysing public data and statements, we estimate that of the 50 largest banking groups in Europe, about 40% are focusing strategy on delivering in-market market share gains, high dividends, stable moderate returns and low risk profile. By contrast, about 25% are targeting high top-line growth rates, access to international markets and higher risk-return. The rest have not yet definitively stated their strategic objectives.

Between 2008 and 2013 we saw more banks get comfortable with strategies that will deliver debt-like earnings profiles. However, this strategy depends on positive real rates of interest that allow decent margins on deposits and on lower macro-economic volatility in core markets – neither of which currently look dependable. As a result, since 2013 we have started to see some institutions shift back towards a desire for an equity-like future. However, macro-economic uncertainties are making it difficult for banks to anticipate the drivers of global growth in the coming years and, hence, to shape international or sector strategies.

European banking is likely to consolidate, with debt-like banks seeking to increase market share and deliver margin improvement in their core markets by acquiring domestic competitors. Equity-like banks are more likely to look for cross-border opportunities.

HIGH COST OF REGULATION DRIVING STRATEGIC SELECTION

Stricter post-crisis regulation has significantly increased banks' equity and debt funding costs. However, it has also increased the operating cost of regulatory compliance. Therefore, the more jurisdictions a bank operates in, the greater the increase.

These compliance costs, which are largely fixed, mean that small banks cannot compete with large and that all banks are at a material disadvantage where they compete with non-banks. Many banks have exited jurisdictions where they can no longer cover the regulatory cost of participation.

MORE COMPETITIVE INDUSTRY STRUCTURE

For six years regulatory uncertainty has dominated the planning of the banking sector. At the same time, barriers to entry have suppressed competitive uncertainty. Now, as regulatory uncertainty declines, competitive uncertainty is increasing.

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Banks are facing threats from an explosion in non-bank providers attracting investors who favour capital-light business models. Loan brokers, new payments companies and peer-to-peer lending are encroaching on the traditional banking space. Meanwhile, non-bank companies, especially retailers, are continuing to move into financial services, using their customer base and brand to reduce banks' market share.

Banks in most markets will no longer enjoy the oligopolistic conditions of the past. Barriers to entry for smaller competitors are coming down as supervisors recognise the high burdens they imposed during the crisis and are now consciously prioritising competition issues to lower the regulatory hurdles to entry. Challenger banks are beginning to multiply and many new non-bank service providers are now active in parts of the customer experience.

Banks must decide where to compete with these new entrants and where to refocus to be complementary. For example, new capital rules mean that banks are often not the cheapest providers of capital for corporate borrowers, yet they have skills in credit assessment and debt structuring that are of value to non-bank lenders. Banks may increasingly become intermediaries between lenders and borrowers without using their balance sheets, becoming the credit equivalent of marriage arrangers rather than marriage partners.

Other changes in the supply structure are more obviously positive for the banks. It makes no sense for every bank to bear the cost of developing and maintaining processing technology which is no longer differentiating. As banks source more from third parties and utility providers, they are starting to create lower cost supply chains similar to those in other industries.

MORE DYNAMIC RESOURCE ALLOCATION

Capital in European banking has grown significantly since 2008. The massive consequent pressure on returns has had two results. First, it is forcing both supervisors and banks to try to understand asset quality and predict balance sheet performance under future conditions (as is the US with CCAR). We expect regulated stress testing to become embedded into regulatory practice. Second, it has forced banks to develop more sophisticated processes to make sure capital is allocated efficiently. Pre-crisis, capital was abundant as regulatory minima were lower. A cavalier attitude toward capital allocation had little cost. No longer. Banks must be more careful about where they take risks, and hence consume capital, in search of returns.

MORE CLIENT-CENTRIC

The cost of serving any client has significantly increased owing to measures such as KYC, AML and the management of more general "conduct" requirements. Banks are increasingly interested in serving customers with high potential value rather than simply expanding their total customer base. At the same time, the explosion of big data and digital tools is revolutionising techniques used to understand what customers' demands and preferences are. This allows leading banks to identify customers who are likely to be valuable, to design propositions that will suit them and to target them with their marketing.

MORE COST EFFICIENT

Increased capital costs have meant that bank returns have plummeted, forcing banks to slash costs to have any hope of maintaining shareholder returns. The pressure is only increased by the new competitive threats lining up, especially in the markets for payment services, deposit-taking, retail banking and electronic trading. As banking becomes paper-free, banks face dramatically reducing costs in their core businesses.

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2.3. THE REPORT CARD FOR THE INDUSTRY ON MANAGING CHANGE

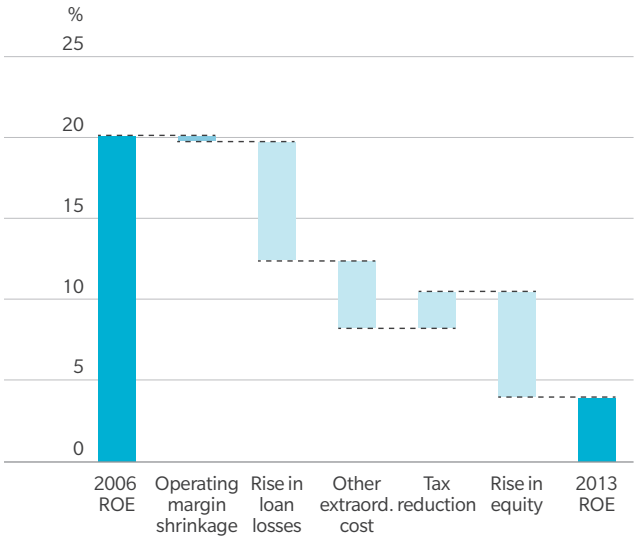
The industry described above is relatively uncontroversial. Most banks are working towards a similar set of assumptions. The challenges presented by this new landscape are profound. Banks must respond by transforming their business models, but they are struggling to make the changes needed.

LOW RETURNS ARE THE OVERARCHING CHALLENGE

Average post-tax return on equity among European banks is just 4%. Of the top European banks that published quantitative performance targets in their 2010 annual reports, just over half set targets for ROE[2] . More than a third of these did not attach a specific year to the goal, aiming for the "medium-term" or "long-term". Of those that did publish a year for achieving higher ROE, 80% missed their targets and two-thirds of these fell short by more than five percentage points.

80% of the top European banks who set ROE targets for 2012 or 2013 missed their targets

EXHIBIT 2: RELATIVE IMPACT OF DRIVERS OF ROE MOVEMENT, 2006-2013



Source: Bankscope data for 89 European banks, representing 85% of total European banking assets. Oliver Wyman analysis
Note: Other extraordinary items are principally restructuring charges and goodwill impairments. They include some, but not all, fines and litigation fees

THE OUTLOOK FOR RETURNS

Current efforts are unlikely to restore decent returns. Macro-economic conditions are not going to come to the rescue, leaving banks with a lot to do to boost performance.

We have considered the blunt scenario where banks get back to cost of equity returns through reductions in costs alone (ignoring revenue growth and reduction in impairments or taxes). In this scenario, we estimate costs would need to drop by a staggering 25%, which would need to be achieved either through reduction in operational expenses or exceptional items. Clearly for banks where revenues grow or loan impairments drop, less operating cost reduction is needed, but our analysis suggests that even allowing for these effects and reductions in exceptional items, an operating cost reduction of at least 10% is needed. Undoubtedly cost reduction of this magnitude will require significant transformation and change management.

