strategy&

The value of operations

&

Using metrics to measure performance in financial services

pwc

Contact

Chicago

Kelley Mavros
Principal, PwC US
+1-312-578-4715
kelley.mavros
@strategyand.us.pwc.com

This report was originally published by Booz & Company in 2008.

Introduction

"Could you remind me how this trade-weighted cost index is related to our strategic goals?"

"Which of these 50 metrics tells the story about how well we are managing our procured services?"

"How can we assure our clients that our service levels are improving?"

Executives who frequently make statements like these could be wrestling with an issue that is becoming increasingly important in financial services: how to measure and value performance in operations across the organization. This challenge has come to the forefront as complexity has increased in tandem with an emphasis on cost control.

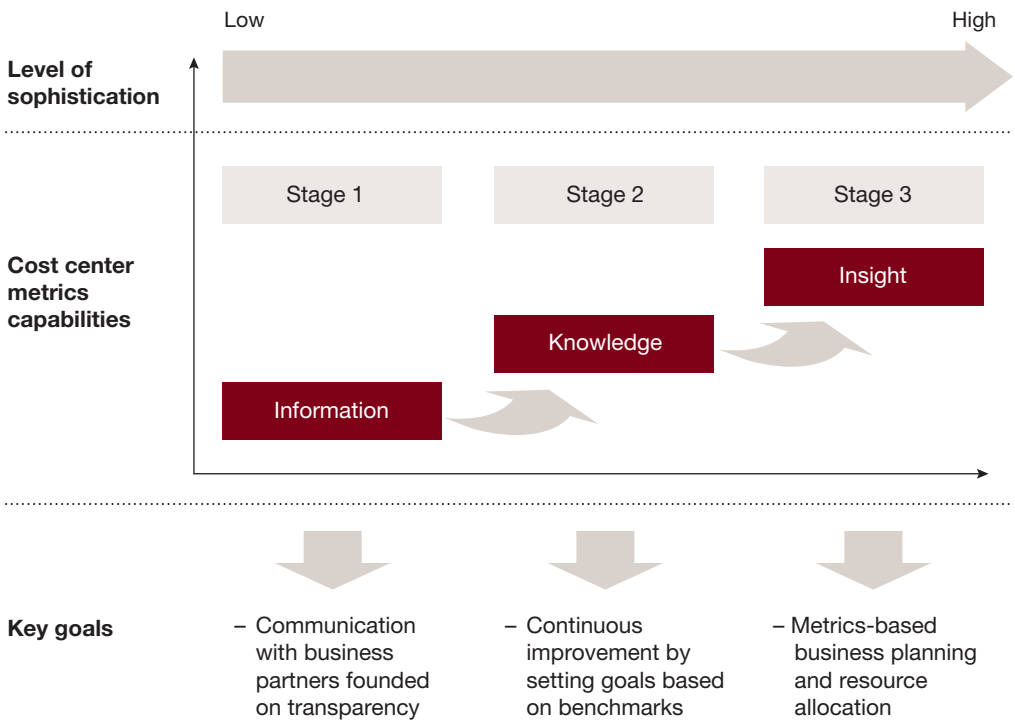
These operations areas, encompassing the front, middle, and back offices, are competitive differentiators for banks, yet the dialogue between operations and revenue-producing businesses has historically been focused on delivery cost. The most forward-thinking financial services companies, however, are expressing greater interest in developing metrics that capture the value of the services being delivered by these areas.

These metrics clearly link operational and individual performance to the corporate strategy and allow operations executives to accurately describe their contribution to business objectives. Such clarity enables operations executives to better articulate their value in the C-suite — or, in the case of companies that provide operations services, to their clients.

These stakeholders, in turn, gain insight into the performance of critical operations. Established correctly, a comprehensive performance measurement program will not just improve performance, but also allow operations managers to better articulate their value (*see Exhibit 1, next page*).

Exhibit 1

Increasing levels of performance of operations



Source: Strategy&

Historical context

Traditionally, financial services companies have thought of operations simply as the cost allocations necessary to support their revenue-producing businesses. Organizations typically buried operations and IT within profit centers and viewed cost as their primary measure of performance. Indeed, such cost allocations were limited to single-line entries on the revenue-producing businesses' scorecards or P&Ls. Consequently, operations were not managed with the same discipline and rigor as front-office functions. In our experience, the reasons for this phenomenon are simple:

- *Links to strategy.* Strategy was tied to front-office functions, with operations simply providing the requisite services. Any linkage between operations' performance and strategic objectives were ad hoc at best or considered unimportant at worst.

