Strategic expense management for corporate and institutional banking executives
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Executive summary

Corporate and Institutional Banking executives face a number of challenges to control expenses in the face of ongoing dislocations in global capital markets and expense management has clearly become a mission critical activity at the highest levels of most organizations. Furthermore, recent severe market events that have forced the mergers of very large organizations make it even more critical to accelerate and master complex expense management initiatives.

While there is significant time pressure, it is important for senior executives to take a step back and properly review expense management techniques to ensure sustainability. As they embark on expense initiatives, executives have the opportunity to make fundamental changes to the expense base. Banks can create a culture of cost-efficiency that will refocus business lines on sustainable growth and client service and allow stronger institutions to emerge from the credit crisis well positioned for growth.

In this article, we provide a framework to identify “good” vs. “bad” costs. Through distinguishing between what drives costs, and what is merely a symptom of the underlying drivers, management will be equipped to build a foundation for strategic expense management. We identify four pillars of a strategic cost management program:

- Setting the right scope
- Tapping the right people
- Creating the right method
- Showing the right commitment

While this paper does not explicitly focus on post-merger integration (PMI) strategies, the techniques and approaches described here are directly applicable to the significant PMI challenges that face the industry – especially given that most recent mergers were executed to resolve critical funding shortages vs. mergers that are explicitly executed to extract costs from the newly combined enterprises.
Four pillars for strategic expense management

Setting the right scope

- **No areas off-limits**: Take a strategic view of the business and identify cost-savings within the traditional areas (large cost pools) and areas previously off-limits (special projects, strategic business shifts, etc.)
- **Motivate for success**: Provide incentive to link to other areas of the business to drive multiple cost-synergies
- **Create the right tradeoff**: Weigh costs against revenue opportunity for each business line to make a well-educated trade-off

Tapping the right people

- **Build continuity**: Create a standing committee for cost-management initiatives to provide stability and continuity in the decision making process and create a culture of on-going cost efficiency
- **Tap into expert knowledge**: Involve business line experts with a deep understanding of daily operating needs to ensure that the organization continues to run efficiently during and after expense reductions
- **Keep fresh eyes**: Rotate business line experts onto the cost-management team to ensure front-office knowledge is leveraged for strategic expense management

Creating the right method

- **Create an ongoing process**: Focus on an iterative method that will allow the business to identify and move forward with large and small opportunities in tandem
- **Think big and small picture**: Mix large cross-business line initiative with small “quick wins” to ensure forward progress without drastically disrupting daily activities
- **Build the culture**: Establish culture of cost-management and efficiency through on-going cost initiatives

Showing the right commitment

- **C-Suite participation, ownership, and accountability**: Successful cost programs are supported by the entire C-Suite and create an environment where business-line leadership owns and is held accountable for results
- **Communication**: Commitment and results need to be both informally and formally shared with leadership and program teams throughout the enterprise. These messages should be incorporated into mainstream messages delivered to all employees to drive cost principles into ongoing management and culture
- **Incentives**: New incentive structures need to be established to reward participation and success

By establishing these pillars, a bank can navigate the current turmoil and set a foundation for a smaller and more flexible cost base in the future. The result will be a significant contrast with results from the typical heavy handed and top-down driven approaches where costs tend to creep back over time. Our goal in this paper is to provide specific new ideas for Corporate & Institutional Banking (CIB) executives to drive their cost management strategies and ensure proactive cost management is a key competitive differentiator in these difficult market conditions.
The rising focus on costs

Over the past two decades, CIB businesses have experienced strong, steady growth. Despite intermittent market crises, revenues have seldom fallen for more than a year and the industry has been able to quickly grow back to profitability. However, the current market situation is different.

Oliver Wyman research found that tumbling revenues and growing costs compounded the deteriorating market situation in the fourth quarter of 2007. In February 2008, employment levels in the US securities industry reached their highest level ever, exceeding even the height of the Internet bubble in 2001. Many financial institutions had hesitated to cut costs or reduce headcounts in the hopes that revenues would rebound quickly and painful cost cutting measures could be avoided.