2 Based on a review of the top 56 European banks' annual reports for 2010

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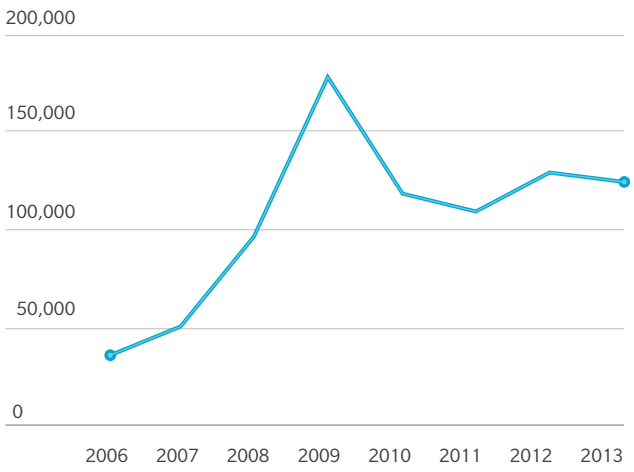
EXHIBIT 4: NPL FLOW IN EUROPE, EUR MM, 2006-13



Source: Bankscope data for 89 European banks, representing 85% of total European assets

"Nobody is going to invest in an industry with returns of 5%"

J Christopher Flowers, quoted in the Financial Times, July 2014

INVESTOR CONCERN IS GROWING

The voices of concerned investors are growing louder. At the time of writing, just under half the banks are still trading at a discount to book value. The agenda right now is dominated by the recently concluded Comprehensive Assessment of asset quality. More fundamentally, however, investors worry that many banks will struggle to reach adequate returns over the coming years. Because this approach to valuation gives little weight to variations in banks' long-term strategies, the relationship between current ROE and MTBV has become tighter.

So how is the industry doing on its current change management programme? In Exhibit 3 we summarise the eight broad change programmes we see underway today at most European banks, and the health status of each for the industry on average. The potted summary is that a tremendous amout has been achieved on RWA. However, in most other areas the industry is struggling, with a prevelance of missed or delayed publicly stated targets. Costs, IT replatforming, legal entity programmes and operating model redesign are proving the most challenging initiatives.

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EXHIBIT 3: SUMMARY REPORT CARD ON CHANGE PROGRAMMES

STRATEGIC SELECTION	• We estimate from public statements that ~60% of banks have made progress around: – Defining a core – Ringfencing non-core activities with clear run-off expectations – Giving medium-term return expectations on the core • However, more improvement is still required – Too many banks are still reluctant to forgo optionality – More is needed to understand what customers want and need	🟡
OPERATING MODEL DESIGN	• Many banks would not even consider this a standalone programme • Interaction with other programmes (e.g. client centricity, cost reduction) is challenging	🔴
RWA MITIGATION AND CAPITAL PLAN	• Without a doubt the greatest area of success for the industry • Enormous effort has gone into compliance with Basel 3 • Around 50% of banks have hit RWA targets and 30% have exceeded them	🟢
COSTS AND IT	• Proving by far the most difficult initiative, not helped by conduct-related losses • Almost 60% of banks have either missed targets for 2013 or are likely to miss those for 2014, 2015 and 2016 • The view that even keeping costs flat is "quite a big request" resonates widely	🔴
DIGITAL AND SIMPLIFICAION	• Some positive developments have been made: – Diagnostic conducted and go-to state increasingly understood – Digital delivery excellent in certain pockets with mobile adoption a stand-out example • However, there is still a long way to go: – End-to-end integration and seamless processes a long way off for most organisations – STP and cost realisation remain behind schedule	🟡
UPGRADE TO STEERING CAPABILITIES	• An enormous amount of effort is underway, with the minimum standard being reacting to demands of regulatory processes • The industry has hit two main roadblocks: – Improving underlying data quality – Resolving process and operating design to cut across Finance, Risk and Capital Management functions	🟡
CONDUCT AND CLIENT CENTRICITY	• These programmes are challenging because they require wide-ranging and technical change: – Client segmentation and P&L structure – Improved analysis of client behaviours and needs – Cultural change to ensure total commitment to better customer outcomes	🟡
LEGAL ENTITY RESTRUCTURING	• This is proving extremely arduous, partly driven to date by regulatory uncertainty • Balkanisation has left banks with a complex task; they need to take into account: – Costs of capital and funding – Operational costs – Tax implications – Resolution	🔴

🔴 - MOST BANKS FACING SIGNIFICANT CHALLENGE; 🟡 - SOME PROGRESS MADE BUT MUCH TO ACHIEVE, 🟢 - MOST BANKS MAKING GOOD PROGRESS

MANY BANK CHANGE PROGRAMMES NEED NEW DIRECTION AND IMPETUS

Fallout from the financial crisis has put the senior executives and staff of banks under intense pressure to deliver massive change. The emerging competitive threats are only increasing that pressure.

Yet the progress on the required change is floundering in many areas. Our conclusion is that many banks need to change the way they are approaching the challenge. In many cases, they need more ambition, and they need to up the intensity of their transformation programmes, devoting more resources to them and making better use of the technology and techniques available.

The rest of this report looks at the transformation challenges banks face, where they are struggling, and what techniques can be used to turn things around.

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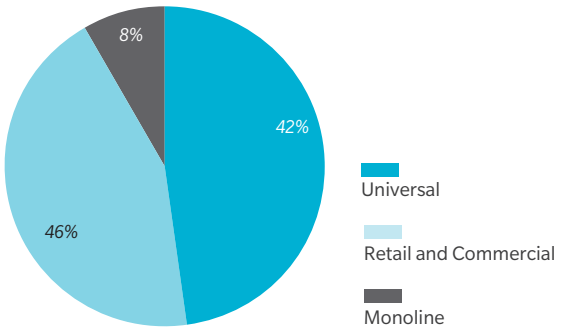
3. WHAT IS BLOCKING EFFECTIVE CHANGE IN LARGE EUROPEAN BANKS?

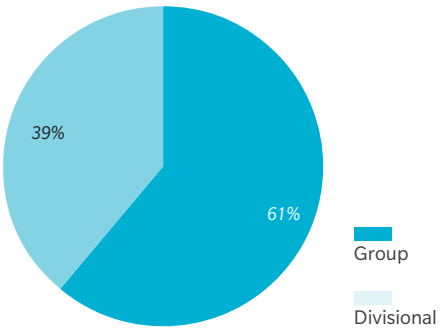
To prepare this report, we conducted interviews with over 30 of the major banks in the region and gathered additional data through an online survey. Together, these banks represent over €13 tn in banking assets, had net income of over €10 bn in 2013 and operate in over 65,000 branches. They are headquartered across the region but many operate globally. We surveyed banks of all business models. And we spoke to managers across both group and divisional positions, and in business and control roles.

EXHIBIT 5: PROFILE OF OUR INTERVIEWEES AND SURVEY RESPONDENTS

"WHAT IS YOUR ORGANISATION'S BUSINESS MODEL?"

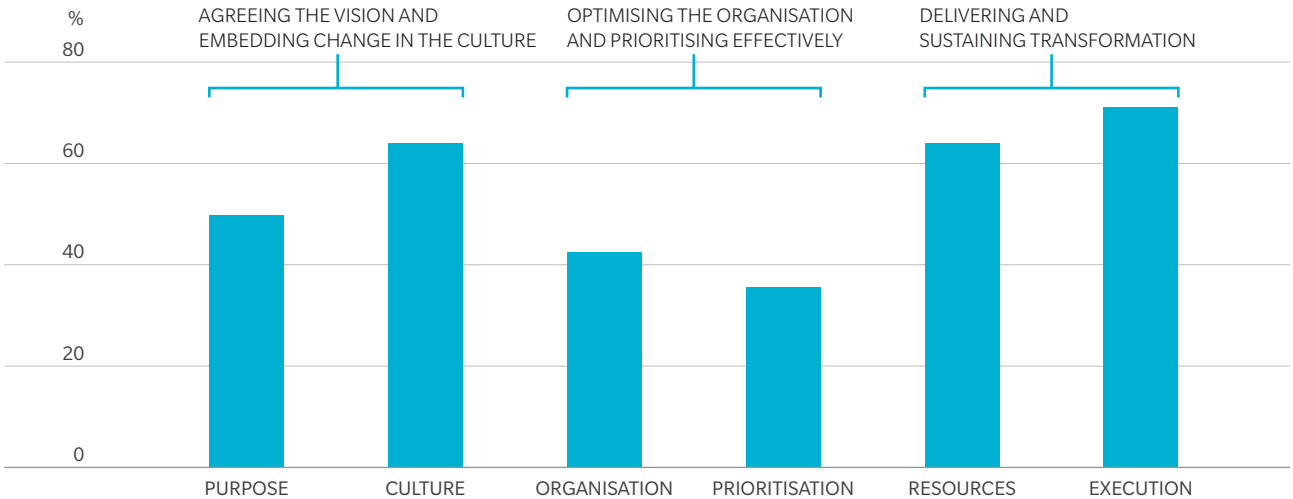


"PLEASE SELECT THE OPTION WHICH BEST DESCRIBES YOUR ROLE"



Our research revealed several common obstacles to successful transformation, each identified by at least a third of banks.

