ASCENDANT STRATEGY

Why Front-to-Back Modernisation Agendas Fail in Financial Services

– And How to Enable Success?

James Maxfield
Managing Director
Ascendant Strategy Ltd

May 2021

Strategic. Evolutionary. Practical.

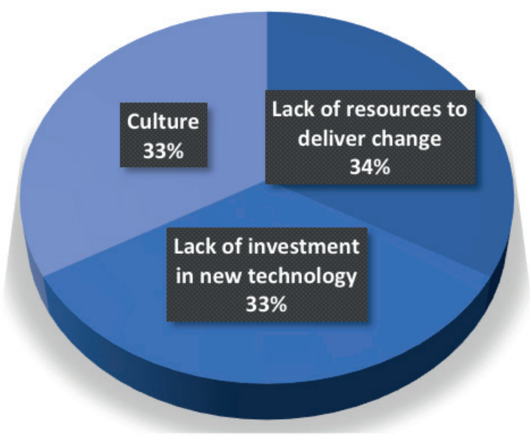
Why Front-to-Back Modernisation Agendas Fail in Financial Services – And How to Enable Success?

The evolution of financial services during the last decade was driven by an overwhelming tide of industry restructuring and regulation associated with fall-out from the 2008 crisis. This dominated management focus and forced business models to adjust (and in some cases pivot entirely to something new) to the new age in which they found themselves. Regulation came at a cost – both in terms of additional capital buffers that needed to be maintained as well as implementation cost associated with compliance – which when combined with declining revenues forced most organisations to adopt radical cost cutting in an effort to remain competitive. In parallel with this, we saw the emergence of new technology which brought disruption to the market-place – both through increased competition (enabled by new innovation) and also as consumer behaviour changed to demand an increasingly digital experience. As the industry emerged into a new decade, digitalisation and business simplification became strategic responses to this new world paradigm – and whilst the pandemic provided a major distraction to these efforts, the criticality of modernisation still remains.

But progress continues to be glacial, with many organisations claiming success around agility, digitalisation and modernisation agendas but in reality, only scratching the surface of the outcomes that could be achieved. And where success is real, it is often localised in pockets – not transformational in terms of enterprise-wide impact. Analysis by IDC estimated that 70% of all digital transformation efforts do not deliver their goals[1] – which shows how much investment gets wasted and as importantly, how often organisations get this wrong.

At a recent conference on back-office efficiency and optimisation, I was invited to provide the opening key-note address. Prior to doing this, I asked the audience via a poll to give their view on the following question, to gauge their perspectives on transformation. The response to the poll is below:

Within your organisation, what do you see as the biggest blocker for transormational change across middle and back office operations?



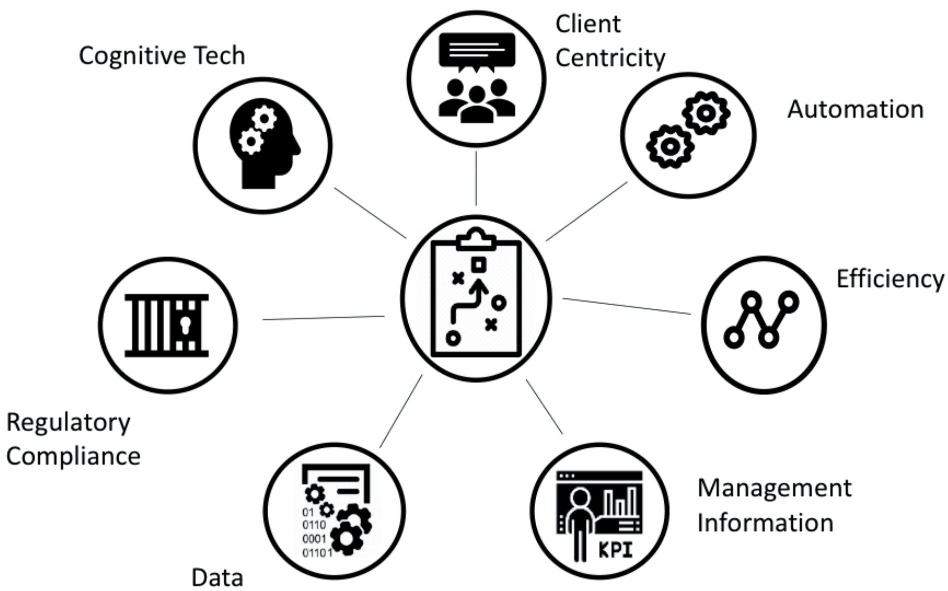
[1] Five ways to accelerate digital transformation, PwC, December 2020

