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Industrializing Swiss Private Banks:
A Strategic Road Map

Pascal Gantenbein

Kristof I. Trautwein



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Industrializing Swiss Private Banks: A Strategic Road Map

Pascal Gantenbein, Henri B. Meier Professor of Financial Management, University of Basel
Kristof I. Trautwein, MSc in Business and Economics, University of Basel

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Abstract

This paper analyzes the industrialization processes of Swiss private banks against the background of strategic approaches, future trends, and potential risks in this sector. Overall, industrialization is identified as the basis for the successful implementation of innovative and disruptive services and technology, and banks' collaboration with (external) service providers is likely to play an increasingly important role with regard to such implementation. Strategic conclusions for Swiss private banks are captured in 10 distinct recommendations that each bank should consider when planning its industrialization strategy. Hereby, three principal themes are covered—namely, the strategic positioning of private banks with regard to bank size, business model, and other factors; optimized operations, which deals with the question of how to increase the efficiency of internal processes; and ways to reduce the obstacles that private banks face with regard to successful outsourcing. The underlying strategic requirements are a holistic approach to strategy and an ongoing improvement culture.



Table of Contents

Glossary.....	6
Executive Summary.....	10
1. Current Challenges for Swiss Private Banks.....	13
2. Current Industrialization Efforts of Swiss Private Banks.....	17
3. Next Generation Banking—Framing the Next Years of Private Banking.....	21
4. Recommendations for a Successful Industrialization Strategy.....	25
4.1 Aspects of a Holistic Strategy Approach to Driving Industrialization.....	26
4.2 Ways of Increasing Internal Process Efficiency.....	30
4.3 Aspects of Successfully Outsourcing Parts of the Business.....	34
5. Conclusion.....	39
References.....	41

Glossary

Application programming interface (API)

Technically speaking, using point-to-point architecture will play an important role going forward while internal and external systems, tools, and processes are expected to increase in complexity and number, as are interfaces. An *application programming interface (API)* enables different software programs to exchange required information in a more flexible manner, including directly in the front office. PwC (2012, p.8) describes an API as a “technology term that means the specifications for how software programs are able to exchange information with each other even if designed and run by different organizations”.

Automation

A process that does not need an interaction or intermediated step performed by a machine or human being. Consequently, it runs more smoothly, saves time, and reduces costs. For example, instead of using hard copy invoices, scanned for documentation purposes, a system delivers or sends the invoice digitally and automatically to another system at the time of the transaction.

Back office

Comprises all sub- and supporting processes that guarantee the smooth running of basic banking procedures. Back-office tasks include administrative, accounting, and internal financial matters; compliance issues in systems and processes; payments and securities transactions; settlement; and supporting systems; as well as all IT operations, and their monitoring and maintenance. The back office has become more important, although it has the lowest level of value creation in a bank (Hoss and Schuster, 2008). Its efficiency is a fundamental prerequisite for state-of-the-art banking.

Banking industrialization

A broad term describing the activity of breaking organizations' value chains up in order to achieve higher efficiency and reduced complexity within the organization and its processes and procedures. Beyond time and cost savings, firms implementing banking industrialization are expected to boost innovation and improve quality. In addition, outsourcing may lead to a leaner structure and more flexibility. Given the complexity of regulation, IT systems, and IT-based banking services, banking industrialization is the basis of a sustainable banking structure that can meet today's service requirements. Automation, standardization, and modularization are key terms within this broader concept.

Business process outsourcing

Comprises the outsourcing of entire parts of the value chain (i.e., business processes) to an external provider. Banks' business process outsourcing focus tends to be on back-office applications and systems, as these elements are less differentiable. Nevertheless, other elements might follow with the advancement of bank industrialization.

Digitalization

A broad catchall term for a transformation concept that includes all front-to-back processes, systems, products, tools, and devices that facilitate digital solutions.

Fintech

Stands for financial technology. A broad term or concept describing firms, mainly start-ups, that are attempting to disrupt and supplant existing products, processes, systems, and tools in the financial services industry by implementing innovative technologies and application-based solutions.¹ Many Fintech solutions are based on or supported by digitalization. Examples include robo-advisory, payment services, and data analytic tools for compliance.

Front office

The front office is associated with client-related tasks, in particular the management of assets, advisory, distribution, client reporting, securities trading, tax advisory, and research. It represents private banks' core business and is the only layer visible to clients. Efficiency and the pace of transactions have become more important with the advent of certain IT developments.² Today, the front office also encompasses certain IT-related topics, including digitalized tools (e-banking, robo-advisory, mobile banking).

Industrialization approach

Refers to a broad structural transformation and simplification of internal processes and procedures, such as the reduction of vertical integration.

Interface management

The notion of interface management was developed in the 1980s and has become more relevant with the implementation of IT systems in organizations. An interface is the connecting point between two systems, products, or devices. If a bank outsources services to an external provider, these services might not fit with—for example—the IT system of that provider. Even though the service itself might work well and add value to the bank, implementation can cause problems. In contrast, a proper flow between two systems should decrease risks and the number of errors possible. In the banking industry, this will become more and more important due to the increasing number of services banks are expecting to offer (from internal and external sources) and it is one key element of industrialization. Proper interface management (by a dedicated person or team) will become mandatory.

Middle office

Comprises global custody, reporting (including tax), risk management, and the management (including analysis and monitoring) of internal and external processes and systems (interface management). The middle office will become increasingly important for banks, as managing interconnectivity increases the level of efficiency and reduces risks, errors, and unnecessary costs. As a controlling and monitoring organ, the middle office is also important for regulation and compliance purposes.

¹ An overview of Fintech in Switzerland can be found at <http://www.swissfinancestartups.ch>.

² For more information about IT in wealth management, its development, possibilities, and the opportunities and weaknesses it presents, see E&Y (2015).

Modularization

Increasingly applied methodology for providing several interchangeable processes, systems, products, or service packages that are standardized but versatile. For instance, a bank does not offer all possible combinations of different assets as a product but only a range of predefined investment combinations. The goal of modularization is to merge sub-processes into useful process or product combinations. As this allows an individualized usage it becomes more important for banks when applying standardized or industrialized services, respectively. This, in turn, leads to more flexible replacement options for individual modules without the need to replace the overall process or package. Modularization can be used both in system and process setups, and in the front office for individualized service packages.