EXHIBIT 6: FREQUENCY OF ISSUES AS REPORTED BY BANKS



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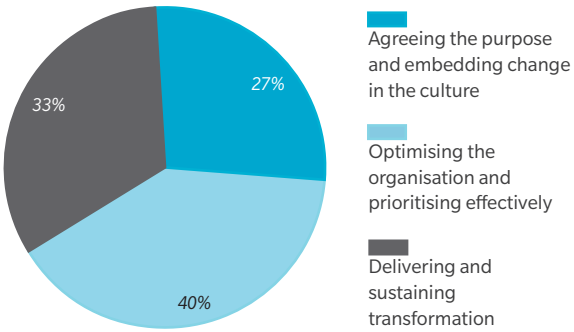
Banks tend to fall into three main categories: those for whom the biggest issues are around agreeing the vision for change and embedding that in the culture; those for whom optimising the organisation and prioritising effectively is the greatest challenge; and those for whom delivering and sustaining change is the most problematic.

EXHIBIT 7: AREAS OF PRIMARY CONCERN FOR BANKS INTERVIEWED



There were some notable trends according to business model:

- Between them, different universal banks cited all three categories as their most serious areas of concern; while the most common was delivering and sustaining transformation, notably, almost half of the Universal banks cited purpose and culture as big inhibiters
- Very few of the retail and commercial banks or monolines we spoke to cited agreeing the vision and embedding change in the culture as their most significant issue
- Retail and commercial banks experienced significantly more difficulties with delivering and sustaining transformation than monolines

No two banks reported an identical mix or weighting of challenges. However, there were patterns in the responses. Those who identified difficulty with agreeing the vision also fell down in the organising and delivery - problems upstream meant problems downstream. Similarly, banks who reported poor organisation almost always experienced issues in delivery. For example, over 80% of those who felt there wasn't a proper place for transformation across the organisation also felt they were short of the resources to make it happen.

A note on the Significance methodology. Because there is no consistent profile of concerns, this chapter details each problem area in turn. To give an indication of weighting, we have distributed 1000 points between all the individual issues we have heard. We allocated these points based on a blend of two things: the frequency with which the problem was mentioned and the severity attached to the problem by interviewees / respondents. The summary tables at the beginning of each of our sub-sections detail this rating.

In chapter four, we describe six innovative techniques for delivering transformation. Because there is no single diagnosis, there is no single cure. Depending on where our findings resonate most, banks may want to prioritise one or two of these techniques to tackle the most deep-rooted problems in their organisation.

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3.1. AGREEING THE PURPOSE AND EMBEDDING CHANGE IN THE CULTURE

3.1.1. THE PURPOSE OF CHANGE: "THROW THE STEERING WHEEL OUT OF THE WINDOW SO YOU CAN'T CHANGE COURSE"

	KEY CHALLENGES IDENTIFIED	SIGNIFICANCE
I	Many banks consider the unclear future of the banking industry to be a barrier for transformation; uncertainty is stopping banks from making big decisions	25
II	Ambition levels are too low to achieve the transformation required	100
III	The agreed vision and purpose are not well messaged or cascaded	25

Note: Significance determined using methodology explained on p13

I. MANY BANKS CONSIDER THE UNCLEAR FUTURE OF THE BANKING INDUSTRY TO BE A BARRIER FOR TRANSFORMATION; UNCERTAINTY IS STOPPING BANKS FROM MAKING BIG DECISIONS

A significant proportion of the executives we spoke to expressed frustration with the lack of a clear "go-to" state for regulation of the industry. The common view was that the uncertainty makes designing an enduring vision and strategy near impossible, and that there are still too many unknowns to be fully definitive.

"We're trying to transform from something clear to something that is less clear. The go-to is still evolving, while other industries have had a clear view on what was needed for change. We know the game needs to be played differently, but the rules of the game keep changing"

What does good look like? At a number of firms where a decisive vision had been agreed, we found interviewees disagreed that an unclear end state was a real barrier to change; senior leaders felt that uncertainty was to some extent being used as an excuse. This was certainly a minority of institutions, and more prevalent in retail banks with lower geographical footprint. We also heard that "things are always changing – yes the regulation is difficult, but is it more difficult than the credit crisis? Is it more difficult than the dot com bubble? Is it more difficult than junk bonds? You're never going to get an optimal environment".

In terms of dealing with the uncertainty, we found some institutions have taken very active steps to ensure that all transformation programmes foster scalability, flexibility and adaptability so that whatever develops, the organisation is well placed to take advantage.

II. AMBITION LEVELS ARE TOO LOW TO ACHIEVE THE TRANSFORMATION REQUIRED

Many banks told us that low ambition was a concern. Senior managers know that radical action is needed, but most organisations are not taking bold enough steps.

"Other non-Financial Services industries have fundamentally changed their cost structures and their operating models. In Financial Services we haven't taken our medicine yet"

Many reasons for this were cited: fatigue after the struggle of the crisis; a lack of belief in the organisation's capacity to deliver; and a lack of a burning platform such as the crisis presented. A "good

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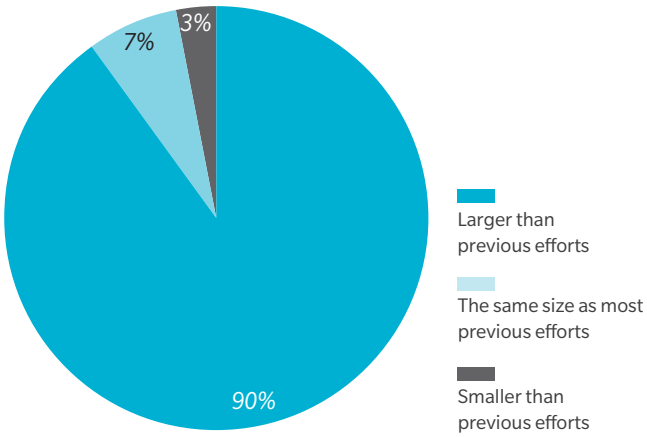
enough will do" attitude seems to have taken hold at some banks. One interviewee told us "our Q1 results are not great, but they're not terrible". Whatever the cause, this lack of ambition is an obstacle to the fundamental overhaul that banks need.

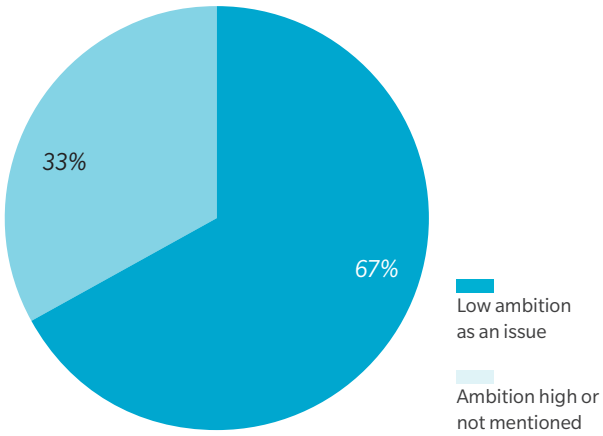
"Should we have Relationship Managers at all? Or...close half of our branches? Who's ready to do that now? But it should be done"

EXHIBIT 8: ALTHOUGH 90% OF SURVEY RESPONDENTS FEEL THE SCALE OF THE ASPIRATION IS UNPRECEDENTED, 67% OF INTERVIEWEES FEEL AMBITION IS STILL TOO LOW

RESPONSES TO "WHAT IS THE RELATIVE SIZE AND SCOPE OF YOUR ORGANISATION'S CHANGE ASPIRATION?"



PREVALENCE OF "LOW AMBITION" AS AN OBSTACLE TO TRANSFORMATION



What does good look like? We found a relatively small number of institutions that had been through a thorough longer-term vision setting process. In these cases the firms had really looked backwards from where they wanted to be in the medium- to long-term, and asked "what is the boldest move we could make in this area, working back from this starting point where necessary, rather than starting by asking "what is the bare minimum we can do?"