I found this interesting – a third of the audience recognised culture as the most significant blocker to change, whilst two thirds saw this as more of a challenge of budget and resources. Whilst these observations from back office and C-level leaders came from across the financial services spectrum, they served to highlight one of the biggest challenges to Front-to-Back (F2B) modernisation. Let's explore why I think this...

Common Enablers for Financial Services Strategy – And Why They Fail

Glancing through investor presentations, public announcements of strategic direction or talking directly to senior leaders within banks – there is a distinct commonality to the levers that organisations are looking to pull (as outlined below). That is not to say there isn't differentiation across markets and geographies between competitors, but it does highlight how organisations are looking to enable their objectives. And what is common to all of these is the overwhelmingly front to back (F2B) nature of each of them.

Common Enablers of Financial Services Strategy



But for organisations that struggle to execute on their modernisation agendas – does this mean that they are pulling the wrong levers? Or is this merely a matter of inadequate resourcing? (as per the majority of the respondents in the poll). Whilst there maybe some elements of both of these at play in certain circumstances, there is another much more fundamental challenge at play – organisational design.

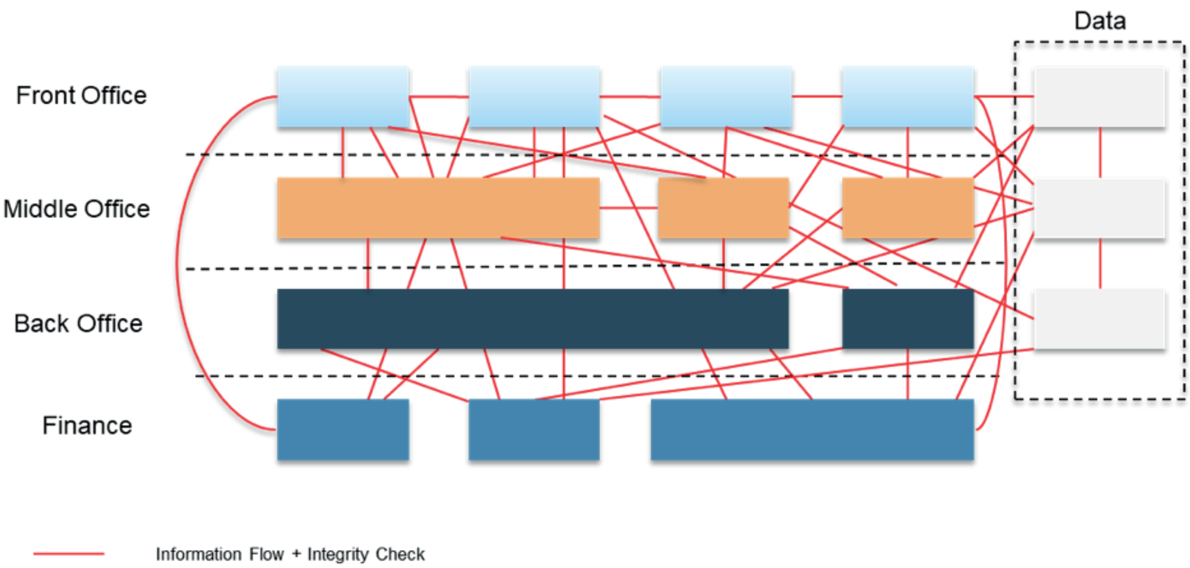
By their very nature, these enablers outlined above cross the functional boundaries within organisations – so to execute on these successfully, objectives must be designed to support this. However, the reality for most organisations is that they are not designed to support this way of operating. Here are a few examples of why:

- 'Customer journeys' are enterprise wide, but usually 'owned' by front office. There is often good connectivity between the client and their entry point to the organisation – maybe via sales or a client service team. But digitalisation or efficiency initiatives often founder as they move down through the value chain and require engagement (or perhaps data) from other functions.
- Data is mostly federated across systems and processes. So, in the example above, requiring multiple groups to come together to join-up a successful customer outcome. This is a challenge in itself, further exacerbated by a general lack of trust in data – making functional groups protective over using their own data to drive their own processes.