Unfortunately, significant near-term improvement in revenues is unlikely, as can been seen in the severe recent market events, forced mergers for funding stability, and the dramatic changes in regulatory oversight for US investment banks. Rather, significant risks will continue to accumulate, exerting further pressure on banking revenues. Given this painful reality, current market players and newly merged institutions will need to take drastic action to remain profitable in this environment and set the stage for future survival and growth.
The good, the bad, and the ugly

Given the current market conditions, you do not have to look far to find cost management programs being put into action. Within the last year, every major bulge bracket bank operating has announced cost management initiatives to combat unforeseen losses. Not surprisingly, the investment banking groups have been the hardest hit by the current initiatives. It is expected that a host of new announcements of this type will be made once firms can finalize merger activities and begin challenging post-merger integration activities.

**Figure 1: Sample of cost management initiatives currently underway**

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<tr>
<th>Bank</th>
<th>Number of Jobs Cut</th>
<th>Details of Cost Cuts</th>
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<tr>
<td>Citigroup</td>
<td>13,200</td>
<td>6,500 jobs cut from the investment banking division</td>
</tr>
<tr>
<td>UBS</td>
<td>7,500</td>
<td>4,600 jobs cut from the investment banking division</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Sale of distressed mortgage assets for Blackrock at a 32% discount</td>
</tr>
<tr>
<td>Merrill</td>
<td>4,200</td>
<td>Sale of 20% stake of Bloomberg (pre-BAC merger)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Sale of controlling stake of Financial Data Services, Ltd.</td>
</tr>
<tr>
<td>Morgan Stanley</td>
<td>3,000</td>
<td>Expected to cut 5% of total workforce in 2008</td>
</tr>
<tr>
<td>Credit Suisse</td>
<td>1,000</td>
<td>1,000 jobs cut for 2008 from the investment banking division (5% of total IB workforce)</td>
</tr>
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The problems with a typical cost cutting program lie in the fact that cuts implemented are generally short-term tactical fixes, rather than long-term structural changes. While the current market conditions are acute, building a sustainable cost management program requires more than sporadic/deep cost cuts throughout the business. Business lines should focus on resizing the current cost base to match future revenue expectations. Many previous cuts have failed to address long-term business needs because solutions fail to address the underlying cost drivers. Traditionally cost management programs have been undertaken in times of duress and narrowly scoped to address a specific cost-cutting target. For example, a CEO may state that all front-office expense must be reduced 20%. Teams typically drawn together from outside the business line are given specific dollar or percentage reduction targets and tasked to eliminate these targeted costs. Additionally, many banks tend to have rapidly designed cost programs which unfortunately blend attacks on costs that could...
undermine the seriousness of these programs (e.g. color copies) with valid attacks on costs that underlie “entitlement” costs such as lavish dinners, limos or unnecessary travel.

The typical approach to cost management programs is to identify the largest pools of cost, and seek ways to reduce these costs. These cost management approaches focus bluntly on cost per head benchmarks as the hammer for justifying and identifying cost savings opportunities. While this approach seems logical, it can be considered the equivalent of treating the symptoms vs. finding a cure. The problem is that such an approach considers all costs to be bad. This is not uniformly the case – there are many types of costs that are good. For example, a cost incurred to gain regulatory approval can pay significant dividends in the form of faster time to market for new products. A cost incurred to provide a senior relationship lead for a complex client can also have significant payback – a client less likely to consider competitors’ offerings, and better coordination of product groups ultimately leading to higher revenues. Another example is targeted costs that improve staff morale (events, employee communications, etc.), improve teamwork and retention leading to higher productivity and lower turnover costs. Clearly there is a balance where these good costs can become too high relative to their impact – effectively the good costs become bad ones – but there is a balance and sometimes spending more money in select areas can be the right answer vs. the standard “cut everything” approach. In the real world, a more nuanced scalpel is needed to identify and permanently eliminate “bad” costs while still treating the symptoms in the short term.

