

# Fit for Future: Optimize your cost structure to accelerate growth, profitability and customer excellence

Cost Efficiency Survey 2012 Switzerland



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# Editorial

The Financial Services industry is undergoing massive change and is challenged by enormous cost pressure caused by sharply declining revenues and significantly increased costs of doing business. This made cost management a key topic for top executives.

While especially Private Banks are forced to massively change their business models by the trend towards tax transparency and regulatory requirements, insurance companies are facing strong pricing pressure. We are convinced that these changes are structural and not cyclical and therefore create a highly demanding entrepreneurial challenge for the leaders: reducing costs and over-capacities with minimal negative impacts on growth potential and client service quality.

## Call for action

Today, for most Financial Services players there is no valid alternative to embarking on cost reduction projects - targeting not only significant, but also sustainable efficiency gains. How are best in class companies doing this? From our experience with a wide range of clients, we recommend the following considerations:

- ▶ Consider Cost Efficiency not just as an isolated topic but as a driver for a fundamental and objective assessment of the current business and operating model and the value chain in an integrated way to move towards a cost effective and differentiated business model
- ▶ Drive Cost Efficiency projects as enablers for growth. Done in the right way, they free up resources, which can then be invested into growth opportunities
- ▶ Focus the project on effective and radical measures - not just on politically easy ones
- ▶ Perform a thorough evaluation of major areas for improvement and define measures, based on the current strategy and deep insights from leading companies
- ▶ Plan for sustained enforcement of the cost reduction measures throughout the organization - not just for implementation
- ▶ Leverage the project as an opportunity to push further simplification, standardization and industrialization
- ▶ Approach Cost Efficiency as a regular and ongoing process which is closely linked to the corporate culture and leadership principles, rather than being a one-off project executed under emergency conditions

With these considerations, clients will ensure that cost reduction projects deliver more than short-term cost reduction but genuinely support the company in becoming "Fit for Future".

Considering the numerous risks when running Cost Efficiency projects, Ernst & Young sees a strong demand and need to share leading industry practices amongst our clients. In order to provide a sound basis for this discussion, Ernst & Young has conducted the Cost Efficiency survey 2012 for Switzerland to collect, analyze and share today's experiences from the leading players from Swiss banking and insurance companies.

We remain available for questions and follow up discussions.



*M. Stalder*

**Marcel Stalder**

Partner Advisory Leader Switzerland



*B. Böttinger*

**Bernhard Böttinger**

Partner Performance Improvement

The authors would like to thank all the participants that have contributed with sharing their insight and Ece Tuchs Schmid and Miyuki Lanz for their help in publishing this survey brochure.

# Key findings

While individual circumstances may vary quite substantially between surveyed companies, our survey indicated the following key findings:

## 1 Cost Efficiency has high priority among FSO leaders - especially for Private Banks

We found that 94% of Banks and 75% of Insurance companies have already performed or started initiatives to address Cost Efficiency. The Private Banking industry is especially exposed by the trend towards Tax Transparency, client behavior and markets. Therefore they prioritize reducing the operational cost base. The burning platform for most players is created by high levels of investments in growth markets, high cost for implementing regulatory requirements combined with substantial asset outflows.

## 2 Saving targets are significant and will require substantial changes of current strategy and business model in many cases

A majority of respondents stated significant savings targets: 48% indicated targeting 5-10% of the operational cost base; another 40% respondents intend to reduce their cost by 10-20%. Achieving these targets and simultaneously investing into growth opportunities and improved service quality will require an adaptation of strategy and both business and target operating models in most cases. We see the high ambition levels also as an indication that Cost Efficiency is seen as a constant challenge going forward and as a part of the "new normality".

## 3 Key challenges vary amongst Banks and Insurers

In the perception of the key challenges for the industry going forward, we found various differences between Banks and Insurance companies. Most commonly stated challenges for Banks are "Cost of implementing regulatory requirements" and "Delivering compelling proposition to acquire customers", closely followed by "Growing customer attrition". Those factors are named more often than "Cost / income ratio" and "Increased competition". Insurance companies focus on demand side by putting forward the "Increased customer empowerment" and "Increased competition for customers" as underlying primary driver and put those before "cost / income ratio" and "compelling client propositions".

## 4 Major areas for efficiency improvement identified

Respondents indicated that whilst their organization's cost awareness is already quite high, there are still areas for significant efficiency improvements. Optimizing the distribution and support models (front-to-back-approach), reduction of duplications within the company and a streamlining of the client service catalogue have been named as options. Additional opportunities are setting up or optimizing shared service centers, as well as outsourcing non-core functions. Our conclusion is that a lot has already been done to reduce the cost base and therefore further progress can only be achieved with more radical changes to the business and operating model.

