Rethink: How banks can drive down cost and protect profit

Digital, cloud and AI are the keys to unlocking cost reduction
Regrets, I’ve had a few ...

COVID-19 has been a major accelerator for change within the banking industry.

Over the last few months, many banks have moved to a more remote, automated and digital operating model. Many global banks are “being run from their kitchens” (to paraphrase a recent comment from Jes Staley, Barclays CEO). There has been increased adoption of digital end-to-end processes and greater uptake of digital wallets and non-cash payments to compensate for the significant decline in branch transactions.

However, many banks regret that they had not done more of this sooner and have resolved to never be this unprepared again. Banks are still shackled by legacy IT. Their approach to decision making has not, in any meaningful way, been sufficiently data-driven. Many are now seriously considering a move to the cloud, despite compliance and regulatory challenges (often internal), as they appreciate the need to be more agile. Plus, there are significant opportunities to reinvent the way people work, with all the implications that holds for culture, property and virtual management.

These are areas that require serious scrutiny as the banking sector experiences reductions in both revenue and profit (estimates range from 5% to 10% and 20% to 30% respectively, depending on the market). The five largest US banks have set aside $25 billion for credit losses in the first quarter alone. According to Morgan Stanley, “only 20-30% of the cost base is flexible today and ... only 5-10% can realistically be exited in the near term (versus 20%+ in the Global Financial Crisis).” Lower profitability and depleted capital could result in serious solvency issues for some banks over the next 12 months.

Given all these challenges, how can banks drive down cost and remain profitable?

As banks move out of their initial phase (“response”), they are now developing major cost optimization programs (“reset”) with a view to being ready for growth (“renew”). We’ve written about these phases in detail. For “reset” we suggest four areas to consider:

- Digitize end-to-end processes, especially loans
- Develop a variable cost structure through greater cloud adoption
- Use intelligent automation (Artificial Intelligence (AI), Robotic Process Automation (RPA) and analytics) more widely to manage credit risk
- Review property portfolios.
Rethink digital: Focus on the end-to-end process

Banks are now adopting a digital-by-default setting and a contact-light physical presence but balancing this with a human touch for complex processes and advice.

For most banks, it means deflecting call center inquiries to contextually-relevant, conversational AI-enabled virtual agents. Banks that have digitized their end-to-end processes will experience significant benefits in the new environment, especially in digital lending and automation (loan origination and monitoring). The benchmark for end-to-end digital product originations used to be 50% to 60% for the world’s leading digital banks but it is now 70% or more.

AI is being implemented by banks within middle-office functions to stop payments fraud and improve the process for AML and KYC regulatory checks. It’s estimated that the savings here ($217 billion) are as good as those implemented in the front-office through biometrics and personal insights ($199 billion).

With Microsoft and Accenture, Avanade digitized a paper-based, labor-intensive loan-approval process for a Brazilian bank. Customers now use computers or mobile phones to upload documents for assessment and approval. The new digital platform resulted in 25% savings for underwriting and processing. Pre-check and document handling time was reduced from six days to a few minutes. Revenue increased by 40%. Customer satisfaction increased by 35%. And loan generation increased by $400 million.
Rethink cloud: Develop a variable cost structure

We appreciate that moving to the cloud needs serious assessment, given the regulatory environment.

Banks are keen to optimize the way they use the cloud in their business and fully understand the benefits that can be delivered, especially in the current crisis. Most banks are aware of what’s required to move to cloud platforms, hybrid or otherwise, and how they’ll manage their service providers. They’ve just been cautious. If nothing else, the last few months have shown that banks can implement programs that they would never have considered before.

Removing dependency on in-house data centers and managing applications portfolios to evolve to a cloud environment will lower TCO and raise technology ROI in the medium-term. Such deals will provide a variable cost structure and the option to move to a managed services environment.

As-a-service capabilities in areas like payments or credit can accelerate operations transformation programs and flatten investment curves. Banks should also make the most of the current situation to work through their legacy technical debt, and consider their mainframe exit agenda. This could be a good opportunity to write off prior year investments and set new goals. Cloud providers are prepared to offer partnership investments to speed up the change process.

When it comes to sorting out legacy issues, banks in our recent study believe microservices (78%) and APIs (69%) are key strategies for unlocking value in the business and for core banking renewal. However, they’re struggling: 43% see legacy IT and the costs of integration as a major obstacle to an agile approach to disruption. And they think legacy is a significant hindrance to retaining staff (39%) and innovation (30%). Half of our banking respondents felt they lacked in-house skills for handling market disruption. Specifically, acquiring DevOps skills is the biggest obstacle (53%) and banking was the top sector (we covered 21 sectors) when it came to this issue.
**Rethink AI:** Streamline applications and manage credit risk

Banks should consider how they can exploit chatbots to help automate thousands of loan applications under the various pandemic programs and avoid manual involvement and error.

This will streamline loan processing by automatically extracting application data and entering the information into the relevant loan origination portal quickly and accurately. Regional US banks are already seeing process improvements from three weeks to three days. We’ve already written in detail about how this approach can be applied in situations of massive customer demand.

