

# BCG

OPPORTUNITIES  
for ACTION

FINANCIAL INSTITUTIONS



■ Financial institutions can cut up to 20 percent of total FTE costs with no negative effect on either revenues or the customer experience.

■ Cuts can be achieved within a six-month period.

■ The key is an innovative process called principles-based cost reduction (PBCR).

■ Enhanced organizational flexibility, better decision making, and tighter accountability are common secondary benefits.

## A Principled Look at Cost Cutting

Major financial institutions, by nature of their size and scope, have a difficult time remaining “lean and mean” operations. As they grow in size, they tend to become bloated and inefficient—trends that hurt revenues, profits, and shareholder returns. Consider the following symptoms that we have observed among numerous players:

- ◇ Too many managers have narrow spans of control (only a few direct reports) and don’t really manage much—essentially living off their titles and tenure.
- ◇ The number of organizational layers between the CEO and the lowest-ranking full-time equivalent (FTE) is in the double digits.
- ◇ Too many employees have roles that are two to three degrees removed from the customer—and some of these workers are often situated in high-cost locations.
- ◇ Business units often have their own set of staff functions (such as finance, human resources, IT, and legal), creating duplicate activities and competing fiefdoms.
- ◇ Employee productivity (for example, in client management, sales, and call centers) is poor when compared with external and internal benchmarks. But line managers often push back, saying the comparison isn’t valid.
- ◇ Some activities represent “invented” tasks that keep people busy but add no value that customers are willing to pay for.

Symptoms such as these cry out for a cost-cutting exercise to reduce overhead. But which method should be used? One based on standard delayering? On outsourcing and offshoring? On process reengineering?

The Boston Consulting Group has developed a cost-cutting approach that builds on the delayering concept and includes elements of traditional methods. But it is broader in scope, more formalized, and somewhat more aggressive. The key

to the method is a four-phase process that involves establishing specific principles through which head count reductions can be identified and carried out. Hence, the method's name: *principles-based cost reduction* (PBCR).

Many financial institutions worry that significant head-count reductions will ultimately hurt the customer. Yet our work with many clients indicates that, typically, at least one-third of total FTE costs stems from non-customer-facing employees. Moreover, one-third of those costs can be cut with no negative impact on revenues or on the customer experience—all within a six-month period. The end result is trimming “a third of a third,” or about 9 to 10 percent of total FTE costs, which can translate into hundreds of millions of dollars. In some cases, up to 20 percent of total FTE costs can actually be cut—with no cost “creep-back” in the months and years following the exercise.

## A Highly Principled Process

Exactly what is a principle in this context? It is a rule that places a limit on—or sets a goal for—a definable aspect of the institution, such as the number of organizational layers separating the CEO from the lowest echelon of employees or the productivity of the sales force compared with benchmarks. Forging and articulating these principles helps cut through organizational clutter in a way that some other cost-cutting methods have not always been able to achieve.

Another aspect of PBCR is that it involves the participation of what we call *discreet insiders*—a small group of senior managers picked by the CEO or project sponsor. These insiders are aware of the endeavor and help facilitate it from the beginning. This group, which expands in a tightly controlled manner as the exercise evolves, represents the institution's core project team. The organization at large should not be aware of the impending cuts until they are imminent.

**Phase One.** During the initial step in Phase One, we perform a full-scale outside-in diagnostic—using data provided by the company concerning overall costs, organization structure, and FTEs—in order to deliver a preliminary view of projected savings and where FTE reductions should come from.

Next comes the critical moment of deciding on the precise principles to be applied—a task we carry out in close collaboration with the company's project team. Although typically the same areas are targeted for most institutions, the principles can vary according to each

company's size, geographic footprint, and particular “DNA.” It is crucial, however, for all parties to reach agreement on the exact principles to be applied at the beginning of the process.

For example, at one company we worked with, the average span of management control had narrowed to four and the number of organizational layers had swelled to 12.<sup>1</sup> More than 40 percent of the company's employees worked two or three degrees removed from the customer. Other problems included low productivity in a variety of roles and many redundant and non-value-adding activities. The principles we forged with this company, aimed at setting specific limits and goals in areas such as these, were typical for a PBCR exercise. (See Exhibit 1.)

The process of forging the principles can be a delicate one. Indeed, it is not uncommon for one or two members of the institution's project team to point fingers at business areas other than their own, saying in essence that the PBCR exercise “is a great idea that we need, but it doesn't apply to my people.” In our experience, however, this type of assertion rarely reflects the true situation. In fact, unlike some other cost-cutting approaches, PBCR makes it difficult for senior managers to “protect their own” in an inequitable way because deviation from the principles, once they are hammered out, is highly transparent.

1. To protect client confidentiality, this is a composite example based on our PBCR work with a variety of financial institutions.

### Exhibit 1. Cost Reduction Principles Set Limits and Goals

Organizational aspect	Principles
1 Span of control	Achieve a span of control of six to eight for most managerial levels
2 Layers: distance from the CEO	Reduce the number of organizational layers between the CEO and the lowest FTE to six
3 Degrees of separation and viability of location	Eliminate activities too far removed from the customer, and move non-location-specific activities to lower-cost venues
4 Duplication	Eliminate shadow groups and redundant activities
5 Productivity	Enhance the productivity of the organization to match best-in-class levels, and ensure performance appropriate to each role
6 Degree of added value	Eliminate activities that customers (both external and internal) are not willing to pay for

Source: BCG case experience.

Note: In order to protect client confidentiality, this is a composite example based on our PBCR work with a variety of financial institutions.

