Wharton

Financial
Institutions
Center

Designing the Future of Banking: Lessons Learned from the Trenches

by
Patrick T. Harker
Larry W. Hunter

98-29

The Wharton School
University of Pennsylvania

THE WHARTON FINANCIAL INSTITUTIONS CENTER

The Wharton Financial Institutions Center provides a multi-disciplinary research approach to the problems and opportunities facing the financial services industry in its search for competitive excellence. The Center's research focuses on the issues related to managing risk at the firm level as well as ways to improve productivity and performance.

The Center fosters the development of a community of faculty, visiting scholars and Ph.D. candidates whose research interests complement and support the mission of the Center. The Center works closely with industry executives and practitioners to ensure that its research is informed by the operating realities and competitive demands facing industry participants as they pursue competitive excellence.

Copies of the working papers summarized here are available from the Center. If you would like to learn more about the Center or become a member of our research community, please let us know of your interest.

Anthony M. Santomero
Director

The Working Paper Series is made possible by a generous grant from the Alfred P. Sloan Foundation

Designing the Future of Banking: Lessons Learned from the Trenches

Patrick T. Harker

Larry W. Hunter

Financial Institutions Center

The Wharton School

University of Pennsylvania

Philadelphia, PA 19104-6366

harker@wharton.upenn.edu

hunterL@wharton.upenn.edu

September 1998

The need for change in the retail banking industry is clear. The onslaught of new technologies, increasing competition, and evermore demanding customers are forcing retail banks to rethink their product offerings and distribution channel designs. While the need for change is clear, questions remain. How does a bank choose what changes to make and, as important, how to go about implementing these changes?

Consider the case of National Bank[1], one of the larger American commercial banks, with branches in many states, which has a retail banking arm that is in many respects typical of the industry. Over the past year, a research team at the Wharton School, funded by the Transformation to Quality Organizations Program at the National Science Foundation, has been tracking the process of change at National, uncovering both the good and the bad. This article provides a glimpse into this process and the key success factors for change management in retail banking.

Re-Creating a Bank

National, confronted by an increasingly competitive environment, was challenged with improving the cost-efficiency of its far-flung retail delivery system, comprising hundreds of branches, while simultaneously transforming these branches into retail stores focused more directly on the sale of financial products and services.

National's retail banking organizational structure was largely decentralized, with separate management teams for each of the major geographic areas served by the bank. The challenge of redesigning the bank was heightened by the institution's rapid growth in recent years through a series of acquisitions. The integration of management practices and systems was incomplete and often varied across geographies.

In responding to these challenges and recognizing the diversity of the environment, an implementation team was established to spearhead the overhaul of the retail delivery system. The team was comprised of over fifty employees, drawn from a diverse set of geographic areas and functional backgrounds.

The redesign at National was initially focused around very basic business process re-

[1] National Bank is a pseudonym.

engineering in the branches. Over a period of decades, an increasing number of administrative functions had accumulated in the branch systems, so that branch managers and service representatives spent a considerable amount of time on these internal activities rather than in contact with customers. Further, most of the time spent with customers was centered on simple, transaction-oriented and basic servicing of accounts rather than on activities that were thought to be likely to lead to sales opportunities.

Recognizing these problems, National Bank engaged an experienced consulting firm to be a key resource as the team, undertook the job of re-engineering of the branch system. The consulting firm spent several months working with the implementation team to identify opportunities to streamline branch functions and re-direct employees to higher value activities. The outcome of this partnership became known as the "pilot" redesign, and it was agreed that the redesign should be tested in a few small market areas before proceeding with a broader roll-out of the design.

From the start, both the consultants and the implementation team recognized the need for broad, systemic change. Effective innovation therefore required the participation of virtually all of the functional areas within the bank, from information systems to marketing to human resources, with each of these areas represented on the implementation team. Anchoring the redesign was the streamlining of branch processes and the relocation of many of the administrative tasks and routine servicing of accounts to central locations outside of the branch. Take the simple example of how to deal with phone calls. Incoming telephone calls from customers were to be re-routed so that phones in the branch did not ring; rather, customers calling National and dialing the same number they always had used to contact the branch, would now find their calls routed to a central call center.

