OPERATIONAL EXCELLENCE

SEVEN PILLARS FOR POST-PANDEMIC PROCESSES IN BANKING

SRM ACADEMY REPORT

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Since March 2020, the extent of operational transformation in financial services has been historic. Yet, slowly but surely, consumers and businesses are beginning to rebuild for life after COVID-19.

One year after the start of the pandemic, after being in the virtual trenches with financial institutions across the U.S. and Europe, SRM project managers were asked which strategies proved most effective when restructuring banking operations for socially distanced times.

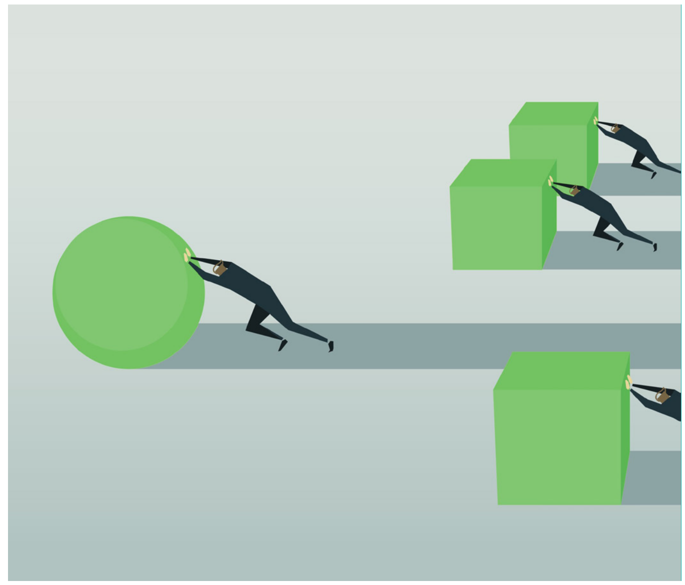
The consumer and business climates are materially different from the ones we left behind in Q1 of 2020. For instance, shoppers have not returned to physical retail stores in the volumes many had hoped, especially given some regions still have lockdowns in place. Meanwhile, customers across many demographics have adopted digital services out of necessity. Digital adoption is especially evident in financial services – which has seen significant increases in online activity among older customers and others faced with the reality of branches being closed during pandemic lockdowns.

With more consumers turning to mobile (or other) devices for their online banking needs, many will likely continue to use digital channels going forward. Further, during this period of digital adoption, many have new expectations of their financial institutions.

"...IT IS INCREASINGLY CLEAR THERE IS NO GOING BACK TO THE "OLD WAY" OF DOING THINGS."

It is worth noting that, while nearly all the challenges imposed by the coronavirus on financial institutions already existed, the pandemic placed them in starker relief – raising the stakes for banks and credit unions to hasten their digital pace. Chief among these challenges is the shift to digital channels, a trend that was already well underway. Yet, the pandemic has also accelerated many long-term digital plans by several years. According to multiple industry sources, including the U.S. Federal Reserve, COVID-19 drove digital migration forward by 18-24 months based on the historical trajectory in the spring months alone.

Although there will be some reversion to prior habits as branches reopen, it is increasingly clear there is no going back to the "old way" of doing things.



THE CHANGING PICTURE

Countless examples of changing with the times, both trivial and transformational, surround us. Grandparents have become familiar with Zoom, and families and far-flung colleagues opt to share virtual meals and happy hours via laptop screens. Business tasks that conventional wisdom once deemed ill-suited for work-from-home (WFH) settings have migrated to remote environments – without missing a beat and even picking up the pace in many cases. Looking ahead, employers can expect more recalibrations for their flexible employee working models, recruitment efforts, and real estate strategies.

Retail banks and credit unions especially have been uniquely challenged to change how they do business, both digitally and in the branch.
A few examples of pandemic-related operational disruptions:

AUTHENTICATION CHALLENGES

Until recently, entering a branch with a face-covering would have been unacceptable. Fast-forward to 2021; even with a photo I.D. at hand, approaching a teller station without a mask is against the rules – creating a new set of authentication headaches. With all the recent changes in consumer behavior, even banks and credit unions that stayed ahead of the curve and built out robust digital offerings could face capacity issues

as channel demand shifts rapidly – and unpredictably. As compressed net interest margins and higher delinquencies exert pressure for all to "do more with less," mobile-first business models could become vital channels for new revenue.

