

Case Study

Determining Systems Alignment To Business Strategy

When “New” Is Not Necessarily “Cheaper, Faster, or Better”

Acquirer and Acquired

A major east coast financial institution (our client) was acquired by a larger, super-regional institution. In order to achieve the promised economies of the merger, the acquiring (parent) organization planned to convert the acquired (client) company to the parent’s internal information systems platform. w j branan | consulting was asked by the client to determine the impact of completing the conversion and to clearly define any negative impacts on their technical efficiency and “book of business”.

Two Different Worlds

Although the two institutions were part of the same holding company, they could not have been more different in terms of management philosophy, product sets, typical customers, and systems approach. The parent institution was a very large organization that had been built primarily by acquiring smaller institutions and integrating them into a streamlined and fairly rigid retail customer approach. Management philosophy was essentially top-down. Systems and back-office operations were run by a wholly owned subsidiary, and had been built from complex commercial application packages, heavily customized, over a number of years. Many of these systems were running older software versions, as a history of significant alterations to the packages made upgrades in the software expensive or impracticable. The systems unit had significant experience in running large technology projects, but these projects primarily focused on achieving a narrow and limited set of goals within aggressive timeframes.

The client institution, also a product of mergers in a highly competitive market, serves primarily commercial business customers and enjoys a reputation for extreme flexibility in accommodating customer needs. As a result, the organization has acquired and been

able to retain a large portfolio of customers that would potentially be difficult for competitors to service, due to flexible and customized processes and systems that supported all of a customer's requirements. These requirements included a heavy emphasis on outsourced corporate finance and treasury processes including: fraud protection, payroll check processing, check image capture, storage, and research, and other specialized services customized to each customer. Accounting for these services had been integrated into a robust account analysis system through the development of a large number of interfaces to the core processing system. Core processing itself was outsourced, but the application utilized was extremely flexible and well-suited to customization. A significant portfolio of ancillary systems and interfaces had also been purchased to support specific client needs. Finally, the culture of the client organization was one that emphasized serving business customers well by understanding their requirements and efficiently delivering cost-effective products that cemented these relationships.

Management Concerns: Customers, Efficiency and Trade-offs

As the project began, client management voiced three chief concerns. These were:

- That conversion to the parent organization's systems and processes, and the relocation of some key processes to the parent's service centers could result in a loss of management control. This in turn could have a negative impact on the client's efficiency ratio;
- That as a result of the inability to continue to offer critical products, the loss of key product functionality, or potential reductions in service levels, customers might begin to defect to competitors; and
- That decisions on functional, process, and technology gaps, and the trade-offs that would have to be made to effect the conversion, could have a significant adverse impact on the culture of the organization and its ability to serve customers. A method for making rational decisions about trade-offs was needed.

An almost unvoiced concern was that, dependent as the client organization was upon relationship officers to cultivate and retain business, these officers could conceivably

become so discouraged by the loss of familiar process and system support that they would take their “book of business” and defect to competitors with stronger systems. Executive management wanted an “impact analysis” that would show how profits and customer relationships could potentially be affected by the systems conversion project, and that would pinpoint, in advance, specific areas of risk.

Analysis Objectives

In order to develop an analysis that would determine the likely degree of business impact due to systems change, a number of objectives for the analysis were selected. One objective was that the analysis had to clearly show the impact of changes to the flagship corporate services products (primarily cash management, corporate checking, recon and image products), and to define how those changes would be perceived by large business customers. Another objective was to develop an analysis that clearly showed the impact of systems change on business processes, customers, products, and the risk profile of the client in a way that was easily understandable to line managers and executives, and could be used to guide change management processes as the systems conversion progressed. It was not an objective to somehow halt the progress of the conversion, the objectives reflect the concern of executive management that it would reflect very poorly on them if they did not anticipate and react to potential threats to earnings and profits arising from the impending systems change.

Focusing on Strategy and Process

In order to accomplish these objectives, the project team chose tools that were business strategy and process engineering tools, rather than technical systems analysis tools (such as TCO metrics or payback analysis). Essentially, the team undertook to perform a process analysis to define processes and systems at risk, and then used activity based costing techniques to understand the implications of moving from processes that were well formed, efficient, and robust toward future states that were less well defined, less efficient, and potentially less able to meet the client’s objectives. Once the implications of systems change were defined, the team used portfolio analysis to understand how

any degradation of systems or process capabilities would impact the strategic objectives of the institution, specifically focusing on objectives like maintaining relationships with customers, maintaining high efficiency, offering competitive products, and controlling risk.