## 5 Key Success Factors

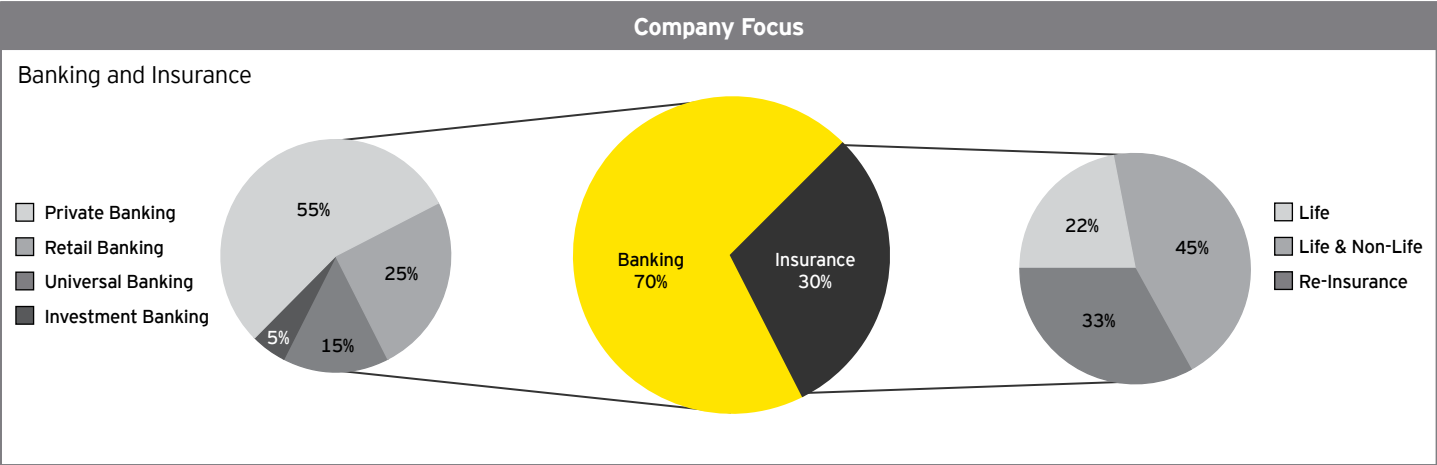
The survey highlighted "Strong top management support" (92% of respondents) as the most crucial success factor. It was followed by "Clearly set goals" (64%) and "Deep industry know-how" (56%). "Good project management" and "Clear methodology" appeared to have lesser importance. This underlines the crucial importance of top leaders' sponsorship and dedication to enforce the success of Cost Efficiency initiatives.

# Detailed survey results

## Survey design

The Ernst & Young Cost Efficiency survey was conducted in February 2012 using an online questionnaire filled in by "C level" executives of major Swiss Financial Services institutions. Survey participants ranged from private and retail banks, to investment banks and Life, non-Life insurance and Reinsurers. The sample was composed of 70% banking and 30% insurance respondents. Bank participants ranged from 170 to 8'200 employees, while Insurance respondents ranged from 215 to 7'000 employees working for those companies in Switzerland.

The sample size of each category is represented on the graphs as follows:



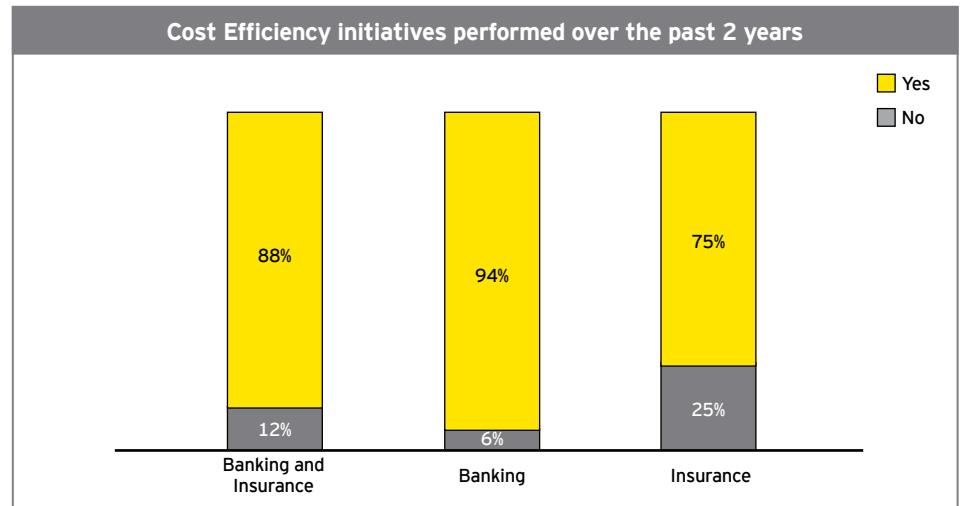
Broad participation across the major industry sectors allows representative conclusions.