The re-engineering process also required redesign of the physical layout of the branches. A goal of the redesign was to encourage more customers to use automatic teller machines and telephones for routine transactions. Customers entering the redesigned branch, therefore, were to be greeted by a bank employee ready to educate them in the use of a nearby ATM or an available telephone. They would be directed toward a teller or a service representative only when they clearly indicated that they preferred to see one, or when such personal attention was necessary: for example, to access a safe deposit box, or to meet with a sales representative about the purchase of a product or service. The physical redesign made new technologies easily accessible by placing both ATMs and telephones near the entrance to the branch.

These innovations, along with the redirection of customers to alternative delivery channels, were intended to realize cost efficiencies. As an example of the expected efficiencies, early projections by the consulting firm (which were quickly revealed to be overly optimistic) envisioned a 65% decrease in the number of tellers required in the branch system. Over time, it was hoped that many customers would cease to rely on the branch and its employees for routine transactions and services. The re-engineering was also expected to move employees from serving to sales functions. The new design was intended to allow for more time to focus on activities that had potentially higher added value such as customized transactions and the provision of financial advice coupled with sales efforts.

The new design thus called for participation not only of the employees but also of customers in the new service processes. In its design, National elected not to pursue some of the more notorious routes favored by other banks (such as charging fees to see tellers), but to lead customers more gently, by making customer relations a key feature of the redesigned retail bank. The redesign created a customer relations manager in each branch, and it was to be the responsibility of this employee to ensure that each retail customer that entered the branch was guided to a sales employee, or alternatively, a technological interface, in order to receive the appropriate level of service.

Improvements in information systems and telephone call center capabilities were also important features in support of the new delivery system design. The information system improvements were intended to enable the relocation and standardization of a large number of routine types of account servicing activities: address changes, for example. Further, information systems were to be expanded to give National employees a full picture of each customer's activities with the bank and their potential for expanded relationships. This more complete picture of the customer's profile was thought to enhance sales efforts, enabling service representatives to suggest a fit between customers and services, and to refer the customers to areas in the bank with particular expertise in a product if that should become necessary.

Expanding and standardizing information systems while continuing to provide current levels of customer service proved a major challenge. Like many banks attempting to do the same thing, National was burdened by many legacy systems that are not easily modified to bring together all of the customer information that exists in the organization. Further, the redesign had both the advantages and disadvantages of being introduced on the heels of a number of earlier, more piecemeal technological and sales initiatives aimed at the same goals. Both the marketing and IT functions had been continuously seeking to improve National's capabilities in these areas. Support for these initiatives, and their success, had been uneven across the various geographic areas. Marketing and IT had also worked with a number of outside vendors. It was not immediately obvious whether the more systematic redesign should complement or substitute for these earlier, more incremental changes in systems, or whether these vendors would, or should, have a role in the redesign. Over time, however, these consultants and vendors came under increasing pressure to coordinate their efforts with those of the implementation team, and those who were unsuccessful in doing so were replaced.

The importance of the telephone call center raised further challenges. National had lagged behind a number of its competitors in the sophistication of its telephone banking system, yet through the redesign, it hoped to make telephone banking, and, eventually, PC or Internet banking, cornerstones of its delivery system. Branch redesign, therefore, also required the construction of new call centers, staffing them as the customers began to be directed toward them, and developing an organizational structure not simply to run the call centers but to manage and integrate the relationship between the call centers and the branches. The increasing importance of the telephone centers in the new design increased the pressures on the call centers for accurate and effective service, even as the centers struggle with much more basic issues around staffing and the physical implementation of the telecommunications systems.