AI and analytics can be applied to non-performing loan portfolios to model and manage credit risk. This is especially relevant where banks are under pressure to relax policy to issue credit faster, but will be liable later for higher default rates. Proactively targeting high-risk sectors and customers will help banks actively manage those loans that are more likely to deteriorate. Setting up early warning systems (even if initially manual) in the light of real-time data signals will be vital.

Avanade used robotic process automation to automate a complex mortgage approval process for a Spanish bank, which had more than 4,000 actions per contract. This led to gains of 75% via staff reduction and conversion time. We developed algorithm-based cash flow forecasting for a large European bank’s small and medium-sized customers.

For a North American investment bank we built a new robo-adviser platform offering client onboarding, investment strategies, portfolio rebalancing and performance monitoring. Account growth has exceeded the client’s original expectations, with the solution currently servicing half a million accounts.

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**Rethink property**: Reinvent the branch and go local

Given that many bank staff are working remotely, now is a key time to assess which combination of models will be used going forward: remote, office or hybrid.

Banks have proved that they can operate with no footprint. Investment in new skills will be required but there will be options for a more flexible way of working, as well as a real opportunity to re-evaluate office requirements in expensive city locations.

The pull of major financial centers, such as New York and London, will be strong. *The Economist* estimates that financial services accounts for a third of Manhattan’s payroll. Initially, to comply with social distancing, banks may need more space per staff member for a number of months, which will keep demand for office space high. *Paco Ybarra*, a Citigroup executive, commented that firms may be able to work remotely now because they built up face-to-face client and team relationships, but these will “erode over time.”

For those not needed at the head office, the existing branch network could be reinvented to accommodate local office workers and act as a workplace community hub, given the trend in reducing customer space in branches and the testing of ‘micro-branches’. There may also be benefits in having product specialists present at or local to a specific branch.
Next steps

Based on our client work, we have four recommendations:

**Digital**
Select critical customer-facing processes where you can drive towards an end-to-end digital approach; review middle- and back-office opportunities around payment fraud and AML/KYC.

**Cloud**
Identify where as-a-service approaches could help you move significantly from a fixed to variable cost structure, such as payments or credit; explore options for developing applications in a cloud-native environment using an agile/DevOps approach.

**AI**
Automate loan applications further (using chatbots, OCR etc. or use partners to speed up parts of the process) and target loans to high-risk sectors for proactive management; model loss provisions based on pandemic scenario data and set up early warning signals to manage non-performing loan exposure.

**Property**
Estimate which staff can continue to work remotely and securely; decide where your city center footprint can be reduced.

Given the pressures on profitability and capital over the next year, it’s vital that banks explore all available options to reduce their cost base and protect their profit margins.
We can help

Let Avanade partner with you to rethink your business. Go to Rethink for more details on our approach. We’re here to help at a time when you’re adopting new ways of working.

We work with seven of the top 10 global banks but our client portfolio includes banks of all sizes. We have access to the most advanced Microsoft technology platforms and Accenture’s global banking and regulatory expertise.

In the current environment we’re finding that our clients want to move quickly and deliver short, outcome-based projects. We’re flexible and happy to respond to your requirements.

We offer pragmatic advice combined with execution in the following areas:

- **Automation and AI**: To improve productivity and speed up business outcomes, we’re helping banks digitize processes. We apply intelligent automation and AI to deliver efficiency and deep customer insight. We can help with data management, chatbot development and even advise on conversational AI.

- **Cloud and IT transformation**: To help banks manage their day-to-day IT services, we deliver a range of cloud services on Azure, trusted by 80% of the world’s largest banks and 85% of Global Systemically Important Financial Institutions. We can speed up application development using an agile approach, reduce your dependency on legacy and help you scale flexibly to meet rising market demand.

- **Security**: Working with national, regional and multinational banks we have developed expertise across a variety of areas, including digital identity and authentication, data protection, encryption, secure collaboration, incident response and cyberdefense.

- **Digital marketing, sales and service**: Building on Microsoft accelerators, we’ve developed a true 360-degree customer view for many banks around the world, improving cross-selling rates and identifying next best actions. We’ve improved lead scoring and qualification, opportunity tracking, campaign planning and automation, personalization and onboarding.

- **Workplace transformation**: We’ve developed a holistic approach, involving IT, HR and business division heads, that we call WX (Workplace Experience), specifically for banks. If you need it, we’ve also pulled together best practice on remote working for employees, business and IT leaders.

Visit [www.avanade.com/banking](http://www.avanade.com/banking) to find out more about our work.
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Let Avanade partner with you to rethink your business.

**Contact us today** to help your organization identify the strategic bets that will make your operations more resilient and your products and services more desirable to customers. We combine business strategy, agile innovation, and deep Microsoft technology expertise to help resolve your challenges.

About Avanade

Avanade is the leading provider of innovative digital and cloud services, business solutions and design-led experiences on the Microsoft ecosystem. With 38,000 professionals in 25 countries, we are the power behind the Accenture Microsoft Business Group, helping companies to engage customers, empower employees, optimize operations and transform products, leveraging the Microsoft platform. Majority owned by Accenture, Avanade was founded in 2000 by Accenture LLP and Microsoft Corporation. Learn more at [www.avanade.com](http://www.avanade.com).

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