III. THE AGREED VISION AND PURPOSE ARE NOT WELL MESSAGED OR CASCADED

Having struggled to agree a vision, many banks then have trouble communicating it both internally and externally. If the vision is not clear to bank staff, they will have difficulty knowing which initiatives are consistent with it and which trade-offs are strategically optimal. We found many banks are aware of this as a prominent challenge, and are actively looking at how to improve the communication and understanding of their strategic vision. One interviewee told us that his bank is trying to use "more success stories with a human interest angle", but "that's not our natural instinct yet".

What does good look like? We heard from several interviewees that the key to getting their organisation to understand and rally around a vision in a way that ensures change was to make public commitments. Once investors hear the message, being "on the hook" ensures cascading which effectively engages employees.

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"Commit the organisation. Decide on the vision and make the CEO stand up publically in front of investors and say we will deliver X by Y. Then it's not optional; there can be no wobbling. There's no better way of galvanising people. Come hell or high water, it's going to happen. It has its risks, but the chances of failure are reduced significantly"

Most success had been achieved where the vision could be easily condensed to a short, memorable message that relates to every employee regardless of function, business line or seniority. The vision or purpose should guide all business decisions and activities, right across the bank. Walmart's purpose statement is simple: "To save people money so they can live better". This purpose guides its employees' every action and translates into always driving to deliver "unbeatable prices", "easy shopping" and "quality products".

"If you tell everyone in January what you're going to do by September, the chances of getting there are much higher. People like that. It's comforting"

3.1.2. A CULTURE FOR CHANGE: "YOU CAN GET PEOPLE MOTIVATED, BUT I DON'T KNOW ANYONE WHO'S ACTUALLY CRACKED IT"

	KEY CHALLENGES IDENTIFIED	SIGNIFICANCE
I	Change fatigue is prevalent	70
II	Employees do not feel change offers them personal benefits	45
III	Delivering change is not routinely celebrated or rewarded	60
IV	Revenue growth is prized over cost reduction	25

Note: Significance determined using methodology explained on p13

I. CHANGE FATIGUE IS PREVALENT

Change fatigue was cited by an extraordinarily large proportion of banks as a major problem. Banks have sought transformation for a long time, but there is still an enormous amount to accomplish. The end of the crisis was not the finish line but the halfway point, and the new phase will require the same energy and exertion again – if not more. Yet there is little appetite to mount a large-scale effort again. One interviewee went so far as to say that inspiring and motivating a very "beaten up workforce" was his most significant challenge – a message that resounds industry-wide.

"Inertia and history get in the way"

What does good look like? We found a near total alignment of the solution to this issue in the vision setting process. Those institutions where we found a culture of energy and ambition around change were also those where the vision for the firm and the purpose of change were extremely well understood, and the corollary was never the case. In these situations the stakes were also raised – failure to deliver was less tolerated, keeping the drive to achieve significantly higher.

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II. EMPLOYEES DO NOT FEEL CHANGE OFFERS THEM PERSONAL BENEFITS

Alongside pervasive change fatigue, interviewees also recognised that banks could do more to persuade employees that transformation benefits them in their roles and offers them greater professional opportunities. The risk for these individuals of visible failure often has key individuals running from responsibility. We spoke to a Head of Change who shared his concerns around the lack of a value proposition for employees, saying "we know we should have, but we don't have one".

"It's important to answer the question: what's in it career wise, for the people who are going to have to make it happen?"

What does good look like? We found this is an area of significant innovation in some firms. Structuring change groups differently (organisational design), changing the make-up (behavioural characteristics) of the people within the group, changing their compensation, increasing their profile, increasing their career trajectory, communicating change in a different way, changing governance structures around this group – these were all techniques being considered. One COO told us that when he communicates IT improvements to his business functions, "I can focus on upgrading technology or I can focus on the new functionality the business will get...even if 80% of a project's purpose is to deliver continuity and robustness, that's just not how I will present it to them". Overall, though, there is more work to be done in "selling" change, and the outcomes of change, to bank staff on a personal level.

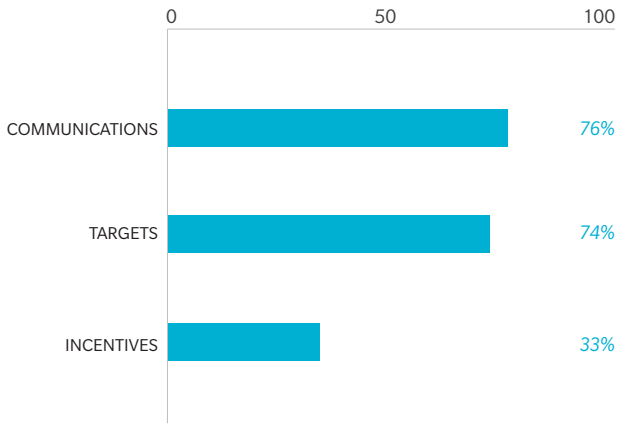
III. DELIVERING CHANGE IS NOT ROUTINELY CELEBRATED OR REWARDED

Celebrating successful change delivery is a key area for cultural improvement according to our clients. Many had concerns on this topic. Some of the banks we interviewed have incentive schemes. "We make it clear", one COO explained, "that there is a substantial pot available" for those who deliver change well.

However, it is clear that even where they are in place, financial incentives are not a panacea. One problem is that "it takes a while to convince people" that their performance really is being reflected in compensation. Other interviewees were adamant that feeling valued as part of something momentous was ultimately a more effective reward.

EXHIBIT 9: UNDER HALF OF EXECUTIVES ARE OFFERED INCENTIVES TO SUSTAIN THE MOMENTUM OF CHANGE

PREVALENCE OF MECHANISMS USED TO SUSTAIN MOMENTUM OF CHANGE, ACCORDING TO OUR SURVEY



Whether celebrating success means an email of gratitude from senior management or more time in steering committee meetings highlighting "Greens", many of our interviewees acknowledged that more could be done to make a habit of showing appreciation for achievement. Many told us that when it does happen, the positive response is really tangible.

"It's so easy to focus on the numbers and forget that the numbers represent people who have families and lives of their own"

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IV. REVENUE GROWTH IS PRIZED OVER COST REDUCTION

Banks need to tackle costs in a radical way. Yet cost reduction is often viewed as the ugly cousin of revenue growth. We heard to varying degrees that labels like "cost reduction programme" do not inspire people to "get on board", and that "cost and efficiency is not part of banking DNA in the same way as in other retail businesses". One interviewee told us that of the organisation's 500 highest-paid employees, up to 90% are from revenue-driven parts of the business.

One reason costs are the last issue people want to address is a widespread conviction that they cannot be reduced significantly – or, if they can, that nobody yet knows how. There is little consensus on how cost reduction can be achieved within individual banks, let alone across the industry. We heard from one interviewee that "the ability of the firm to come together on cost specific topics is not yet in place".

"People know how to drive growth in revenues...but don't fundamentally understand how to manage costs"

How best to tackle this? The banks making progress in this area were seeing cost reduction – and selling it internally – not as an end in itself but as the key to a healthier, more modern bank. They were considering redistributing the compensation paid to various roles to lift the relative earnings of those focused on costs rather than revenues. And, most importantly, senior managers were beginning to insist that cost reduction really can be achieved and accepting the loss of some "revenue optionality" for the sake of it.

"If you start with your goal as cost reduction, you will get the wrong outcome. That sort of short-termism means that you don't get a solid foundation for the future. You should look at it as a customer or an employee proposition"

3.2. OPTIMISING THE ORGANISATION AND PRIORITISING EFFECTIVELY

3.2.1. AN ORGANISATION FOR CHANGE: "SEGREGATING CHANGE FROM BUSINESS-AS-USUAL (BAU) IS CRITICAL TO ENSURE FOCUSED EXECUTION"

	KEY CHALLENGES IDENTIFIED	SIGNIFICANCE
I	Organisations are siloed while most change is transversal	70
II	Without formal separation between change and BAU activities, employees struggle to manage both	30
III	Size and complexity makes change difficult	25
IV	Banks are insufficiently radical in their approach to outsourcing	25

Note: Significance determined using methodology explained on p13

I. ORGANISATIONS ARE SILOED WHILE MOST CHANGE IS TRANSVERSAL

Many banks felt they were reasonably good at delivering programmes where there was direct ownership for delivery residing within a function or within a business line, but were much less effective when an initiative cut across different parts of the organisation. Cost reduction was very prominent in this regard, with many banks telling us they had managed to cut the first one or two layers of cost when effectively each part of the firm was simply asked to make reductions, but were finding it much more difficult to get to structural cost layers that require processes that span the organisation to be re-engineered.