Changes in the physical layout of the branches, in information systems, and in the design of key business processes therefore attracted the attention of the implementation team from the beginning of the innovation process. As planning for the implementation of the pilot redesign proceeded, however, it became increasingly obvious to many on the implementation team that the true anchor for retail delivery design went beyond these factors. Most critically, the innovations relied upon significant changes in key jobs in the branch systems, on the human resource practices that supported these jobs, and on employees' reactions to these changes.

In order to reinforce the idea of standardization across the branch system, and to focus efforts toward sales and efficient delivery of services more clearly, the implementation team recommended that the redesign eliminate the position of local branch manager. In each branch, a customer-relations manager would coordinate customer service efforts, but this person would not have direct authority over the tellers and platform employees in branches. Rather, branch employees would report to supervisors by geographic area: customer-relations employees, branch-sales specialists, and tellers each would be assigned to remote leaders. On the platform, a variety of specialized customer service and sales positions were to be consolidated into a position that was eventually titled "Financial Specialist." Local areas were also to be supported by a few roving Financial Consultants that did not have specific branch assignments, and these Consultants would be charged with seeking business from individuals who were not existing customers of National. Only the tellers were to remain relatively unaffected by the proposed changes.

Armed with this new design, the team began a pilot implementation in two small local markets. Most of the literally hundreds of administrative and servicing processes were removed from the branch. Telephones no longer rang in the branches. The financial specialists were freed to concentrate on sales activities, and found themselves with time available to pursue sales opportunities prospectively rather than simply reacting to walk-in traffic. Most customers responded to the innovation positively, quickly migrating to the new technologies with few problems. The active roles played by the customer-relations managers, some of whom were former branch managers, helped this migration along.

Despite the general success, the pilot implementation also revealed a number of problems in the design. First, employees and customers in a few of the most rural branch locations met the redesigned branch with skepticism. After a period of wrestling with modifications to the design, considering the benefits associated with the implementation of a single, standardized form of service delivery, and the budget required to implement a comprehensive redesign, the implementation team agreed to focus on urban and suburban locations. While the team was reluctant to abandon the idea of a single best design, they did acknowledge that the characteristics of rural markets differed fundamentally from other locations. Customers in rural locations expected banks and their employees to provide more personalized service. Further, because rural branches generally employed fewer employees, it seemed less likely that these branches could realize meaningful efficiencies from the redesign. Thus the team chose to focus its efforts and resources on branches where the redesign was most likely to show benefits. A new task force was commissioned to explore the problems that surfaced by the “one size fits all” philosophy that underpinned the initial design. It developed a new design that gained some of the efficiencies associated with standardization and re-engineering for rural branches, while the implementation team spent its time and budget on suburban and urban locations.

A second critical problem encountered in the pilot was the slow implementation of new technology. Many of the features of the technology needed to support the new design, simply were not ready or did not work as promised. The implementation team, finding it necessary to push forward and being uncertain as to exactly when these features would be ready, moved ahead with the new design anyway. In the end, the technology changes successfully supported basic services, but problems remained in bringing up the databases and other systems intended to provide additional sales support.

Third, while most customers quickly migrated to the new channels, and the new processes that were accompanied by supportive technology worked effectively, turning the retail bank branch into a sales-focused financial store proved more difficult. Financial specialists found it difficult to move from the idea of reacting to the sales opportunities that routine servicing occasionally provided, to the more pro-active role that the redesign called for. Some even claimed that the redesign was responsible for decreased sales as a result of the streamlining and fewer opportunities for personal service. The implementation team wondered, in turn, how much of this difficulty could be attributed to the design, and how much to skills deficits among the financial specialists.

Fourth, the rerouting of all phone calls away from the local branch proved difficult to implement in practice. Employees almost universally applauded the dramatic decrease in distractions associated with incoming calls. This improvement was not without cost, however, and customers and employees began to ask for exceptions to the central routing. These pressures did not abate, and eventually, the design team modified the original plan. All calls continued to be routed through a central system. However, this automated system now allows customers (as the fourth among four options) the choice to be connected directly to their local branch.

