

How can Financial Institutions better perform in changing environments?

Who has not been questioned about the banking turmoil we know since 2008? Several times, we were confronted to tough discussions and debates about the subject. People coming from industries and without experience in financial services are sometimes the most critical about safety plans organised by Governments. Incomprehension about the business of banks is also a regular discussion point. How many individuals or companies have bought complex financial products with strong advices from their banker? For them, lost were sometimes important.

These last weeks in Belgium, KBC was sued for having sold Credit Default Swaps to loyal customers. Why did the bank sell such products to its clients? Only to make money on a specific deal? There is no single answer to these questions, but sometimes banks sold products without taking care to answering customers' needs. We propose to compare industry and financial services regarding the commercial process and discuss ideas of adjustments that financial sector could take to provide more added value to its customers.

Push mode...

People having worked in industrial world know that a lot of money is invested in Total Quality Management programs and that this philosophy includes the measure of the customer satisfaction. Such programs do not exist or are exceptions in the financial world. Customer satisfaction measure is also very poor inside banking world. How many bankers call its customers to know if they were happy of a product when this one is sold or when the product is at the end of its lifecycle? Few.

Why do we face such a situation when, in some industries, a lot of time is invested to assess the quality of a product and how far this one had met customers' needs?

The answer is maybe in the type of commercial strategy implemented by banks. For most of investment products, banks are in a push mode. Product Management provides guidelines to the banking Production world. Products are built from market conditions, then they are proposed to the clients through different Channels (commercial branches or direct channels). The commercial force meets customers and gently listen their requests. But most of the time, they do not care about the real customer needs. Each month, they receive commercial targets that they have to meet. These targets are based on what the bank want to sell and therefore the drivers come from the production. This is the reason why most of the implemented commercial strategies

are in a push mode. They push the products to the customers without really taking care to real customer expectations. What happened with structured products sold to customer is a good example. For instance, banks had produced CDO and commercial targets were defined to sell these products to customers. Large companies could better assess the quality of such products, but smaller ones were not able to do it. Therefore, they believed bankers, invested cash in structured products and sometimes lost a lot of money.

...versus Pull mode

In years Seventies, some industries have changed their mindset. They understood that there were needs to better understand their customers and sold them products they really expected. Production lines were adapted. These industries started to produce goods from orders and no more from planning only. They created a Pull production mode: production based on client needs and therefore on customer demand. Since then, various models were developed by the industrial world to improve the quality of products and to better answer to customer expectations. They innovated and created models combining orders and planning. Quality took more and more place in industries and today almost all industries have adopted quality approaches.

Financial sector has not followed this trends!

It is interesting to stress that some best-in-class companies in Quality Management made mistakes, such as Toyota in years 2010. Being the leader in car production, the company reduced vigilance and errors appeared in the production process.

Banks must react

We are convinced that the bank must change its mindset as the industrial world did a few decades ago. If the financial world has invested a lot in new technologies these last years with Web-technologies or smartphone applications, there is still some delay to understand what matter for their customers. Clients are not equally treated: multinationals get more attention that smallest ones. The product portfolio is also different. If large firms have access to the most advanced services, the gap is now almost reduced on technology level. Almost every client can use direct channels to perform standard operations. A few years ago, it was not the case.

However, all banks have not followed this trend concerning products and services offer. How many clients expressing specific needs never got what they expect?

Today, this way of working is maybe outdated, because clients' behaviours have changed. They do not want to invest as before in home-made product such as

funds or unit trusts with poor performance and high fixed costs. They also think twice before investing in complex products. Lot of clients remain then in a grey zone with their cash and they do not know how to invest their money. The banking world must therefore react. Banks must truly understand the right product or service that the customer need. They must listen to them, reinvent new segmentation and define new customers' profiles. Till now, we do not see that type of reflexion around us.

Banks are like supertankers

Have you already experimented how difficult the mentalities change inside financial world? Most of bank managers speak about Change Management. They train their senior managers who attend seminars about the subject, but on the field, few of them are present to provide messages to enable that change happen. Large banks can be compared to supertankers. These sea vessels are so huge that to change direction or speed, several miles are required to see the result of a captain decision.

When some agile decisions are taken to rectify errors or waste, there are often a set of decisions that must be taken by managers to allow their implementation. It takes time and long discussions are required to decide any action. To illustrate this, we provide this real example. During a project, the decision was taken to analyse a process where access rights are provided to extract information from a database. The process to grant access to controllers was heavy and inefficient. Workshops were organised and an overview of the situation built with all people implied in the process. In a second phase, some clever ideas were collected to adapt the process and to automate access. Each party understood inefficiencies and gave support to change the process.

Time gain for the department was on average 10 full days a month. Effects were measurable and actionable on short term. The decision took months before being implemented because the Management feared to take wrong decisions. They asked multiple advices, agreement from all departments implied and asked to get all details about the change impact. It took months to simplify an organisational process quite simple, mainly because the change culture was very poor. There is plethora of such examples in banks today.

