strategy&

Fit for Growth in financial services organisations

Practical lessons from Asia and Australia

Introduction and context

The financial services industry across the world – from Japan to Australia and South-East Asia, to Europe and the Americas – is under threat from a number of factors:

- Interest rates remain at record lows. Although these bring cheaper capital, they also reduce the returns that financial services firms can generate.
- Regulation has intensified since the global financial crisis, and this is expected to continue.
- Companies are increasingly focusing their efforts on the needs of the customer, while there are threats of disruption from new and established players at every corner.
- Although globalisation remains a critical consideration for financial services companies, the largest organisations are starting to be more selective about which parts of a market they focus on.

Against this backdrop, most companies pursue financial targets, such as return on equity, market share, a percentage reduction in the cost base, or a target growth rate, hoping that these will translate into success. But this is not enough. The road to successful transformation is littered with organisations that have failed to transform: either investments did not deliver, costs were much higher than anticipated, or both.

In fact, very few organisations manage for sustainable success, particularly on the cost side of the ledger. They spend their money on the wrong things, or they curtail investments for the wrong reasons, ultimately leaving the company weaker and unfit to compete. In our years of experience and research, we have found that those companies that succeed in the long term adopt an approach that links their organisational identity, strategy and cost base. If your reason for existing is to serve customers and protect their futures, and you can cope with lower profits, then you need to get yourself into the best position to compete more effectively.

This approach brings tremendous benefits. These companies succeed because they assemble a coherent set of choices for markets and customers to select from, and they develop the capabilities needed to set themselves apart from their competitors, based on those choices. Our research has shown that highly coherent companies are more profitable (as measured by EBIT margin over a five-year period), and that those companies that follow a ***Fit for Growth***® approach pay greater returns to their shareholders. This is particularly true in mature, low-growth, post-consolidation industries. Ultimately, it is not one single capability, but the combination of them in service of your company's strategy, that will set you apart from your competitors.

Although the strategy *process* is easy to understand, most companies have difficulty knowing *how* to transform. What should we focus on? How do we create the capacity to invest substantially in building new capabilities? And, most importantly, where do we begin? Without clear answers to these questions, a company is likely to embark on a large program that neither transforms nor yields the envisaged return on investment.

Our experience in working with large, complex financial services organisations across developed and developing markets in the Asia-Pacific region has shown us that, for a financial services organisation to transform successfully, its leadership team must do five things:

1. Be collectively aligned as a leadership team on the problems that must be solved, and what can be traded off in order to solve them – then have the courage to make the big decisions.

2. Know which capabilities will help the company to differentiate itself, which ones to over-invest in, and which ones are superfluous. This helps them link together strategy, capabilities and costs.

3. Deeply understand the organisation – not just its unique capabilities and structure, but also the activities and interdependencies that contribute to its cost base. This allows leaders to clearly identify 'good' and 'bad' activities and their effects on costs.

4. Make sure the organisation is *ready* for change. This is particularly important at the early stages of the process.

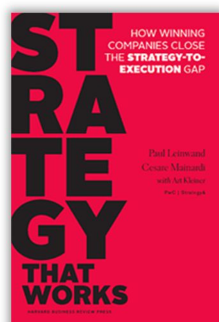
5. Recognise that updating an operating model involves not only changing structures and processes – it also means redesigning the business to encompass formal and informal levers of an operating model (as defined in *Fit for Growth*).

For a company embarking on a transformation, the most crucial decision is: where do we start? If there is not a shared vision throughout your company, your leadership team must firstly come to a unanimous view on the following questions:

- Where is our organisation today?
- What will our strategy be?
- How will we get there?

If most of the company is not ready for change, focus your early efforts on changing mindsets and making sure people understand and support the shared vision. By starting at the right place, and following the steps set out in this paper, your company can transform itself, using the ***Fit for Growth*** approach.

Fit for Growth *is a guide for senior executives and middle managers on how to align their company's costs and organisation with their strategy so they can grow, create value, and sustainably outperform competitors.*



Based on new research, the book ***Strategy that Works*** *reveals five practices for closing the strategy-to-execution gap used by today's winning companies. Packed with tools executives can use for building these five practices into their organisation, it is a powerful guide to connecting where enterprises aim to go and what they can accomplish.*

Five prerequisites for transformation

1 Collectively aligned leadership team

The leadership team must **agree** on the long-term goal, the reason for transforming, how the company will achieve this, and – most importantly – what it can trade away in order to get there.

Every organisation is familiar with the 'strategy offsite': the executives get together to discuss issues that they consider important, and some of their conclusions then make their way into strategic plans. But the lack of a shared understanding – both overt and subtle – makes such discussions less fruitful than they should be.