Analyzing Corporate Services

The project split into several parts, corresponding to the business functions being examined. A separate analysis was completed for corporate services, deposits, lending, and “banking services”. The corporate services project utilized data from the client and comparative information from industry databases to identify processes at risk. At the time, it was thought that many corporate services products would need to be discontinued, because the acquiring organization’s applications platform did not support the products and it was not contemplated that software or applications to deliver the products could be acquired and integrated. An initial analytical task was to determine what products were typically offered in a corporate services or cash management product portfolio by competitive institutions. This gave the project team a set of critical products and supporting business processes and systems to evaluate. The team then looked at how specific process and system changes would affect critical processes – would the organization be able to continue to offer its full suite of customized image products, for instance? Would positive pay and various account reconciliation plans still be offered, and would new systems be as efficient with regard to delivering these products? Process analyses of inputs and outputs to actions and activities showed gaps – missing risk data would affect internal client processes; more cumbersome CD formats and changes in viewer technology would impact internal business processes of customers. A host of other small and large changes, in some cases adding up to revocations of entire products from the marketplace, revealed significant risk to the portfolio of corporate services customers.

Valuing Customers by the Products They Use

But how important were these customers? It was axiomatic within the organization that corporate services clients were the “bread-and-butter” customers, but was it really true? And if certain services were taken away or just “impaired”, would these customers bolt, taking deposits with them, or would existing lending relationships keep them in the fold? Two subsequent analyses looked at the degree of penetration of corporate services products within the customer portfolio. The products were grouped into 7 major categories, and the degree to which important customers used multiple product categories was quantified. The top 25 product customers in each category were identified, and the degree to which they were also top 25 in other categories was collated with this information. For instance, customers that were top 25 in any category were highly likely to be top 25 in use of image products. Indeed, image was a common thread among corporate services clients, so that any change to image products was seen as something that would unduly impact all customers. It became clear that removing or impairing certain products would potentially alienate top corporate services customers, and interviews with existing customers and line personnel about the importance of these services reinforced the view that certain threatened services were critical and should be retained, if at all possible.

“What I saw and what most appealed to me in this analysis was the dollars and cents impact of change on key customers and the clear link to profitability. That enabled us to change our management focus to address the customer needs and to reduce risk from customer defections”
- President

So if the corporate services customers were so important, what was the financial impact of losing some or many of these customers? A final analysis showed executive management and staff the importance of doing what was necessary to avoid the loss of corporate services and cash management services and products. When the use of corporate services products was collated with the size of depository and lending relationships, astonishing facts began to emerge. The customers that were the biggest

users of threatened cash management, risk management and image products, though contributing only about 20% of corporate services revenue, actually contributed almost 80% of the deposits attributable to corporate services customers, and held the lion's share of loans. The other 80% of corporate services customers, primarily small to medium-sized businesses, used more common services, but did not bring much in the way of deposits, and had few "fully realized" customer relationships that included loans or lines of credit. The small number of very large customers that used the more esoteric and customized products (the ones most at risk of being unsupported on the new platform) and that had loans or lines generated almost 80% of the institution's profits attributable to corporate services clients. Losing corporate services products and processes probably meant significant losses to the deposits, bleed-off of the loan portfolio, and possible changes to capital requirements and ratios.

Too Great a Risk

When presented with these facts, a rapid reversal of course took place in the acquiring organization's systems management. With clear financial implications now known, support was thrown to fixing existing systems and acquiring more sophisticated systems to continue to support the "Best Customers", and adjustments were made to project plans to accommodate the time needed to implement these applications. Essentially, the whole direction of a multi-year, multi-million dollar systems upgrade changed, and the change was effected at a strategic level. However, other areas of the client organization were just as much at risk, and the type of analysis used for corporate services clients would not be as effective there. Other tools were needed.

