Breakthrough IT banking

Some Asian banks achieve superior returns despite relatively low IT expenditures. What's their secret?

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Banks have long relied on technology to introduce products such as online banking, ATMs, and mobile payments, and to improve back-office efficiency. But that reliance comes with a price. Globally, the banking sector spends an average of 4.7 percent to 9.4 percent of operating income on IT, while other sectors spend less: insurance companies and airlines, for example, spend 3.3 percent and 2.6 percent of income, respectively.

Our Asian Banking IT Benchmarking Study[1] finds, however, that a bank's high IT expenditures do not always correlate with superior performance. Some banks with large IT budgets often have trouble leveraging investments to generate commensurately high revenue growth and operational efficiency. Survey data show that 66 percent of banks with higher-than-average IT spending relative to income generated lackluster results, with revenue growth 0.4 percentage points lower than the industry standard and a cost-income (C/I) ratio 2.5 percentage points higher.

By contrast, 23 percent of the 44 banks surveyed outperformed the market on both revenue growth (up 10.9 percentage points) and C/I ratio (down 4.6 percentage points) while spending 29 percent less on IT than other banks in our study. These outperforming banks are more likely to view IT as a strategic enabler, and their investments mirror this outlook. Outperformers direct a higher share of spending toward technologies designed to create new business value and a lower share of spending on support operations, such as finance and human resources. These banks are also more likely than the lower performers to promote efficiency through a consolidated IT footprint as well as formal vendor- and demand-management practices.

The common denominator linking high-performing Asian banks is a commitment to strong governance and spending alignment with the needs of the business. This finding supports our experience with bank clients in Europe and the Americas, and prompted us

[1] The 2010 biennial McKinsey Asian Banking IT Benchmarking survey comprised 44 banks across 11 Asia-Pacific countries, with the results tracked against prior year benchmarks from 2006 onward.

Takeaways

Banks that reap better returns from lower expenditures on IT accomplish a stronger alignment between IT spending and organization strategy than do their high-spending competitors.

These top institutions have slimmer application landscapes, use common-asset databases and standardized hub-and-bus interfaces, and are hesitant to use custom applications; they save space with techniques such as server virtualization, employ better data governance, and rotate staff often, in order to facilitate collaboration.

to explore what high-achieving Asian banks do to optimize results from their IT investments.

Characteristics of high-performing Asian banks

Top banks align IT capabilities and spending with business strategy

Banks that achieve superior returns for lower IT expenditures, a group we call "effective business enablers," are much better at aligning IT spending with the organization's strategic priorities. These high-performing banks spend 14 percent less than those in the bottom quadrant of our survey on day-to-day support for IT functions, such as finance and human resources, and more on business-functionality and operational-efficiency improvements such as business intelligence and back-office automation. Top Asian banks are not alone in achieving success with this approach. One high-performing North American bank eked out $100 million in savings by optimizing IT capital expenditures, blunting the effects of the 2008–09 economic crisis on the bank's operating budget.

While many banks strive to capture this efficiency, effective business enablers often maintain a more rigorous demand-management process to govern project selection and funding. One large bank, for instance, calculates the projected return on investment for each application-development initiative it approves and plots the performance on a business scorecard that is reviewed by the management function. This procedure reduces the number of noncritical projects entering the pipeline.

Top banks are also more likely to regard the CIO role as a true C-level position. CIOs at 78 percent of the banks in our effective-business-enablers category report directly to the CEO, compared with just 54 percent of CIOs at the banks in the bottom quadrant. The CEO of one of India's most successful private banks, for example, meets regularly with the CIO to discuss business-IT strategy. This collaboration shapes the bank's IT road map, knitting deliverables with business strategy and contributing to the bank's reputation as a leader in technological innovation.

As for outsourcing, top-performing banks are more likely to retain differentiating capabilities, such as application development, in-house and to send more routine work, such as maintenance activities, to external providers. About twice as many high IT spenders (50 percent) as effective business enablers (24 percent) outsource application development. At the same time, banks that are effective business enablers are 5 percent likelier than bottom-quadrant players to outsource maintenance and other less specialized tasks to capture cost and scale benefits.

Top banks manage complexity across multiple IT layers

These top banks cut complexity by using a combination of strong governance frameworks, established architecture-management boards, and streamlined systems environments. Their application landscape features 50 percent fewer programs than those implemented by high IT spenders. In addition, more than 80 percent of banks in our effective-business-enablers group employ common-asset databases and standardized hub-and-bus interfaces (components that move data around) to reduce duplication. Only 42 percent of high spenders do the same. High-performing banks raise the bar for custom applications as well. One top bank, for instance, mandates a strong business justification