## Driving for Cost Efficiency

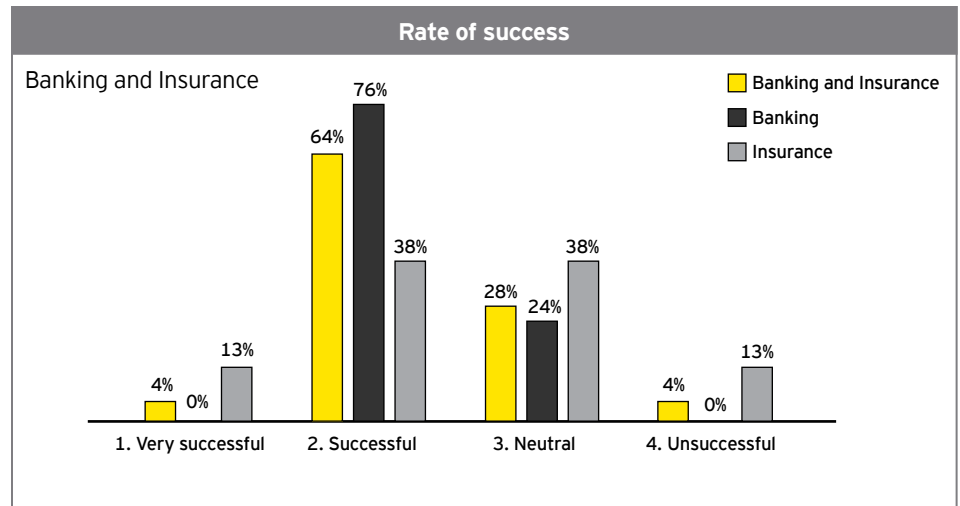
The survey indicates that 88% of respondents active in the Financial Services industry have run Cost Efficiency initiatives within their organizations over the past two years, with vast majority of banks (94%) and somewhat less insurers (75%) having undertaken cost reduction projects. This finding confirms Ernst & Young's view of the crucial importance of increasing Cost Efficiency in today's challenging market environment.

Ernst & Young's practical experience shows that Cost Efficiency is mainly driven by customers' determination and willingness to protect revenues and maintain market share, limited availability and increasing cost of capital, as well as limited growth opportunities paired with rising costs of doing business triggered by regulatory requirements. We also observed that Cost management is often done in "emergency mode" rather than having it established as an integrated and permanent part of the corporate culture.



Of the survey respondents, 64% reported that their Cost Efficiency initiatives have been successful, while 28% were neutral and only 4% indicated their projects as being very successful. While the majority of banks (76%) consider these initiatives as “successful” with none “unsuccessful”, Insurers are mostly choosing “successful” to “neutral” options (38% each). Although these results indicate a high level of satisfaction of respondents with past achievements, the survey authors believe that as market conditions continue to deteriorate, there is room for further improvement and additional efforts in this area.

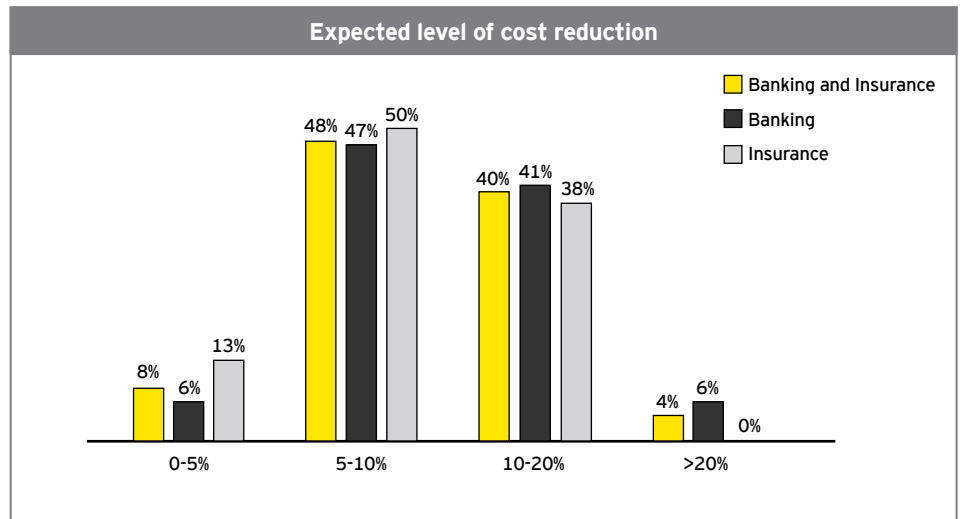
While these answers reflect a rather optimistic perception of the achievements, further international Ernst & Young research studies also showed that 70% of Financial Services companies failed to sustain results of the cost reduction program 3 years after its completion, demonstrating a less positive view in the ability to deliver sustainable results over the economic cycle (see chapter “Ernst & Young’s solution”).