Outsourcing and insourcing

In the present context, outsourcing refers to single processes or systems the responsibility for which is handed over to external service providers. Insourcing is the integration of processes or systems taken over from other banks by the insourcer's banking platform. With the latter approach, capacities are better used and banks can generate new revenue streams.

Standardization

Refers to consolidating (and coordinating) multiple options into one approach without losing the necessary compatibility of these options. Hence, it defines a certain set of standard tasks, systems, processes, and tools, and delivers reduced complexity.

Value chain

The value chain can mostly be divided into three main parts:³ production, distribution, and transaction/transformation. Banks' value chains are nowadays mostly structured into front, middle, and back office⁴ and this is the way in which the value chain is approached in this White Paper.

³ See Lamberti (2005), Riese (2006), and Thiessen (2009).

⁴ For an overview of industrialization's effect on individual back- and front-office elements, see Capco (2014, p. 35).



Executive Summary

Following the most recent financial crisis, banks worldwide turned their business focus to wealth management, which is often linked to new developments such as digitalization. An appraisal of the period from 2007 to the present reveals that many Swiss private banks have missed the opportunity to engage in the ongoing transformation process of establishing a state-of-the-art bank, and hence of satisfying today's operational prerequisites and meeting today's client requirements. Banks' processes have become very complex over recent years and operations are often inefficient. In some banks, the entire banking structure and related value chain has remained essentially untouched. Moreover, several external influences that have hit most private banks have turned out to be cost-intensive and difficult to manage.

In contrast, an up-to-date banking structure is based on efficient value chains, including automated and standardized (and modularized) processes, a cost-efficient and agile IT infrastructure, and efficient and lean front-to-back operations. In this context, the term banking industrialization refers to breaking up value chains to ensure higher efficiency and in order to meet the requirements of managing today's complex operational systems. Industrialization addresses fundamental operational challenges and is the foundation for the introduction of additional services and technology and for reshaping the banking environment using up-to-date services (e.g., digitalization, Fintech). Industrialization is, further, important if a bank is to offer sufficient and profitable cross-border business, where promising opportunities exist for Swiss private banks. Today, industrialization has to be part of every banking strategy.

Adding new processes to the highly complex existing ones makes banks inefficient and leads to a heavy burden from the cost side, especially if accompanied by low margins. This situation is more critical still, since banking is becoming

even more complex due to the influence of new competitors, increasing regulation, and a higher level of interconnectivity in banking functions. External service providers will take over more banking services; and within the bank, front-to-back services will increase in numbers, while the function of the client relationship manager will change, moving toward the sharing of tailor-made information with clients. Hence, banks need to undergo radical change, with industrialization as its foundation.

Industrialization in banking is an established topic. But, independent of bank size, it has either not yet or only partially been implemented, and has in most cases not been aligned with the entire banking structure. Consequently, the focus of this White Paper is on strategic opportunities and the question of how to restructure and industrialize Swiss private banks in order to sharpen their profile in the increasingly competitive global environment of private banking. The paper should provide an approach to discussing some of the most fundamental strategic measures that may be applied, rather than a conclusive set of results.

To achieve this purpose, this paper first frames requirements for the next years, often referred to as next generation banking, and outlines the role of client relationship managers in relation to industrialized procedures and state-of-the-art services. Further, it defines 10 recommendations banks should consider, when implementing their transformation strategy, in order to ensure successful industrialization, which includes strategic positioning, optimized operations, outsourcing, and proper risk analysis.

The main findings regarding current industrialization efforts are as follows:

- Several Swiss private banks that participated in the survey carried out for this White Paper have already added banking industrialization

features to their strategies. However, few have completely revised or fully industrialized their value chains. Hence, there is a gap between strategic ambitions and execution. Notably, hardly any bank exhibits a cost-to-income ratio below 70 percent.

- The often-quoted concept of critical mass—that is, the size banks must have in order to run their operations profitably—is not the most crucial decider of future success as long as banks apply industrialization approaches. Moreover, bank size seems to have no impact on the progress of industrialization. Where large banks can gain scalability while maintaining a larger service offering and more locations, smaller banks can reduce complexity by adopting a clear and leaner business model and, as a consequence, a clear and leaner operational setup.
- Remarkably, banks with specialized business models have advanced the most with regard to the industrialization of their processes, due to their clear and straightforward business models and lower complexity levels (e.g., in terms of regulation, products).
- Process-related solutions for reducing complexity, single process changes in the areas of IT and back office, and—in the case of banks with a higher degree of industrialization—a strategy that focuses on a bank’s individual strengths while outsourcing other activities are the most prevalent measures being implemented.
- Hardly any private bank is tackling the front office, mainly because of back-office operations legacy and a lack of visibility with regard to clients’ expectations.
- Outsourcing in general is still limited. Several banks expressed their fear of lock-in—that is, of no longer being able to change providers or systems once the bank has moved to an outsourcing platform. Some others still see a competitive advantage in keeping systems internal. Most banks pointed out that they are lacking clear visibility on external solutions for the front office and on client needs.

- In general, data analysis for process optimization and for determining efficiency and failure rates is still in its early phases—irrespective of bank size and business model. Not one single bank measures its progress with regard to industrialization accurately.

The recommendations defined in this paper are embedded in two main overall strategic requirements. They comprise a holistic approach to strategy (i.e., breaking up the full value chain and improving systems and processes while integrating new approaches into the entire business model) and an ongoing transformation and improvement culture. Today, many banks implement some industrialization approaches. But such implementation is separated from their overall strategies, which often results in cost cutting alone. Even today, many banks are still trapped in old thought patterns, and once they have implemented some modicum of industrialization tend to stop their efforts. Industrialization needs to be an ongoing process, requiring a continuous analysis and improvement culture.



1. Current Challenges for Swiss Private Banks

Following the most recent financial crisis, the banking industry shifted its business focus. Banks worldwide turned away from investment banking, which became less profitable given the climate of stronger regulation. Almost every large bank invested in its private banking or wealth management business instead, implementing client-facing improvements involving technology or services. While these banks have changed their strategies, Swiss private banks—the masters of this business for almost three centuries—seem to be struggling to keep up. Negative news has dominated, including the need to resolve legacy burdens, the withdrawal of foreign banks from Switzerland, and a move to market consolidation.

