Aligning and rationalizing your business applications

How to simplify the IT portfolio and reduce costs in financial services
Contacts

Atlanta

Ajay Nayar
Principal
+1-404-271-3890
ajay.nayar@strategyand.pwc.com

Florham Park

Ramesh Nair
Partner
+1-973-410-7673
ramesh.nair@strategyand.pwc.com

Frankfurt

Volkmar Koch
Partner
+49-69-97167-412
volkmar.koch@strategyand.pwc.com

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Executive summary

Banks are placing significant emphasis on operating efficiency as revenues stagnate and costs increase. In particular, IT spend for the banking industry has ballooned, compelling banks and financial services companies to undertake large initiatives for “application rationalization”: consolidating and improving the ways in which IT systems are used.

This document describes proven strategies for banks to successfully execute application rationalization programs. At the heart of this approach is bottom-up design along with top-down guidance. This approach allows you to address not just the symptoms, but the root causes of portfolio incoherence. Further, it will cut costs and allow your business to grow stronger.
During the last 10 years, stagnant revenue and increasing costs have diminished the operating efficiency for many banks.

Efficiency ratio calculation: Non-interest expense/operating revenue.
Lower efficiency ratios are more desirable; in effect, this measure describes the percentage of revenue consumed by overhead and other spending.
Source: SNL Financial

The typical bank would need to save $1 billion (-26%) or grow revenue by $2 billion (33%) over the next two years to return to a 60% efficiency ratio median.
Among selected technology-intensive industries, the banking industry spends the most on information technology.

**IT spending**

<table>
<thead>
<tr>
<th>Industry</th>
<th>As percentage of revenue</th>
<th>As percentage of operating expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banking &amp; financial services</td>
<td>6.0</td>
<td>7.3</td>
</tr>
<tr>
<td>Software publishing</td>
<td></td>
<td></td>
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<tr>
<td>Education</td>
<td></td>
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<tr>
<td>Media &amp; entertainment</td>
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<tr>
<td>Professional services</td>
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<tr>
<td>Telecom</td>
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<tr>
<td>Pharma</td>
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</table>

Source: Gartner IT Metrics Report; IT spend, operating expense, and profit data collected between 2009 and 2011.
A major factor in rising IT expense is the cost of applications, which are often highly fragmented at major banks.

[Chart showing the total cost of ownership (TCO) for IT applications for a typical large U.S. bank. The chart ranks applications by TCO, with the top 10 applications on the left and the lower 44 applications on the right. Appropriately scaled applications, touching multiple customers or business units, are probably only those at the far left.]

Disguised data—a composite from multiple projects
Source: Strategy&
To improve operating efficiency by decreasing IT spend, banks have pursued different application rationalization strategies

<table>
<thead>
<tr>
<th>Application rationalization strategies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strategic cost reduction</td>
</tr>
<tr>
<td>• Reducing TCO for the application portfolio by cutting expenses in people, processes, and technology</td>
</tr>
<tr>
<td>• Focusing on core business, reducing non-related IT expenses</td>
</tr>
<tr>
<td>• Aligning the IT architecture with the portfolio of products and services</td>
</tr>
<tr>
<td>Repositioning for future growth</td>
</tr>
<tr>
<td>• Improving speed-to-market and agility through organizational restructuring and process improvements</td>
</tr>
<tr>
<td>• Improving scalability through automation</td>
</tr>
<tr>
<td>Simplification and modernization</td>
</tr>
<tr>
<td>• Consolidating IT infrastructure</td>
</tr>
<tr>
<td>• Making use of new technologies such as virtualization and cloud sourcing</td>
</tr>
<tr>
<td>Regulatory compliance</td>
</tr>
<tr>
<td>• Combining policies, rules, and practices</td>
</tr>
<tr>
<td>• Spreading compliance practices across multiple systems</td>
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</tbody>
</table>
But as banks execute these strategies, they may need to pay more attention to the root causes that contribute to portfolio incoherence