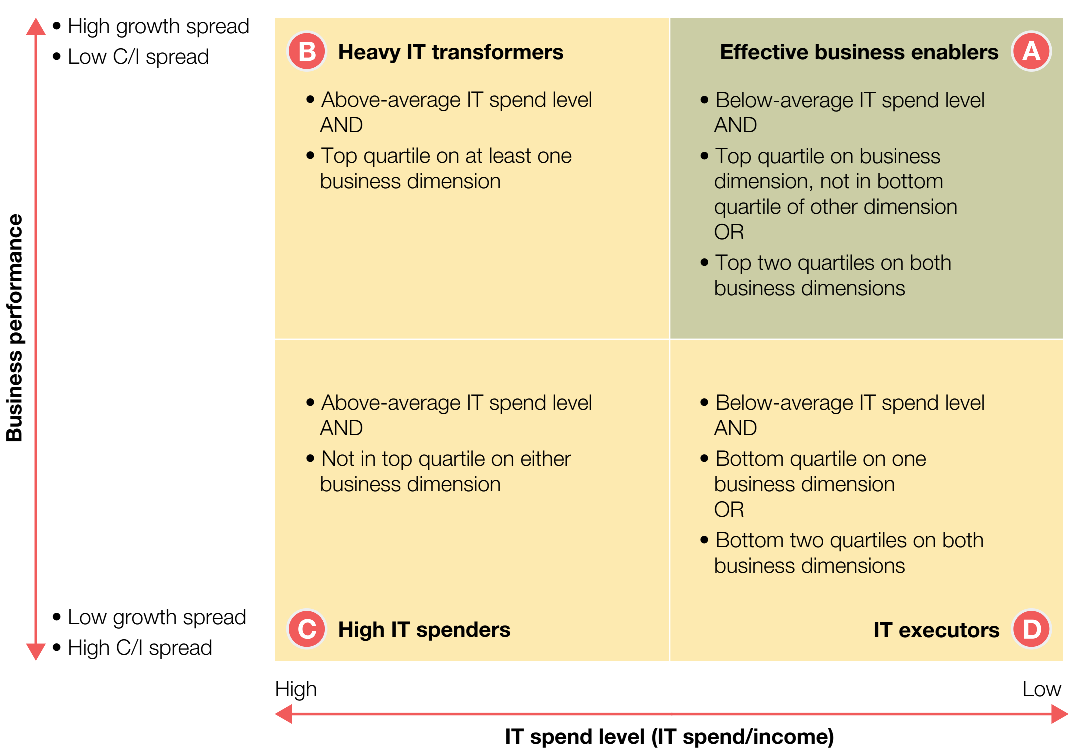
Effective business enablers versus high IT spenders

The benchmark assessed 44 banks' income growth and cost-income (C/I) ratios relative to their respective markets. We also examined IT use across the organization, evaluating more than 250 parameters in seven operations areas: IT spending, business-IT alignment, architecture, infrastructure, project delivery, staffing, and vendor-management models.

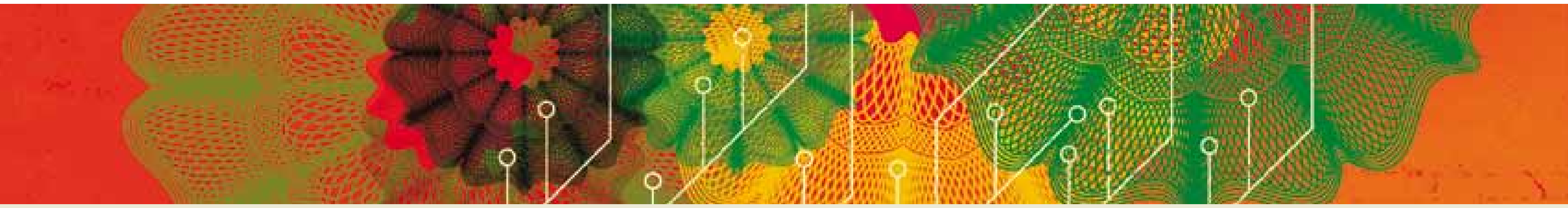
With those results, we assigned banks to one of four categories (exhibit).

Exhibit

ABCD classification methodology.



Source: McKinsey Asian Banking IT Benchmarking; McKinsey analysis



Effective business enablers. These top performers achieved the highest revenue growth and lowest C/I ratios, outpacing the pack by 10.9 percentage points and 4.6 percentage points, respectively, while spending an average of 29 percent less on IT than other Asian banks in our survey. Of the 44 banks surveyed, 10 fell into this category.

High IT spenders. The bottom quadrant (30 percent of the 44 banks surveyed) allotted an average of 9.7 percent of operating income to IT but had the weakest growth (by 0.4 percentage points) and higher-than-average operating costs (by 2.5 percentage points).

Heavy IT transformers. The six banks in this category made the top quartile for revenue growth or cost efficiency, often propelled by “change the bank” transformation efforts such as IT consolidation and automation or new product features. But they spent an outsize share (8.2 percent) of their operating income on IT to reach that mark.

IT executors. The 15 banks in this group spent less than 4.5 percent of operating income on IT, but they failed to convert these expenditures into superior returns. Instead of redesigning their spending portfolio to capture new sources of value, these banks appeared to let their IT strategies “stay the course,” leading to the erosion of both revenue growth and operational performance.

for any custom development project, and further requires specialized features to be modularized and added to a shareable component library.