**Phase Two.** In Phase Two, using our initial cost diagnostic along with the newly forged principles, we conduct a reality check with the institution’s project team to review and refine head-count and savings targets on the basis of what feels truly achievable. This effort leads to the development of *commitment packages*—highly precise cost and FTE targets.

**Phase Three.** The commitment packages are then delivered as direct challenges to the leaders of specific business and functional units. These leaders, unaware of the PBCR initiative until this point, are given a period of weeks in which to respond with a detailed action plan to meet or exceed the targets under their purview. Often, they are allowed to choose one or two additional colleagues as collaborators. At the end of this phase, these managers bring their strategies back to the overall project team for ratification.

**Phase Four.** In Phase Four, the implementation of the ratified action plans is designed. This stage includes drawing up the details of FTE displacements and severance payouts, and constructing new organization charts. No organizationwide announcements are made until all implementation plans are ready.

What kind of results can be expected from a PBCR exercise? In the example described above, the result was typical and included the following: Average spans of control were increased from four to seven. Organizational layers were cut from 12 to 6. Activities deemed to be redundant were eliminated, and resources devoted to activities and products considered to be of low value were significantly reduced. Some work streams were shifted to lower compensation bands. Ultimately, the overall management head count was reduced by about 25 percent, and the total annual savings from the exercise amounted to about \$300 million—\$200 million in compensation and \$100 million in benefits. (See Exhibit 2.) This figure represented roughly 15 percent of the company’s total FTE costs.

In some projects, we have witnessed FTE cost savings of 20 percent in IT activities and 16 percent in operations—all, as in the above example, implemented within six months.

### With Vigilance, Long-Lasting Impact

There are, of course, risks involved in PBCR. For example, it is critical to keep the number of discreet insiders to a minimum. If the “cat gets out of the bag” and word of the cost-cutting initiative spreads, heads of some

business units and functions may try to erect barriers to change or game the system. For example, some may try to pad their FTE base lines in order to claim compliance with a commitment to cut, say, 20 percent, when in fact they are cutting only 10 percent.

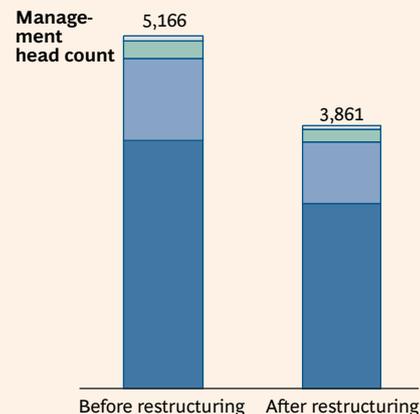
Also, benefits from the cuts will be short-lived unless the institution takes steps to sustain them. Indeed, just as it is easy for a person to regain weight after taking it off, so too the symptoms of a bloated, inefficient enterprise can creep back insidiously. It is therefore critical to plan for regular checkpoints in the months (and years) following the initiative to guard against this possibility.

### Exhibit 2. PBCR Reduced Management Head Count by Around 25 Percent and Saved Roughly \$300 Million Overall

#### Percentage of total impact by cost category

- ~25% Reduced organizational layers and increased spans of control
- ~30% Eliminated redundant and customer-distant activities across functions
- ~30% Reduced resources on lower-value activities and products in decline
- ~15% Moved work to lower compensation bands

#### A 25 percent reduction in management ranks was achieved



- ~\$300 million in annual savings
- ◇ ~\$200 million in compensation
- ◇ ~\$100 million in benefits

- Senior executives (~30 percent reduction)
- Executives (~30 percent reduction)
- Middle management 1 (~25 percent reduction)
- Middle management 2 (~25 percent reduction)

Source: BCG case experience.  
 Note: This is a composite example: numbers have been modified to protect client confidentiality, but they illustrate typical results.

Yet, there are also advantages to PBCR beyond substantial cost savings and a leaner, crisper organization. For example, with fewer managers and increased spans of control, decision-making processes tend to run better. Senior managers are closer to the action, and decisions are made more often—and more rapidly—by those with a real understanding of the issues. Accountability is enhanced, there are fewer turf battles, and intracompany communications often become faster and more reliable. What's more, with less micromanagement, employees feel more empowered. This leads to higher morale.

Ultimately, the key advantage of PBCR is that it focuses on resources that usually have accumulated over time and do not drive real value. Building on the core delaying approach, PBCR enables financial institutions to cut very substantial FTE costs without risking revenue attrition or damage to the customer experience—and, in so doing, to improve organizational flexibility and nimbleness. Moreover, PBCR typically accomplishes these goals very quickly—unlike cost-cutting initiatives that target core processes and products, which can take years to complete.

Financial institutions can start the PBCR process by carrying out a prediagnostic effort and asking themselves questions such as the following:

- ◇ On average, how many direct reports do our senior executives and senior and middle managers have?
- ◇ How many organizational layers are there between our CEO and our lowest-level FTE?
- ◇ What percentage of our work force is non-customer-facing? Could some employee tasks be cut in some locations? Outsourced? Offshored to a lower-cost venue?

- ◇ Are there roles in corporate functions that are duplicated in different business units?
- ◇ Does the productivity of different classes of employees measure up to best-in-class benchmarks?
- ◇ Are some FTEs dedicated to activities whose end value to the customer is questionable?

If your answers to such questions give you pause, you might consider taking a fresh look at your overall cost structure. Your competitors are probably trying to slash their own overhead costs.

It's a matter of principle.

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6/08