- Organisational design is typically functional in nature, not end to end. Think front office. Think middle office. Think back office.
- Legacy architecture is often designed to address functional objectives. These objectives are often cost, and efficiency driven outside of revenue generating functions. What this means in reality is that disconnects between functions then become further reinforced by the technology decision making of these functions. Making boundaries even harder to cross.
- Functional objectives and goals typically dominate resource allocation. 'What do I get paid for/fired for' drives allocation of scarce resources, and this is rarely dedicated to transformational outcomes (per our poll results)
- Legacy systems and processes are usually organised in silos (horizontal or vertical). The emergence of the horizontal silo – think shared services or 'utilitisation' of services – has become popular as organisations look to drive efficiencies and economies of scale across middle and back office. But it creates further disconnect from the F2B mindset.
- Corporate 'anxiety' over failure/doing wrong things reinforces the status quo. Regulatory censure of senior managers has been a cause of blame for this mindset, but this actually oversimplifies the challenge. The short-term planning (and reward) cycle for most organisations disincentivises risk taking on transformational outcomes.

All of these limit the ability to deliver the objectives that underpin the strategic direction of the organisation – making implementation functional at best for most. And as the diagram below shows, system, data, and process complexity of an organisation further compounds this effect. Functional agendas dominate within this environment, which is why it is not uncommon to see strategic programmes focussed on area such as 'electronic execution' (why not electronic trading and lifecycle management?), 'middle office transformation' (why not F2B transformation?) or 'trader and sales communication channels' (why not F2B communication channels?). Success within this environment becomes mainly controlled within the function – limiting the strategic outcome and in most cases, making success superficial.

Typical System, Process & Data Design in Financial Services



And Organisational Complexity is Compounded by Management Mindset

Most organisations encounter the conflict between revenue generating functions and the traditional cost centres. This often becomes personal and is detrimental ultimately to strategic aspirations of the firm. As the conflict persists, siloed mentalities become further entrenched leading to a lack of connectivity and the commonality of goals required to succeed dissolves. Whilst simple as an organisational challenge to diagnose, the reality is that CXO's don't always understand the fundamental conflict this creates with their strategic goals and why they fail to deliver on their objectives.

Let's take a look at what this looks like in practice and how this mindset runs contrary to the F2B objectives that organisations are pursuing to modernise their business models. And why it creates tension.

Cost Centre vs Revenue Generation Mindset

Cost Centre

- Cost justification
- Functional agenda
- Revenue not relevant
- Rewards driven by cost performance
- Manage to cost outcomes
- Internally focussed
- Typically risk averse

Revenue Generation

- Business outcomes
- Customer journeys
- 'Growth' mindset
- Focus on value, not cost
- Externally focussed (Competitor / Market)
- Entrepreneurial
- Typical risk takers

Most corporate functions are run as a cost centre, putting the focus for them in direct conflict with those of revenue generating functions. This lack of alignment is why delivering enterprise wide in pursuit of strategic objectives is so challenging and is also why so many modernisation agendas fail. And whilst many organisations may lay claim to success, this is often superficial as it fails to deliver the full benefits that could have been achieved.

The reasons for conflict between the two are obvious, as there is a clear disconnect between the objectives being pursued and the how success is defined. But alongside this is the 'institutionalising' impact that this conflict creates – which reinforces the mindset in behaviours and limits awareness around how to bring these objectives together. And as I refer back to the feedback from my audience poll, the focus for two thirds of the audience on lack of resources blocking transformation highlights this point. Which is symptomatic of the mindset that dominates most organisations within corporate functions such as middle and back office – the cost centre mindset. This limits cross-functional thinking, as the focus is purely on managing to a cost line – and transformation failure is simply viewed as a factor of resources. Spend more, deliver outcome. When the actual reality of this is quite different. And as the minority highlighted, the real challenge here is one of culture.