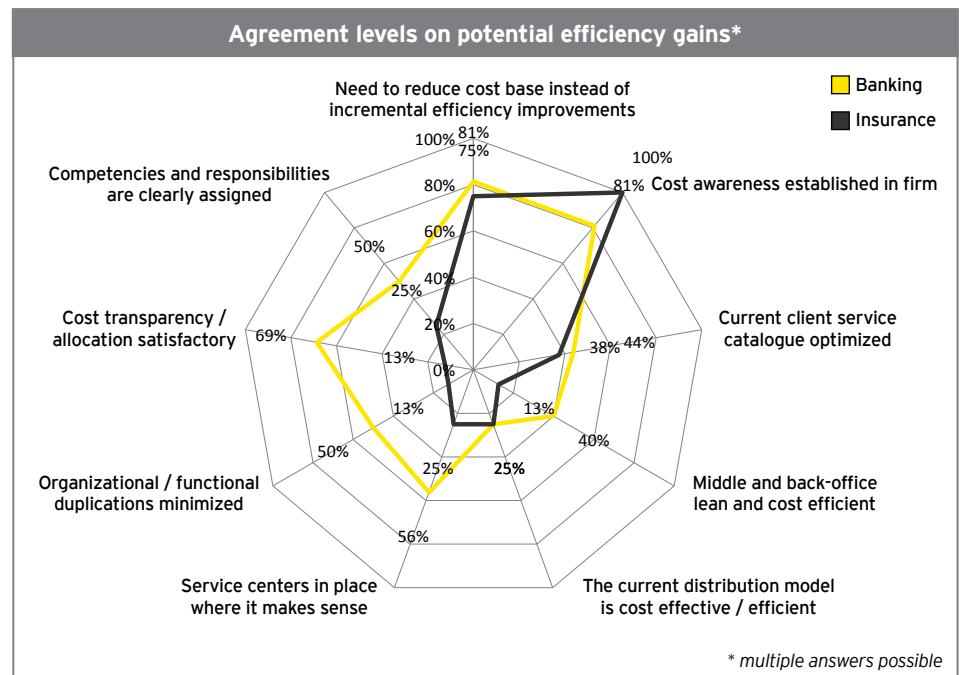
## Efficiency targets

The high ambition level regarding cost reduction in our survey results clearly reflects current market pressures on Financial Services organizations: 48% indicated a target of 5-10% of the operational cost base; another 40% respondents are intending to reduce their cost by 10-20%. Achieving these targets and simultaneously investing into growth opportunities and improved service quality will in many cases require an adaptation of today's strategy and business model as well as the underlying target operating model. This finding is aligned with our project experience and conversations with executive leaders.





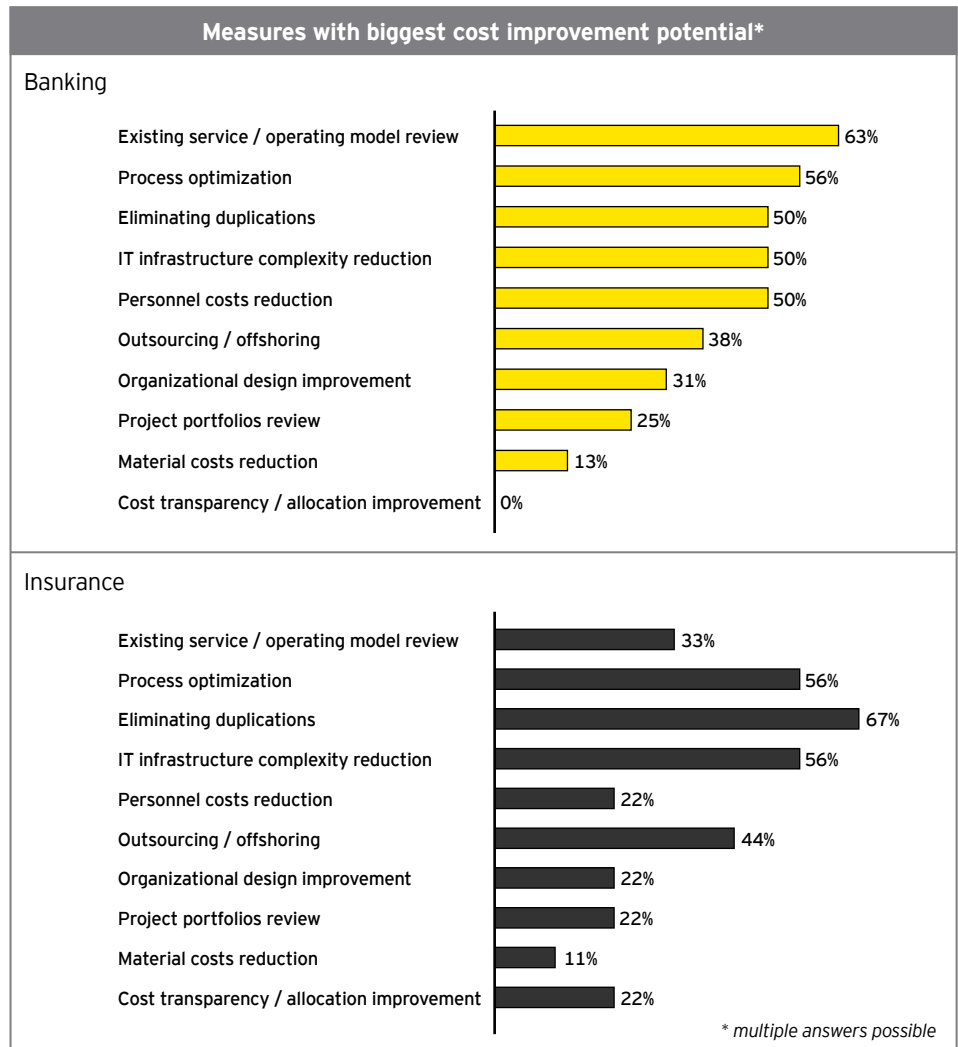
Respondents strongly agree that cost awareness is well established in their firms. Nevertheless, the analysis of the other agreement levels shows that the survey participants see a clear need for a step change of the cost base and do clearly disagree that incremental improvements are an appropriate way forward. The answers also indicate room for improvement in a variety of other areas: higher cost effectiveness in distribution and middle and back office and optimized services & product catalogue are the most prominent. Whereas agreement levels are relatively low (and vary substantially between Banking and Insurance) for the following areas: clearly assigned competencies and responsibilities, minimized organizational duplication, use of service centers and satisfactory cost transparency and allocation.