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"Organisations have become federated. Whether you're banks, Rolls Royce or the Church of England, most people are dealing with this problem and struggling to cut through it. The next time we run a big change programme I'm going to try and take more people out of their divisions and create a cross-functional team with the right people who can make the decisions so they truly work for the process"

What does good look like? The most advanced institutions are striving for transversality and even adopting a "network organisation" approach to counteract siloes and complexity. Chapter four elaborates on this technique in more detail.

II. WITHOUT FORMAL SEPARATION BETWEEN CHANGE AND BAU ACTIVITIES, EMPLOYEES STRUGGLE TO MANAGE BOTH

Many of those we spoke to identified an inadequate division between change and BAU teams and responsibilities as a barrier to success. Most firms felt that the process of delivering large programmes of change certainly needed wide buy-in from the entire organisation and failed if personnel in BAU roles were not enrolled. However, change does also need a designated place within banks, with specific skills developed, ring-fenced resource allocation and clear reporting lines that allow the status quo to be upended and rapid progress to be made.

"Separating BAU work from change is our greatest problem. We're not setting up a new bank; the same people are needed to run the bank as to change the bank, and this creates bottlenecks"

What does good look like? We probed where this was not seen as a problem, and found that in these institutions the people driving the change do it as a full time job; they are amongst the institutions' best and brightest, with excellent existing networks and relationship building skills; they monitor change on a weekly basis; they are compensated at levels equivalent to front office positions and their roles are seen as a stepping stone from business into a higher ranking business role.

43%

of banks reported organisational barriers to change

Clearly identified, empowered "owners" of change are instrumental to its success. Some banks told us that such owners are lacking and that the lines of responsibility for change are not uniformly clear. The banks who had decisively addressed this problem were reporting good results. One Head of Change Management who has overseen a successful programme insisted that it hinged on "heavyweight central control and governance" run by experienced people with "stripes on their shoulders". He explained that attempts to emulate the change programme had fallen flat without "big hitters" with explicit responsibility for managing the transformation.

III. SIZE AND COMPLEXITY MAKES CHANGE DIFFICULT

The enormous scope of different businesses and regional presence makes coordination difficult. We heard that "for different businesses and across different geographies alignment is not always achieved".

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"Because of the different cultures, businesses and pressures, you inherently have different views and that makes decision making difficult. People try to do the right thing, but different perspectives on what the right thing is can lead to misaligned objectives"

Notwithstanding the sheer size of many banks, structural complexity is also an obstacle. Many echoed the concerns of one COO we spoke to who admitted that "there is a shared realisation of the fact that the bank's structure makes it difficult to direct processes end-to-end".

This challenge exists even in domestic banks. It is yet a greater problem for banks with a global footprint. One Head of Change for a local bank told us that "I pity the people who are global" when it comes to achieving convergence on change; "it can be done, but it's much harder". We heard from global banks of constant "noise in the tail" from different regions once group priorities were established, and of difficulty uniting different regions under a common banner.

What does good look like? The institutions making headway are implementing programmes which are devised and agreed at group level, but then implemented and managed locally with scope for an appropriate level of tailoring to the local situation. This model allows for a set of sensible common parameters to be agreed but also empowers those "on the ground" to interpret the best approach for their geography within those parameters.

IV. BANKS ARE INSUFFICIENTLY RADICAL IN THEIR APPROACH TO OUTSOURCING

Everyone we spoke to recognised that there is significant potential in intelligent outsourcing and shared services, and that their institution's thinking on this had progressed a lot in the last two years. They also recognised, however, that this potential has yet to be fully tapped. We consistently heard from banks that they know they need to make the leap. One interviewee told us that his bank would "probably end up with more of the value chain outsourced, albeit probably more slowly than people think". But few told us that they had a clear roadmap to a fully optimised sourcing model.

"We don't do any meaningful outsourcing. We've got to get better at making bets and testing"

What does good look like? The banks we found leading the charge in this area have gone or are going through a full strategic evaluation of which parts of each value chain must remain in-house and which could generate better results if they were outsourced or used shared services in conjunction with peers. Where done, we found this was usually being conducted alongside a very long-term IT architectural design process. They are also applying the same level of strategic evaluation when appointing third parties: discussions are focused on where their expertise can best be leveraged, and on which arrangements will deliver long-term returns or savings that will justifying the investment or any short-term increase in operating costs.

"The use of partners allows you to bring in worldwide expertise of what's happened elsewhere"

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3.2.2. PRIORITISING CHANGE: "IT'S NOT REALLY AN EITHER/OR"

	KEY CHALLENGES IDENTIFIED	SIGNIFICANCE
I	Regulatory compliance hijacks all the resources	50
II	The large number of change programmes is not well prioritised to meet broader strategic objectives	35

Note: Significance determined using methodology explained on p13

I. REGULATORY COMPLIANCE HIJACKS ALL THE RESOURCES

The hefty regulatory agenda puts the change budget at many banks under considerable pressure. In our interviews, we found most institutions quoted regulatory change taking up >50% of change budgets and bandwidth, and in some cases as much as 75%. The opacity of the cost of regulatory change was often cited as well. A common theme was that if you wanted to get anything done today, you had to get it categorised under the umbrella of a large mandatory regulatory project, and as a result many of these projects have ballooned out of control, with broad unclear objectives. It is very difficult to track delivery progress and success.

"The enormity of regulatory transformation hijacks budget, intellect and resource"

What does good look like? Most banks we spoke to recognised that the focus on regulatory compliance has got out of hand and become unsustainable. The banks fighting back had rethought the concept of "mandatory" as a categorisation of investment spend. They were forcing a very clear delineation between regulatory projects, with minimal bells and whistles and clear delivery accountability, and business change projects with a different assessment and RoI challenge. We were told by one bank that "we've started to crack the problem that it's not really an either/or... but in the short-term, it has to be both".

II. THE LARGE NUMBER OF CHANGE PROGRAMMES ARE NOT WELL PRIORITISED TO MEET BROADER STRATEGIC OBJECTIVES

Alongside juggling regulation, BAU work and strategic change, banks are struggling to prioritise the various different change programmes themselves and relate them to the organisation's broadest objectives. Trying to operate several different programmes at the same time strains both infrastructure and resources beyond capacity and obscures the picture of what matters most, how much time each programme will really take, and how the benefits of each should be weighted.

"If you imagine core infrastructure as one runway, what banks have tried to do is take 10 A380s and ... refuel and land them at the same time. They don't have prioritisation. They are not taking time to assess benefits and they don't understand the legacy"

Silo organisations were again regularly mentioned as being a major problem in this regard. Many interviewees cited their firm's project prioritisation as effectively a bidding process – each part of the organisation puts in its bids for its change projects, and there is a negotiation process to settle who gets how much money and which projects get approved. The frustration is that the result is a change slate built bottom-up with poor overall prioritisation.

What does good look like? We found this issue to be at the very core of what drove the more effective institutions. In a handful of cases, a process was cited involving a high quality dialogue between the senior leaders about the priorities of the organisation – independent of individual business line or functional priorities. This dialogue was then the starting point to steer the three to five areas where the firm would invest its money. Beyond this starting point, those who are seeing progress in prioritising are applying a relentlessly

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structured attitude. They are striving for as much unity of strategic focus as possible, so that priorities are not viewed as conflicting but as complementary. They are also ensuring they have holistic and granular view of how everything is going to be achieved.