"Our greatest risk turned out to be the fact that individual products and services are inextricably linked to and impact entire customer relationships. A product line focus can turn out to be quite important when seen in the context of all of the business a customer generates, and it can be very hard to 'unbundle' or eliminate products or services, once established with the customer." - CIO

Basic Products & Services - Different Tools Required

In the areas of deposits, lending, and other banking services, changes would primarily be felt inside the institution, and mostly by the customers who were not large businesses or users of customized, sophisticated banking products. These changes would also be felt by loan processors, new accounts personnel, credit administrators, tellers, and others whose job it was to make the organization more efficient, personable, profitable, and sound.

In order to analyze the impact of these changes, the team went back again to ascertaining the degree of change associated with processes and the systems that supported those processes. Based on meetings and conversations with counterparts within the parent company, personnel were asked to compare how “new” processes that were to be adopted compared with processes as they were currently performed, and to judge how the client’s current processes would change when implemented on new systems. These activity-based comparisons included developing diagrams of information flows, reviewing forms and reports, and identifying issues with timing, service levels, management authorizations, and risk mitigation approaches.

500 Impacts

The process was comprehensive and exhaustive, and identified over 500 specific and actionable impacts on the client. Some of these impacts were positive, some were negligible, and some were truly onerous. The majority had some appreciable impact on either operations or customers. Where possible, the impacts were quantified with regard to costs (in terms of the need for more personnel, expansion of cycle times, lost sales opportunities, or the need for review or follow-up that required additional FTEs), potential new or aggravated risks, re-configuration or re-training to be delivered, or impact on customers (longer wait times, less personal service, inability to complete transactions, need for “customer retraining”). All of this information, including process descriptions and comparisons, impacts, and projected needs, was entered into an issues management database in order to manage the large volume of information and to make

sure that the data could be reported, that changes could be managed, and that the “loop” could be closed, to insure that each impact or process deficiency had a mitigating change strategy implemented.

Faced with over 500 subtle changes, how was the project team to communicate the magnitude of the change management problem? It wasn’t enough to simply call it “the death by a thousand cuts” -- the individual issues were extraordinarily diverse, affected widely different customer sets and departments, and on the whole did not add up to the same sort of financial impact that had been seen in the corporate services analysis. Some individual changes were seen as significant and the parent company had agreed to systems changes that would mitigate the impacts of these changes. However, the number of significant changes that would be addressed was less than 10% of the total. The client would have to develop workarounds and approaches to deal with the other 90%, and the project team needed executive and management team buy-in to push the change agenda.

Portfolio Analysis - A Simple Tool for Complex Problems

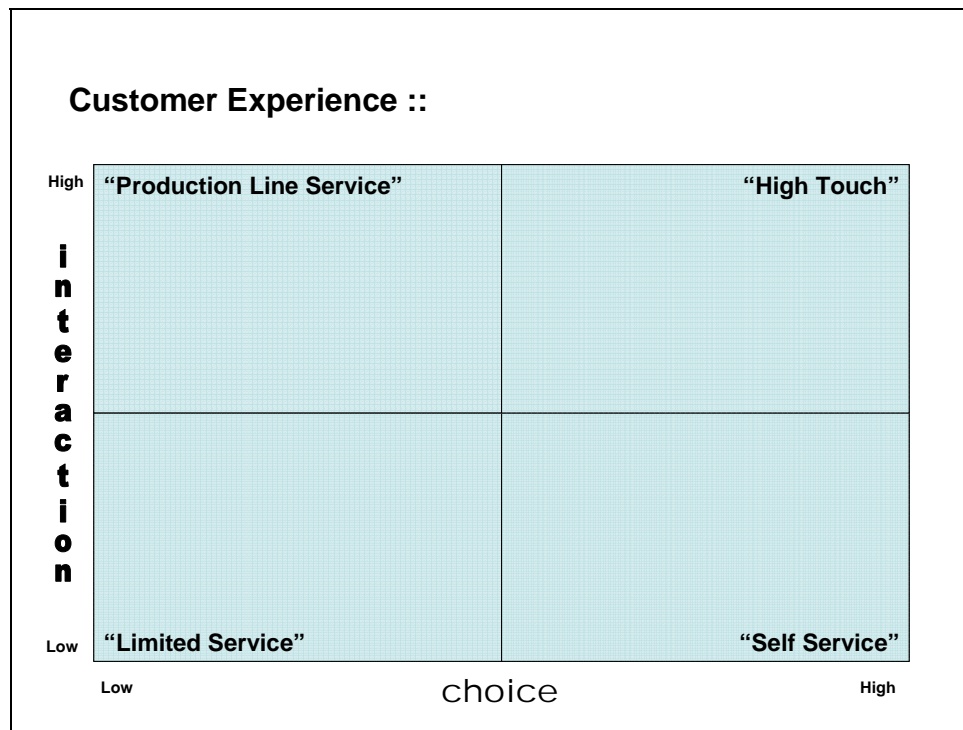
In order to show the high-level implications of many systems and process changes, the team determined that portfolio analysis tools would be the best choice to show how changes would impact the subjective business