Certainly, private banks have faced several external problems in the past eight years that have negatively impacted their reputations (e.g., tax evasion issues, problems with potentates' money, the quasi-abolition of banking secrecy) and profitability (e.g., low interest rates, high compliance and regulatory costs). However, these constraints are not unique to private banks. Rather, it is—in particular—the occurrence of an often-overlooked transition phase that has rendered private banks, on the whole, self-absorbed.

Efficient processes and banking infrastructure are vital if banks are to offer modern services.

An appraisal of the period from 2007 to the

present reveals that Swiss private banks have missed the (right) moment to transform their business and thus to establish a state-of-the-art bank, and hence the opportunity to satisfy today's operational prerequisites and meet today's client requirements. The banking landscape has changed, new players entering the market, applying disruptive innovations, and offering new ways (including digitalization—i.e., Fintech and mobile banking) of conducting banking business. At the same time, banks' processes have become very complex—due to technological developments, new regulations, more complex operational systems and financial products, and the interconnection of business functions—in recent years. This applies in particular to the cross-border business of private banks, with regard to various tax laws and other regulations. Moreover, in many banks the entire banking structure and related value chain has remained essentially untouched.

However, it is important to understand that efficient processes and banking infrastructure are, today, prerequisites for introducing any modern service offering. Significant opportunities exist, but adding new processes to highly complex existing ones makes banks highly inefficient and leads to a heavy burden from the cost side—low margins, meanwhile, lead to a threat to the entire bank and are a question of survival.

The investments required for banks to prepare for the future were, in many cases, made too late; some banks may even have thought to continue with their former business model of primarily keeping clients' money secure in the safe haven of Switzerland. Moreover, IT invest-

ments have often failed, and have not been aligned with the investors' existing architecture and client demand, even though many banks have invested huge amounts of capital in refreshing their IT systems.⁵ Other industries and the large universal banks seem to be years ahead.

This is unfortunate, as the market environment has been positive in recent years and the private banking sector in Switzerland has experienced continuously increasing levels of assets under management (SBA, 2015).⁶

Going forward, the recent results of many Swiss private banks paint a quite pessimistic picture: their return on equity fell, on average, from the 2007 pre-crisis level of 13.1 percent to 3.8 percent in 2015 (KPMG and HSG, 2015 and 2016).⁷ Since 2010, the figure is almost unchanged. Almost 30 percent of Swiss private banks reported losses for 2015. Given these numbers, it is no surprise that over one-third of all Swiss private banks have withdrawn from the market, have been acquired, or have merged since 2005 (FINMA, 2016; KPMG and HSG, 2016). In light of the changes required of them, the legal obligation to account for their past activities, and the fact that they are operating in a low-margin environment, more than a few might prefer to waive their licenses.

However, not all private banks are suffering in equal measure and some have already changed and restructured their operations and services successfully. Some banks are even further ahead, having reorganized their structures early on, benefiting from less system and process legacy. Nevertheless, the list of necessary changes is long. The main challenges include IT systems,

⁵ KPMG and HSG (2016, p. 18) state that only a few Swiss private banks “run new generation IT core banking systems” and most systems are older than 20 years.

⁶ Even though assets under management of Swiss private banks increased, Roland Berger (2016) report decreasing net new asset figures since 2011.

⁷ Roland Berger (2016) report that only 25 percent of the Swiss private banks analyzed were able to increase revenues and/or gross margins in the period 2011–2015. Moreover, KPMG and HSG (2016) state that two-thirds of the banks analyzed had a decreasing return on equity in 2015.

the assignment of outsourced services and the role of the front office, digitalization and the efficiency of transaction services, defining a broader variety of products and more transparent pricing models, and the integration of new waves of regulatory and compliance requirements. Moreover, old systems and processes and sometimes entire value chains are too complex and barely IT-compatible in terms of efficient usage (IT and process legacy), while individual services are highly cost intensive. This entails inefficiencies and low margins and ultimately an unacceptable cost-to-income ratio, the last of which has increased to over 80 percent in recent years (KPMG and HSG, 2016).⁸ In addition, the low-interest-rate environment, the non-acceptance of certain fees by clients, and the high regulatory barriers push margins down further.

Given these challenges, changes—both structural and fundamental—are unavoidable. Banking industrialization—a broad catchall term for breaking banks' value chains up in order to achieve higher efficiency, innovation, and reduced complexity—is not a new concept. Industrialization refers to a broad structural transformation and simplification of internal processes, such as the reduction of vertical integration. Industrialization reduces complexity and costs and increases process efficiency and service quality. It is the fundament for the introduction of the latest in banking services and, consequently, supports innovation.

An area of tension, however, may exist between individualized services and industrialized solutions. While the latter refers above all to automation and standardization, it may be viewed by clients as a significant potential threat to individualized services. External solutions offered by service providers—a market that has developed significantly in the past 10 years—are barely even considered by banks. And many banks, irrespective of their size, are still convinced that they are offering a unique selling proposition using their own (cost-intensive) transaction services or IT systems.

⁸ KPMG and HSG (2016) report that 18 percent of the Swiss private banks analyzed were strong performers in the period 2010–2015 and only these banks were able to reduce their cost-to-income ratio to less than 70 percent on average.

Despite the importance of these issues, there has been little research on this topic so far, most current research dealing rather with topics related to innovation, such as digitalization. Moreover, the specific business operations and strategies of private banks have not yet been analyzed comprehensively.⁹ The present study addresses these problems, examining the current situation and the future opportunities that banking industrialization offers to private banks in Switzerland. The study highlights 10 aspects (embedded in two overall strategical approaches) banks should consider when planning their industrialization strategy in order to ensure a successful transformation. The present study is based on over 30 in-depth interviews conducted with (mainly C-level) executives of Swiss private banks and with their counterparts from external service providers, and on an extensive literature analysis.¹⁰ The study aims to pinpoint the problems experienced by each side—by banks when working with providers, and vice versa—and also addresses the fact that the Swiss wealth management market is characterized by heterogeneity in terms of size and specialization in various business models.

within their group in terms of size,¹¹ legal structures, and possible special business models. The overall question is how to industrialize Swiss private banks in order to increase their competitiveness.