- *Availability of data.* Performance metrics came from accounting departments, which sourced the information from the profit centers and operations in their general ledger. Individual operations areas, on the other hand, made limited efforts to develop strategic performance measures.

- *Familiarity with data.* Senior managers focusing on financial results were typically interested in metrics they could easily relate to the bottom line. Managers were unwilling to step outside their comfort zone and work with data related to operational drivers, such as FTP rates, transaction costs, percentage of transactions processed manually versus electronically, and error rates.

Driving change

While some financial services companies continue to "manage by gut" when it comes to operations, industry changes demand a more comprehensive way of understanding and reporting performance. Over the past several years, it has become increasingly important for financial services companies to use a balanced set of measures focusing on both value and cost to understand the performance of operations. Two important levers contribute to this change:

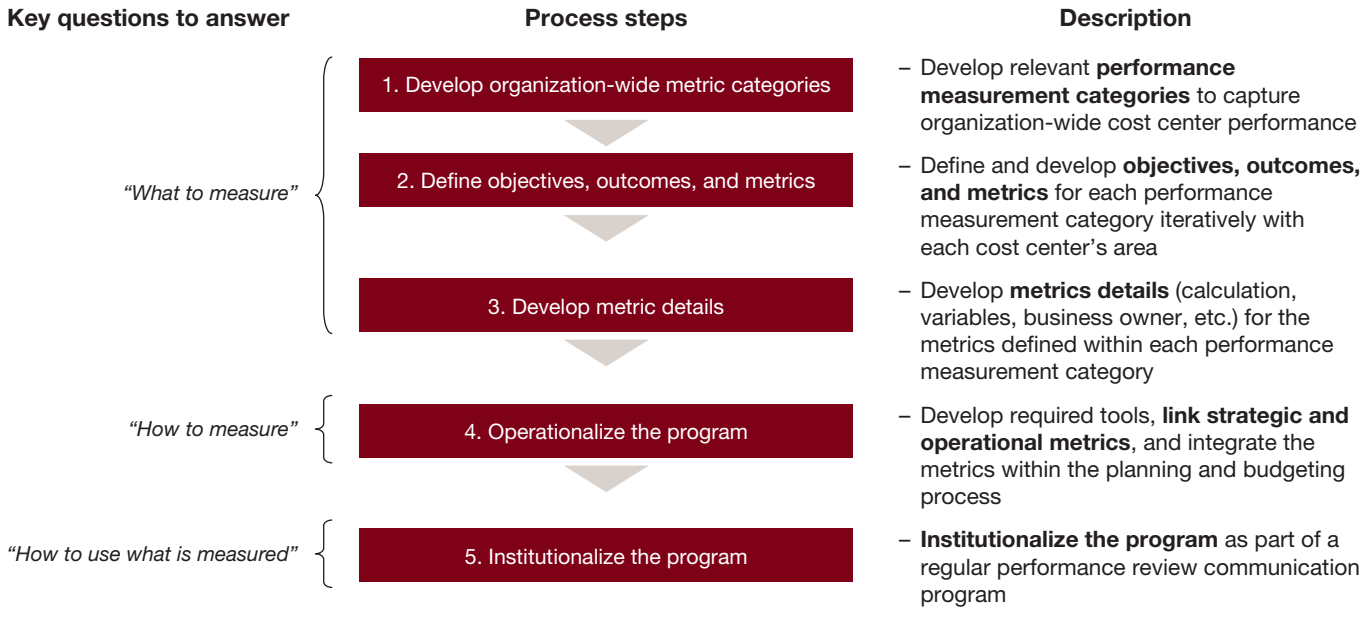
- *Shared services and outsourcing.* Shared services and outsourcing arrangements have moved operations away from the direct management of individual business lines. Because these new arrangements require operations to meet the needs of multiple business partners, it is increasingly important that operations managers understand and demonstrate the value of the services their functions provide. On the other side of the equation, business line managers now have less direct control over these support functions and consequently require new ways to ensure that their needs are being met.