We often find that, while leaders can usually *explain* the strategy to others who were not present at the discussions, they have different understandings of the roles each one of them should play – collectively and individually – in *achieving* that strategy. So leaders must take the time to **reach a shared understanding** of the links between different functions, the role each of them plays in the ecosystem, and who has the authority to make what decisions.

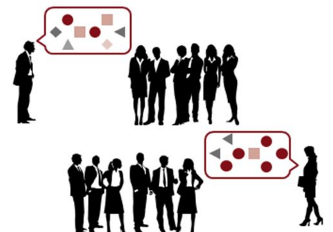
To achieve this shared view, **individual discussions** are essential, because they often reveal diverging views that would never come to the surface in a group forum. In many ways, Japanese firms have done this for a long time, using a process called *nemawashi*, which can be translated as 'preparing the ground'. (In Japan, disagreement, even of a respectful nature, is avoided in formal group meetings. The real discussion work takes place beforehand, in informal settings.)

In this way the leadership group members will not only agree on the vision, but will also trust each other and be able to make sound decisions about reprioritising capabilities and costs. **In essence, this senior team makes a few big and bold decisions for the benefit of customers and the company.**

Misaligned leadership creates ongoing problems:

At a global Japanese bank, there was limited direct communication between Tokyo headquarters, the North American division and Tokyo HQ leaders.

Although executives *said* they were aligned in agreement when coming out of management meetings, in practice they took diverging approaches to managing talent, developing capability and planning for succession.



All this led to inconsistencies in executing company strategy, planning leading to variances in strategy execution.

2 Be clear about your capabilities

Fundamental to getting this right is understanding what capabilities are. A capability is not, of itself, a process or a technology system; it is the right combination of a process, supporting tools, talent, and information flows, which helps a company differentiate itself from its competitors in the eyes of its customers.

More and more, financial services companies are working in ways that call for greater collaboration between different parts of the organisation. This often requires a fundamentally different set of capabilities from the ones that helped build these companies into the successful businesses that they are today.

Companies often over-invest in whatever is the buzzword of the day – real-time pricing analytics, seamless omnichannel customer experience, high-performance culture, digital core, and the like – without articulating what the buzzword really means for *them*. This results in wasted investment, as well as unrealistic expectations of benefits. Closely questioning what a capability will mean for *your* organisation is essential to getting the best out of that capability.

A company that answers this question accurately will understand clearly which capabilities it needs in order to succeed in its chosen markets. It will know:

- what will help set it apart from its competitors (so that it can invest in these capabilities)
- what are the prerequisites for competing in a market (so that it can run these capabilities as cost-effectively as possible)
- which capabilities it does *not* need (so that it can significantly reduce, or even eliminate, these activities) – this is particularly important
- what *specifically* to invest in, and what not to invest in. A company can only be clear on the activities associated with a capability if it gets specific about it.

Getting this level of clarity is again a result of collective agreement among the leadership on what differentiation means **for their company specifically**. Companies often aspire to a gold standard in areas or activities that will give their customers only limited benefits. For instance, real-time pricing analytics could be a luxury in industries where pricing changes are infrequent (and customers place limited value on personalised prices). This sort of critical analysis lets companies free up capital to invest in those capabilities that matter to *their* clients.

So, companies that transform successfully understand which capabilities their business needs, have identified which ones are not required, and are able to define both at a fine level of detail.

Understand and invest in differentiating capabilities

On investigating capabilities with an insurer, we found that real-time pricing analytics brought few benefits in a market where customers placed limited value on pricing and valued service a lot more.

This allowed the company to replace real-time analytics with monthly pricing updates, while investing more in customer service, particularly in processing insurance claims.

3 Deeper understanding of how your organisation really works

What we typically find is that organisations rarely have a deep understanding of the interplay between:

- what customers value
- the company's various activities
- the capabilities needed to succeed in a market
- revenues
- associated costs.

At the same time, staff typically understand their own functions in detail, but know little about the functions of other parts of the company.

The result is an organisation with several silos that understand themselves very well, but not necessarily how they need to work together in service of the customer. Very few executives have a full understanding of the breadth of their business, so it is often worth investing the time to develop this understanding, as it allows you to make better decisions on where to invest and how to manage the business.

So it is essential that a company truly understands itself. This means more than close knowledge of the products and services it sells; it means deep familiarity with the markets in which it participates, identifying where it has the right to compete, and then truly understanding underlying activities, such as:

- where money is spent
- where money is made
- what do customers value
- current activities that do not benefit customers.