After presenting an overview of the current status of industrialization, framing the requirements for the next years (often referred to as next generation banking) and outlining the role of client relationship managers with regard to industrialized procedures and state-of-the-art services, the main body of this White Paper is structured into three parts: (1) strategic positioning, (2) optimized operations, and (3) outsourcing, including proper risk analysis. Along these dimensions, banks are analyzed

⁹ While Morschheuser et al. (2014) also analyze an area of tension, focusing on the number of services supplied in different service segments, the research question of the present paper is based on individual processes and services for wealth management clients.

¹⁰ Expert interviews were conducted in 2014 and 2015 with 18 percent of the Swiss private banks existing as of May 2016; the literature analysis covers the period until August 2016.

¹¹ Banks were segmented based on assets under management and head count: small (up to CHF 20 billion and less than 500 employees), medium-sized (CHF 20-100 billion and less than 1,500 employees), and large (more than CHF 100 billion and more than 1,500 employees).



2. Current Industrialization Efforts of Swiss Private Banks

This section briefly discusses the current state of industrialization in Swiss private banks. It summarizes the process's most important cornerstones and the progress made, and highlights the most striking deficits.

Banks' industrialization is mostly linked to cost cutting and reduced complexity, but not primarily to higher efficiency.

The first, general observation is that most Swiss private banks have already added various banking industrialization elements to their strategies, although in very different ways. This means that banks are not only aware of the topic of industrialization but see the need to act and have analyzed potential initiatives and measures. Second, industrialization is mostly linked to cost cutting and reduced complexity, but not primarily to higher efficiency. Overall, three main aspects of banking industrialization were identified:

- Single process changes (in particular in IT¹² and back office).
 - Applying a strategy focus on banking operations in the case of banks more advanced in their application of industrialization (i.e., outsourcing vs partnerships vs internal solutions).
- Process-related solutions for the purpose of reduced complexity (mostly by means of the standardization and automation of single processes).

Most of the banks surveyed claimed that industrialization efforts had already been applied to a medium extent—that is to say, that they had analyzed and, if necessary, revised and optimized single processes in around half of their value chains, and that this process included an appraisal of outsourcing initiatives. But not all banks had started to revise their value chains at the time the interviews took place. Around one-fifth of respondents said they were hesitant to apply measures due both to their clients' negative view of industrialization and to the uncertainty of their business situation, either in respect to waiving their banking license or due to potential mergers (uncertainty of future business focus, core banking/IT systems, processes, etc.). Only very few banks stated that they had

¹² E&Y (2015) reports improvements in terms of transformations toward sustainable IT infrastructure. Total IT expenditures for private banks in Switzerland are stagnating though. Additionally, E&Y (2015) states that banks spend more on running their daily IT business than they do on investment in IT innovation. One reason for this is that returns from IT investments are seen as being too low, although the transformation process that is replacing legacy core banking systems and old technology is ongoing. It is crucial, in E&Y's opinion (2015), that all outdated systems are replaced soon. KMPG and HSG (2016) have a rather pessimistic view for core banking systems and report that only 50 percent of large and 25 percent of small private banks operate with new IT core systems.

revised and optimized their value chains entirely. The banks in this last group have benefited either from the early application of transformation processes, and thus from less legacy in systems and processes, or from opening in recent years while applying the latest concepts to their strategies from the very beginning. All the banks in this last group had a very clear business focus, specializing in certain business models or operational aspects.

In general, no impact of bank size on level of industrialization is visible. Smaller and medium-sized banks, from an assets under management perspective, achieved both the highest and the lowest industrialization rates, while larger private banks displayed medium and lower rates. This might not be surprising given the higher complexity of processes and higher number of business units and divisions in such banks. Missing data prevent an accurate measurement of the progress of industrialization in respondent banks. Not one single bank measured the progress of industrialization across its banking units in a manner that would allow its management to measure optimization accurately.

On the business side, very few banks concentrate their industrialization efforts on the front office. The system legacy from back-end operations (i.e., the complexity of old systems and processes that have grown organically or have even arisen through mergers) is still too complex for most of the surveyed banks to shift their focus to the front end. Another problem for banks is the unclear picture they have of clients' current and future demands regarding innovative front-office solutions and the digitalization that enables Fintech solutions. Banks hesitate to implement solutions while future client expectations and trends are unclear or may prove unsustainable.

Most banks surveyed claim to have progressed only to medium-level industrialization.

Summarizing these insights, most banks have not entirely analyzed, revised, and updated their value chains, transforming them into state-of-the-art banking organizations; neither do these banks possess the approaches necessary to measure the progress of industrialization. Indeed, only very few banks have completed their industrialization efforts, and bank size is not particularly relevant with regard to the level of progress achieved to date. Finally, it is important to note that legacy in the back office and in IT systems restrains banks from revising old systems or from implementing new solutions, due to the complexity involved in such endeavors. The front office is the least revised part of banks in general.

When looking exclusively at outsourcing, about half of the private banks analyzed exhibit an outsourcing of operations level of less than 25 percent. Only very few—all of which are small banks—have reached 50 percent. Medium-sized banks lie between zero and 50 percent, whereas all large banks exhibit levels below 25 percent. Most outsourced operations are IT related (often core-banking systems¹³). Others include white labeling, reporting issues, other administrative back-office services, research, and some asset management functions.

Some banks are about to increase their number of outsourcing projects, especially those related to their back offices. However, the overall impression to be drawn from this survey is that many banks still try to optimize their value chains and business lines using internal solutions. The same applies for innovation and is, in particular, valid for front-office solutions. As the latter is their unique selling proposition, only very few banks attempt to enrich their front office with external solutions.

Related to outsourcing is the satisfaction of private banks with their service providers. Given the rather low incidence of outsourcing initiatives described before, it may be surprising that around half of the banks surveyed are generally satisfied with the current state of the provider market: satisfaction with outsourcing when it

¹³ For further information about future requirements for core banking systems, see E&Y (2015).

comes to IT/core banking systems reaches even higher levels. This is not the case for many of the larger banks, however. They do not yet see solutions suitable for organizations of their size.