3.3. DELIVERING AND SUSTAINING TRANSFORMATION

3.3.1. RESOURCES FOR CHANGE: "THERE ARE MASSIVE CONSTRAINTS ON THE QUALITY OF RESOURCES. THIS IS BOTH A CAPABILITY AND A MOTIVATION ISSUE"

	KEY CHALLENGES IDENTIFIED	SIGNIFICANCE
I	Change management capabilities of the workforce are inadequate	80
II	Effective change leaders are rare	35
III	Leaders perceive a lack of sufficient IT skills, while IT staff feel the demands on them are unrealistic	30
IV	Banks struggle to hire and retain talent	45

Note: Significance determined using methodology explained on p13

I. CHANGE MANAGEMENT CAPABILITIES OF THE WORKFORCE ARE INADEQUATE

The scale of transformation required is unprecedented for most banks. Many are concerned that their workforce does not have the appropriate change management capabilities to deliver results. In the current model, skills are concentrated in product areas or functional expertise. Even the strongest performers in these fields may not have the right experience or skills to deliver change.

"If you go back 25 years in the car production industry, the most important people were designers and engineers. Now, they're operations managers ... programme managers are the ones making sure a project comes out with the right result"

COOs are concerned that change is not often recognised as a valuable discipline or specific skill set. One Head of Change told us that "typically organisations didn't use to, and to some extent still don't, value this stuff".

70%

of survey respondents reported misallocation and / or shortage of resources and skills as one of the top 3 challenges of change delivery in their bank

II. EFFECTIVE CHANGE LEADERS ARE RARE

Our interviews and survey reveal that banks need to significantly increase the number of senior staff members allocated to driving change programmes. Most significant projects are incredibly difficult to deliver – they require multiple parts of the organisation to work together, complex governance and potentially deep technical understanding of a breadth of issues. Most banks have a very small handful of individuals capable of steering initiatives like this. As a result these individuals themselves become the bottleneck.

"Every project has the same five names attached; clearly, we're not smart at unlocking the potential of all our staff"

What does good look like? The banks who have set out to ease these bottlenecks are trying to do so in two ways: by increasing the number of senior change managers they have available, but arguably more importantly by using those they do have as effectively as possible. In the case of the former, the most effective technique

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we uncovered was a couple of firms "cloning" the talented change managers they have by using them as a blueprint for recruitment. However, we found most innovation in leveraging the key change agents. A number of firms have cracked this problem by taking the best change managers and instead of having them lead specific programmes for one to two years, having them manage the first three months of design work, then hand over to another manager and step into a steering role. In this way they stretch five senior change agents more effectively across 10 to15 major initiatives.

III. LEADERS PERCEIVE A LACK OF SUFFICIENT IT SKILLS, WHILE IT STAFF FEEL THE DEMANDS ON THEM ARE UNREALISTIC

The vast number of programmes requiring expert management and maintenance present a real challenge for banks, and we heard that they struggle with the trade-off between having the most advanced systems and having systems their staff can really use.

However, a few of those we spoke to argued that the failure of some IT staff to deliver change programmes was not caused by a lack of capabilities, but by a disconnect between leadership and IT on what is feasible given time and funding restraints. We heard that without IT literacy at the top of organisations, and without representatives from the technology teams on decision-making committees, unrealistic expectations are common.

"I have a lot of sympathy for IT teams. People just really don't understand how brutal a job it is, and just how complex the application estates and underlying infrastructure really are"

We have seen successful cases where IT staff across the bank feel their contribution is just as valuable as that of frontline staff, and that they are being given a clear voice on decision making bodies. Additionally, initiatives to improve IT understanding amongst senior and middle management are proving fruitful.

"We need to stop using the term 'back office'...There is only one customer – the customer who uses and pays for your services. Everyone is part of the value chain to support the customer"

IV. BANKS STRUGGLE TO HIRE AND RETAIN TALENT

We were regularly told that the crisis and its aftermath have left banks in an unenviable position with regards to hiring and keeping the best talent. As one interviewee explained, there are now "massive constraints on the quality of resources" available. Those we spoke to attributed this problem to the image and collective identity of the industry, and stressed that it affects not only potential candidates for jobs but existing staff. In particular, in some of the new key roles under change initiatives, banking is competing directly with industries for staff in areas like big data, digital, cyber security, and finds itself in the unusual position of simply not being competitive on compensation for these roles.

"Attracting individuals into banks is getting more and more difficult, especially UK and European banks as opposed to Asian ones. There's a whole new generation of people who don't want to go into finance, and a separate generation who are leaving, and this is leading to a gap. It will take time to feel a sense of purpose again, especially in Europe. It's hard to be proud of the place you work and the job you do if society isn't"

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What does good look like? Some of the banks we spoke to referenced significant efforts to change the value proposition for recruiting key staff, particularly around IT. They are actively marketing themselves as optimistic places to work, where change and technology is celebrated, and constant improvement is embedded in the ethos. The case of Yahoo! was referenced. After the dot com slump the company faced a similar situation: low morale, little sense of purpose, and an unattractive value proposition for employees. They mounted an impressive turnaround in this area by talking to their staff and publishing simple lists of findings named "Things We Don't Value" and "What We Value at Yahoo!" on their websites. This and other initiatives ensured not only that they developed a new value proposition, but that it was mirrored in recruitment as soon as possible[3] .

3.3.2. EXECUTING CHANGE EFFICIENTLY: "EMBRACE TIME AS ONE OF THE SUCCESS FACTORS FOR CHANGE"

	KEY CHALLENGES IDENTIFIED	SIGNIFICANCE
I	The funding cycle is not suitable for long-term transformation	70
II	Banks lack good mechanisms for monitoring and measuring change	45
III	Banks prioritise delivering results quickly over taking time to deliver more powerful transformation	75
Iv	Delays and high attrition mean it is hard to establish continuity	35

Note: Significance determined using methodology explained on p13

I. THE FUNDING CYCLE IS NOT SUITABLE FOR LONG-TERM TRANSFORMATION

The mismatch between the timescales for funding projects and delivering long-term change is a major concern.

Almost everyone we spoke to felt that for change to be more successful, a new approach to funding is required – one that ring-fences investment for change and allows time to prove the worth of that investment.

"We need to do a better job with the investor community and explain that in order to get to a better place, investment is required that's separate to the BAU... We haven't really been smart enough with this; we need to be more upfront and explain that you have to spend a dollar to save a dollar"

What does good look like? Smarter funding requires banks to monitor the benefits of investment decisions after they are made. One interviewee told us that "the issue is really around benefits realisation. People feel funding is decreasing because it's backing up in programmes which don't finish. But in absolute terms, the amount of funding is constant".

II. BANKS LACK GOOD MECHANISMS FOR MONITORING AND MEASURING CHANGE

Many in the industry recognise the need for metrics that are easy to use and understand. When we asked our respondents which metrics they use to monitor change, we found that most had a clear vision of what a good scorecard would look like: a data driven, simple "dashboard" comparing past, present, and end-state. However, few had a version of this scorecard in place.

Those who have metrics and monitoring deeply entrenched in their banks are seeing real benefits and feel they are well worth the time and effort invested in them. Interviewees tended to favour having a high number of detailed metrics over a broad brush approach, believing that specificity is needed for operational relevance.

3 A Capur, C O'Reilly III, T Perlstein, Internal Branding at Yahoo!, Crafting the Employee Value Proposition, Stanford Business School Case, 2006

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"I think striving for "10 metrics" is too simplistic. Things are complex – don't try and make it seem they're not"

One Head of Change said that at one point in the last programme arranged, there were 50,000 milestones across the bank. Monitoring progress against them on a weekly basis was "painful but necessary".

III. BANKS PRIORITISE DELIVERING RESULTS QUICKLY OVER TAKING TIME TO DELIVER MORE POWERFUL TRANSFORMATION

Delivering large-scale transformation inevitably demands trade-offs. Some we spoke to felt that balancing the need for quick implementation with appropriate thoroughness was a particular challenge. Many change managers felt they weren't always given enough time to complete jobs properly.

"As a programme goes on, time not only helps to see what things we've missed, but also people can absorb, accept and understand"

Achieving quick wins may tick boxes but these changes often come unstuck with time and force projects that may have yielded more promising long-term results off the agenda. One Group COO we spoke to was fully aware of these risks, saying "to get to market quickly, programmes may not be as robust as you'd hope… months or even years later I will end up paying for that".

"You have to look at these things as being three year decisions – three years of funding, three years as an operating priority, three years of the best people working on them. That's where a lot of these things fall down"

The broad consensus was that real transformation requires breathing space: "if you're really focused on long-term results, you say you'll ignore the next two years". That said, to avoid a loss of momentum, the strongest approaches we heard about had built-in opportunities for success into every stage of the transformation process.