In addition, top banks are about twice as likely to adopt space-saving techniques, such as server virtualization (to partition existing server space into virtual machines). This practice allows physical servers to carry higher load volumes and thereby increases usage. Greater rigor in designing architecture frameworks, such as common middleware and service-oriented features, helps top-performing banks expand and utilize their infrastructure judiciously.

One high-performing bank, for instance, shrunk a sprawling data-center network down to six sites by increasing capacity at those particular locations. This initiative also made it easier to integrate new volumes, which reduced data-center operating costs by 70 percent.

Better data governance allows effective business enablers to deliver superior analytics capabilities: 78 percent of top banks, compared with only 45 percent of our high IT spenders, provide their managers with some form of value-added data to assist with decision making. Top banks are also more likely to track infrastructure- and

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asset-utilization levels. This transparency helps cut unit costs. Leading banks spend some $500 per banking employee—compared with high IT spenders' $2,000—on, for example, end-user computing.

Top banks invest in resource development and performance management

Talent management is also a priority. To facilitate collaboration, IT-staff rotations are common. One Chinese bank, for example, rotates 5 percent of its IT staff into its business units every year. Such exposure gives the staffers the chance to see their work in context and integrates employees into the overall business culture. Top banks are also more likely than lower IT performers to link compensation to business performance. At two-thirds of leading banks, for instance, variable, performance-based criteria account for 21 percent or more of salaries, which is not the practice at one-third of the high IT spenders. Effective business enablers bring the same performance rigor to their external-provider relationships. Each of the top-quartile banks surveyed maintains some form of enterprise-wide vendor negotiation and selection strategy, to maximize the value captured through vendor relationships.

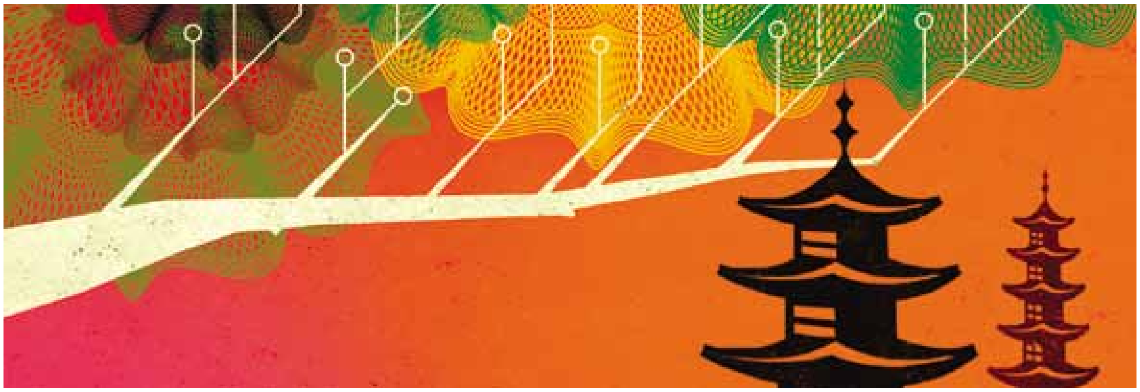
Improving performance one step at a time

While becoming an effective business enabler conveys distinct benefits, remaining one can prove to be a hard slog. Only 69 percent of effective business enablers had retained their position since our last survey. Attrition in this category was higher than that of banks in any of the others. Of the 31 percent that dropped from the top quadrant, about half landed in the bottom one, with the remainder split between the heavy-transformer and high-IT-spender categories.

That slippery footing may have less to do with how high the bar is set than with these banks' missteps. Too often, organizations pursue a high-impact IT transformation initiative only to see the effort derail as the cost, scope, and risks mount. Others allow reform efforts to be directed by technical considerations rather than the larger issues of business-IT alignment, with the result that investment objectives and outcomes often diverge. And still other banks postpone action on business priorities until they get their IT shop in order, which invariably takes longer than planned, leading to tensions with the business and delays in launching market deliverables.

A phased, multiyear action plan limited to two or three initiatives annually often produces better results. A management dashboard that provides access to a handful of core business metrics (usually 15 to 20) can help keep plans on track, foster greater reporting consistency, and allow management a chance to address potential trouble spots.

Incremental performance changes, based on a bank's current quartile position, often work



best. Such initiatives might include the following, per quadrant:

- Effective business enablers. Rebalance investments annually to stay on top of market changes. Build capabilities to exploit emerging innovations quickly.

- Heavy IT transformers. Shore up governance and performance-management techniques to align IT spending with priorities and redirect spending once the current phase of transformation is complete.

- High IT spenders. Evaluate the IT projects currently under management to see which ones offer the greatest economic and strategic benefits and which should be cut. CIO collaboration with the CEO and senior management is especially important in this quadrant to prioritize development and speed delivery.

- IT executors. Increase strategic, front-end investments to build out new sources of income, such as mobile banking, and redirect back-end spending to boost cost performance.

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By viewing IT as a strategic capability and shoring up governance and alignment, banks can roll out innovations at a faster rate and deliver a higher-quality customer experience than they currently do.

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