- *Performance measurement as a differentiator.* As top-line growth becomes more difficult, effective operations management through performance measurement is emerging as a competitive differentiator. For example, The Bank of America Corporation[1] underwent an effort in 2001 to implement a performance measurement system that linked key metrics with high-level strategy. By 2003, the effort resulted in a 9 percent increase in customer "delight," a 100 percent increase in the number of checking accounts, 640,000 net new savings accounts, and growth of 16 percent in earnings per share.

A performance measurement program that is comprehensive and metrics-driven can help financial services companies meet these challenges (*see Exhibit 2, next page*). Such a program features scorecards for each operations division and includes key financial and non-financial performance metrics, targets, and a driver map that links

Exhibit 2

Metrics-based approach to performance measurement



Source: Strategy&

each metric to an overall strategic business objective. This program gives operations managers actionable measures at their disposal not only to get a seat at the table but also to brag about their performance to business managers.

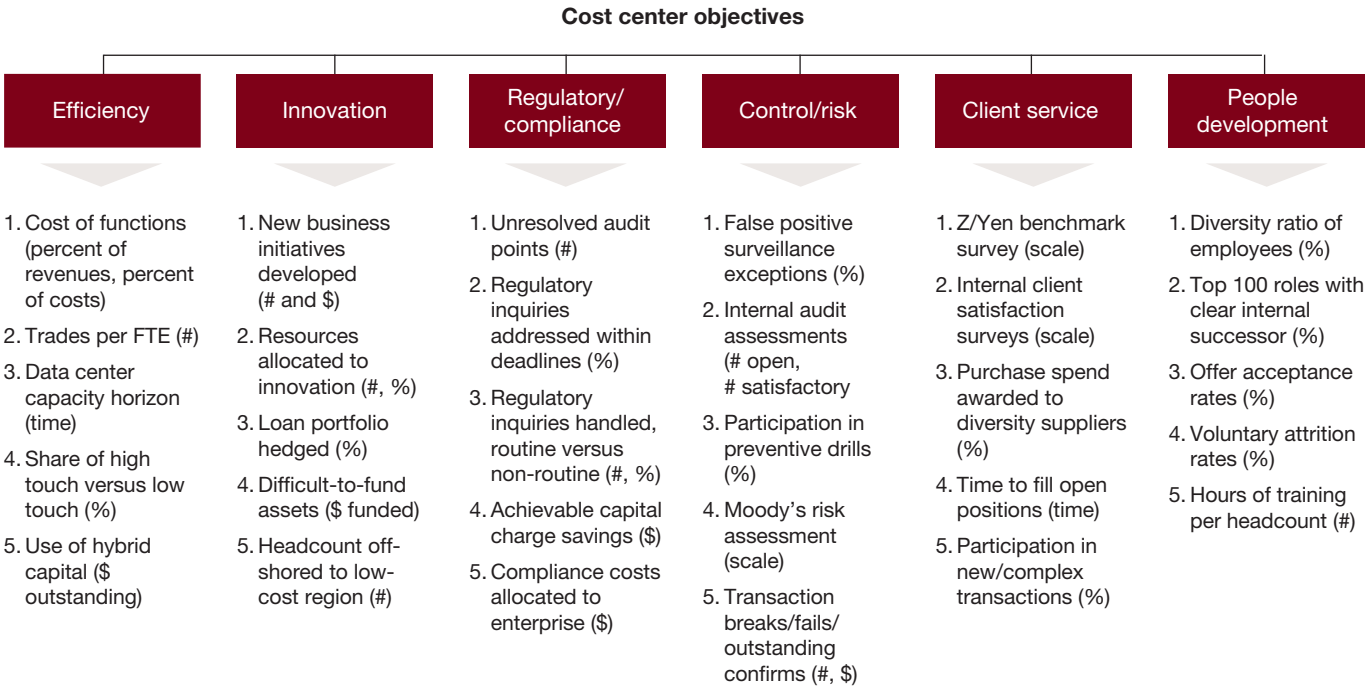
The benefits of a metrics-driven program

By requiring managers to develop specific measures that are linked to strategy, a metrics-driven performance measurement program builds awareness and understanding of what's most important for the business. Previously, operations managers could only balance the qualitative or "value" demands of the executives in the business lines they serve with quantitative cost targets. Now, however, they have actionable measures and quantifiable targets that recognize both the cost and value of services provided. Such metrics quantify the value of operations services such as efficiency, innovation, client service, and control/risk (*see Exhibit 3, next page*).