## Measures with biggest potential

Most respondents see greatest improvement potential in areas of "Process optimization" and "Eliminating organizational and functional duplications / centralization" (56% each), followed by "Service catalogue / operating model review" and "IT infrastructure complexity reduction" (52% each). Outsourcing and personnel costs reduction earned 40% of votes each. Material costs reduction as well as cost transparency / cost allocation improvement are the least sought of (12% to 8%).

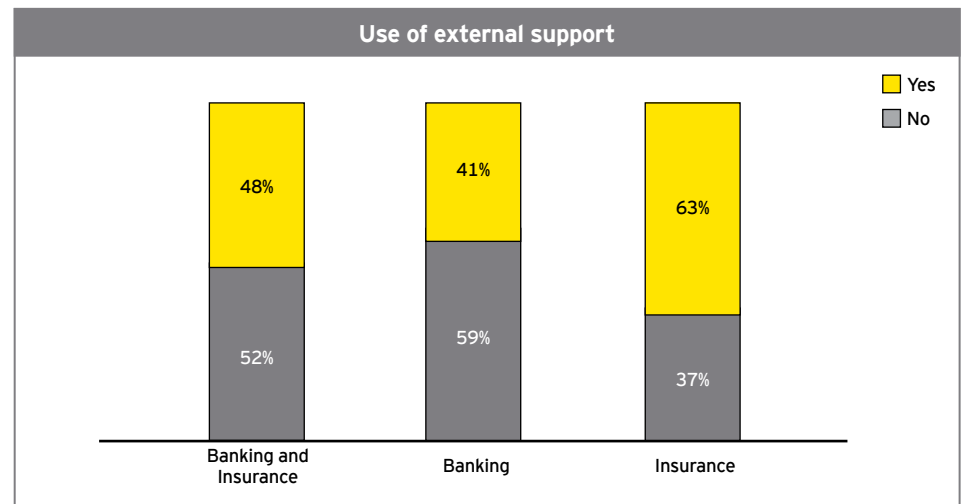
Banking and Insurance respondents' opinions diverge in their view of Cost Efficiency measures. Insurance respondents are in line with the total sample distribution, naming elimination of the organisational and functional duplications (67%), as well as process optimisation and IT infrastructure complexity reduction (56% each) as factors with greatest cost reduction potential. Banking respondents favour a review of the existing service catalogue and operating model (63%), followed by process optimization (56%). Personnel cost reduction is seen as an important factor by half of the banking respondents, while they merely account for 22% of insurance votes. Material cost reduction was considered as least important, accounting for slightly more than 10%.