How to Successfully Enable Modernisation – Own Your Culture

The first step on the journey for financial services organisations is one of awakening – the realisation of the problem that this embedded mindset creates. And reinforcing these mindsets through the annual planning cycle only makes the challenge harder. But for leaders – boards, the C-suite, business unit owners – who can recognise this, then proactive steps can be taken to address it.

Here are 5 things organisations must consider to enable them to make progress on their modernisation agendas.

1. **Cost management is important but is not a strategy in itself.** Functions must stop being viewed as costs to manage, as this perpetuates the disconnect with the modernisation objectives of the organisation. Where cost is a focus, it should be attacked cross functionally – with agendas set across functional boundaries to incentivise the right behaviour. Not encourage cost justification agendas, which typically foster conflict.

2. **Make strategy real, bringing functions together to address business objectives.** This should focus on driving shared ownership, across functions, for delivery of business outcomes. Leaders should create a narrative and take action to sponsor these outcomes by making their support visible and real. Momentum can be fostered quickly and as progress becomes visible, buy in increases. Celebrating successes and highlighting delivery of outcomes then helps to accelerate progress, providing a real catalyst for change. These are not long tenured activities either – I have witnessed organisations make dramatic changes in the way they operated in a matter of months, where business necessity forced it. And cultural change quickly became evident as a result.

3. **Challenge functional agendas.** There will always be a place for localised functional agendas, but these should sit alongside contribution to business objectives. The role of senior leadership is to challenge where and how resources are allocated – and does this align with the objectives of their organisation? This often requires sponsorship from the top, as there may be conflict between the agenda of the CFO with that of the CEO – but unless this can be addressed, functional objectives will ultimately dominate. And stymie F2B outcomes.

4. **Breakdown hierarchies through dissolving functional boundaries.** Whilst dismantling an organisational construct may not be a quick exercise, aligning resources across functions can be. Creating shared agendas across functions, mobilising a project focus to work on key initiatives and encouraging mobility of people can be quick and straightforward to do. Leaders should adopt an action orientation to encourage this and foster mobility. Within the financial services organisation of tomorrow, where digitalisation has been successful and the business model modernised, the labels of 'back office' and 'middle office' will not exist. They will have been replaced by constructs that are agile, operate cross functionally and are tech-savvy. Leaders should recognise this is coming and start to position their organisations accordingly.

5. **Measure outcomes.** The measurement culture within most organisations is heavily focussed on financial data points – cost, revenue, P&L – which whilst important dominate management attention. As a result, organisational focus is also dominated by this as managers 'manage' to financial outcomes associated with these data points. This must change to both measure progress against strategic objectives and also to make real to management layers the change in focus, so they understand success is defined by different criteria. Alongside this should come the investment in analytics and data intelligence to monitor metrics such as F2B efficiency (and ultimately cost to service), client retention and profitability (to focus attention on the right customer journeys) and levels of automation (and exceptions, to drive focus for investment). These are all commonly referenced as strategic objectives at a macro level by boards, but rarely move away from being little more than concepts. This change in focus will require investment but is essential to moving forward – because as the great Peter Drucker said himself 'if you can't measure it, you can't improve it'.

Much is written about some of the organisational limitations that prevent progress against digitalisation within financial services – a lot of which echoes the sentiments of my audience I referred to at the start of this article. And some of these – such as legacy technology or transformational capability – will be limiting factors to success. But these should be viewed as by-products of the culture of the organisation – functional agendas influencing technology decision making or the cost centre mindset limiting resource bandwidth – not the fundamental root of the problem. To deliver on the agendas to implement the digitalised business models of tomorrow, culture and mindset have to adapt. Organisational culture can be long tenured to change, but progress can be rapid if the right behaviours are adopted, and behaviours encouraged. Those organisations that are able recognise the need for change and mobilise accordingly will be at a significant advantage to their peers in the battleground for economic sustainability. Which will ultimately be defined by their ability to digitalise and modernise their business models F2B.

ASCENDANT STRATEGY

Take control of change, with a partner you can trust.

If you need to deliver complex transformational change with rapid positive impact, contact us today

Visit **ascendant-strategy.com** for further information
Email us at **contact@ascendant-strategy.com**