environment of the client (essentially the “quality” of the way in which business is done.) The team chose to divide the many impacts into four major categories: impacts to customers, impacts to products and product sets, impacts to process efficiency, and impacts on risk exposure. In each of these areas, the team chose two indicators of quality, and these metrics were arrayed

on a 2 x 2 matrix diagram. For instance, the customer service quality metrics were “interaction”, the degree to which personnel could interact with and meet the needs of the customer, and “choice”, the breadth of choices available to and selectable by

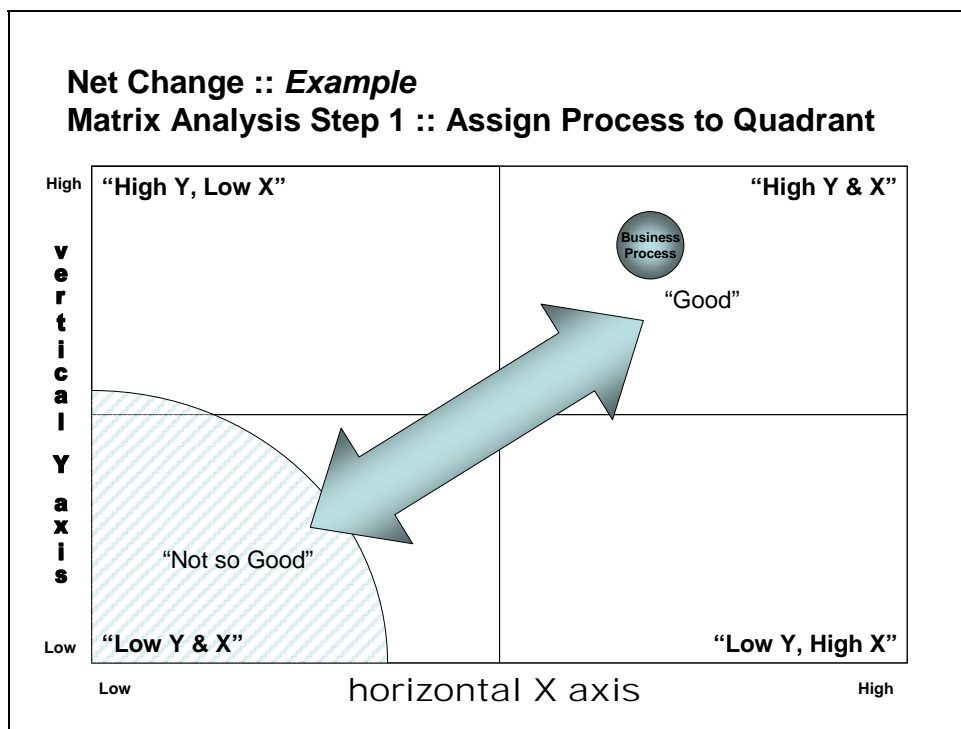
“This project was one of few that I have seen where a technical problem was translated into specific business consequences. These were then used as a spur to creative problem-solving, particularly with regard to understanding the relative priorities of actions to be taken.” - CIO