Conversely, some costs exist that contribute nothing to clients, staff, or even regulatory well-being. Other costs may support unprofitable clients, products, and channels. These we classify as bad costs. Of course the hard part is separating the good from the bad. In order to do so, one needs to avoid the temptation to focus solely on big pools of cost. Instead, one must develop an approach that examines underlying cost drivers. To illustrate this concept, consider the example from one client for whom we conducted a benchmarking analysis and found high middle office costs relative to peers. The institution’s initial reaction was to break down silos and create a middle office utility between cash credit operations and synthetics.

In such a case, the high costs were actually driven by the products the cash business was in – in essence, the chosen strategy came with a certain price tag. These cash credit businesses rely on broad multi-asset strategies with cash instruments rather than a relatively homogenous synthetics business based on standardized credit
default swaps (CDS). Other than some optimization of obvious waste, spending further time scrutinizing the pool of costs was a waste of time unless the underlying strategy driving this cost structure was deemed unsound. Such a conclusion enabled the client to focus their attention instead on cash credit operations and mortgage-backed securities processing where the combined middle office costs were in fact excessive – the underlying driver was duplication between two similar products and support processes. By addressing these silos, greater middle office consolidation made sense and savings were estimated to be above 20% of total middle office costs.

In summary, cost management initiatives in wholesale banking tend to fall short in four main respects:

1. Focus on short-term “squeezes” that too narrowly define the scope
2. Staff selection solely from a central team instead of involving business line experts
3. “Blockbuster” style initiatives that are difficult for the business to digest
4. Lack of effective communication to the business lines to build support from employees

The next section will highlight specific ways to address these typical shortcomings in strategic expense management programs.
Succeeding in strategic expense management

While it is clear that severe short-term actions need to and will be taken given the unfolding credit crisis, it is still critical that businesses take a comprehensive approach to cost management in order to sustain cost discipline and prepare for growth opportunities. The ability to recognize changing business requirements and adapt to new market pressures faster and better than the competition will create a sustainable competitive advantage for businesses that are able to manage these costs effectively. Developing a system for sustainable cost management programs will equip business line managers and senior executives with the tools and people necessary to rapidly adjust in today’s tumultuous economy. We have identified four pillars for strategic expense management that will allow institutions to overcome the limitations of the past and accelerate the transformation to leaner organizations that will be able to take advantage of the current competitive and market dislocations:

1. Setting the right scope
2. Involving the right people
3. Establishing the right method
4. Showing the right commitment

Right scope: lead with business/product strategy linked to cost drivers

Determining the right breadth of cost management programs is a very politically sensitive issue within organizations and often only examined closely in time of duress. This type of high-profile but sporadic program can lead to cost management initiatives that are either too narrow, only cut costs from front-office mature business lines, or too broadly scoped (e.g. cut 20% of costs across the organization). An effective program will establish a bi-focal scope that marries short-term reduction requirements with long-term strategic objectives. A scope that includes examining standard “business-as-usual” (BAU) expenses as well as special projects, risk, compliance, IT and other areas that have traditionally been off-limits during cost-cutting initiatives will allow executives to identify costs previously not considered.
Employees must feel that constant forward progress is being made and that changes are large enough to have a real impact on business operations. Executives should identify opportunities across a range of payback maturities, as well as identifying initiatives that allow for “jumps” in cost performance, to allow for larger and more durable reductions to be made. Adapting the cost management program and focus based on expected scenarios for given business lines will increase the likelihood that the program remains effective across diverse business units. Cost management exercises should be undertaken with a lens toward the future to give proper perspective to executives and employees undergoing the process and ensure that any cuts made will be sustainable in the long term.

Setting program scope
Looking across business lines, special projects, risk, compliance and other areas that have traditionally been off-limits during cost-cutting increases the probability of finding all available cost management opportunities. Recognition that the cost structure is driven by the underlying strategy is a critical first step in identifying cost-savings opportunities. Uncovering sustainable “big wins” will not likely all come from traditional cost management techniques (e.g., head count reduction, IT review) as these options are constantly reviewed and evaluated. Instead, focusing on areas within the business that are undergoing a broad strategy review and potentially shifting the way in which business is conducted can uncover hidden opportunities to identify strategic and sustainable cost-savings.