73%

of interviewees felt that a more long-term approach to change was needed, particularly regarding the funding cycle

IV. DELAYS AND HIGH ATTRITION MEAN IT IS HARD TO ESTABLISH CONTINUITY

The struggle to prioritise projects properly causes delays. This often combines with high attrition rates among relevant staff to make many projects "stop-start" affairs. Many programmes are cut-off midway, and even those that do resume suffer from a loss of continuity and momentum.

"We need continuity of personnel and philosophy, which allows for real accountability to be established"

One interviewee said that the employees in his team often started projects excited, "but that goes away if things are hijacked and there is no plan B". When projects start to go wrong, problems are often exacerbated by even more elevated rates of attrition. One Head of Change told us that "some projects are very combative and quite draining; some of our best people have left". The banks who were experiencing fewer problems with delays insisted the key was simply taking a "let's just get on and do it" attitude – "there's no option called we're not going to do it", explained one interviewee.

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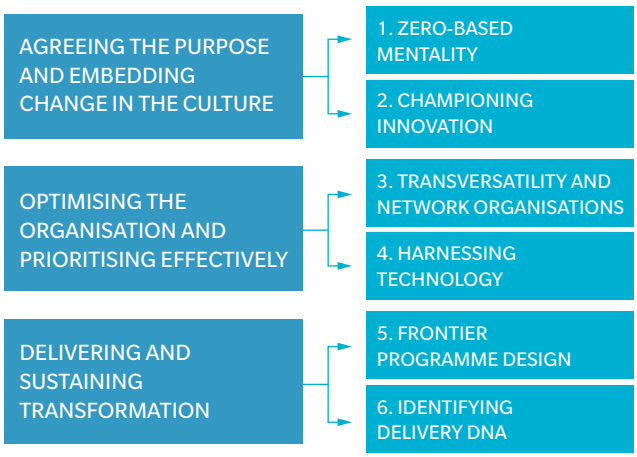
4. INNOVATIVE TECHNIQUES TAKING ROOT



Our research reveals that many banks are facing similar obstacles to transformation. In chapter three we identified some common solutions which collectively could make up a reasonable handbook of good practice in banking today.

Beyond good practice, we looked for truly innovative practices – break-out ideas or techniques that have the potential to radically improve change delivery. Not all of these are proven; some are being invented within banking, while some are being borrowed from other industries and reshaped around the needs and peculiarities of banking. Below we describe six of the most interesting and innovative new practices we encountered.

1. ZERO-BASED MENTALITY

Banking has not yet faced the kinds of disruptive digital competitive threats that have swept through industries such retail, telecoms and media. At many banks we heard that has resulted in a tendency to make incremental changes to the basic model of the past rather than profoundly questioning that model.

However, we have found some firms starting to reject this approach. Taking the view that radical transformation is required, they start their thinking from a blank sheet of paper. This is the "zero-based mentality" (only loosely related to zero-based budgeting of the 1980s).

On this approach, justification is required for maintaining an activity, not for removing it. Planning starts with "why do we do this at all?" rather than "why do we do it this way?". Zero-based thinking thereby promises far more radical transformation than the incrementalist approach. It is certainly most needed today in cost and delivery model programmes, but can be an effective planning tool in everything the organisation does.

2. CHAMPIONING INNOVATION

We encountered rigorous debate at many firms about the value of innovation. In quite a few banks we found negative views on the topic. In some cases, we found the view that innovation has been a source of the Industry's woes. In others, we heard that in a mature and highly regulated industry innovation has little place. And in a few cases, the perspective was that fast followers are the winners in banking, so being one step behind is to be encouraged.

However, we found several banks that were championing innovation around change delivery. Several of these firms have effectively re-organised and rethought incentives to promote innovation. For example, some have in-house innovation centres or "labs". These often employ a combination of tech and start-up expertise, with a focus on developing testable concepts based on new technology, sometimes even opening up Application Programming Interface (API) platforms to allow innovation by third party developers.

Some banks are also systematically incubating strategic partnerships with third party vendors or entering joint ventures with a view to pushing the boundaries on what the relationships deliver over time, rather than just locking in benefits today.

Some banks are using targeted venture investment as a research tool, funding firms that are working on technology relevant to banking, especially where it promises disruptive change.

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3. TRANSVERSALITY AND NETWORK ORGANISATIONS

Some institutions are setting themselves up as network organisations. The terms "transversal organisation" and "horizontal organisation" are starting to enter the lexicon. These organisational structures avoid P&L categories, such as business line, geography, client segment or legal entity, creating boundaries or siloes across which it is difficult to form teams, deliver initiatives or foster collaboration.

In a network organisation, personnel group together across siloes to deliver against objectives, be they short term and project based or continuous. The organisation bends and adjusts around these networks, allowing transversal objectives to be achieved. Network organisations are prevalent in other industries – most notably software development, which has managed workflow through networks for decades. The media and retail industries are also increasingly working this way.

This transformation is by no means easy or without risk. The entire talent management model, progression model and governance of the organisation needs to be reformed. But the benefits are potentially huge.

4. HARNESSING TECHNOLOGY

Banks face the seemingly impossible task of maintaining service levels and dealing with ever increasing regulatory burdens on their processes, while radically reducing costs. These obligations cannot be met simultaneously without new productivity boosting technologies.

Below we lay out some of the innovative techniques emerging across industries to leverage technology effectively by highlighting a number of behaviours we've seen adopted by institutions to drive outperformance. We are starting to see banks think about these practices, though the analogies in some instances remain imperfect. Examples include:

- **Cashing in on the data dividend**

One example of this is using operational and behavioral data as an early warning indicator. For instance, in the Energy industry, oil rigs are equipped with sensors that measure wind speed, incline, temperature and other metrics in real-time, allowing operators to identify and address potential problems before they happen. We found few banks are really good at using operations data to provide early and proactive warnings of problems, for example, in new process delivery, controls or service levels

- **Eradicating the cushion between back and front office**

Creating a culture of customer service by eradicating the cushion between back and front office has yielded results in other industries. Airlines and hospitality companies have pushed their staff forward into customer management and recovery roles by arming them with mobile technology. For example, hotel staff are empowered to resolve complaints on the spot and pilots increasingly greet passengers by name in their seats. We found a handful of banks thinking hard about operational delivery as part of the customer experience – for example, taking operations heads to institutional client relationship meetings

- **Digital innovation**

Transforming processes in a digitally enabled world can be another successful approach. For example, in Aerospace, NASA's robot guidance systems were fed by vast numbers of satellite images of landscapes that took weeks to process at huge cost. By thinking radically and partnering with Amazon Web Services the agency reduced processing time to a few hours and reduced the processing cost to roughly $200[4]. On the channel side, Apple have long been pioneers in this space, delivering gold standard customer experience using smart technology infrastructure. This allows an Apple store staffer to demonstrate products, solve problems, schedule service, conduct a transaction or redeem a warranty, all without leaving the customer

4 AWS Case Study: NASA/JPL's Desert Research and Training Studies, downloaded from Amazon company website http://aws.amazon.com/solutions/case-studies/nasa- jpl/ on July 27th 2014

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5. FRONTIER PROGRAMME DESIGN

In our research we found many firms struggling with the fundamentals of good programme management. For example, many lacked strong governance, well-run PMOs (programme management offices), access to the right subject matter expertise and clearly articulated road-maps and interdependencies.

However, we also found some frontier approaches to programme management beginning to surface. The most prominent example is a technique that could be termed parallel processing. This discards the traditional "diagnose the problem, then design the solution, then implement the solution" approach to delivery. Programmes run on this slow traditional basis risk losing momentum, for example, when key executives leave or change roles during the early phases of the work.

Parallel processing quickly identifies early tasks that are effectively "no brainers" or at least low risk and runs parallel sub-initiatives to push these straight into implementation. The programme thus scores quick wins and builds credibility in the organisation, which helps to draw in support. Experience shows it can accelerate programmes significantly.

This is a technique that is now used quite extensively in the construction industry. Architects and contractors shave months off the time it takes to complete a building project by collaboratively designing processes that let construction begin while the design is still being completed.