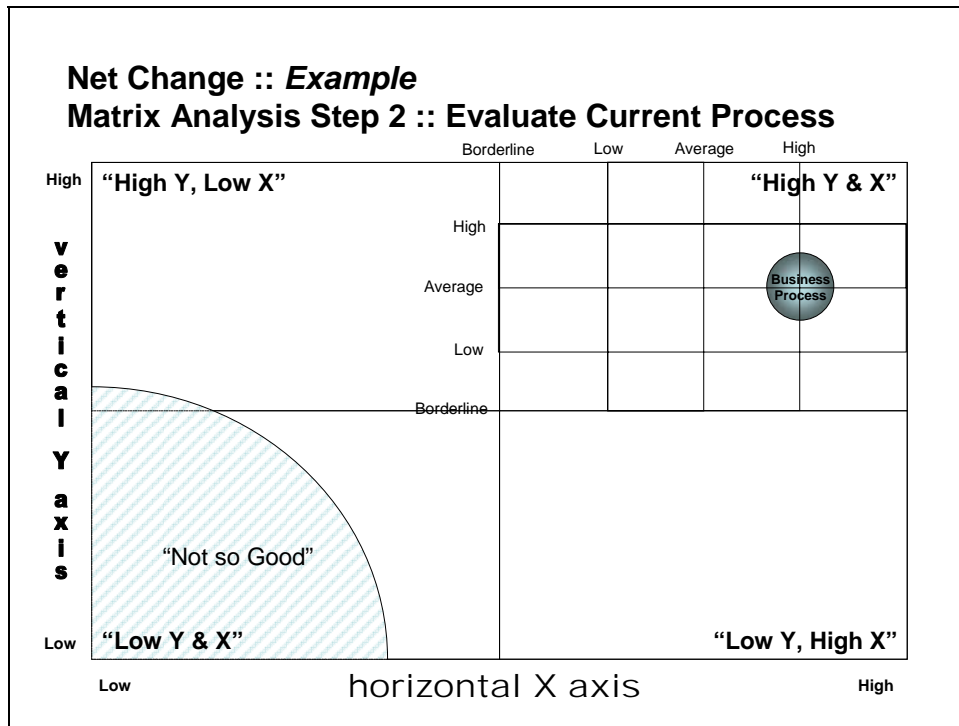
customers. A process that allowed customers to make a wide variety of attractive choices (high choice), but also offered the customer the ability to have customer service personnel guide, assist and serve them (high interaction) was the type of process that the institution prided itself on offering. The upper right quadrant of the matrix, where such a process would reside, was called “high touch” to describe this type of process. Other process types included “production service” (higher interaction but lower numbers of choices), “self-service” (lower interaction but more choices), and “limited service” where both customer choices and the ability of customer service personnel to assist are limited. In the product dimension, the chosen quality metrics were function and return; in the process dimension, they were ease of use and delivery, and in management / control (risk), the quality metrics were control and performance. Below is a diagram showing the customer experience impact matrix.



For each type of matrix, based on the quality criteria, client personnel were asked to rank the “threatened” processes in their current configuration. For instance, was a back-office process and system to provision cash easy to use? Did it deliver on its objectives? If so, it would probably be ranked high in both areas and be placed in the upper right

hand “best practices” quadrant of the process matrix. Where multiple activities and systems were involved in a single “top” process, the summary quality of the current process was gauged by management and the process was placed on the matrix accordingly. Ultimately, all affected processes were arrayed on the matrix. This usually resulted in a process “footprint” (a circle that could be drawn around all of the processes) skewed to the upper right of the matrix (the “golden” or “magic” quadrant in the parlance of portfolio analysis.) Below are shown the first two steps in the process of evaluation.