Those banks that are less satisfied are unhappy with the small number of service providers offering back-end solutions. They wish to see more competition in this market as it would give them more alternatives to choose from, in particular for business process outsourcing. Generally, almost all banks prefer large, domestic providers. This is mainly due to the potential for regulatory problems with providers situated abroad. The three biggest problems in terms of service provision are (1) linking front-office services to back-office applications, (2) the time needed for implementation, and (3) the lack of compatibility and effective interfaces. Small banks, in addition, struggle with business process outsourcing due to their size and the related limitations on their resources and know-how. Furthermore, providers claim that banks are—too often—not cooperative enough out of a fear of losing clients should those clients look unfavorably on the sharing of client data necessary in outsourcing scenarios.

It is, further, interesting to note that the presence of additional capital resources (e.g., in the case of listed banks or subsidiaries of a group) exhibits no measurable impact on the progress made toward industrialization. Additional technical resources from parent companies (e.g., transaction platforms, IT, products, research, and investment banking) do, however, seem to be positively related to such progress, despite the fact that certain banks argue that such a relationship is not always an advantage as more effective systems cannot be used given the binding implementation of the parent company's own systems.

Many banks still try to optimize their value chains and business lines using internal solutions.



3. Next Generation Banking— Framing the Next Years of Private Banking

Disruptive innovations and regulatory adjustments are expected to bring further significant changes to the banking environment, although the direction these changes will take is still hard to predict. According to the authors' expectation, banks will remain at the center of a large service provider cluster, but that cluster will provide a range of services no longer managed within or developed by banks. The banking business itself will change less than the operations behind that business. Over recent years, more and more service providers—from core banking systems and IT to digitalization and Fintech, and thus from back to front office—have emerged. This trend is expected to continue in Switzerland and it offers banks a significant opportunity to remain up-to-date.

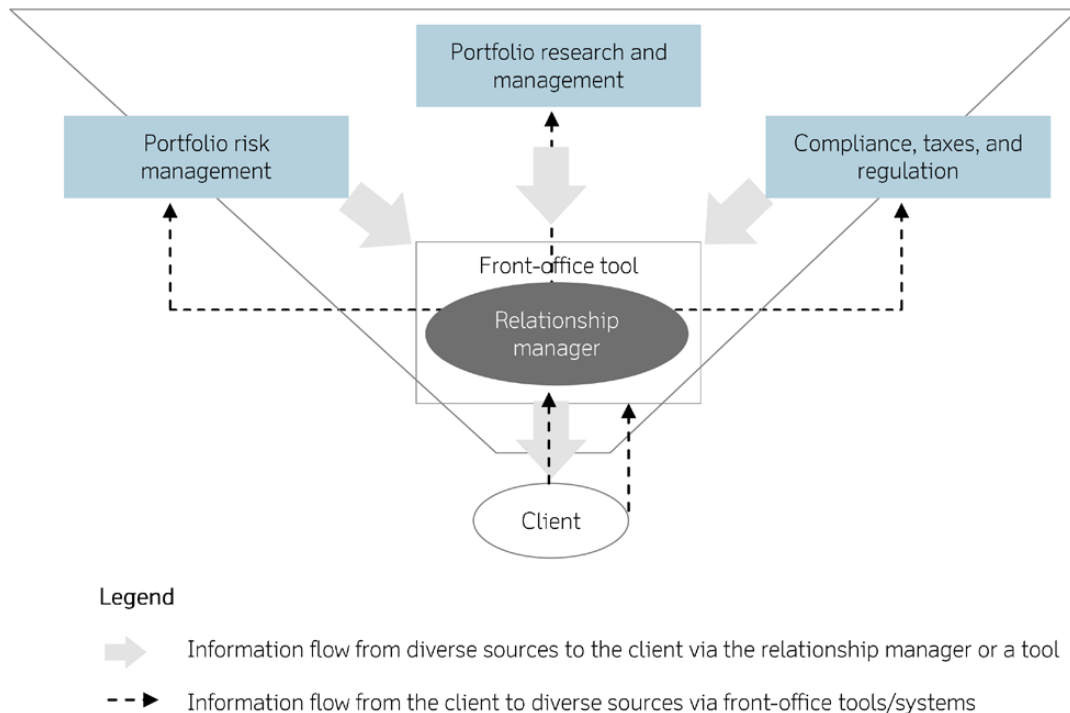
This will mean, however, that the number of dependencies from external sources will be increasing and that their management will be a key part of managing banks. Client advisory is expected to stay within private banks as a pivotal element of the value chain, while payments, transactions, and even asset management and product development will be outsourced to a larger extent in the future, with information being streamed into the bank. Digitalization will soon become a crucial element, providing clients with many sustainable features and simplifications with regard to how they use the services banks offer them, notwithstanding some of the hype that currently pervades the Fintech scene. It is important to understand that digitalization is not only linked to front-office applications. It is a transformation concept that enables new service possibilities.

In the finance community, there are big visions regarding the banks of tomorrow. But, in general, the business has not changed much over the centuries. Although technology has partly replaced manual work and the banking world has begun to move faster thanks to technological improvements, the business itself still operates with a simple advisory-to-client relationship—that is to say, by advising clients how to best manage and invest their wealth.

The client advisor will continue to play a central role but will be assisted by information from systems.

Based on the expert interviews conducted for this White Paper, most banks believe that the role of the client relationship manager will remain central but that it will be a less important role when it comes to decision-making. The authors do not expect a pure robotic approach to dominate the relationship manager role, believing that a hybrid digital model for advisory will prevail. More precisely, the relationship manager will stay the main contact person for the client but will be assisted and guided by decisions made and information supplied by other (data) sources and supported by a digital front-office tool (see Figure 1). At the same time, clients will receive a more transparent overview of their portfolio going forward (aggregated information on all banking interactions and accounts) supported by digital solutions (in particular mobile banking), leading to improved client empowerment.

Figure 1: Information and decision flow with state-of-the-art front-office tools from a client relationship manager’s perspective.