A key challenge in this scope-setting effort is to first gain a view across major business, IT programs and BAU investments that are normally not captured in one place. While it would be theoretically possible to conduct bottom-up analyses against project databases and business unit finances, such an analysis could take several months. Instead, “round-table” sessions with key leadership from business, IT, operations, compliance, legal, and research can develop a hypothesis driven approach to cost management and identify the top 100 “target list” for further investigation. This top-down analysis is then to be complemented by a “bottom up” analysis of data and costs for these individual programs.

To provide an industry comparison, a CIB institution can look directly to the hedge fund (HF) industry. Large HFs have similar operations to CIBs; however, due to the difference in industry development, HFs often benefit from a significantly lower cost structure. The primary difference between the two industries is that while CIBs have been inclined to always build operations in-house unless convinced...
otherwise, HFs have chosen to outsource anything not considered a core competency or strategic competitive advantage. This has allowed HFs through the use of third party vendors to be more nimble in market, have a higher variable cost base that can be reduced quickly and be quicker to adapt new technology for a competitive advantage. There are many potential best practices to be gleaned from the HF industry as they apply to broader CIBs within the market.

**Identifying big wins**

Larger savings require broader initiatives, which in turn require engagement of business leadership. The key is to present business unit heads with a factbase that is tailored to the unique characteristics of wholesale banking. This will allow business heads to cut through debate and drive greater efficiency. It is critical to understand differences in productivity and risk taking in the front-office, as two identically resourced businesses could have very different efficiency ratios if the amount of capital at risk is different, and front office inefficiencies can drive significant downstream cost.

As mentioned earlier identifying “good” and “bad” costs within the system are critical in strategically reducing cost while remaining competitive in the marketplace. Given that front-office headcount, IT infrastructure, operations outsourcing, etc., are expense items reviewed often, it is unlikely that all cost-savings will come from within these areas. Therefore, it is critical, particularly given the current market environment where business models are in a state of flux, that companies identify where they are changing the underlying nature of their business and what opportunities this creates to reduce the cost base. To illustrate this point, at work with a previous client we were able to identify opportunities around offshoring that were previously unconsidered due to the nature of the capital markets business. The client had historically determined that all modelers must sit close to the traders within the investment bank in order to facilitate quick communication. However, an opportunity was identified to have the modelers remain within close proximity to the investment back but to offshore model testing and validation to India to reduce cost for the bank and time burden for the modelers. The bank was able to offshore non time-dependent, time-consuming work at a lower cost than performing the operations in-house. Through strategic offshoring the client was able to lower overall cost to the bank and free time for the modelers to work on research and development.
Greater understanding of where productivity shortfalls originate should be used to identify key areas of potential costs savings and drive debate and decisions about value proposition from front-office productivity all the way through to the infrastructure required (i.e. what services, which clients, which risks, etc.). Cost savings can come from redesigning processes, replacing front-office staff with automated systems or operations staff, eliminating “hobbies” and other excesses of the boom phase, and driving scale and efficiency across infrastructure units.

One of the biggest front-office opportunities clearly lies in reviewing the compensation pool. In the current climate, with shareholder groups clamoring for equitable, value-aligned compensation, we believe that CIB players have a unique opportunity to move to lower levels of compensation without suffering the “first-mover disadvantage.”

To illustrate this concept, consider another example from one client for whom we conducted a cost management exercise. A large universal bank was interested in cutting their cost base to improve profitability across all business lines. We were engaged to perform an additional review of business line operations and propose areas for cost-savings. Following the initial review of costs across business lines we were subsequently engaged in a reengineering exercise globally to review business line activities and propose long-term strategic cost management initiatives to drive a culture of cost-efficiency. The combination of short-term immediate actions and long-term strategic goal setting identified areas of opportunity for cost savings across the business lines and introduced the concept of a savings sharing program to fund growing business lines.