A performance measurement program can also improve the dialogue between operations managers and the business or revenue producers. With metrics tied to strategic objectives, discussions on performance become focused on the critical issues that drive business performance. For example, for a global bulge-bracket bank, we developed performance scorecards to allow operations managers to provide an easily understandable performance report. The net impact was dramatic; operations managers not only improved their performance, but also were better able to articulate their progress and demonstrate success; as a result, business managers are now able to better appreciate the efforts of their service providers. The operations managers now have a seat at the table with the revenue producers. By delivering against quantitative metrics as opposed to providing anecdotal evidence, they have bolstered their credibility.

Exhibit 3

Performance measurement metrics for a global investment bank



Source: Strategy&

Deceptively simple

Even though a performance measurement program seems conceptually straightforward, financial services companies find it challenging to implement and maintain these programs. A common mistake is the absence of a clear linkage between performance measurement metrics and the overall business strategy. Typically, this problem arises for two primary reasons. First, some performance measurement programs were developed with minimal business involvement and therefore focus only on operational efficiency measures. Second, programs that were initially developed with clear linkages between strategy and performance metrics lost that connection over time. Without strong links to strategy, operations and business goals become misaligned and performance suffers.

Another common pitfall relates to the type of measures used to manage performance. Typically, organizations fumble when choosing what to measure and end up with metrics that gauge processes instead of performance. Too often we have heard the phrase "It's easy to measure what we do, but not how well we do it." If an organization is judged by process metrics that are not tied to performance, it can easily find itself meeting targets with no beneficial end result.

Finally, many organizations make the mistake of equating an IT solution with a performance measurement program. These organizations focus on picking the ideal performance measurement software or tools while neglecting to thoroughly understand how operations performance is linked with the organization's strategic goals. These companies waste time and resources on system implementation efforts, only to find their systems rarely used years later.

Developing a successful program

Despite these difficulties, it is possible for many financial services companies to develop a successful metrics-driven performance measurement program for their operations. We've found three critical questions that together foster a successful performance measurement program:

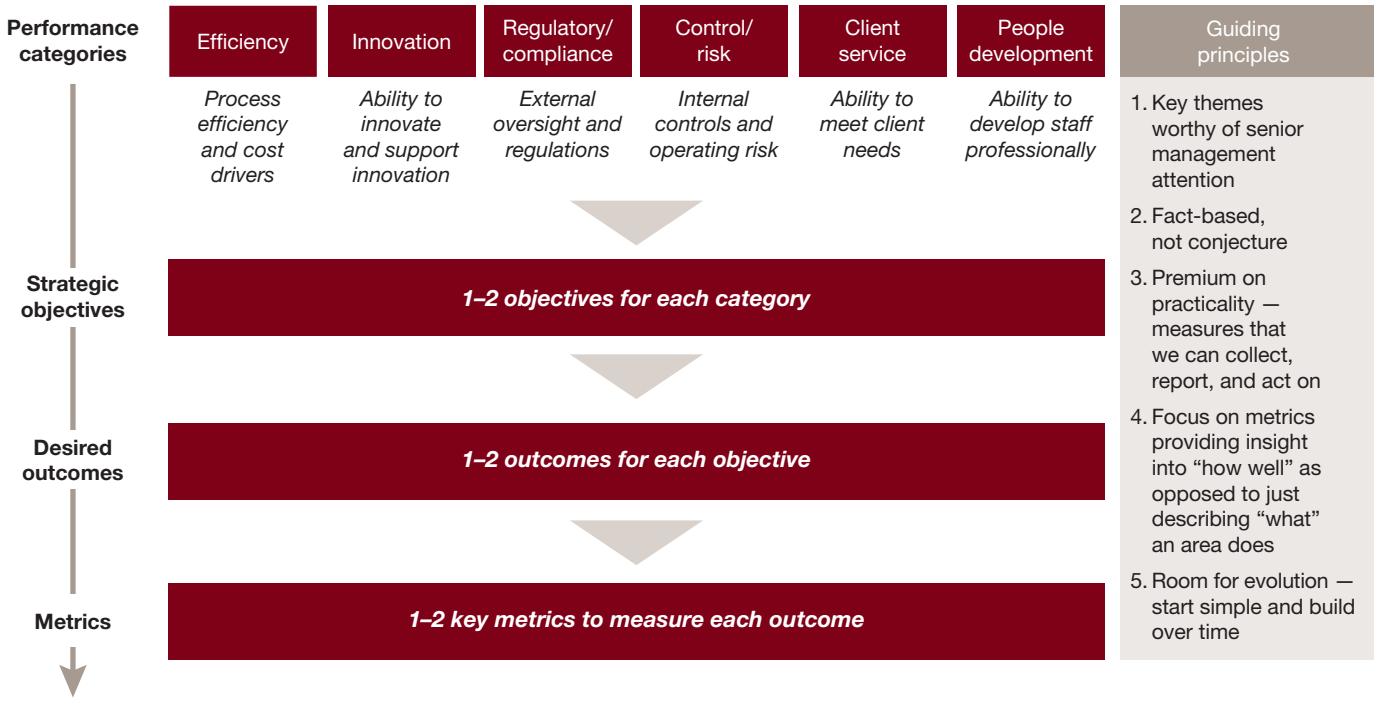
1) What to measure? In principle, the answer to this question is simple. Choose metrics that provide an understanding of performance vis-à-vis strategic objectives and outcomes. For instance, we developed the operations performance metrics for a global investment bank by first identifying six relevant performance categories. The strategic objectives were then mapped to each performance category. The principles guiding the development of these performance metrics were that they should be based on key themes worthy of senior management attention; they should be based on facts, rather than conjecture; they should be practical and actionable; they should provide insight into how well the operations function is performing, not just what it is doing; and they should initially be simple to allow room for evolution over time (*see Exhibit 4, next page*).