## Use of external support

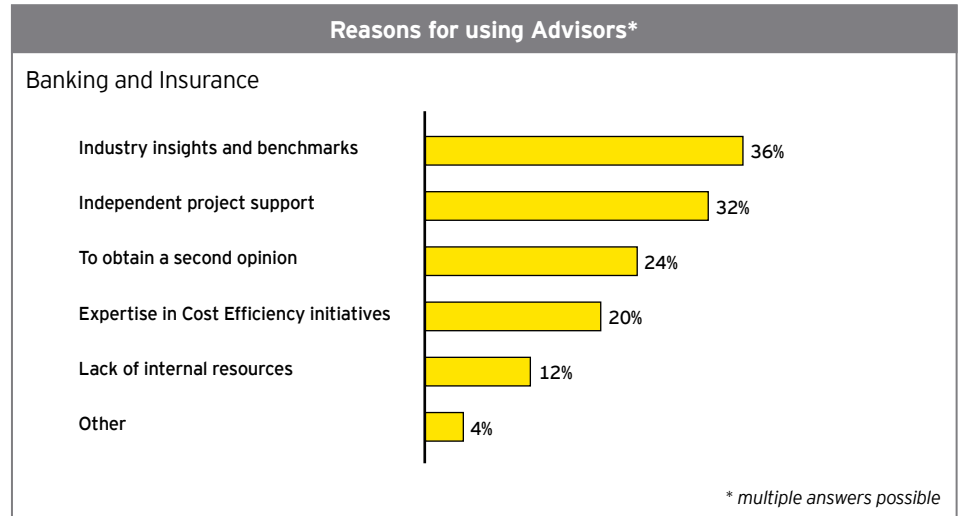


Roughly half of respondents (48%) make use of external support to run the Cost Efficiency initiatives. Banks rely on internal capabilities for roughly 59% of the Cost Efficiency initiatives, while insurers rely on external support in 63% of the cases. Survey authors find this percentage relatively low in comparison with the large number of cost reduction projects currently run with the support of consulting firms. A possible explanation is that a high number of Cost Efficiency initiatives are very much focused on specific areas, processes or cost blocks and are therefore conducted using in-house capabilities. Whereas overarching Cost Efficiency projects tackling the organization as a whole mostly make use of an independent external advisor according to our experience.



“Besides a proven methodology and deep industry insights, we expect from our Advisor to challenge our thinking with fresh ideas”  
*Client CEO*

The most commonly stated reasons for using an advisor are “Need for external industry insights and peer benchmarks” (36%), followed by “Need for external and independent project support” (32%) and “Need for second opinion” (24%) for the whole Financial Services sample. These results give a clear indication of the reasoning behind using external sparring partners for this type of projects. External Advisors are expected to bring “out of the box” thinking and to establish an objective fact-base in order to offset internal politics and apply leading industry practices.

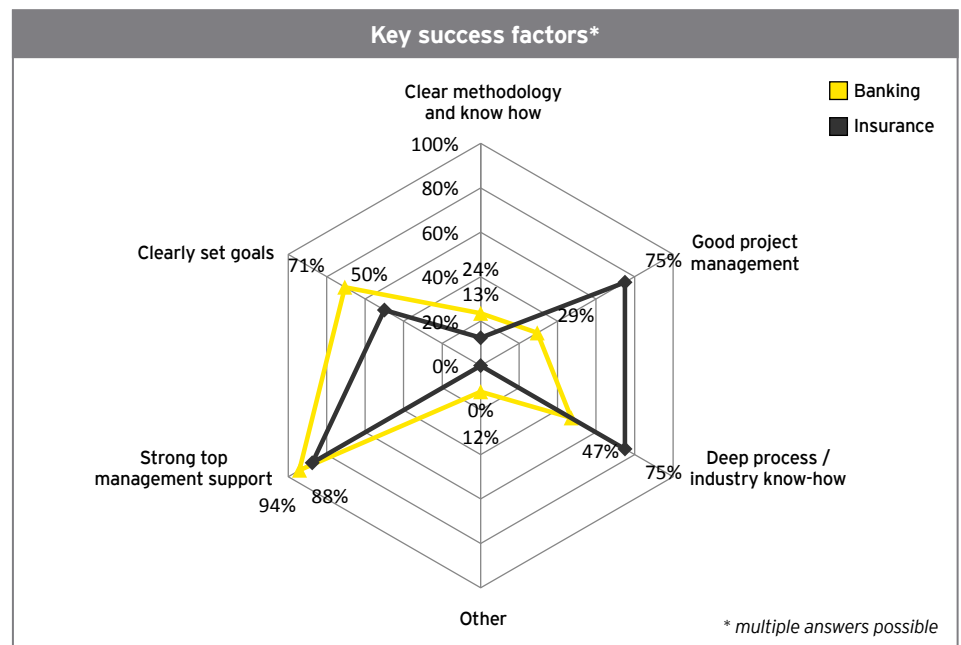


### Key success factors

In order to share good experience among the industry leaders, we have asked the survey participants what has been key for successful projects. Banks and Insurers clearly see management support (94% and 88%) as the most important success factor.

This finding underpins Ernst & Young’s hands-on experience showing that C-level executives’ support and buy-in are the most important factors for running successful Cost Efficiency initiatives. “Clearly set goals” and “Deep industry and process know-how” (40% each) are equally seen as major aspect of the successful Cost Efficiency enterprise. “Personal commitment of all employees” is noted as an additional factor.

