Learning from the Manufacturing Industries

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Industralisation

Since the late 1990s, many large and regional banks were ridden with heavy cost structures arising from rapid expansion since the mid-80s and more so for banks that had undergone massive and repeated mergers and acquisition. In the aftermath of these mostly non-organic expansions; banks have to embark on organisation restructuring, business process re-engineering, technology upgrading, centralization/decentralization activities and outsourcing strategies to reduce their cost structures. When banks have reached the point where they can no longer improve their bottom lines through productivity improvements and cost reduction initiatives, they have no choice but to explore other options to remain competitive. One such option is to look beyond the banking industry and examine how companies in other industries are delivering sustainable performance while managing their cost components.

Accenture, a proponent of learning from other industries such as automotive and fast-moving consumer goods believes that the best route to high performance is through industrialization[1]. Supported by its extensive research, the consulting company developed a framework and consultancy practice to "help banks gain greater differentiation in the competitive market place while achieving simplification in their operating models". It noted that contrary to conventional wisdom, the back-office contributes about 14 percent of the banks' cost base. Bank's distribution channels and enterprise-wide functions on the other hand account for almost 66 percent and 21 percent respectively of the cost base. While Accenture advised that "banks should focus on reviewing the cost components of their enterprise-wide functions which include information technology, they have to thread with caution when attacking front office costs[2]".

On the other hand, a Jul 2012 article by McKinsey Quarterly[3] on "automating the bank's back office" pointed out that its' research showed that a significant opportunity exists to increase the level of automation in (banks') back offices. The article cited an example involving a large universal bank where almost fifty percent of the full-time employees (FTEs) in operations could be relieved of current back-office tasks if an ideal-level of automation were reached. While cost structures of back office functions vary significantly from banks to banks across countries and regions, it is clear that there are many areas where banks could take a leaf from the manufacturing industries for improvements in cost cutting, productivity and product design.

Some Examples

Global manufacturers are increasingly facing stiffer competition from domestic and regional manufacturers in developing countries that are not only more nimble, responsive to market needs and have lower cost base. According to McKinsey Quarterly's authors, Ananth Narayanan, Asutosh Padhi, and Jim Williams[4], some global manufacturers have responded by "fostering greater collaboration amongst different functional groups (notably marketing and sales, operations, engineering/R&D, and procurement) and are combining deep insights about customers, competitors, and supply bases to strip out costs and amplify what customers truly value".

For instance, a large, low-cost manufacturer of appliances and white goods were losing domestic share in two important, and fiercely competitive, product categories of household fans. After several conjoint analysis of customers' needs on product features and price points, the company conducted a series of product teardowns of it's and the competitor's fans. Just on the fan blades and motor, re-design of some components such as snap-fit cover, smaller shank, shorter spindle led to a savings of 7.4 percent of cost base. The re-designing of the packaging reduces 3 percent in cost due to less usage of cardboard. While the individual cost savings were small, the collective impact helped the company reduced the total cost of manufacturing of its fans by over 10 percent, contributing a 50 percent increase in operating profit in the first year of introduction of the new design.

In previous studies, a manufacturer of forklift trucks found that its customers want to lower cost of ownership, see a reduction in carbon dioxide emission but were not willing to pay a premium for these benefits. After extensive studies, the company was able to reduce the overall weight of its forklift truck by 7 percent (200 kg) through a combination of weight reduction features including use of smaller front wheels. The end result was a reduction in manufacturing cost of 12 percent, 4 percent less fuel consumption and a reduction of 8 tonnes of carbon dioxide emitted throughout the life span of the truck.

Even for consumer goods as common as hair shampoo, a top manufacturer found that replacing clear/white colour cap with dark colour ones can reduce cost of manufacturing by 2 percent per bottle. Printing directly onto bottles reduces 50 percent of printing cost due to the printed label, glue and cost to fix the label. The thickness of the container can reduce about 50% of the bottle materials and the use of rounded bottles instead of rectangular/square ones increases packing density by up to 40 percent per cartoon thereby saving on storage space and warehousing rental. While some bankers may ignore these savings as marginal, they must recognize that the manufacturing industry has razor-fine margin and a small reduction in cost or savings in material use will contribute a significant improvement to the bottom-line given the large quantities produced.

Another often overlooked area is the packaging of the end products. Although Sony still produces attractive and eye-catching smart phones gear towards segments that use these phones for entertainment lifestyle, the packaging size is thrice in terms of cubic volume compared to the recently launched Samsung Galaxy SIII which has a compact box measuring only 150 mm by 80 mm by 55 mm. While no information is currently available for iPhone 5, the packaging for iPhone 4 is 42 percent smaller than for the original iPhone shipped in 2007 – this translated to 80 percent more iPhone 4 boxes fit on each shipping pallet resulting in fewer carbon dioxide emission[5].