We've identified several best practices that can set the foundation for determining what to measure within operations:

- Develop the performance metrics iteratively, gaining buy-in along the way from stakeholders in operations and the business units.
- Ensure that the metrics strike a good balance between breadth and depth of visibility into current and future performance. They should have leading indicators, such as outstanding trade confirmations, from both a numerical and cost perspective, and lagging indicators, such as the number of open and satisfactory audit assessments.
- Develop measures that allow performance targets to be benchmarked across products, divisions, and companies — for instance, against information in Z/Yen and Moody's Risk Management reports.

Exhibit 4

Performance measurement development approach



Source: Strategy&

- Target a limited number of strategic metrics as opposed to a laundry list of operational metrics. For instance, in its first year of implementing a performance measurement program, Bank of America[2] began with 20 to 30 metrics. This number was subsequently reduced to the 12 metrics that best indicated operations' contribution to the company's overall strategic objectives. Companies can use a driver tree analysis to determine the relevant lower-level drivers of these metrics.

- Use simple measures to report performance; make processes easy for senior management to understand and act on. For example, use exception-based reporting as opposed to creating indices or aggregated metrics.

- Evolve metrics over time to match changes in strategy and desired operational outcomes. Establishing periodic reviews can help ensure that these tight links are maintained.

2) How to measure? Answering this question requires first answering a number of others: What technology and tools should be used, and how granular should the capabilities be? How should the relationship between strategic and operational metrics evolve? What is the linkage to the planning and budgeting cycle? Addressing these questions will enable operations to implement their performance measurement program. A phased approach that starts small and evolves through time is most appropriate (*see Exhibit 5, next page*).

Best practices for determining how to measure:

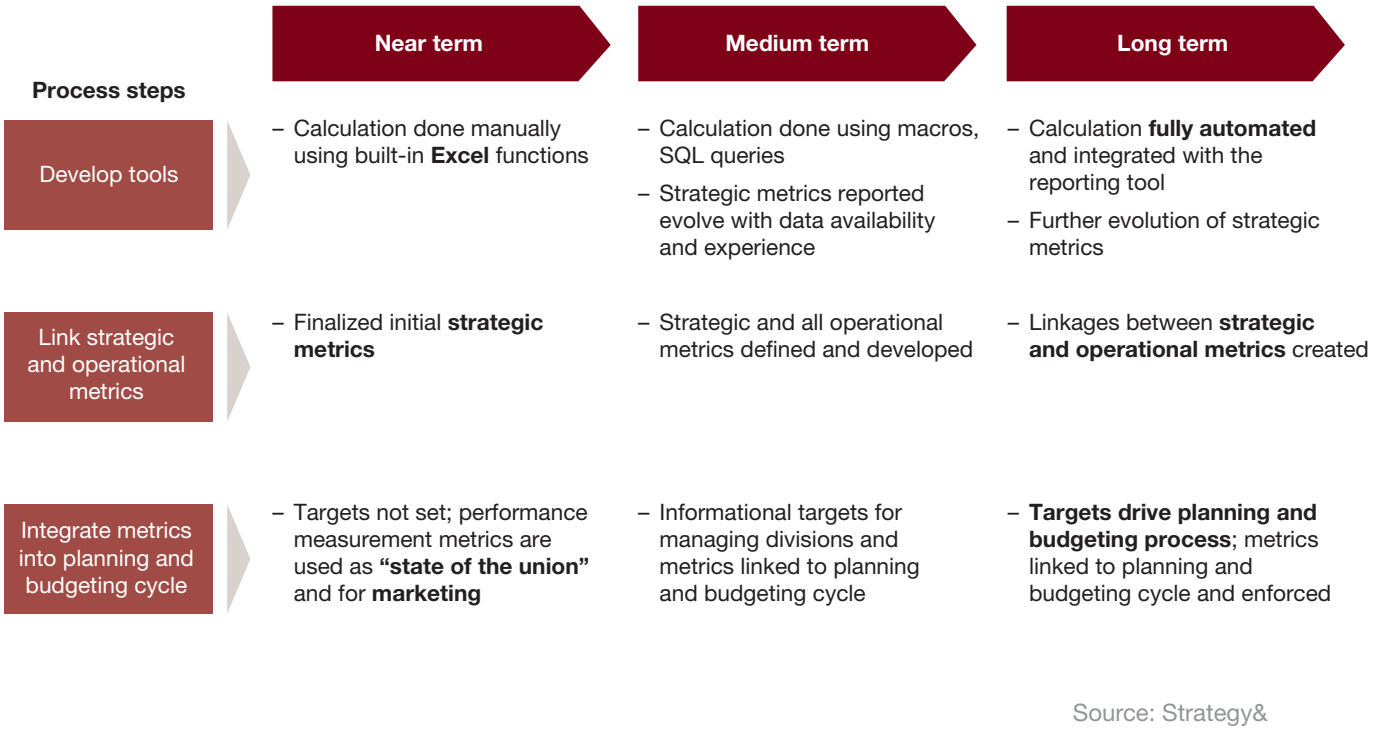
- Ensure that the metrics developed can be easily collected through existing processes and systems. If they can't, develop a plan for collecting and using the metrics. For example, when we developed the performance measurement program for a global investment bank, we categorized the metrics' "go-live" time lines into three buckets: less than one month, one to six months, and more than six months. We then created detailed plans to operationalize the metrics for the first two buckets; based on results in the initial phases, we later did the same for the third.

- Rather than determining metrics based on the tools that are available or the suggestions that vendors offer, first determine which metrics would be most useful and then find the tools to capture them.

- Develop the capability to measure the quality of a process when failure is not an option. For example, effectively measuring the security of corporate systems may require measuring not only

Exhibit 5

Putting the performance measurement program into operation



Source: Strategy&

security breaches but also attempted security breaches. As one senior executive at a global investment bank pointed out, "We should have the capability to measure not only goals allowed but also shots on goal."

3) How to use what is measured? The final area of best practices concerns how a metrics program is used within an organization. How should information be reported and organized? How is it distributed? Who is accountable for performance, and what are the incentives? Clear accountabilities should be established both for adhering to processes (e.g., timely collection of data) and for performance results (e.g., reaching a target). Once clear accountability is established, an organization should proceed cautiously with efforts to formally tie performance metrics to incentives. Although a clear connection with incentives can focus behavior on achieving targets, it can also cause undesirable distortions as managers feel more pressure to achieve their goals. Formally institutionalizing metrics as part of a regular communication program tied to performance reviews is an important step in ensuring senior management accountability (*see Exhibit 6, next page*).

Adopting best practices in these areas can help guard against a performance measurement program being rejected:

- Ensure that the metrics can be rolled out across the enterprise, and that comparisons among divisions Company can help in the strategic planning and performance review process for overall operations and for each element in particular.

- Avoid perfection; begin the process by using the metrics to guide decision making as soon as sufficient data is available. For a global investment bank, we divided metrics into levels of operational readiness for reporting (easy, medium, and hard). Metrics defined as "easy" were immediately reported to gauge operations performance, while the "medium" and "hard" elements were set aside to be revisited as technology improved.