A fifth problem was the difficulty in implementation of human resource practices necessary to support the new organization. The skills deficits raised further issues. For example, training was critical to the success of the implementation, yet the organization had little time to spend in development of the skills critical to the success of the pilot. Further, it had been clear that the selection process for new employees would have to be adjusted to find employees who were more likely to be effective sales agents, and the initial difficulties with the design made this even more important. And while incentive compensation systems were also changed to reflect the new goals of the redesign, these were still experimental and required considerable fine-tuning. Perhaps most important, however, was that the new jobs had effectively eliminated hierarchical career ladders in the pilot branches. No longer could tellers easily move to platform positions; these positions were now expected to require an entirely different skill set, and, typically, a college degree for new applicants. The financial specialists, who typically had been platform employees, could no longer expect to be promoted to branch management positions: there were no branch managers in the redesigned bank, and some of the branch managers became customer-relations managers. In each functional area, the hierarchy was flattened. While this yielded efficiency gains, it left employees less certain about their future in the organization, and anxious as to what a career in the new bank would look like.

The implementation team spent much of its time with the nuts and bolts of the new design. Initially, technological and process related problems with implementation, and the challenges associated with performance measurement, consumed the attention of the team. However, human resource problems became increasingly worrisome, raising concerns among some on the team about the longer-range success of the redesign. Because the team was concerned about the effectiveness of the technological, process, and architectural changes, they had decided that in the pilot branches the redesign would not be accompanied by any layoffs. Even in this environment, designed to soft-pedal concerns over job security, employee confusion and skepticism over the new design emerged as an impediment to the success of the program. The team knew that to achieve the eventual efficiencies they expected, some downsizing of the retail bank would be necessary. They did not expect that natural attrition, even in the relatively high-turnover retail bank, would yield the cuts in jobs that they hoped for. The team believed that that in future implementation stages, the insecurity generated by the job changes would be intensified by layoffs, because they did not intend to extend the new layoff pledge beyond the first pilot areas. Thus human resource issues drew an increasing share of their attention.

Despite these problems, the redesign, with some modifications, moved forward. A second pilot redesign was implemented in urban and suburban markets, in a geographic area distinct from the earlier pilot. More attention was paid to training and selection into the new positions; again, outside consultants were relied upon, this time to help identify employees with appropriate skills and to structure training develop those skills. Some of the technology gaps and challenges had been addressed and process design enhanced. But, the second pilot revealed a new set of issues. In the pilot markets chosen, the situation in the branches before the change differed considerably from those in the first set of pilots. In particular, these branches had already been sharply focused on building a sales orientation, a reflection of the bank's strategy in this geographic area. Disruption of the status quo in the first set of pilots had been considered to be a positive contribution. The benefits of this disruption in the second group of pilots, which had already begun to move sharply toward sales-focused branch delivery, were less clear to mid-level managers with local line responsibilities. These managers were, consequently, more skeptical about the benefits of redesign and of a new, standardized model. They consistently argued for local adaptation of the model, and attempted to slow down implementation, claiming that they knew best what sorts of processes, technologies, and job structures were likely to be most effective in their area.

The implementation team, while sympathetic to these claims, generally resisted the pressure to adapt, but recognized a further difficulty. To argue that the redesigned model must be strictly adhered to, was to admit that no further learning was to occur as a result of innovation. Thus, they struggled to find ways to differentiate between local learning that truly represented a positive improvement to the design concepts, and arguments grounded more in resistance to change in established routines. A new objective was set to discover principles for making these distinctions as the design continued to be rolled out over wider areas.

Currently the team is implementing the new design across the remainder of the retail bank, with substantial modifications as a result of experience from the both pilot areas, and wrestling with new issues that arise out of the learning process. Among these challenges include the problems associated with introducing the new design in areas that have already experienced significant change management challenges in recent years as a result of the frantic pace of mergers and acquisitions in the industry. Some of the branches that will be the objects of the redesign will have had three parent banks in the past three years; each change has been accompanied by changes in jobs, processes, systems, and supporting human resource practices. Heaping yet more change on to these locations will be especially difficult.