This detailed understanding of the organisation and its various activities enables a company to make better, evidence-based decisions about which customers to focus on, where to cut costs, and where to invest. At the very least, it enables a company to deliberately eliminate activities that do not help bring customers the things that they value, or help the company achieve its strategic intent.

Interrogate what really drives your performance

An Asian insurer invested in better understanding the link between agents' performance, their location, the customers they served, and the products they sold. Surprisingly, the biggest driver of performance outside the top quartile was product mix – something the company had never used to influence sales performance.

Similarly, a Japanese life insurer and an Australian wealth manager made channel investment choices after deeply understanding activities and value in different channels.

4 Visualise, and connect emotionally, to be ready for change

We typically find that organisations lurch from one large change initiative to another, with varying degrees of success. Often the company spends a lot of financial and human capital, but does not achieve the envisaged benefits. We also find that most of the accompanying efforts at managing change adopt a one-size-fits-all approach, and cover traditional domains like change-readiness assessments, communications, and process training.

It is worth the effort to make sure your organisation is ready for change – often, it is not about the communication but making sure that people are in the right mindset for the change. This means you have to paint a vivid picture – for all the staff – of what the change would look and feel like.

Rarely does a company pause to help its staff understand and feel connected to the goal – not just intellectually, but also emotionally – or use this period to identify those who are truly committed to the change. This often leads to a generic approach to managing change, which fails to account for three distinct cohorts that are often present within the one organisation:

- **Deeply ready for change:** This seems like the easiest cohort to convince, but if these people are not involved early, and in a meaningful rather than superficial way, this reservoir of enthusiasm and goodwill can be lost. These are the staff who can visualise the organisation's potential and are motivated to fulfil it. Simple techniques to keep this group enthusiastic include:
  - using them to build pride and take their colleagues with them
  - making sure they are involved in designing the new ways of working
  - getting them to evangelise outside their own organisational silos.
- **Superficially ready for change:** These organisations are characterised by pockets of leadership gaps, people who only *claim* to support the vision, and immature processes or capabilities. There is often a disparity in levels of enthusiasm between groups and individuals, an overwhelming focus on why something failed the last time it was tried, and a resistance to changing core activities for the benefit of customers. In such cases, it is critical to spend the time early on to increase maturity and help people understand the vision, before investing significantly in capabilities.
- **Weary of change:** At the far end of the scale are organisations that have been through too many unsuccessful changes and are likely to be unreceptive to new ideas. They are characterised by sceptical staff, a mindset of 'we've tried this before', and reluctance to take on new responsibilities. In such cases, it is essential to demonstrate differences from earlier approaches. We often find that showcasing several small but successful changes is more effective at breaking down barriers than aspiring to deliver a single large change.

It is important to recognise that different parts of an organisation may belong to different cohorts. Companies that transform successfully **make sure first of all that the organisation is ready for change**.

Put your staff and customers first in your change program

A wealth manager sought to reimagine the traditional customer experience in his company's face-to-face channel.

Instead of developing slides and communicating via email, he set up a 'concept store' to showcase the experience, firstly to staff, then to financial advisers, and lastly to customers.

This was one visible symbol in a series of change initiatives aimed at helping staff visualise the future.

5 *Redesign both the formal and informal elements of your operating model*

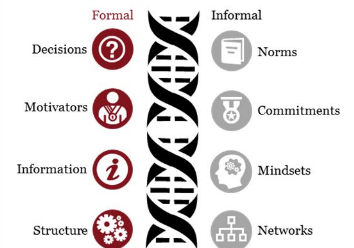
Often, a company will refresh its operating model from time to time, to make it align more closely with its strategy. We find that these efforts typically focus on changing organisational structures and responsibilities in order to make short-term gains. Often overlooked are important tools such as KPIs, linking capabilities with each other, ways of working, desired behaviours, and norms that guide day-to-day interactions.

Successfully reorienting an operating model requires a company to fundamentally redesign its business around those capabilities that will set it apart. In doing so, most think about the formal elements: processes that span across functions, ownership of different capabilities, decision rights, governance. However, they also need to think about the informal elements that help ensure that processes, tools, talent and information come together effectively: success measures, behaviours, ways of working, and mindsets that will help achieve business goals.

The companies that do this successfully recognise that it takes time to redesign the operating model. They know that the first answer is rarely the right answer, and do not shy away from continuing to refine their operating model as the organisation matures.

Understand how you will measure your success

A Japanese insurer defined its most important capabilities, in order to help differentiate itself in the view of its customers – offer innovation and speed to market for new offers – and defined cross-functional processes with clear decision rights to bring accountability and give clarity to staff.