Top management support and clear goals are seen as the most important conditions for making the projects a success

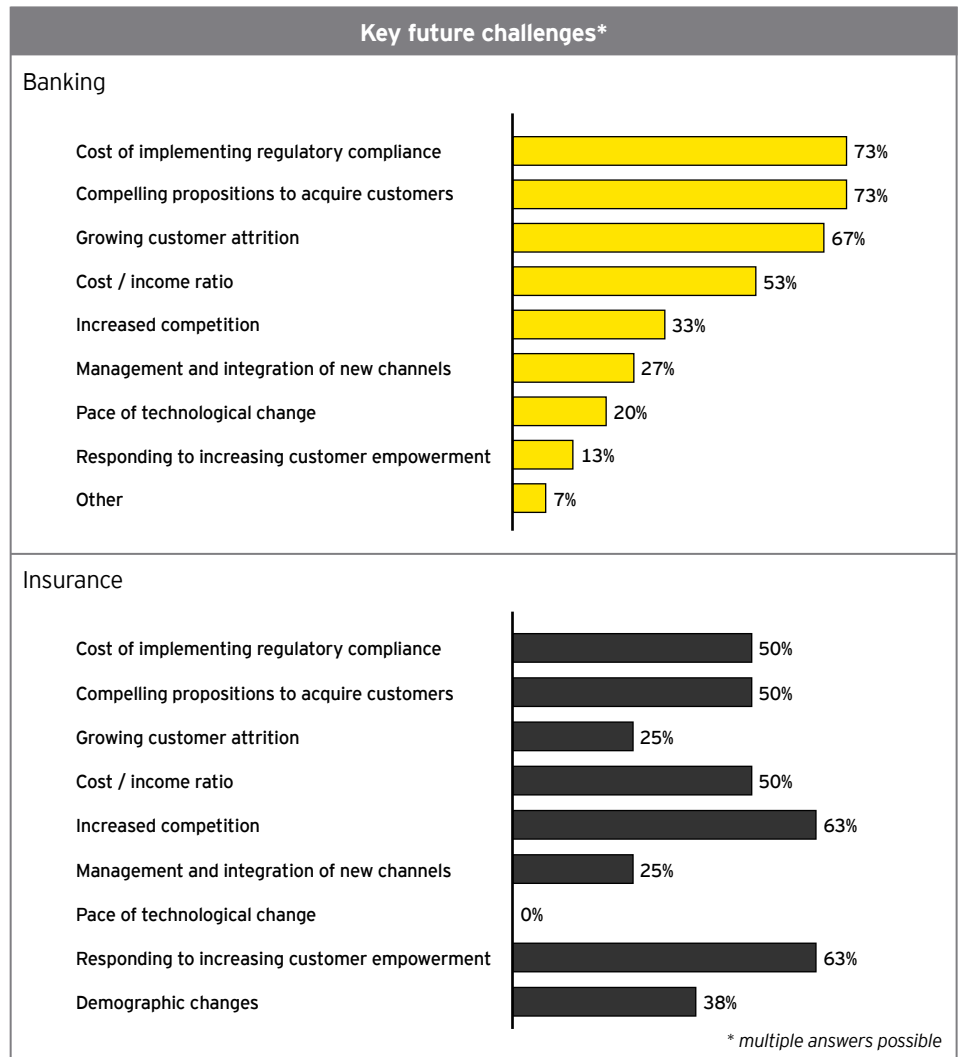


## Future challenges

The key future challenges voiced by Financial Services respondents are “Cost of implementing regulatory compliance” and “Growing customer attrition”, accounting for 60% to 70% of responses. This finding is confirmed by Ernst & Young’s practical experience of running most of its current large business transformation projects in Switzerland in the regulatory compliance area.

Additionally, for companies active in banking, the key challenges facing business over the next five years are “Delivering a compelling proposition to acquire new customers” (73%) and “Cost / income ratio” (53% each), followed by “Increased competition for customers” (33%).

In view of Insurers, the key challenges are evenly distributed between various topics ranging from “Increased competition for customers” and “Responding to increasing customer empowerment and requirements”, accounting for 63% each. “Cost / income ratio”, “Delivering compelling proposition to acquire new customers” and “Cost of implementing regulatory compliance” accounted for half of the voices. Topic “Pace of technological change” was not of interest for Insurance respondents.

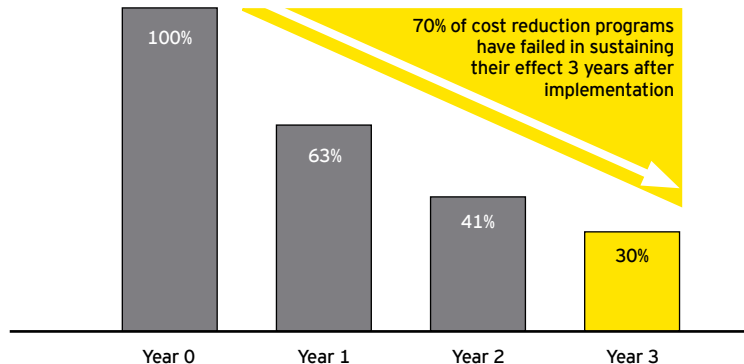


# Ernst & Young's solution

## Cost Efficiency program challenges

Based on a vast number and variety of Cost Efficiency projects in various industries, Ernst & Young has developed a structured standardized approach to cover either the full breadth of Financial Services Organizations or specific areas. This approach acknowledges the material risk linked to these projects, as well as its classical pitfalls. These may include project lead positioned too low in the organizational hierarchy, blind faith into benchmark data, challenging time line forcing the project team to "jump to conclusions" and the application of unsuitable methods (e.g. the Lean Sigma approach should be used for continuous improvement but not for a significant short term cost reduction).