A second challenge facing the implementation team stems from the current decentralized approach to management of the retail bank. Well before the details of the pilot redesign were formally disseminated across the various geographic areas, word of the "bank of the future" traveled widely. Some of the members of the implementation team have returned to management positions in their old structures, and smart managers, aware of the redesign, have begun to identify the trends that the implementation team was charged with addressing. Both groups are now applying their own change visions in their local markets. Thus, the implementation team is trying to innovate not in a static or standard set of channels, but in a wide array of varied and dynamic conditions: in short, against moving targets. Local managers have expressed explicitly a desire to get ahead of the game by proceeding with implementation of the features of the pilot redesigns they find most attractive. Left unanswered is how and whether the implementation team will be able to implement other features, or how they will reconcile differences in the pre-emptive local redesigns with their desire for increase standardization across the entire system.

Appropriately configuring human resource practices to support innovative systems and process changes raises further, significant challenges. On the one hand, it has long been clear that simply changing job design and pay systems, and coupling these with other technological and system changes, will be insufficient. Attention must also be given to employee selection and promotion systems, training programs, appraisal systems, the use of flexible scheduling, and the bank's overall approach to employee involvement. However, contemplating such sweeping change severely taxes the organization. While piecemeal change in the human resource system is unlikely to yield the results desired, more comprehensive change raises significantly more challenges in implementation. At National, the hope is that investment in the redesign will improve several areas of performance simultaneously: sales effectiveness, productivity, and the quality of customers' relationship with the bank. In practice, this has proven difficult. The early, piloted version of the redesign was effective at serving customers efficiently: the bank streamlined processes and introduced new technological options. However, the effects of the redesign on sales performance were slower to realize. Effects on the overall depth and quality of the customer relationship remain to be seen. In fact, some of the streamlining designed to supplement or improve employee-customer interaction may be replacing this interaction; this may mean missed sales opportunities and fewer chances for bank representatives to assess and attempt to meet customers' needs. How National addresses this challenge will be a critical factor in the re-design's ultimate success.

Should the design prove successful, this itself will raise sequential challenges for National, which must further innovate to deliver on the promises raised by successful change. To the extent that customers are convinced to migrate to alternative, more efficient delivery channels, the Bank must continue to develop its ability to manage those channels effectively. Such channels – particularly telephone and PC- banking – are not only more technology intensive, but also raise new sets of organizational and human resource problems. As the use of such channels grows, and as their functionality increases, questions over appropriate staffing, training, performance measurement, and reporting structures multiply. Innovation, both organizational and technological, may actually have to intensify as a result of the success of prior changes.

The Keys to Successful Implementation of Bank Redesign

Through our analysis of National's implementation of their "bank of the future", it became clear that some branches were better than others in implementing the changes and achieving the desired outcomes. That is, some stores are increasing customer migration and sales while keeping the customers and employees satisfied while simultaneously reducing costs. What made one branch successful and another a failure? The ongoing work of the implementation team at National, coupled with our analysis of the early results, suggests six key factors for success in bank redesign:

Success Factor 1: Have a good phone center (and believe it!)

As they say in show business, timing is everything. For this new model of banking to work, customers must shift to the lower cost phone channel. However, if customers have a bad experience on the phone due to the lack of improvement in the phone operations, they're right back in the teller line! As a result, customers won't use the phone and the employees begin to mistrust management's advice to move customers to the phone. The better the phone center, the more the employees believe that the customers will get good service on the phone and thus, the more they encourage customers to use the phone. It's all about timing. Make sure that the services available over the telephone (or the Internet-based services) are high quality operations *before* moving customers to these operations. Furthermore, make sure that the employees trust these new services or they'll never get the customer to believe in them (ask yourself a simple question: how many employees personally use the service that they're pushing!).