The difficulty for financial service is the identification of these problems. In industries, it is easier, because we can materialise what is wrong. It is much more difficult when system bugs appear or when people leave a department with operational knowledge. However, it is crucial for financial service to become agile, to reduce inefficiency, to manage its key processes and quickly take actions when required. We are convinced that banks must rethink their current Organisation driven by innovative commercial strategies. It is not easy, because more and more constraints are imposed by

local and European Regulators. But it makes sense to objectively analyse the complexity that banking sector has created and consequent actions must be firmly taken to simplify processes. After 2008, most of the banks use words such as 'Simplicity', 'Lean' or 'Make it simple!' but they mainly stay marketing words. The hierarchy and the mindset have not followed. There is still hard work for all the banks.

Start with clear dashboards!

If we can advise banks to start with simplification, they can start with the number of reports and dashboards. When you question managers about the number of reports received or produced inside their departments, answers received are mostly not accurate. The person needs to ask around to get a correct inventory. As already stressed, laws and regulations were strengthened these last years with a strong impact on reports produced. There is currently more pressure to control activities. This brought strong increase of reporting.

Again, there is a trend to push reports to the Top of bank Management. Some controls are not always justified. There is a necessity to also redefine what are good controls, what need to be reported and why. It is also interesting to measure who is using which reports. Top managers should better challenge the various reports present into their departments and impose standardisation and homogenisation. The best people who can do it are the Top Management. Banks live since years with heavy reporting. It increases the difficulty to reshape a reporting framework. If reporting simplification is not an easy exercise, it is a good start to identify where processes need to be reviewed.

More and more signs show that banks will need to adapt their business model faster than before. Starting with a customer-oriented approach seems a clever way to proceed for 3 reasons:

- If banks can answer to the real customer needs, clients will come back with satisfaction and not as today, by habit or resignation!
- Banks have the opportunity to anticipate client needs and pro-actively offer them solutions. It is a good way to implement a 'pull mode' mindset.
- Finally, identification of products providing the most satisfaction would help to review and rethink products portfolio suiting to customers. The segmentation could be also based on the needs and not only on financial or socio-economic parameters.

The velocity to change will be also predominant. We advise financial sector to transform their structures from hierarchical to agile and flat organisations. They will de facto simplify their processes and ways of working.

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«AIFMD is not the only on-going regulatory issue under discussion»

Sandrine Leclercq of Baker and McKenzie Luxembourg discusses some of the most important regulatory changes coming up.

The annual ALFI (Association of the Luxembourg Investment Funds Industry) Spring Conference took place at Luxembourg's New Conference Centre in Kirchberg on 19 and 20 March. Since its inception 25 years ago, ALFI and its members have worked extremely hard together to the point that Luxembourg is now the largest fund domicile in Europe, with in excess of 2,405,928 bn euro in Assets Under Management (AuM) in 3,820 funds.

The Luxembourg investment funds industry has also become a world leader in cross-border fund distribu-

tion. From its humble beginnings in 1988, ALFI has also witnessed the steady increase of European and national regulation, aimed at ensuring investor protection, but also having a significant impact on its members conducting their businesses.

Sandrine Leclercq, Counsel at Baker and McKenzie Luxembourg, attended the Spring Conference and reported on the key legal and regulatory topics under discussion. "The ramifications of the AIFMD (Alternative Investment Fund Managers' Directive) took centre stage, both in terms of timeframe and the creation of new legal structures within Luxembourg to create a full "tool box", meeting the needs of Anglo Saxon promoters."

She explained that clients' principal concerns regarding AIFMD are, "In the short term, how investment funds

who delegate management outside of Luxembourg respond to the limitations on delegation clarified by the AIFMD. We are also advising our clients on the legal aspects of mutualisation of human resources and the consequences for promoters in the US and Asia for the changes ahead, especially with regards to distribution as private placement and reverse solicitation are being challenged under the new regime."

However, AIFMD was not the only on-going regulatory issue under discussion. How will the onset of the Foreign Account Tax Compliance Act (FATCA) affect the Luxembourg market? Have fund companies accepted this regulation and begun to prepare or is there still work to do?

"Since the industry has known that investment funds qualify as FFIs, there has been a huge amount of work

preparing for the relevant due diligence. Fund companies might benefit from both a simplification of the burdens as a result the Sponsoring FFI status - allowing a fund manager, custodian or administrator to carry out all the diligence on behalf of the fund or multiple funds - and the additional time window for compliance as a result of the extension of the grand fathering period for certain assets."

"There are many challenges ahead," concludes Leclercq. "Especially for non EU Fund managers located in jurisdictions for who the local regulations will not be considered equivalent to EU regulations. The Industry will have to be able to provide solutions to create a friendly environment for fund relocation, like notably supporting the emergence of local management and compliance expertises that will add the necessary substance under AIFMD"

Un nouveau Yen pour le Japon

Au Japon, même un brin d'inflation peut aller loin. Après sa démission il y a six ans, le premier ministre Shinzo Abe est revenu au pouvoir en novembre, avec la promesse de mettre un terme aux cycles déflationnistes qui frappent le pays depuis plusieurs dizaines d'années.