- Have a clear process improvement methodology to drive positive change throughout the operation. At the Royal Bank of Scotland,[3] even the HR function has been transformed into a quantitative discipline. Employee HR HR data is linked with reward preferences, business productivity, and turnover to provide a rich source of feedback pointing to trends that require action.

Exhibit 6

Institutionalizing the performance measurement program

Communication purpose	Format	Audience	Frequency	Number of pages
Periodic review of division-level performance	Division-level reports	Shared service organization management committee	Quarterly	One page per cost center division
Periodic review of shared service organization performance	Organization-level report	Management committee; business-side executive management	Quarterly	1-2 (“Top 25” metrics)
Management committee talking points	“Story” presentation is supported by metrics	Management committee	Ad hoc	Presentation supported by relevant metrics

Source: Strategy&

Achieving buy-in

In our experience, the challenge is not actually in determining the performance measurement metrics, but rather in getting the organization and stakeholders to embrace them. Senior team alignment is critical, but senior executives usually have their own perspective on which strategic objectives, outcomes, metrics, and goals are most important. Internal customers — i.e., the senior executives in the business lines — often have an unbalanced view of performance priorities, with too much focus on cost. Very often, operations managers tend to migrate toward metrics that indicate only positive results, especially when compensation and other rewards are tied to meeting a performance goal. Finally, people do not like to be measured on metrics that have been developed without their input.

However, all is not lost. In our collective experience, there are five key success factors for instituting such a performance management program:

- Set a compelling vision. Senior leaders need to set a clear and compelling vision of where the organization needs to be in terms of the program with clearly defined measures of success in the short term, medium term, and long term. This vision and measure of success must be shared across all levels in the organization.

- Make sure leaders are committed and accountable. There needs to be visible and proactive involvement of senior leaders in the transformation to the performance measurement program. In addition, there must be clear accountability and adherence to the performance measurement metrics (e.g., links to compensation or to the planning and budgeting cycle).

- Achieve early wins. The organization should plan key milestones of operationalizing and institutionalizing the metrics program and drive toward celebration of early wins. For example, the validation and buy-in of metrics at the corporate level and within each operations group is a quick win that should be celebrated as it paves the way for achieving longer-term milestones.

- Enroll people in the change. There needs to be a concerted communication and change management effort that maximizes near-term opportunities to engage and mobilize stakeholders. Senior leaders should be committed to overcoming organization-wide skepticism and moving stakeholder perceptions from awareness to acceptance of the performance measurement program.

- Organize for sustainability. Change champions should be identified within each line of business. These change champions understand the content and will lead and promote the performance measurement program in their areas in close cooperation with corporate champions. There also needs to be a periodic review of the performance measurement framework to verify and adjust the links to the overall corporate strategy.

Developing a performance measurement program for operations is no simple task. As top-line growth becomes more challenging, performance measurement of operations is increasingly seen as a differentiator. Winners will extract superior margins by focusing on "how well" they do, as opposed to "what" they do. Financial services companies face an inevitable choice: challenge the status quo or risk being left behind the pack.

Endnotes

[1] Carl Thor and Mark G. Brown, “Effectively Managing Performance Measurement Systems,” APQC, 2004.

[2] Carl Thor and Mark G. Brown, “Effectively Managing Performance Measurement Systems,” APQC, 2004.

[3] Richard Donkin, “Human-capital measuring at the Royal Bank of Scotland,” Human Resource Management International Digest, 2005.

Strategy& is a global team of practical strategists committed to helping you seize essential advantage.

We do that by working alongside you to solve your toughest problems and helping you capture your greatest opportunities.

These are complex and high-stakes undertakings — often game-changing transformations. We bring 100 years of strategy consulting experience and the unrivaled industry and functional capabilities of the PwC network to the task. Whether you're charting your corporate strategy, transforming a function or business unit, or building critical capabilities, we'll help you create the value you're looking for with speed, confidence, and impact.

We are part of the PwC network of firms in 157 countries with more than 208,000 people committed to delivering quality in assurance, tax, and advisory services. Tell us what matters to you and find out more by visiting us at strategyand.pwc.com.

This report was originally published by Booz & Company in 2008.

www.strategyand.pwc.com