Source: the authors

Generally, the front-office tool will play an increasingly important role for the client relationship manager as it will provide a full set of client information, tailored service offerings, an aggregated portfolio overview, risk assessments, and diverse ways of interacting with the client. Hence, both client and relationship manager will benefit from a transparent and aggregated portfolio overview. The presence of individualized needs will likely lead to an opportunity to generate higher revenues if clients’ desires are known and addressed immediately with tailored offers and solutions. The narrowing of options helps both the client and the relationship manager focus on the most realistic approaches. This should lead to high client satisfaction. Furthermore, a front-office tool will support client relationship managers in time management terms by providing optimized answers and—ideally—significant support from other sources, on investment research for example. Moreover, the relationship manager and the bank will benefit from reduced complexity with regard to regulation and compliance policies. The relationship manager should be supported

by onboarding and background checks (e.g., know-your-customer solutions), and will benefit from automated processes that limit the need for documentation, whereas the tool will—ideally—perform such tasks. In summary, both sides will benefit from digital front-office tools, while solutions will be delivered in a more tailored manner than they are today.

Generally, the front-office tool will play an increasingly important role for the client relationship manager.

As a consequence of the increasing number of revised and digitalized solutions in the front office, which will support the actual advisory business and the client relationship manager, the need for well-structured underlying data—that is to say, data analytics and data management—will increase. As shown in Figure 1,

many sources will support the actual advisory business both for business reasons and investment research and for compliance, regulatory, and risk clarifications. It is expected that inputs will be provided by internal and external sources; only the assembly of these inputs being managed completely internally, including for reasons of data confidentiality. Information from the client will be automatically and comprehensively collected to support the front-office tool with regard to tailored solutions. The confidentiality and sensitivity of data are important topics for banks. However, considering current regulatory policies, it is also important to have a better understanding of the client going forward (e.g., onboarding, know-your-customer).

The increasing number of digitalized solutions in the front office will increase the need for data analytics and data management.

Generally, there will be greater empowerment for clients, who will interact with their banks more often, supported by digital solutions such as automated trading and information with advanced analytics. These solutions will provide banks with the opportunity to supply services with greater precision, as a consequence generating higher client satisfaction. Moreover, they will reduce the effort required and the time spent by client relationship managers on administrative matters and will thus lead to potential cost savings. They will also reduce risks. If they are to offer such solutions, however, banks need agile, comprehensive, and modern processes and systems that are standardized and automated—these will secure the highest possible efficiency levels for the advisory business. In addition, a willingness to collaborate with external providers is required. All this means breaking up value chains in order to better manage their underlying operations thanks to reduced complexity and clear opportunities to implement further improvements.

On the client side, the authors expect increasing demands for more flexibility in terms of services (a broader product range and services offered from various locations), for a proper online/digital service (in parallel to direct communication with a client relationship manager), and for broader digitalization regarding tailored solutions.¹⁴ For a certain number of clients, technical innovations (such as digital tools or Fintech) might be interesting. Banks might therefore create competitive advantage by providing such interesting services and tools for their clients. This is important for smaller private banks in particular. Many of the banks surveyed for this White Paper welcomed these new features and expected to implement some of them in the near future if they were available. In addition, and of significant importance, clients expect a more transparent and fully backed investment strategy that they can feel comfortable with regarding both regulation and investment risks.

Finally, the authors further expect a substantial generational change to occur in the coming years. Many clients are—based on the banks' own information—over 60 years old. Their demands are different from those of the IT and mobile generations. Younger generations are more likely to be disappointed if digital solutions are not on the table. Banks in Switzerland need to understand that a younger generation will inherit their elders' assets at some moment in time, and that this younger generation might not be willing to manage the assets bequeathed locally in Switzerland, but might prefer to do so digitally from wherever they might live.

A younger generation will inherit their elders' assets at one point, and might wish to manage them digitally from wherever they live.

¹⁴ E&Y (2016) states that most banks in Switzerland (including private banks) have no digitalization strategy as yet. For further aspects of digitalization for wealth managers, see PwC Strategy& (2016).