Identifying sustainable cost management opportunities

A complete review of the business lines and activities, from front-office performance skews to synergies available through shared services, will allow businesses to identify a wide range of cost management opportunities. The broad framework (Figure 2: Front-to back-office cost management) illustrated below identifies opportunities to recognize cost-drivers within an organization and begin to eliminate “bad” costs throughout the business.
Figure 2: Front-to-back-office cost management

Planning for future business needs

Effective cost management requires business line management to be forward thinking. A program that fails to consider the future state of the business will be unrelated to business reality when it is finally implemented – creating friction between the proposed cuts and BAU activities. Evaluating the product or business lifecycle allows management to segment emerging and maturing areas. Cost management programs can be tailored based on the lifecycle phase of markets and products to optimize spending by sub-group. Management should not starve growing business lines while over-funding mature ones. Flexibility and re-evaluation in cost management decisions is required as products and business lines progress through the product lifecycle.

Like product lifecycle considerations, scenario planning allows the business to monitor the risk of cost management decisions. Management must have a view of where the overall market is positioned to grow, decline, plateau, etc. For example, 2008 has been a volatile year within the commodities market across the spectrum of energy, agriculture, livestock and metals. Continued volatility and global trading volumes need to be considered when analyzing the potential impact on trading groups, related client services, and required investments. An effective cost program allows management to consider these possibilities and establish contingency business plans for each event.
Changing the focus of information technology analysis

Information technology has been an area of continual cost focus for decades and the pressure on IT has only increased as budgets for IT within CIB firms have grown into the billions. When examining IT spending, management is concerned with minimizing the total spend (e.g., we need to reduce IT spend by 10%). However, in an effort to identify necessary and unnecessary (“good” and “bad”) costs executives must focus on the operating model and the associated processes that drive IT spending rather than starting with IT itself. Unfortunately, the focus often has been, and continues to be, on the rapid replacement of major legacy systems that form the backbone of these enterprises.

While there have been some successes in these areas, the more common conclusion is that these systems have to be innovatively “ring-fenced” with new technologies that allow them to be leveraged throughout the enterprise. This allows the gradual reduction of significant maintenance costs for the core legacy systems and the orderly transition from legacy to more modern vendor platforms.

The key is to not waste 6-12 months on “pull the plug” exercises that do not succeed and waste time and money. Instead, scarce resources should be focused on IT component and service-oriented solutions that can extend the life of legacy systems, while also establishing clear roadmaps for orderly and substantial reduction in the costs associated with these platforms.

One exciting example here is the combined use of Web 2.0 collaborative technologies combined with enterprise service-oriented architecture (SOA) in the form of rapidly developed trading desk “mash-ups”. These “mash-ups” extend the long history of trading desks developing critical applications for new products by allowing desk personnel to access rich internal and external pricing and risk data that is exposed by central IT groups through robust data services. The result with this innovative combination of desk and centralized technologies is radically reduced cycle times for the delivery of critical risk and pricing data to traders - allowing them to react quickly and safely ahead of their competitors.

Right people – experienced, empowered, organized

Major organizations consistently stumble in cost management initiatives because they do not properly involve business line experts who work with the technology, clients and operations staff on a daily basis. Cost cutting in isolation without in-depth knowledge of
business line activities can create more problems and costs than it alleviates. As importantly, improper team organization, sporadic meetings without team member continuity, and/or too much hierarchy in the team structure will limit the efficacy of any cost management program. An effective cost cutting program aligns the right people with the proper organization and within the right team structure to develop a sustainable long-term cost management program.

Involving the right people

Too often, cost management decisions are disconnected from business line activities. Poor fit between cost cutting decisions and business line operations is frustrating to both business line managers and cost management teams. This can lead to programs that are smartly designed from a theoretical perspective, but are disconnected from daily business activities. Misalignment creates frustrated employees, unintuitive cost structures and potential for increasing costs in the long-term.

Bringing business line experts into a cost management team can be a difficult trade-off for firms and a concerning relocation for business line experts. However, even given these challenges, an outcome driven by the daily users within the business line will be more relevant and sustainable in the long-term and ultimately will be more beneficial for the business line. It takes senior business leadership to reach out directly to front-line staff to let them know that these are important assignments that will be rewarded with career enhancement and appropriate financial incentives.

Organizing teams

Regardless of the individuals chosen to participate in cost management decisions, proper organization is required. To create a culture of efficiency, cost management must become an ongoing initiative. Regular team meetings and review are essential in ensuring that initiatives are not lost in the shuffle of daily activity and costs do not inflate out of control in prosperous times.