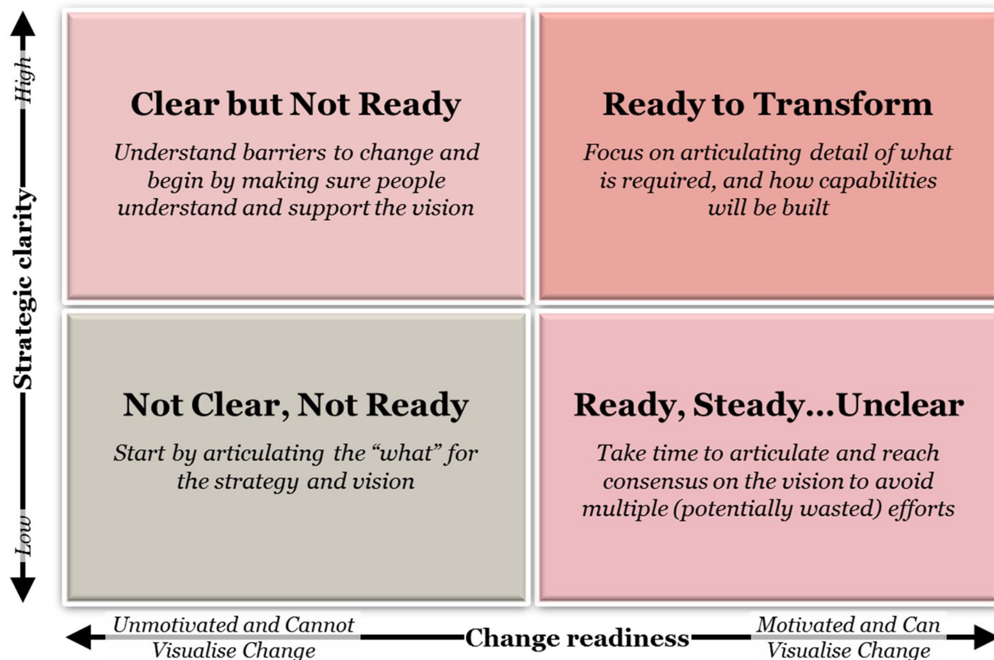
Tied to this was a vastly simplified scorecard that focused on just a few critical outcomes as a proxy for measuring success in building capabilities: customer advocacy, channel mix, staff engagement at different levels in the organisation, and revenue.

The next step …

Companies come in all shapes and sizes, in all sorts of industries. But if we strip away the industry-specific nuances, the core that remains is a strategic process that is largely similar, and five fundamental things that companies must get right in order to transform successfully:

What you must do …	What this means in practice …
Be aligned as a leadership team at every stage: on vision, tradeables and how the leaders interact with each other.	Recognise that you may have to revise structure and refine the operating model a few times as capabilities mature.
Be clear on your capabilities: which ones will help you differentiate, which ones you must do efficiently and which ones are not needed.	Be ready to closely question whether something will help you differentiate, but be prepared to make the final decision as an aligned leadership team.
Know your organisation: which markets to participate in, where value resides, activities and costs, and how they relate to each other.	You must spend time on the detail so that you can bring the organisation together, sharpen your focus, and make informed decisions – not just about current activities but also to define future capabilities and activities.
Be ready for change. If you are not, you must invest in getting ready for change.	It is okay to spend time helping staff to understand, accept and support the vision – both rationally and emotionally.
Understand that an operating model is more than structure. Information flows, decision rights, KPIs, behaviours, mindsets and ways of working are equally important.	Your operating model is not static. Don’t be afraid to change and reallocate decision rights as you mature.

As with any transformation, this is a tall order. The difficulty for most companies is knowing where to begin. In our experience, companies that transform successfully are clear on the purpose of the change, and are fully ready for change. The simple framework below **can help you identify where for your organisation should start.**



So, the first step for a company seeking to reposition its business is to figure out where the company is in these four quadrants. We have found that discussing this together is a powerful way to help bring the leadership team together. To get started, just ask a few simple questions to understand where you are today:

- ***What is our strategy?*** Would everyone articulate it the same way, and is everyone clear on how they interact with each other?
- ***Why will our strategy be successful?*** How will we differentiate ourselves in the eyes of our customers and other partners? Why would they give us their business?
- ***What capabilities do we think we need***, and why do we think these will help us differentiate? Do we all share the same view on this?
- ***How successful have we been with change efforts in the past?*** What are the tangible examples of success, and why were they successful? What lessons did we learn from unsuccessful initiatives?
- ***How involved are our staff with our vision?*** What are staff surveys telling us? What are we hearing through informal networks? Where are the pockets that differ from the norm?

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