Lessons for Banks

Many in the banking industry would argued that financial products are unlike consumer goods where the latter are often mass produced and therefore appropriate application of automation and process re-engineering would likely lead to cost reduction and/or increase in productivity. Financial products on the other hand are intangible but yet important products that help their customers grow and protect their assets. Moreover, unlike consumer products, financial products and services are heavily regulated. This comparison is flawed because industries such as food manufacturing and pharmaceutical companies are imposed with more stringent global and local regulations; other manufacturers not only have to keep cost down while complying with regulations on ethical sourcing of materials, environmental controls and national level trade agreement with counter-parties. Where markets are not well regulated, established manufacturers are often challenged by the ever growing new competitors that are often ready to fill the niche markets or gaps that are not fulfilled by existing product features. It is such challenging environment that makes these industries more innovative, more responsive in terms of product designs and ability to keep cost down while achieving a sustainable level of productivity and growth.

There are several areas where the banking industry could look towards their industrialized counterparts. For instance, it is not uncommon to see credit card companies sending welcome package to their new customers comprising huge stack of promotional vouchers in elegantly printed materials. How often have banks analyzed how many of these vouchers landed in the waste bin without being looked at or the proportion of their customers actually finding some of these vouchers useful? While the cost of producing these promotional vouchers could be funded by the participating merchants, the material wastage and the impact on environment of producing these paper-based products should be considered and evaluated. Even welcome packages for priority and emerging affluent customers are also laden with lots of printed materials that often gone to waste. While some may consider these as one-off expenses per new customers, the mailing of monthly/quarterly magazines, redemption catalogues, new product launches, etc are often printed on non-recyclable glossy and heavy-weight paper that add on to general expenses and increased carbon dioxide emission from tree felling, paper production, printing, mailing and disposal – in the process, incurring the wrath of their environmental conscious customers and stakeholders.

With 3G mobile subscriptions in Singapore exceeding 6 million[6] in 2Q2012, banks operating in Singapore should consider leveraging on the mobile platform to disseminate such promotional vouchers – the rapid adoption of tablet and portable devices would make the mobile medium a more logical choice compared to few years ago where mobile phone screen size hardly exceeds 2 inches in diagonal. While a few banks have started doing so, the majority have not caught up. Besides saving in cost of printing, material and mailing, there are two other advantages: customers are likely to have these 'vouchers' in their possession compared to carrying the hardcopy alternative. As these 'vouchers' are on-demand, customers are likely to use them leading to more sales for the participating merchants. The last but not final benefit is that the delivery and usage is more environmental friendly.

Like banks, manufacturing companies often have to manage and sustain several lines of products concurrently to meet the different needs of their customers. From concept development, research, design, procurement of raw materials, manufacturing, warehousing, marketing, promotion and distribution; manufacturers have to go through these product lifecycle not unlike the manufacturing and distribution of banking products. While bank's products may require more customization to meet the more sophisticated customers, the overall operating framework is similar.

According to a recent Accenture paper[7], its research showed that "high performing banks have been early adopters of industrialized models so that these banks can deliver best in class cost operating performance (that is) balanced with excellent customer service". A white paper[8] published recently by the Asian Banker entitled "Core banking transformation: Five strategies to find the capital within" recommends that "banks continuously separate distribution from manufacturing components". The paper also proposed a "two-tiered factory ecosystem" with the Product Factory taking inputs from the Customer Information System and the Services Engine; the latter responsible for the product's fee, pricing and interest rate based on a set of configurable business rules.

Summary

The aftermath of the global financial crisis have resulted in greater uncertainties in economic and market conditions; revenue growth continues to be difficult to achieve under these weak market conditions. Coupled with the imposition of new regulatory structures including new capital requirements are impacting banks' performances. Although banks are trying to manage their cost and profit levers better through deepening of relationship with their customers, enhancing product mix and pricing decisions; technology platform upgrades, re-organisation, process re-engineering and outsourcing initiatives, many banks have reached a point where they cannot rely on these tried and tested strategies to further improve productivity and achieve sustainable growth.

Studies have shown that high performance banks have taken the cue from the manufacturing industries and have invested in industrializing their organisations – a major task that not only impact the entire organisation but changes the way it operates fundamentally. While many would argue that banking and manufacturing are two distinct industries that require different operating models, there are others who have benefitted from learning from manufacturing companies on how they operate, manage costs and improve operating profits in a sustainable manner amidst the current difficult environment post 2008 financial crisis. Others who think that managing the wide varieties of banking products and customization for different customer segments are complicated may be interested to know that the Coca Cola Company[9] produces over 3,500 types of beverages to cater to varying needs of its customers in more than 200 countries. Even Coke itself has 14 variants – talk about product diversification!

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