6. IDENTIFYING DELIVERY DNA

The toolkit used by effective change agents is evolving rapidly in a digital world. It now includes planning tools, communication methods that suit networks, risk identification and so on. But such tools alone are not enough. Delivering programmatic change requires effective people – "go-get-'em" leadership, the ability to deal with complexity, leading edge programme management skills and the staying power to grind out performance.

We found out-performing change leaders build teams with a "delivery DNA". They create a culture of accountability around deliverables; they infuse a process mind-set; they encourage self-awareness about behaviour and interaction styles; and they shift emphasis from individual success to the performance of the effort itself.

A number of cutting edge practices of the best change agents stood out from our discussions. A focus on quality assurance was prominent. Some of the best change agents insert much more QA into their programmes, including early indicators, challenging subject matter expertise, benchmarking and course correction. A second behavioural feature was a focus on scenario planning. Most of the initiatives we are talking about take two, three or more years to implement, over which time the organisation is likely to experience significant external and internal conditional changes. The best change agents are building the flexibility to deal with this into their scenario and risk management planning.

The behavioural characteristics that make an effective change leader are quite particular, and often do not emerge in the same people who design good products or manage client relationships well. We found leading institutions are recognising that these characteristics need to be understood, and are using science to understand what's required and to identify them in their key people. who they then continuously invest in.

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5. ASSESSING YOUR BANK'S READINESS FOR TRANSFORMATION

Almost everyone we spoke to in researching this report agreed that European banks need to transform if they are succeed. That consensus needs to be translated into action.

Forgoing optionality, rethinking the organisation, investing heavily in delivery technology, revolutionising the employee skill mix: these are daunting challenges, but they will only become more so as time passes, as the winners deliver stronger economics, and as new competitors start to make more material inroads.

We hope this research will help banks to bridge the gap from strategic planning to successful delivery. In addition we have created a short self-assessment across the components of our framework for successful change delivery. Any bank executive can access the self-assessment tool and score their own organisation according to how well our key indicators of "health" are satisfied. We invite you to access the tool - it allows you to compare your organisation against peer cohorts that have already contributed to our benchmarking through the course of the research for this report. To self-assess, please access the following link: www.oliverwyman.com/europeanbankingreportsurvey.html

There is much still to be done to put European Banks on the path to a flourishing future. The toolkit to improve change delivery is increasingly available to banks that really want to deploy it. The results of doing so will justify the investment and help to bring them into a new and exciting era of banking. As one of our interviewees so aptly concluded: "It's almost existential ... nobody wants to be associated with the demise, they now want to be associated with the revolution, and that's really quite motivating".

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APPENDIX: ACADEMIC LITERATURE ON CHANGE DELIVERY

Much of the academic literature on transformation centres on the challenge of engaging, motivating and supporting the workforce to deliver change. This has historically been a significant issue for all organisations attempting change, irrespective of size, industry or business model. In this appendix, we have pulled out five of the key themes across the established research, all of which are applicable to a banking setting.

1. COMMUNICATION

Communication throughout the organisation is frequently highlighted as the cornerstone of engaging the workforce who will be responsible for success (or failure). In *Campaigning for Change* [5], Hirschhorn insists that organisations master the three different "campaigns" that are required: political, marketing and military. None of these are dispensable; political campaigning is necessary to forge alliances, marketing is required to cascade the message through the firm, and military campaigning is key to securing manager dedication and creating "beachheads".

The advice on communication elsewhere tends to be similarly simple but uncompromising. Clarity is essential, as is having an identifiable, digestible theme: "a rule of thumb – if you cannot communicate the vision to someone in five minutes or less and get a reaction that signifies both understanding and interest, you are not yet done with this phase of the transformation process"[6]. This is important at every stage of transformation, but especially the beginning. One leader of a Manufacturing Ops division announced a major transformation programme in person as follows: "I'd like to welcome you all to the beginning of a journey. What we begin today will dramatically impact how we conduct our business in the future"[7].

Academics are also at pains to point out that, even more importantly, communication does not mean one-way dictation. It means dialogue – which in practice is a commitment to listening, to continuous feedback processes, and to constantly refining based on what those in the front line are reporting.

2. OVERCOMING RESISTANCE

Researchers on the topic of change agree that resistance from the various levels of the company or organisation is a recurring obstacle. The consensus is that best change programmes will be designed by those who anticipate, and have concrete plans for, meeting resistance, rather than aim unrealistically to eradicate it altogether. This involves detailed situation analysis that seeks to profile the likely resistance: where it may come from, how it may manifest, and how severe it may be.

Where they can, change leaders should not be afraid to determine the optimal speed of their programme based on the intensity of probable resistance. But of course, most large-scale transformation will demand a faster pace and broader scope than most staff are comfortable with – so another crucial step is paying close attention to the different methods needed to manage resistance[8].

5 L Hirschhorn, Campaigning for Change, Harvard Business Review, 2002
6 J Kotter, Why Transformation Efforts Fail, Harvard Business Review, 1995
7 S Wirth, J Kavanaugh, V Sower, Radical Bearing Team: A Manufacturing Group's Transformation to Self-Directed Work Teams, Case Research Journal, Spring 2014
8 J Kotter & L Schlesinger, Choosing Strategies for Change, Harvard Business Review 2008

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3. CHANGING EMPLOYEE BEHAVIOURS

Changing the fundamental behaviours of a workforce is understood as one of the most challenging aspects of organisational transformation. There is a great deal of emphasis on tapping into how employees think and feel and achieving a genuine "reframing" of how they perceive the organisation and their role within it. Achieving this level of turnaround is considered relatively unlikely. For example, Deutschman's *Change or Die* estimates the odds are around 9:1[9] .

However, this piece insists that supporting staff from day one with the training and discussion they need to alter their mind-sets will give organisations the best chance of success. What does this look like? Addressing personal concerns, appealing to people's beliefs and feelings, and linking change to the issues people care most about, rather than merely business deliverables. One major telecommunications company did this by issuing a set of clear and simple "Guiding Principles" to encourage behaviours that supported transformation. The principles were short, memorable and specifically relevant to behaviour: "I put my full energy into executing the decision", "I act honestly and openly", "I take ownership for what I do[10]" .

4. OPTIMISING TIMESCALES

Devising the right timeframe for transformation is central to success. The broad agreement is that meaningful transformation requires many different stages and that skipping steps is likely to have serious negative long-term consequences. Furthermore, setting both short and long-term objectives helps to get the most out of the workforce in two concrete ways:

First, it is widely agreed that having a series of 'short-term wins' helpfully boosts morale, and underscores the real purpose of transformation. Achieving short term goals instils confidence for the next phase.

Secondly, setting short-term objectives while simultaneously spelling out the long-term roadmap demands that staff take ownership immediately, and are therefore incentivised to commit 100% effort throughout the process. Sometimes this can even be linked to monetary incentives: one major airline which underwent a total turnaround in the 1990s issued various short-term bonuses for staff who improved performance over the previous quarter, and saw real results[11].

Check-ins a short way into the process provide a built-in opportunity for these owners to identify "white space risk" – the risk that some unplanned activities will be required as programmes progress [12]. What is more, they offer leadership the chance to identify areas where the disparate activities of various different teams are not working together. The long-term end state can therefore come more into focus.

9 A Deutschman, Change or Die, 2005

10 S Ben-Hur & J Anderson, Deutsche Telekom: A Transformation Journey, Harvard Business Review, 2011

11 N Nohria, A Mayo, M Benson, Gordon Bethune at Continental Airlines, Harvard Business Review, 2010

12 N Matta & R Ashkenas, Why Good Projects Fail Anyway, Harvard Business Review, 2003

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5. TRAINING AND DEVELOPMENT

Much of the prominent research on change delivery stresses the importance of targeted training and development initiatives, not just for the leaders of change but also those responsible for its delivery. One major energy company developed a "multi-pronged" training approach to support its major IT transformation programme[13]. There have been successes in other industries with programmes that train teams rather than just managers, ensuring instantaneous unanimity and creating a common vocabulary on the spot[14]. Other papers highlight the importance of using training to empower staff; it is not enough to communicate a vision, there has to be a clear process in place so that everyone understands what they have to do to achieve that vision, and – critically – feels they have the tools to do it.

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