VENDOR AGREEMENTS

Supplier contracts may contain restrictive clauses and require realignment for socially-distanced conditions. The services contracted may also need adjustments. Much like the financial institutions themselves, supply chain players must **evolve to meet these new demands**.

DECISION-MAKING

More changes mean more decisions, and slow or erratic decision-making detracts from effective leadership responses. In an environment requiring maximum flexibility and responsiveness to fluctuating inputs, delayed deliberations can grow from a hindrance to an existential threat. Since the pandemic's announcement, banks and credit unions have been racing to find the most direct path to the "next normal" as quickly and safely as possible. Although the banking industry's response to the first waves of coronavirus proved broadly successful, there was a good deal of ingenuity and brute force behind the scenes to keep the engine running.

As financial institutions settle into post-pandemic realities, the next step is to streamline these gains into efficient, sustainable processes that deliver operational excellence.

With this in mind, SRM proposes seven pillars – three strategic and four tactical – to position banks and credit unions for success in the next normal.

STRATEGIC PILLARS = SOLID FOUNDATION

1. THE LOCATION STRATEGY

BRANCH STRATEGY: Questions surrounding branch strategy are not just about location. In addition to how many are needed, how should they be configured and which services should they prioritize, new ones are emerging. These include how much space do we need and can we consolidate existing footprints? Pre-COVID work on branch rationalization will continue to grow, encompassing other business locations like headquarters, offices, and service centers.

WORK FROM HOME (WFH) STRATEGY: The extent to which an organization elects to embrace long-term remote working models carries far-reaching implications.

For example, a higher ratio of WFH employees reduces square footage requirements for company-provided space. However, recent trends toward open floor plans and "pods" could be considered as well. Space-sharing concepts such as hoteling and hot-desking will also lead to ongoing sanitation requirements to reassure employees of a safe environment.

A long-standing trend of declining square footage per full-time employee (FTE) will almost certainly reverse; however, the relevant denominator will be on-premise FTEs. Depending on a firm's approach to remote work, square footage required may yet decrease – and take on a different form. Existing technologies will need to adjust to underpin the transformation of – for example – contact center environments for call queuing and management for remote agents.

PERFORMANCE MANAGEMENT MODEL: A performance management model for remote working should be designed quite differently from a legacy one, with unique coaching/training requirements, implementation of collaboration tools, and, in many cases, a greater reliance on key performance indicators. A new set of leadership skills is required to operate a remote workforce. Further, the criteria for recruiting must align with (broadened geographically, potentially adjusted skill set-wise) WFH models to prove successful.

2. THE OPERATING MODEL

Parity with competitors' offerings has been deemed sufficient in the past, but this may no longer be the case since social-distancing raised the stakes on operating models for customer experience and brand differentiation.

Much like digital transformation, operating model strategies that were in flight before the pandemic have now taken on greater urgency. Even institutions that have already reviewed these strategies in past planning cycles are revisiting them with a fresh perspective. Answers to other mission-critical decisions may have changed as well, given the new environment. Marketing resources may also need to be transitioned between channels or products to align with a new set of customer and prospect needs.

For example, a list of markets suitable for entry, re-entry, or retreat – based on geography, product, or customer segment – may now look different. There may be emerging target demographics and a need to react to a competitor's moves. Traditionally insourced or outsourced functions may also receive renewed attention.

3. ORGANIZATION REDESIGN

Too often, the notion of organization redesign has implied downsizing, but this does not have to be the case in the future. In truth, the exercise is at least as necessary for a growing company preparing itself for new challenges and scalability. Also, these various workstreams naturally overlap.

For instance, the remote working model and digital channel decisions noted above will necessitate the redeployment and re-skilling of staff across an array of functions. Reporting lines, spans of control, and even geographic parameters for managerial relationships may benefit from a fresh look.

The ultimate goal is to empower teams with the mindset and tools to respond nimbly to challenges in an unpredictable environment.

TACTICAL PILLARS & QUICK WINS

While strategic initiatives are essential for setting a solid go-forward foundation, there are also quick-win tactics that are not to be overlooked. Accomplishing such early results can help build momentum and support for further initiatives across the organization – while also generating cost savings to free up additional investment dollars.