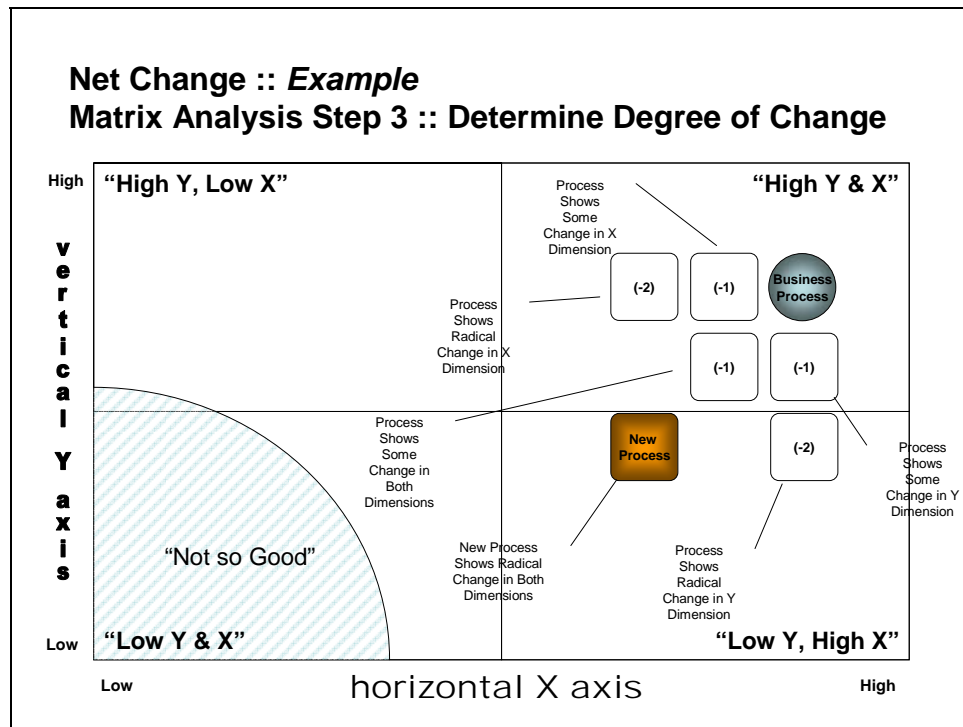




Aligning to the Future

Once the current state had been evaluated, the future state was projected. This involved determining if changes to processes or systems primarily affected the measure of one or both quality metrics, and the degree to which the change affected the metric. It was determined that changes could either result in no appreciable change, or a positive or negative impact, and that the impact could only be quantified as either some change or significant change. Significant change was defined to primarily represent monetary losses, significant additions to staff / losses in efficiency, new or increased risk exposures, or large customer service impacts (either due to the magnitude of the issue or the number of customers affected). Once the degree of change for a process was ascertained, a marker representing the "new" process was affixed to the chart, positioned relative to the current state process based on the quality metric(s) affected and the degree of change. Once all affected processes had been populated on the matrix, a line could be drawn around the "future state". Almost invariably, this resulted in a significant net change in the quality of the customer experience, the perceived quality and efficiency of processes, or an increase in exposure to risk (product changes turned

out to be minimal, and were almost always better reflected as customer or process impacts.) Following is an example of how the “future state” is evaluated.



A Major Business Impact

Once these diagrams were completed, the results were presented to the executive management group. Previously, some members of this group had dismissed the changes that were to occur as primarily systems and operations problems that had few impacts on the branch network, customer service, credit quality, or some of the other “front-office functions”. The clearly presented changes in the client’s “quality profile” and the significant and inarguable impacts on customer service, process efficiency, and risk caused this group to re-engage with the conversion problem and throw their support behind a comprehensive internal change management program. Subsequently, presentations to line management enlisted their cooperation in developing mitigation strategies, process reconfiguration approaches,

“One of the interesting results of this project was that the team was able to identify a number of processes that affected the executive mind, and were then able to measure the impact of changes to those processes and to clearly communicate that impact.” - CIO

and retraining efforts in order to reduce the number of impacts at conversion. At this time, the portfolio diagrams are being used to show progress, as projects to mitigate process and systems impacts move forward and new work methods are implemented to “bridge the gap” between the current and future state.

Summing Up

The engagement portrayed here was somewhat different from the traditional consulting engagement, in that it required the analysis of the impact of moving from a “good” state of systems effectiveness to a “not-so-good” state. This is rather the opposite of what consultants like to do – most are focused on improving systems and process quality. However, having seen the power of strategic systems portfolio analysis and process engineering tools for effecting positive systems change, it is interesting to see that the tools are just as powerful in situations where process and systems risks need to be identified and mitigated, and where the situation calls for doing “the best we can”, rather than “the best we can possibly do”. Strategic planning tools can be very powerful in gaining buy-in from executive teams, as they can be used to reduce the many, many details of a change management plan down to a few clear effects on business health. They are also flexible, and in conjunction with process description tools can be used to span control structures from the executive suite to backroom supervision, delivering strategic information to change agents at the point of change.

For more information about these tools and techniques, please contact:

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