<table>
<thead>
<tr>
<th>Root cause</th>
<th>Impact to the application portfolio</th>
<th>Recommendation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Decentralized technology selection processes</td>
<td>• Redundant IT practices, with limited reuse of technologies across products and services</td>
<td>• Live asset management database, regularly updated and monitored, to provide a better view of the IT portfolio and options for reusing the technology</td>
</tr>
<tr>
<td>Inadequate integration before and after M&amp;A</td>
<td>• Absorption of incoming application portfolios on nearly an as-is basis; barriers to interoperability among IT systems</td>
<td>• Comprehensive pre-merger integration plan, mapping existing applications between parties—including a plan to eliminate redundancies</td>
</tr>
<tr>
<td>Inconsistent governance of technology standards</td>
<td>• Overlapping platforms with ambiguously defined or inconsistently enforced standards</td>
<td>• Clearly defined technology standards that eliminate redundancies</td>
</tr>
<tr>
<td>Limited focus on IT cost efficiencies</td>
<td>• Suboptimal portfolio planning that does not take into account the total cost of operations for different products and services</td>
<td>• Comprehensive breakdown of TCO for the entire portfolio</td>
</tr>
<tr>
<td>Suboptimal demand management</td>
<td>• Expensive and inefficient rework in application disposition plans when functional demands change</td>
<td>• Enterprise demand management process that determines a “home” for each functionality that is needed—and a norm oriented toward minimal modification of plans</td>
</tr>
<tr>
<td>Suboptimal sourcing</td>
<td>• Redundant licenses and underutilized capacities across the enterprise, stemming from fragmented asset management</td>
<td>• Unified and clearly defined asset management process</td>
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**Banks routinely use a bottom-up approach to rationalization (in which each department plots its approach), but there are limits to this method**

**Typical bottom-up approach**

1. **TCO & overlap assessment**
   - Determine TCO for application portfolio and set target TCO
   - Assess functionality overlaps among the applications and overall effectiveness of the application portfolio

2. **Portfolio cost reduction priorities**
   - Identify opportunities to retire, consolidate, or extend applications based on overlap analysis
   - Prioritize the rationalization effort and develop a roadmap to achieve performance targets

**Limits of the bottom-up approach**

- Bottom-up rationalization effort is based solely on TCO
- Overlap assessment fails to factor in long-term strategic view
- Less recognition of changes in target state architecture, driven by new technology and shifting investment priorities
Combining the typical, bottom-up approach with top-down strategies will help build new capabilities to complement rationalization efforts.

Recommended combination (bottom-up and top-down) approach

- Assess ways in which the application portfolio can support business strategy and improve differentiating enterprise-wide capabilities
- Understand the type of applications required and assess requirements against existing portfolio
- Define target architecture and operational processes

Business capability alignment

Portfolio cost reduction priorities

Top-down

Application rationalization target state

Bottom-up

TCO & overlap assessment

Portfolio cost reduction priorities

Strengths of the combined approach

- Clearly identified priorities ensure that the portfolio delivers strategic capabilities
- Enterprise-wide and local perspectives help balance long term vision and short term tactical needs
- Comprehensive understanding of business and IT fitness criteria for each application ensure optimal portfolio rationalization
- Exhaustive assessment of prospective applications and updates finds opportunities to reduce costs and support capabilities
- Defined target state architecture addresses the IT support needed for existing and emerging business models
The combination approach decreases the number of applications, lowers TCO, and drives the development of new capabilities

Composite example (drawn from several companies)

Observations
- The top-down approach enables the identification of the key business capabilities required to achieve strategic priorities, along with the necessary IT support
- The tech projects portfolio is aligned to deliver IT support in a way that better fits the company's strategy
- Plans for the affected applications are incorporated into the rationalization strategy
- The final TCO assessment reflects the savings from rationalizations and the incremental spend for new capabilities
We suggest using proprietary, accelerated models to execute these top-down and bottom-up application rationalization programs.

Top-down steps:
1. Identify business and IT Priorities that support business capabilities
2. Align Target State Architecture with business strategies and capabilities
3. Incorporate change management plans to migrate to IT operating model
4. Analyze individual applications against developed fitness criteria

Baseline & analysis:

Bottom-up steps:
1. Analyze TCO of the application portfolio
2. Assess functionality overlaps across applications
3. Perform cost/benefit analysis and integrated program-level reporting plan
4. Identify and prioritize rationalization opportunities

Planning & roadmapping:

Migration plan development:
- Define current state application disposition
- Determine roadmap to migrate to target state
- Decide whether each application will be extended, maintained, consolidated with others, or retired altogether

Business case development:
- Assess tco impact and cost of migrating to target state architecture
- Identify benefits from new capabilities to be delivered
An effective application rationalization approach might be piloted in one part of the company, and then rolled out across the whole enterprise.

**Coordinated rationalization strategy**

- **Create & establish artifacts and provide integrated reporting**
  - Communicate to each business unit the templates, artifacts, and models
  - Define and/or enhance program structure and reporting requirements
  - Implement and/or enhance process for data collection, review, and reporting

**Enterprise coordination**

**Business unit execution**

- Each business executes its work streams, using templates provided by the enterprise
- Each BU reports back to enterprise leadership
- Targeted execution support provided by enterprise groups as needed
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