A sustainable approach is to create a rotating team structure that draws team members for a limited amount of time on a regular basis (i.e. two weeks per quarter) to review the portfolio of initiatives and propose new ideas. A standing management committee will create the stability required to effectively manage change and reinforce a culture of cost efficiency throughout the business cycle. A rotating team recognizes the desire of business line experts to remain in the business, while matching the business need for effective cost
management. It is important to change the members of the cost management committee as required, but maintain a structured steering team responsible for all cost management programs. The steering team should be established with a limited hierarchy – no more than two layers – and have the seniority and responsibility for all cost management within the business unit.

All of these organizing principles should be enforced with a “self-organizing” team approach, reinforced with nimble management and not with heavy and central project management offices (PMOs) that are disconnected from program goals.

**Right method: establish, review, repeat**

**Creating an iterative method**

Managers can compress the distance between getting things done by designing, developing, and deploying a portfolio of joint projects in order to drive sustainable change. This is in contrast to the “big bang” approach generally taken:

- Design all initiatives and roughly determine the total costs savings.
  - Designing initiatives based on a hypotheses driven approach creates a storyboard of a potential future, but is limited in the accuracy of cost savings predictions
- Develop each of the initiatives into actionable items.
  - Development of multiple complex and simple initiatives is often difficult for a firm to process as each initiative is either not given enough or given too much consideration in the process
- Deploy all initiatives at the same time in order to quickly drive change.
  - Mass deployment/implementation creates confusion among employees and chaos within the organization as business units strive to cope with the many moving parts

The key lesson learned from past failures is that businesses should not wait to design all projects, and then develop all projects, and then finally deploy all projects, because such a process will create changes that will be too large and difficult to digest. A sustainable method will instead be iterative, involve a balanced portfolio of initiatives, and be selectively open to upfront investment where it can produce sizeable cost savings in a short payback window.
Embedding sustainable and repeatable cost management

A critical step in this approach to cost management is to ensure that saving is not a one-time event but a sustainable and inherent part of the management culture. Once a wholesale business has achieved its target efficiency level, further savings can only be generated either by continuously reengineering the relevant business processes or by intelligently avoiding costs during growth. Management techniques from other industries can certainly be leveraged, but at the effort’s core should be four unshakeable tenets:

- Embed the enhancement of operational efficiency into business unit strategy, recognizing that different businesses will be at different stages of development

- Fast-track the deployment of efficiency initiatives across the business – whether through centers of competence, shared platforms or group-wide utilities. Move systematically from pilot projects to production (for example, moving from selective offshoring of certain function services to global optimization of operations)

- Integrate indicators of operational efficiency into the performance measurement and compensation of every business leader. Historically, business leader compensation has been primarily driven by top-line revenue or sales targets. Managers had the incentive to maximize revenue for the quarter with little regard to the cost base that would be required to generate that revenue (provided they were within or near their target budget). Operational efficiency targets will push business heads to operate at the most efficient levels regardless of pre-determined budget

- Ensure that senior business leaders are accountable for front-to-back cost management, not just front-end costs. Ensure that front-office costs are not viewed in isolation of the costs that they can create across the enterprise

Recognizing CIB specific needs and opportunities

CIB businesses need an approach suitable for their highly compensated and risk-intensive front offices, rapidly evolving product and client landscape, and vast array of low and high volume products and services. CIB product investment and management requirements change substantially over the product lifecycle. For example, a fast-growing product in an emerging market will require significantly more time and management attention than a commoditized product in an established market. See Figure 3 below for an illustration of the capital markets S-curve product lifecycle.
Standardized cost management techniques that depend on repeatability and predictability (such as DMAIC, Kaizen or Six Sigma) do not fare well in this environment for anything other than highly mature products. Review of products on a case by case, region by region, basis is required. The ability of a business to recognize where in its lifecycle each product falls and invest/manage accordingly will impact overall efficiency and ensure that each product is receiving the optimal amount of money and management attention.