4. PORTFOLIO RATIONALIZATION

If there's ever been a natural time for a fresh look at a bank or credit union's product portfolio, there is no time like during a pandemic. Portfolio rationalization need not involve product introductions or retirements; more often, it represents revising priorities or adding new features.

Given the realities of the changing business landscape, leadership should reasess the risk profiles and scopes of various projects - both in-flight and planned – and adjust as needed. It is also likely that the cost/

benefit dynamics have changed compared to any analysis performed before February 2020.

With new resource demands such as support for WFH models and a potential need to reduce expenses, re-evaluating existing portfolio strategies becomes a matter of due diligence.

5. PROCESS RE-ENGINEERING

The events of 2020 created ample opportunity for non-standard procedures to enter the system. When providing uninterrupted service during socially distanced times became "job one," such ingenuity is to be applauded.

However, with many working models permanently changed, it's critical to optimize these processes for long-term efficiency, security, and exceptional customer experience.

Some process re-engineering methods include eliminating workarounds, streamlining processes, and readying areas that could benefit most from automation.

Most banks and credit unions were overdue for process re-engineering heading into 2020. The events of the past year have only raised the stakes. For those behind the curve, consider mapping out the customer journey across all digital channels. As the digital curve steepens, now is the time to refresh processes for a greater purpose.

6. INTELLIGENT AUTOMATION (IA)

For years, businesses have sought to leverage the technologies classified under the umbrella of Intelligent Automation (IA), especially machine learning, robotic process automation, and artificial intelligence.

After March 2020, these have become especially relevant for financial services firms dealing with multiple types of high-volume, low-value transactions.

An important feature to note is that IA can work alongside humans, supplementing their expertise rather than replacing it. Automated workflows can remove the clerical aspects of the process from the experts' plates, allowing them to efficiently focus time and energy on the high-value (and more interesting) parts of their jobs.

For instance, fraud and underwriting decisions are becoming automated, escalating the more complicated cases to personnel for further analysis. Over time, through machine learning, IA can also increase the share of such cases it can address without human intervention.

Realistically, there will always be a reason to retain human expertise in the workflow. However, by leveraging automation, these processes can empower the existing workforce through value-adding activities while eliminating tedious manual work and legacy infrastructure.

7. SUPPLIER CONTRACTS

For those in the know, existing vendor contracts often include clauses that are inconsistent with one another or are inaccurately applied. During a pandemic, auditing invoices for errors can be like finding a needle in a haystack, in the dark.

For instance, invoices from digital banking and core service providers can run on for dozens of pages with hundreds of line items. Errors often go undetected (i.e., applications of new pricing tiers missed, etc.).

Given the degree of complexity, it's common for payables clerks to count an amount due as "correct" because it aligns with the prior month's balance. Eventually, minor errors can creep into the run rate – errors that accumulate over time into significant dollar discrepancies.

Long before the next contract expiration, approach the negotiation table with knowledge of prevailing market rates, the available range of functionality, and reasonable expectations for performance levels. With contracts that typically reset only every 3-5 years, it is unrealistic to expect leaders at small and mid-sized institutions to be intimately familiar with prevailing rates.

To level the playing field, even as more waves of change keep coming, decision-makers can first weigh their options by issuing a request for proposal (RFP) to several different vendors. This process can require considerable attention and time, but the results often speak for themselves.

A second, often more direct approach, is to enlist an impartial third party – one with current industry benchmarks and niche expertise in the fine print of the incumbent provider's contract terms. Such third-party experts can also help design win/win incentive structures that reward future growth – adding clarity to items like force majeure clauses that should carry added resonance in the next normal.

BUILDING A CAPABILITY MATURITY MODEL

Even with seven pillars to choose from, one does not simply identify the building blocks for operational excellence. It's a process.

When working with financial institutions to develop a Capability Maturity Model, SRM's project managers recommend a three- to five-week process. This systematic and evidence-based methodology should uncover inefficiencies and immature capabilities across the operational infrastructure.

> "WHEN WORKING WITH FINANCIAL INSTITUTIONS TO DEVELOP A CAPABILITY MATURITY MODEL, SRM'S PROJECT MANAGERS RECOMMEND A THREE- TO FIVE-WEEK PROCESS."