Ernst & Young research and practical experience clearly show that approx. 70% of the projects do not produce a sustainable saving effect. A number of challenges are leading to this alarming result:



Ernst and Young has identified the following challenges in Cost Efficiency program delivery:

- ▶ Political aspects determine the priority of proposed measures
- ▶ Focus on implementation instead of enforcement planning
- ▶ Missing incentives and enforcement plan for achieving the goals
- ▶ Cost postponement instead of cost reduction
- ▶ Temporary and isolated measures
- ▶ Missing consequences and no sustainable change in company culture
- ▶ Underestimated costs and time needed for implementation
- ▶ Saving on wrong areas may be counterproductive
- ▶ Insufficient data quality may lead to taking wrong decisions
- ▶ Interdependencies with other ongoing initiatives

Without a real change in the company's culture, achieved savings will be lost rather quickly

## Ernst & Young Cost Efficiency approach

Thorough consideration of Cost Efficiency challenges for mandates and project setup is therefore key for successful implementation. Ernst & Young's Cost Efficiency approach works within the themes of Complexity, Cost and Confidence and looks across eight cost improvement levers, focusing on drives of cost to deliver sustainable value beyond 'across the board' cuts.

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Cost Efficiency can help you developing a differentiated and client-focused business model which fits the structural changes of the Financial Services industry

The launch of operational cost base reduction projects creates stress and uncertainties for both organization's employees and management. Diligent and proactive planning and preparation are key to avoid unnecessary re-work. A structured approach allows to rapidly identify organizational measures representing a substantial amount of the overall efficiency gains. A review of the strategy, service / product catalogue and the current organizational setup is substantiated by detailed analysis of financial and operational data. As next step it is underpinned with pragmatic examples from leading Financial Services organizations. Sustainable measures to increase efficiency of the organization and its processes can be achieved within a short amount of time through a review of sourcing model and strategy. Such analysis has a positive impact on the whole value chain: Client Advise and Distribution, Operations and supporting function like Finance, HR, Procurement and Marketing.

Ernst & Young's approach has proven to be successful in identifying tangible measures, which take into consideration strategic growth targets and minimize negative impacts on the client experience.

Our experience clearly shows, that success rate of Cost Efficiency initiatives is higher if those are driven by the top management, executed rapidly and supported by independent advisors. An external partner can contribute by bringing in a clear methodology, deep understanding of industry and core processes. A sustainable success will be achieved if the identified Cost Efficiency measures are widely accepted by the company's employees.

# Your contacts in Switzerland



**Bernhard Böttinger**

Partner  
Performance Improvement Leader Switzerland  
Ernst & Young  
Maagplatz 1, P.O. Box  
CH-8010 Zurich

Tel +41 58 286 46 92  
Mobile +41 58 289 46 92  
Fax +41 58 286 30 04  
Email [bernhard.boettinger@ch.ey.com](mailto:bernhard.boettinger@ch.ey.com)



**Bernd Karrer-Müller**

Manager  
Financial Services Advisory EMEIA  
Ernst & Young  
Maagplatz 1, P.O. Box  
CH-8010 Zurich

Tel +41 58 286 46 26  
Mobile +41 58 289 46 26  
Fax +41 58 286 30 04  
Email [bernd.karrer-mueller@ch.ey.com](mailto:bernd.karrer-mueller@ch.ey.com)



**Anastasia Pushkina**

Senior  
Financial Services Advisory EMEIA  
Ernst & Young  
Maagplatz 1, P.O. Box  
CH-8010 Zurich

Tel +41 58 286 32 47  
Mobile +41 58 289 32 47  
Fax +41 58 286 30 04  
Email [anastasia.pushkina@ch.ey.com](mailto:anastasia.pushkina@ch.ey.com)



**Stefan Eigenmann**

Manager  
Financial Services Advisory EMEIA  
Ernst & Young  
Maagplatz 1, P.O. Box  
CH-8010 Zurich

Tel +41 58 286 35 65  
Mobile +41 58 289 35 65  
Fax +41 58 286 30 04  
Email [stefan.eigenmann@ch.ey.com](mailto:stefan.eigenmann@ch.ey.com)



**Martin Gertsch**

Manager  
Financial Services Advisory EMEIA  
Ernst & Young  
Maagplatz 1, P.O. Box  
CH-8010 Zurich

Tel +41 58 286 43 40  
Mobile +41 58 289 43 40  
Fax +41 58 286 30 04  
Email [martin.gertsch@ch.ey.com](mailto:martin.gertsch@ch.ey.com)

$\pi = f + y$

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