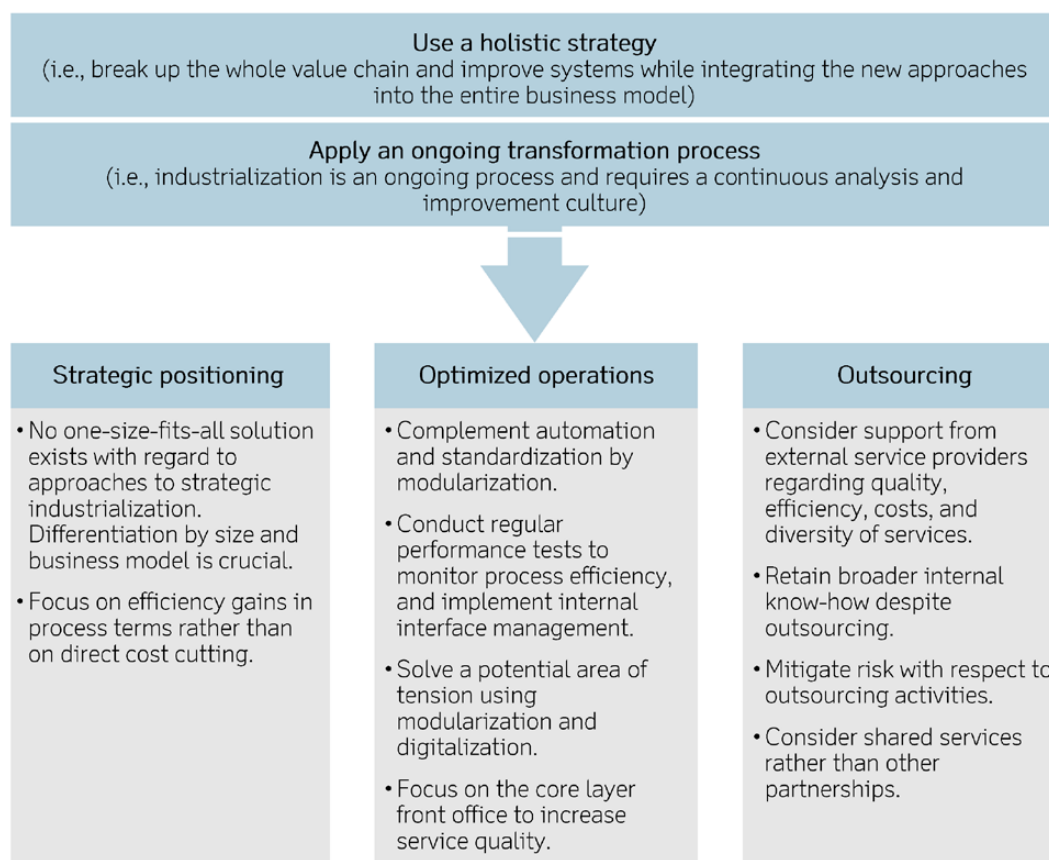


4. Recommendations for a Successful Industrialization Strategy

This chapter provides 10 distinct strategic recommendations (see Figure 2) banks may wish to consider when industrializing their value chains. This is a spectrum of strategic, operational, and outsourcing-related directions. The 10 recommendations are embedded in two main overall strategic requirements—namely, a holistic strategy approach and an ongoing transformation and improvement process. When

applying a holistic strategy, it is important that banks integrate these 10 approaches into the entire business model. The ongoing transformation and improvement culture requires a continuous analysis and optimization of all relevant internal processes. This chapter's first subsection (4.1) focuses on fundamental strategic positioning and solutions.

Figure 2: 10 distinct recommendations banks should consider when evaluating an industrialization approach, embedded in two overall strategic approaches.



Source: the authors

4.1. Aspects of a Holistic Strategy Approach to Driving Industrialization

Swiss private banks are widely heterogeneous in terms of their size and business models, and partly in terms of their relationships with their respective parent companies. While these specificities are often overlooked, they are crucial when it comes to choosing an appropriate industrialization strategy.

In general, the frequently expressed opinion that small banks will not survive in the current climate is questionable. Certainly, smaller banks are undoubtedly confronted with higher costs and investment requirements relative to their total assets, as some requirements do not change much with respect to size. But industrialization offers opportunities to reduce costs, for example by standardizing processes, business focusing, or outsourcing. The fact that a bank embraces an industrialization approach seems to be a more important precursor of future success than the size of the organization per se, and thus scalability.

Embracing an industrialization approach seems a more important precursor of future success than the size of the organization per se.

Furthermore, currently client demand is often not comprehensively built into business processes. Instead, it is considered separately or only after processes have been established. This is a very basic but important point that must change, in particular considering the imminent growth of digitalized services. Operational functions are highly interconnected, with various elements relevant to decision-making—including compliance and regulation or IT and digitalization.

Recommendation 1: No one-size-fits-all solution exists with regard to approaches to strategic industrialization. Differentiation by size and business model is crucial.

The act of differentiating strategies is often overlooked when strategic changes are considered. Even though all Swiss private banks operate in the same business area, their actual business models (e.g., products, clients, regions) differ, as do their sizes. This White Paper categorizes the banks surveyed—using a classical approach of assets under management and number of employees—into three different sizes: small, medium-sized, and large private banks.

Smaller banks only have two options: specialize in specific business models or only keep the front office in-house.

Beginning with the small and smaller medium-sized banks, these organizations are expected to face the biggest challenge when industrializing their processes. On the one hand, their capacities are limited. On the other, they carry a much higher level of internal investment (with respect to their total assets) than their larger counterparts. Third, the territories from which they might acquire new clients are as limited as these banks' ability to relocate to growth regions. In addition, complex regulatory and compliance requirements come—again, given the size of these banks—at a high cost. Smaller banks must therefore choose one of the following two fundamental strategies:

- Specialize in specific business models (investment classes, client groups or domiciles, special offerings with regard to technologies) and concentrate their resources.
- Focus on front (and middle) office only and outsource all remaining operations.

The former strategy allows banks to industrialize more easily thanks to leaner structures and a lower level of complexity. It allows them to focus on specific corner points in each area rather than covering different options on each layer (e.g., the regulation of the cross-border busi-

ness of specific countries only). Significant outsourcing decisions are not a high priority in this case, but banks should still not lose sight of them. It is important to analyze the business model carefully and potentially to specialize in high-quality services in a niche, acting as a boutique service. Even if these banking organizations would benefit from offering high-premium services that are tailored to specific needs, the validity of this approach depends on the extent to which the bank is able to enforce premium pricing for its services. Most specialized private banks included in the survey already use industrialized processes and outsourcing solutions widely. However, to date, only few organizations have focused or specialized their strategies. Hence, it is of the utmost importance for small banks to carefully analyze their focus and to consider offering specialized and innovative services.

In contrast, the latter strategy implies a shift from transaction-based banking to pure advisory banking. There are already a few examples of this in Switzerland. For these banks, the quality of front-office services is even more crucial, and state-of-the-art solutions a constant necessity. In addition, these banks are highly dependent on the quality of outsourced services, which has to be considered a potential risk and will be discussed later in this paper. This approach is suitable for a banking clientele in a lower assets-under-management segment or for clients interested in advisory only rather than a full service offering. These client segments might be interested in general guidance and standardized asset management, which should be less cost intensive. Boutique services, on the other hand, may cover specific, complex advisory segments, deciding not to supply any other internal bank processes. Both proposals lower costs and complexity, and increase the focus on the specific chosen business.

Implementing an open product platform is mandatory for both strategies. None of the smaller banks has the capacity to adequately match market demand. Partnerships with larger banks could be an option, but this idea was rejected by almost all the private banks consulted during the interview process. Even the

cross-border business may become attractive again if specialized in specific markets, thereby maintaining the core strength of the Swiss financial center (i.e., cross-border wealth management).

Medium-sized private banks need to be clear about their long-term goals with respect to their size and business model in order to apply the appropriate industrialization strategy.

Medium-sized private banks' primary challenge is to ensure clarity in their long-term goals regarding their size and business model. More precisely, the question is whether a private bank categorized as medium-sized with regard to its operational structure, the regions it serves, and the range of services and products it provides is oriented toward smaller or toward large private banks. This question is important as it drives the banking strategy and entire operational setup. In the course of this study, the authors regularly uncovered unclear and unrealistic goals, such as banks seeing themselves as competitors of large private banks. But a bank's choice of industrialization strategy depends on the answer to this question—the answer enabling a bank to settle on the direction to be taken, the potential to be exploited, and the extent of industrialization required.

