Cost-effectiveness and risk management

Frank Marzilli, CFO Advisor OTP Bank (Russia)

SAS Conference - Moscow
October 2014
4 basic levers of cost management

I. Simplify the organization
   - Reduce layers & optimize span of controls
   - Reduce duplication between functions and roles

II. Optimization of business processes / functional optimization
   - Benchmark
   - Costing activities
   - Business process reengineering
   - Transfer of business process
   - Outsourcing

III. Rationalization of infrastructure
   - IT rationalization
   - Optimizing location (centralization, relocation, shared services centers,...)

IV. Spending cuts
   Spending cuts by using:
   - Managing demand
   - Strategic procurement planning
   - Management of tax liabilities
I. Simplify the organization

• Reduce layers & optimize span of controls
• Reduce duplication between functions and roles
I. Simplify the organization – Span of control

**Cost efficiency initiative**

**How Risk can contribute?**

**Examples:**
- Simplify the structure of the risk management division:
  - reduce the number of organizational layers between the CEO and the lowest staff
  - Set / increase the minimum number of staff managed for each level of management
  - reduce non-management management (e.g., deputies, ...)
- Reduction / outsourcing of activities too far from the core of risk management

**Potential risks & Mitigants:**
- Real organization is different from the official => analysis of the actual organization
- Psychological difficulty => top management decision
I. Simplify the organization – Analysis of activities

Cost efficiency initiative

How Risk can contribute?

Examples:

- Reducing duplication:
  - "Shadow activities" (e.g., duplication of HR or IT tasks in risk)
  - Redundant activities with other departments (e.g., financial reporting, collections performance)
- Align staffing to benchmarks (for example, to strengthen the score development vs. procedures)

Potential risks & Mitigants:

- Benchmarking: use of similar business model => analysis of the actual organization
- duplication: undocumented tasks, transition => interviews and tests
II. Optimization of business processes

- Benchmark
- Costing activities
- Business process reengineering
- Transfer of business process
- Outsourcing
II. Optimization of processes – Process redesign

**Cost efficiency initiative**

**Process redesign**

1. Identification of value
2. Map the value stream
3. Creating a process map and timing
4. Optimization of business processes
5. Checking with Customer
6. Implementation

**How Risk can contribute?**

**Examples:**
- Focus on mass processes (underwriting, collections) and back-office
- Automation, simplification of procedures, reducing errors and improving methods of operations, reduce complexity in key areas

**Potential risks & Mitigants:**
- Support of staff and management => Change Management
- Quality of the process => Expertise in Process Improvement
II. Optimization of processes – Must have vs. Nice to have

Cost efficiency initiative

Must have vs. Nice to have

Rating: management of functions + project team

- Must have
- Mixed
- Should have
- Could have
- Would like

**Examples:**
- Reduction / outsourcing of tasks too far from the core risk management
- For other non-core tasks, determine the level of performance for each major role, and align employees to the objectives of performance

**Potential risks & Mitigants:**
- Support of staff and management => Change Management
- Quality of the process => Expertise in Process Improvement

**Criteria:**
- income > expenses
- regulatory requirements
- competitive advantage
- save costs
- keep customers happy

**How Risk can contribute?**

- Support of staff and management => Change Management
- Quality of the process => Expertise in Process Improvement
III. Rationalization of infrastructure

- IT rationalization
- Optimizing location (centralization, relocation, shared services centers,...)
III. Rationalization of infrastructure – IT rationalization

Potential risks & Mitigants:
- Overlap between the systems and processes => careful analysis of the processes, expertise in process improvement
- Common understanding among all stakeholders (business and IT) about the benefits => interview

Examples:
- Standardize and simplify the technical architecture of risk (reduce the number of databases, ...)
- Determine the fastest reduction of hardware and software maintenance
- Standardize key processes to standardize applications

How Risk can contribute?

<table>
<thead>
<tr>
<th>Business architecture</th>
<th>Data centers</th>
<th>Reduce data center General services centers Offshoring</th>
</tr>
</thead>
<tbody>
<tr>
<td>Information architecture</td>
<td>Business databases IT support databases</td>
<td>Consolidate databases Standardize processes to consolidate information</td>
</tr>
<tr>
<td>Applications / Services</td>
<td>Business systems Business applications IT support applications</td>
<td>Standardize front offices Consolidate applications Standardize service platforms</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>Servers Databases</td>
<td>Optimize infrastructure management Merge databases Consolidate servers</td>
</tr>
</tbody>
</table>
III. Rationalization of infrastructure - Relocation

**Potential risks & Mitigants:**

- Capacity to perform remotely => careful analysis of processes, IT systems
- Protect efficiency => Keep the staff at the Head Office with very high efficiency
III. Rationalization of infrastructure – Shared Services Center

Cost efficiency initiative

Unit, in which are transferred certain business processes across the organization

How Risk can contribute?

Examples:
- Staff in the branches (e.g. underwriters, monitoring, ...)
- Non-core tasks of risk (e.g. controls, compliance, Basel, FATCA, ...)
- Support staff (risk technology support, data support, collection support, ...)

Potential risks & Mitigants:
- Differences in processes in different parts of the organization => careful analysis of processes, process improvement expertise
IV. Cut expenses

Spending cuts by using:
- Managing demand
- Strategic procurement planning
- Management of tax liabilities
IV. Cutting expenses

Cost efficiency initiative

• Reduce the number of single / expensive purchases
• Combining similar expenses, optimize the supply base
• Verification of taxes paid

How Risk can contribute?

Examples:
• Negotiate the fees credit bureaus
• Negotiate license fees
• Optimizing the use of telephone by collections
• Cut the budget (training, office supplies, ...)

Potential risks & Mitigants:
• Protect the efficiency (underwriting, collections) => Tests
Thank you