With the knowledge gained from this process, it is then possible to assess the financial institution's current state compared to a realistic, achievable position. This creates a set of prioritized initiatives tailored to close the gaps between the current and desired states. Based on the insights provided, clients can then, with confidence, choose the best path forward.

While building a Capability Maturity Model, it is advisable to take a prudent, bespoke approach based on the bank or credit union's unique market position. The incremental cost involved in building up to the "next level" must also be part of the equation.

RAISING THE ROOF FOR OPERATIONAL EXCELLENCE

The two case studies below demonstrate the outcomes of the seven methods outlined above with real-world scenarios.

CASE STUDY #1 | THE $1B US CREDIT UNION

An IT executive at the credit union was continually receiving reports of tedious, inefficient processes both inside and outside his division. The issues occurred in part because the systems had inadequate integrations from third-party vendors. The credit union identified intelligent automation as a short-term, cost-effective solution. Still, the project required niche expertise to evaluate IA vendors, in addition to calculating the scope, value, or extent of their use cases.

Upon project completion, the credit union had successfully:

- Reviewed a thorough evaluation of their operations
- Drafted a set of guiding criteria for vendor selection and a graph of 17 vendors charted according to price and fit
- Determined the technologies and vendors they needed
- Developed a robust backlog of dozens of automation candidates prioritized according to the credit union's strategic objectives
- Laid the informational groundwork for their intelligent automation capabilities
- Set the scope and plan for its pilot program to address the most urgent internal and external pain points and to introduce IA technologies to the enterprise

To date, the IT executive has been able to identify and evaluate 75+ use cases across 18 areas. By prioritizing low-cost, high-impact opportunities in a backlog, the credit union was well-prepared to rapidly build and scale value from iterative automation.

CASE STUDY #2 | THE $5B US BANK

The bank faced regulatory findings around significant gaps in its technology strategy and technology roadmap – in the middle of its efforts to modernize its technology and operations – with a tight deadline to address them. Guided by SRM's systematic and evidence-based methodologies, the bank carried out a capability maturity assessment of its Technology Directorate and a broader organizational review to support a response to the regulatory findings. In the process, they created a Technology Strategy from the ground up.

Upon project completion, the bank had received:

- A detailed 'living' 63-page Technology Strategy and medium-term technology roadmap meeting regulatory requirements
- A 'Bank-on-a-Page' diagram – giving insight into the efficacy of how the bank is operationally structured today, including insight on the bank's hierarchies
- A staff survey identifying how well staff are connected to the corporate strategy and their understanding of its objectives
- An assessment of the line-of-sight to corporate strategy, based on SRM's 'telescope' methodology
- Two capability maturity assessments across 'Technology' and 'Rest of Bank' leading to over 50 tailored and prioritized initiatives that formed a 'roadmap for change' to support the bank's transformation journey
- Targeted recommendations to improve other aspects of the bank's overall strategy based on alignment, structure, incentive, and visibility issues identified in the course of reviewing of over 100 documents, 50 hours of workshops and interviews, and analysis of the survey results from 200 staff

The project outcomes enabled the bank to meet the regulatory requirements and immediately embark upon the highest value initiatives to improve its strategy and operations.

CONCLUSION

While the financial services industry has been successful thus far in keeping operations running uninterrupted, it's now time to prepare operating models for the next chapter.

Whether the task at hand is authentication with masks, recalibrating pandemic-grade supplier agreements, or supporting an increasingly WFH workforce, SRM recommends a "business health check" designed to:

- Identify process gaps for optimization
- Highlight priority areas to address market changes
- Anticipate and safeguard against potential risks
- Accumulate insights to deliver dividends over the near- and long-term

As SRM's **recent survey** of banks and credit unions shows, most leaders expect COVID-19's operational impacts to persist into 2022, at least. With this in mind, there truly is no time like the present to optimize operating processes – ones that align with our new socially-distanced realities.

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ABOUT SRM:

SRM (Strategic Resource Management, Inc.) has helped more than 1,050 financial institutions add $3.6 billion of value to their bottom line in critical areas such as payments, digital transformation, core processing, artificial intelligence, and operational efficiency. SRM's decades of experience have lowered costs, enhanced revenues, increased productivity, and provided a competitive edge for clients in an environment of constant and accelerating change.

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