Success Factor 2: Acknowledge the importance of human resources

Under the redesign, employees at National are experiencing increased stress levels and longer work hours while seeing their promotion opportunities diminished. To many, this does not seem like a good deal. Successful local leaders address these concerns head-on and help the employees clearly understand how to manage the challenges raised by these changes. Areas and stores that have been less successful may have simply assumed that employees will "figure it out." The success or failure of this redesign effort ultimately hinges on the employees in the trenches believing in it and communicating their belief to the customer. Success comes from understanding the centrality of meeting the human resource management challenges raised by this new design.

Success Factor 3: Not only acknowledge, but address the human resource issues

While it is important to recognize the human resource issues, this is not enough to guarantee success. Systems must be put into place to develop the new skills necessary for employees to thrive in this new environment and to explicitly address their career expectations. In addition, new employee selection processes must be instituted to make sure that new employees are excited by the prospect of working in an environment where teamwork is crucial and pay is more important than old-style upward mobility. None of this will happen by chance; human resource processes and procedures must receive the same attention as the technology investment decisions.

Success Factor 4: Clarify employees' roles and develop team players where they're needed

Leaders and customer relations managers must help all employees to develop a new understanding of the role of the branch in the overall success of the bank. Branch employees are no longer competing with the telephone call center or Direct Bank for business; all channels are partners in serving the customer. Employees in the branch must work together to service customers while containing or reducing costs. This all involves teamwork, and it does not come naturally. Successful branches work hard at building an understanding of teamwork. This understanding is crucial, for example, if a teller is going to coach customers, to say, "Why don't you use the phone over there, and they'll be able to answer your question," or "has anyone shown you how to make a deposit in ATM?" when the teller knows she can continue to perform the function in question. Only when the teller truly understands the importance of changing the transaction behavior of customers will this redesign be successful. Employees must understand that they are a team of experts, each with a unique role to play, and not a collection of interchangeable parts.

Success Factor 5: Not all employees need the same kinds of commitment

While teamwork and commitment to the bank are crucial, these factors are not equally important for all employees in the branch. Everyone needs a basic understanding of their role in the team, but managers only have a limited amount of time to develop this understanding across all of the branches they manage. Clearly, the customer relations specialists must be heavily committed to the goals and philosophy of the organization. The commitment of the tellers to these overarching goals is important to the overall success of the redesign, but less so. Finally, sales specialists must understand these goals and believe in them, but they must first and foremost be committed to selling! Therefore, be very careful in implementing the redesign that you don't force-feed a "one size fits all" training program to the employees. Make sure that the training is appropriate for their specific role in the team!

Success Factor 6: Be ready and willing to adapt your model, but don't fall for anything!

Last, but surely not least, the experience at National has clearly illustrated the need to be committed to your design, but not be inflexible. As the redesign rolls out across the organization, people will want to tinker or radically change the design for two reasons, one good and one bad. First, there may be compelling local conditions that require adaptation of the basic design, and it is crucial that these adaptations be allowed to occur. Nothing is worse than requiring an employee to obtain three forms of ID from their mother or pastor! However, some change requests arise from the desire to revert to the old ways of doing business. "The customer likes me and doesn't like the phone, so why shouldn't I take 30 minutes to talk to him, even if he isn't the most profitable customer we have?" Adaptation of the basic design will occur continuously. The ultimate success of this design hinges on the ability to sift through the myriad changes that occur to decide which one to keep and which ones to reject. Thus, National has begun to develop an evaluation process for processes themselves: a group of "process auditors" that will certify good changes and gently remove the bad ones from the system. Management must be committed and ready to take on this role beyond the short-term support of an ad hoc re-engineering team, or the "new bank" effort will ultimately fail.

For Further Information:

Please go the Web site for the Wharton Financial Institutions Centers at http://fic.wharton.upenn.edu/fic.