

Where Strategy and Risk Meet ©

Alma Grove Consulting

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Banks & Financial Institutions

Banking in Mature Markets: Strategies for Squeezing Blood out of a Stone

It is now some four years since the early onset of the Global Financial Crisis. Many banks and financial institutions around the world have not only survived but taken advantage of strategic opportunities that have arisen. They have acquired competitors, businesses, assets, customers and – in general - profitably grown market share. The benefits from

declining asset portfolios, low credit growth, increasing operating expenses and unrelenting competition. This gives a lethal combination of flat or declining revenue streams, margin pressures and an increasing cost base. The increasing cost base is the result of general inflationary pressures, the demands of new regulatory

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these acquisitions and the rebound in profitability - from lower levels of bad debts and non-recurring asset writedowns - have now waned however. A new reality has set it in for many banks and financial institutions in operating in mature markets.

For organisations without significant growth channels in emerging, developing and/or higher growth markets this new reality consists of stagnant or

requirements and ongoing IT capital expenditures.

What other strategies can be developed to deal with this new reality ? The common reaction is to aggressively pursue market share and undertake extensive 'across the board' cost cutting. The more measured approach however lies in developing multifaceted strategies that include:

About Alma Grove Consulting

Alma Grove Consulting is an Australian based, specialist consulting firm servicing Banks, Financial Institutions, Corporate & Government clients, in areas of Strategy and Risk Management.

Alma Grove Consulting provides support to Boards, CEOs, Senior Executives and management teams in the following areas:

- Strategic Planning; and General Strategic Advice
- Establishment of Risk Appetite / Risk Boundaries
- Enterprise Risk Management
- Strategic Planning Workshops
- Change Management and Organization Restructuring
- Independent Project Quality Assurance Reviews
- Independent Reviews of Problems / Issues
- Credit Risk and Client Engagement Training
- Coaching & Mentoring in Strategy, Risk and Finance for Senior Executives

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- **Reassessing Existing Growth Strategies.** It has been fashionable in the banking – in retail, and commercial banking and wholesale ends – to build out capability and expand distribution channels in home markets. Home markets have quite correctly been identified as lower risk, from a strategy execution and risk management perspective.

An assessment should however be undertaken to determine whether or not the original rationale is still supportable. Lower revenues, lower margins and potentially a lower achievable market share will have undoubtedly changed the economics of the original business case.

- **Dust off Expansion Plans for Emerging, Developing and New Higher Growth Markets.** Consider bringing forward business plans to expand in higher growth markets. This may entail taking on additional if the new markets are higher risk, but may be necessary to offset long term declines in revenue and margins in existing markets.

Banks effectively need to quickly latch on to profitable, successful and growing businesses, and potentially invest / grow at a faster rate than originally intended.

- **Reassessing Post GFC Risk Appetite.** Whilst not advocating increasing risk

appetite across the board, banks and financial institutions will need to selectively ‘cherry pick’ customer groups, segments and lines of business that present acceptable risk profiles. Risk appetite should, in any event, be reassessed annually and aligned with approved

Businesses. Basel III and other capital changes - either in place now or flagged – necessitate a more in depth review of capital intensive lines of business.

There continues to be ‘cross subsidisation’ across businesses in many financial institutions. Lower

Banks and Financial Institutions in mature markets need to develop multi-faceted strategies that include identifying high growth segments within the existing business portfolios, reassessing existing growth strategies, reassessing post GFC risk appetite and reassessing IT expenditures.

business strategies (and vice versa).

- **Reassessing IT Expenditures.** IT projects continue to be one of the three largest expense categories for banks (along with the cost of risk and wages & salaries). Regulatory and compliance requirements are also now driving a significant increase in IT expenditure. These costs are either crowding out or adding to the cost of capability enhancements, cost reduction initiatives and/or customer relationship management projects.

Boards and executive teams need to be vigilant in ensuring the appropriate prioritisation of expenditures and the ‘capping’ annual IT expenditure.

- **Undertake a Deep Dive into Capital Intensive**

profitability (and unprofitable) departments or areas are being supported - effectively subsidised - by other profitable areas. In financial markets businesses for example there are segments or desks that do not cover the full cost of operating taking into account staff costs, IT and risk management infrastructure, and the cost of liquidity and capital.

- **Enhance Customer and Product Profitability Tools.** Despite dramatic improvements in transaction processing, customer relationship management and IT systems infrastructure generally, customer and product profitability tools continue to lag.

Investment in customer and product profitability tools will assist accurately identify

lower profitability segments that require attention.

- **Identifying high growth segments within the existing business portfolio.** Using customer and product profitability tools and other

analytics, banks should look to quickly identify high growth segments and capitalize on these segments. Banks should look to emulate other industries such as consumer electronics and fashion retailing, in such

a way that they can rapidly adjust the 'supply chain' (in this case their sales and fulfillment functions) to meet changing consumer demand.

Risk Management in Business

SPOTLIGHT ON: MERGERS & ACQUISITION RISK (M&A RISK)

Over the past twelve months Alma Grove Consulting has been developing a comprehensive - yet easily to understand - framework for the identification, assessment and management of risk issues in the business world.

In this newsletter we focus on an important *Strategic Risk* – **Mergers & Acquisition Risk. (M&A Risk).** M&A Risk is the risk that an acquisition made by an organisation will adversely impact on the organization's future business or financial condition. Key issues that can give rise to risks in this sub-category of *Strategic Risks* are:

- The businesses or assets being acquired are not worth the price being paid;
- The change in ownership results in a diminution of the valuation of the businesses or assets. This includes any adverse impact on customers and staff;
- Subsequent integration of the businesses or assets is not concluded successfully (Integration Risk); and
- Key assets being acquired – such as intellectual property or management / key

personnel – are not adequately protected or addressed in the purchase arrangements.

Successful mitigation of many of these risks can be achieved through careful investment analysis, due diligence (commercial, financial and legal), integration planning, and other post settlement activities.

Failure to adequately address risk issues that arise under the broader **M&A Risk** category – particularly when coupled with a significant increase in financial leverage is one of the most common reasons for financial distress.

Next Month in the *Risk Management in Business* Series:

SPOTLIGHT ON: MODEL RISK

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