Les premiers résultats sont encourageants. Abe a exercé de la pression sur la banque centrale du Japon pour qu'elle assouplisse sa politique monétaire et qu'elle fixe un objectif d'inflation à 2%. Par ailleurs, la banque centrale est désormais responsabilisée à un niveau inhabituel pour les fonctionnaires japonais. En marge de cette politique d'assouplissement, le yen s'est affaibli de 20% à 30% par rapport aux principales devises, depuis l'arrivée au pouvoir d'Abe. Et pour une économie aussi tournée vers les exportations que le Japon, cette baisse est salutaire.

Si ces tendances se poursuivent, elles pourraient changer la donne à la fois pour l'économie du pays mais également pour les marchés actions japonais. La faiblesse du yen favorise les bénéfices des exportateurs et devrait, à ce titre, dopper les valorisations des actions. Et si les marchés actions japonais se portent mieux, l'économie suivra. Nous avons déjà pu observer ce cycle vertueux, lorsque le marché actions japonais a tiré l'é-

conomie à la hausse, de fin 2005 jusqu'à la crise financière de 2008. D'autres conséquences liées à la lutte contre la déflation devraient également profiter aux actions. Comparé aux autres pays, le consommateur japonais détient une part importante de son épargne en liquidités. En parallèle, les fonds de pension japonais ont sousinvesti dans la classe d'actifs actions, favorisant les obligations souveraines durant la longue période de déflation qu'a connu le pays.

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Si nous arrivons à un point d'inflexion, marqué par la fin de la déflation et un début d'inflation, une très forte injection de liquidités pourrait arriver sur le marché japonais, tirant les actions à la hausse. Si les bénéfices liés au retour à une inflation saine et stable sont certains, plusieurs risques peuvent néanmoins la mettre en péril. Deux tranches de taxes sur les produits de consommation sont prévues au Japon dans les prochaines années, qui augmenteraient la fiscalité existante de 5% à 10%.

Ces taxes sont tributaires d'un retour du pays à la croissance économique, mais pourraient freiner cette dernière une fois entrées en vigueur. Il existe également un risque politique. Abe n'a pas été un premier ministre efficace il y a quelques années car ses choix politiques

avaient été bloqués par l'organe législatif du pays. La capacité du premier ministre à mettre en oeuvre sa volonté politique sera testée prochainement lorsqu'il devra faire valider sa nomination d'un nouveau gouverneur pour la banque centrale du Japon. Mais les premiers signaux sont positifs. La cote de popularité d'Abe progresse depuis sa prise de fonctions, ce qui n'était pas arrivé au Japon depuis une dizaine d'années.

Les marchés ont également bien accueilli son élection, avec une hausse de plus de 20% des principaux indices sur les derniers mois. Les actions japonaises devraient pouvoir rester sur leur lancée si Abe parvient à maintenir les niveaux d'inflation. Mais la sélection de titres sera primordiale dans les prochains mois. Les cours des entreprises les mieux placées pour bénéficier de la faiblesse du yen—les grands exportateurs aux marges bénéficiaires les moins élevées—ont déjà été tirés à la hausse. En effet, ce sont ces grands exportateurs, dont les marges bénéficiaires sont les moins importantes, qui ont le plus à gagner d'une devise affaiblie. D'autres opportunités, moins visibles, restent à exploiter.

Selon nous, les sociétés de l'industrie de l'automatisation sont particulièrement attrayantes. Alors qu'une grande majorité de leur chiffre d'affaires provient des exportations, leurs coûts de fabrication sont en yen. Un yen plus faible renforce leurs marges bénéficiaires. Nous pensons que le marché a négligé ces sociétés exportatrices car leurs niveaux de marges sont déjà importants.

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Mais pour le secteur de l'automatisation japonais, l'effet devise est conséquent. Nos échanges avec les sociétés utilisatrices de ce type d'équipement confirment l'avance technologique des acteurs japonais par rapport à leurs principaux concurrents, situés en Allemagne. Or la dévaluation du yen face à l'euro ces trois derniers mois a mis les produits japonais à des prix très compétitifs par rapport aux équipements allemands. Les promoteurs immobiliers japonais offrent également des opportunités intéressantes.

Dans un contexte d'inflation stable, nous attendons une hausse rapide des prix de l'immobilier. Les promoteurs japonais détiennent une part importante des plus beaux parcs immobiliers du pays. Par exemple, Mitsubishi Estate détient 60% de l'immobilier du centre des affaires de Tokyo, qui représente également le coeur névralgique du réseau ferroviaire de la capitale. Dans un contexte de remontée des prix, les loyers dans cette zone progresseront fortement. Le pays du soleil levant a déjà connu de faux espoirs. Mais si Abe et son équipe parviennent à atteindre leurs objectifs, la récession japonaise, qui dure depuis 20 ans, pourrait enfin cesser. Avis aux investisseurs.

Source: Janus Capital International Limited,