South Africa’s banks need to get better at cost controls

South Africa’s banks have some of the highest operating costs relative to income in the world – an issue that according to World Bank data has grown steadily worse over the past decade.

Source: Supplied. Kwaku Debra, a expert at Partners in Performance.

Despite a strong performance under tough economic conditions, South Africa’s banking sector is less profitable than more than half of its global peers, ranking 35th out of 133 countries in terms of highest operating costs, with an estimated cost-to-income ratio between 54% and 61%.

“Legacy cost-cutting and short-term approaches don’t work, but banks and financial services companies can turn around their sub-par cost efficiency through four key operating initiatives,” says Kwaku Debrah, a seasoned banking executive with comprehensive expertise in the African banking sector, currently serving as a partner at Partners in Performance, a global business optimisation firm catering to clients across 33 countries.

“A bank’s cost-to-income ratio is one of the key financial measures for evaluating its performance. For large legacy banks, reducing costs sustainably has typically not been done well, and consequently, costs have increased faster than revenues. With high cost-to-income ratios negatively impacting shareholder value creation, banks must look for new ways to reduce costs effectively and sustainably,” says Debrah.

Debrah says banks can start controlling their costs and get more profitable by following four tactics:

1. Let your people generate cost-cutting ideas and turn it into an ideas pipeline

A common response to cost pressure is swift, top-down cost optimisation. While this looks good on paper and could deliver short-term results, it nearly always fails to provide long-term, lasting outcomes.

When top-down, knee-jerk cost targets are set, banks often apply short-term cost-cutting initiatives that close the taps on training, travelling and hiring, a move that cannot be maintained for very long.

Another often-used and ill-fated method is the ‘Lawnmower Approach’, when all cost centres are held to a set percentage over a set period, regardless of their challenges or successes. These actions are not particularly strategic and can cause long-term damage.

Rather foster a culture which encourages open idea-generation. Encourage teams across the organisation to have unemotional, data-informed conversations about where they can improve efficiencies. Ideas can be prioritised and implemented with sufficient specificity, which helps create a culture of collaborative accountability.

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To drive costs down sustainably, an ideas pipeline is critical. Just realise that in most cases, a lack of ideas is not the problem - it’s about the prioritisation and execution thereof. Traditional banks often take on too many ideas and tasks, the pipeline gets blocked, productivity falls, and cost optimisation becomes unsustainable.

Progressive banks that drive costs down sustainably focus on ideas implementation and prioritisation – thus a high-velocity pipeline that delivers results.

2. Align the organisation behind your cost optimisation plan to create ownership

Cost reduction initiatives need support from within the organisation to be successful. Buy-in for a shared plan is required from those who must implement spending cuts, otherwise costs invariably come back over time.

Buy-in also requires clear, organisation-wide communication of the plan and vision, so that everyone understands what they are expected to deliver. Messages must be frequently reinforced, and successes celebrated.

Cost-cutting cannot be achieved if organisations and their people lack a clear understanding of the true cost drivers, how to manage them or what their measures of success are.

When there is a lack of clarity and transparency, leaders struggle to communicate consistently and individual accountability within the organisation becomes impossible.

Clear communication of the plan and vision drives accountability, and ensures everyone is working towards the same goals, knows their role in the scheme of things and what they are responsible for.

Beyond communication, alignment can also involve co-creation, celebrating successes, and establishing feedback loops to get the organisation's feedback on proposed changes.

3. Assign accountability to create demand for improvement

Assume a bank discovers that one of its greatest profitability problems was within its call centres, where agents spent an average of 15 minutes on client calls instead of five minutes. To solve this problem sustainably, a good starting point would be to build a Key Performance Indicator (KPI) such as ‘client holding time’ into the call centre staff’s deliverables.

Assigning accountability for specific cost issues created by certain people or segments of the organisation is a must. Build stretch targets into KPIs to indicate what “good” looks like.

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Employers need to figure out how to hold single individuals to account for driving performance. Having identified single-point accountability is not enough though – it requires daily, weekly, monthly and quarterly progress reviews, clarity on how individuals will be held accountable, and so on.

Banks have multiple layers of structural and functional duplication that adds to costs, confusion and unnecessary work. Removing unnecessary duplication can create much-needed capacity and a sense of motivation. Again, single-point accountability helps drive behavioural change at executive level, which cascades through the organisation.

4. Build the right capabilities to get the job done

Cost-cutting can only be successful if you bring in the right capabilities and tools.

Organisations need to get clear on critical roles, capabilities and gaps. To hold people accountable, set targets and identify root causes of problems; it’s often necessary to first train and coach your people to close these gaps.

Sometimes fairly specialist, technical skills need to be developed in your teams. It is often quite important to teach your people how to generate, access, collect and use quality data in the organisation, how to visualise data, and how to use available technologies more effectively to be more productive.

Rising inflationary pressures and negative economic headwinds are impacting the competitiveness of South African banks.

While financial institutions are doing many things right, to keep their competitive edge they need to avoid top-down actions, focus on identifying areas that can deliver lasting cost reductions and build a collaborative culture that can achieve them. Only by doing so can they get, and keep, costs under control.