**Right commitment: determine a course of action and follow through**

Cost management is often an unpopular activity. Too often, cost management programs fail to achieve the desired cost savings because management does not undertake cost measures suitable to a CIB business and/or are unable to address the opportunities within shared services. Management is often unable to commit to the unattractive and painful steps necessary to fulfill the program. Making cost cutting part of the corporate culture is essential in establishing and maintaining a commitment to and culture of cost management.

**Establishing leadership commitment and involvement**

Total management commitment to the creation and maintenance of a cost management culture is required. Without the backing of the C-level (i.e. CFO, COO, CEO), business line managers will
lack the required support to effectively implement ongoing cost controls, causing operational efficiency to lag, particularly in times of prosperity. Driving change from an existing culture of more lenient cost controls will be challenging for embedded management. In that respect, the current market turmoil provides a base from which new management can begin to rebuild business lines and continue to grow profitably. Management must show commitment to cost cutting at every level of the organization in order to drive sustainable change within the organization.

Communicating change
Traditionally, CIBs have not taken an in-depth look at the softer side of cost-cutting initiatives: Change management. Most executives realize that managing change is unlike managing any other aspect of the business, but are ill-equipped with the tools necessary to facilitate the process. Failure to properly manage the expectations and goals of employees during the cost management process will result in discontent within employee groups and could permanently damage employee morale. Establishing a process to handle employee communication is a critical component of change management. Whether the process requires individual meetings, department-wide discussions, internal business conferences and/or press releases to the general public business leaders must determine the appropriate messaging and communicate in a way that effectively manages the expectations of employees, shareholders and regulators.

Aligning incentive structures
Arguably the most effective way to build a culture of cost management is to properly align employee incentives to match those of the organization. Similar to fundamental economic principals, if every member of the organization acts in their own best-interest, to maximize their compensation, then they will also be acting in the best interest of the organization, to minimize expenses while driving revenue. Spending time to determine how business units are measured, what incentive individuals receive and how executives can align business and personal goals to drive change within the organization is a pivotal role in cost management planning.

Determining business unit objectives will vary by business and product line and be established by the underlying business drivers. Once good and bad costs have been identified, incentives can be set by the business unit to eliminate bad costs from the system. For example, an organization with high cost structure may learn that their higher than average cost structure is driven by a number of highly manual processes in their front-office. After determining
the necessity of each manual process business managers may realize that a number of manual processes are legacy practice that was established when the product was in the initial development stages and still a high-margin, low-volume product in the market. As products evolve and become low-margin/high-volume, legacy systems must be updated to reflect the current state. Developing an incentive scheme that encourages employees to consistently review front-office services for automation possibilities will increase the likelihood that these opportunities will be flagged and resolved in a timely manner. Depending on the design of the incentive structure, a percentage of savings from each identified opportunity can flow back to the business line in the form of employee bonuses and investment dollars.
Conclusion

As the capital markets industry undergoes massive changes, many players will feel intense pressure to operate more efficiently. This will be exacerbated by market demands on newly created and expanded universal banks where expense optimization is inherently difficult due to the breadth and depth of businesses that these firms contain. Successful players will have the foresight to plan for the future, the flexibility to react to changing market conditions, and the commitment to a culture of expense management throughout the business cycle. Developing an expense management culture is not fast and sustaining a cost management culture takes time, but both are essential in gaining a competitive advantage through business efficiencies. Management teams must make a commitment to cost cutting and undergo initiatives to drive long-term sustainable change:

- Right scope – Lead with effective business/product strategy linked to the right cost drivers. Identify good costs vs. bad costs to understand underlying business cost drivers and identify long-term strategic cost savings
- Right people – Commit business line experts to cost management roles and provide the organization and structure to effectively review and implement changes across business units, shared support services, special projects, etc.
- Right method – Build an iterative and repeatable approach to broad cost programs that ensure that concrete results are delivered to the business every quarter while long-term cost management transformation is achieved
- Right commitment – Drive change from the top with C-Suite sponsorship, participation and ownership complemented with incentives and communication across the enterprise to ensure long-term cost efficiency and profitability

Success in designing the program, choosing the people, determining the method and committing to change will push CIB businesses forward in adopting long-term strategic expense management techniques and gaining a competitive edge in today's volatile market environment.