Large and larger medium-sized private banks, in contrast, can differ from smaller banks as a result of economies of scale (especially in, e.g., transactions, IT, product and service range, and regulatory issues). Moreover, their greater human resource capacities support a wider range of products and services, which allows them to move into growth markets. This does not mean that industrialized processes and systems are less important. But compared to their smaller counterparts, internal industrialization solutions are more suitable and manageable for larger banks. Many, however, are

yet to shift their focus to this topic, and this can be seen as a long-term threat.

Large private banks often exhibit a high process complexity and weak front-office solutions. Interconnecting (cross-border) business functions have to be streamlined, product ranges and different IT systems and transaction platforms merged, front-office services standardized, processes and systems automated, all without losing an agile and modernized environment. Furthermore, lean structures are a prerequisite. Hence, industrialization for such institutions is particularly linked to business process development. The organization and structure of some larger private banks tend to be rather complex. As already mentioned in Chapter 2, larger banks often need to catch up with regard to IT systems in order to create the foundations of a more structured value chain. The resources freed up by such reduced complexity or higher efficiency can then be applied to finding appropriate solutions in the front office, hence concentrating on the main private banking area, which often needs to catch up with those of the large, global universal banks and smaller peers. In this respect, open product platforms are also recommended, and many banks already offer products via such platforms.

Industrialization in larger banks should be specifically linked to business process development.

It is important to remember that large private banks are much smaller in size and benefit less from economies of scale than large, globally operating universal or investment banks. This means that competing with this range of institutions is impossible unless a larger private bank is concentrating on highly efficient processes, high-premium services, and specific regions. The investments necessary and costs incurred represent a much higher proportion of their total assets than is the case for large and globally operating universal or investment banks. They can, however, benefit from a more tailored and individualized service and product line, and

from know-how about specific regions.

Generally, the level of industrialization is rather low in larger private banks, which often goes hand-in-hand with a more internationally diversified client base and opportunities in growth regions, which in turn enable these banks to generate higher margins abroad. Internationalization, however, is a risk in terms of complexity regarding processes, regulation, and systems. Hence, industrialization should be understood as an opportunity to mitigate these complexity risks. Irrespective of the progress of industrialization, larger banks attempt to align it with their business offering—a point on which many smaller banks tend to fail.

An opportunity exists for larger banks if they consider the insourcing of services, which would also accelerate process dissemination to other banks. Larger capacities (e.g., in transactions or system utilization) can be achieved by sharing costs and innovations. Banks are well advised to reflect on their opportunities to become in- and outsourcing partners, and—by doing so—concentrate on their own strengths; although the risks of such an approach should not be underestimated. Other forms of partnership—with competitors, for example—might prove more problematic for large banks.

Recommendation 2: Focus on efficiency gains in process terms rather than on direct cost cutting.

As previously mentioned, private banks often link industrialization to opportunities to reduce costs by means of standardization efforts and outsourcing. As cost-cutting programs should be part of any business strategy, it is reasonable to link those initiatives to an industrialization strategy—and considering the profit situation of most private banks, it is understandable that many prioritize these programs accordingly.

However, modern industrialization does not target pure cost cutting, but involves breaking up value chains in order to increase efficiency in terms of processes and systems in order to create smoother workflows, to reduce the number of unnecessary processes and tasks,

and to allow an organization to concentrate on its own strengths. Focusing primarily on cost cutting provides less room to leverage banks' strengths as it fails to address the issue of how to become a modern, lean, structured bank with well-defined processes and innovative, profitable services. Therefore, banks must focus both on efficiency gains and on the development of a sustained, long-term strategy for continuous improvement and innovation.

Driving a clear standardization and automation strategy as the basis of streamlining or unfreezing the structure from complexity and the unnecessary use of resources provides more flexibility when it comes to reducing costs permanently. The coordination of related processes and systems is important from the very beginning as most processes are interconnected (e.g., regulatory issues and digitalization), which again contributes to the overall complexity present.

Today, most private banks are primarily concentrating on industrializing their back offices. Although the back office is the basis of a well-structured bank, as services are components of all other areas in the bank (middle and front office), this part of the organization is the one that differentiates any given individual bank the least. It has mostly a similar structure and provides similar services across banks. In addition, the back office is not visible to the client and thus modifying its operations does not affect competitiveness. Nevertheless, a state-of-the-art, lean but flexible, and cost-efficient back office is a prerequisite. And banks must be open to both internal and external solutions.

Going forward, the largest efficiency gains will come from the front office, as it is the most costly part of a bank's structure (and not only in terms of human resources). Most steps to serving clients in private banks are tailor-made. As described in Chapter 3 of this White Paper, the function of a client relationship manager is likely to change in the future. And with this change, complexity will grow. The information flow between the relationship manager and the client will increase, as will the interchange between the different service providers and

internal functions of the front office. This will need to be coordinated if a well-addressed advisory framework for the client is to be created and maintained. In addition, the flow between the front and the back offices will become more important, as many services, tools, and devices for the front office are supported by the back office, in particular with regard to digitalized services. Hence, banks are well advised to concentrate more on front-office efficiency. Apart from this, it has to be clear to every bank that its front office is its only visible element and that unstructured and complex services will most likely be rejected by clients. A qualitatively high standard in the front-office layer contributes to increasing the satisfaction of clients, and thus to their willingness to accept a certain level of fees.

Going forward, the largest efficiency gains will come from the front office—the most costly part of a bank's structure.

A proper structure and well-defined processes are crucial to achieving efficiency across the entire bank. Efficiency, then, goes hand-in-hand with long-term cost reduction, but also includes the effect of high standards for processes and services. Hence, direct, short-term cost reduction is expected to become less important compared to a long-term efficiency strategy with greater potential for reducing costs by smoothing processes. Aligned with this leaner structure and lower complexity level, a bank has more available resources and the clearer processes required for it work on innovative services and address client needs in the front office.

4.2. Ways of Increasing Internal Process Efficiency

Shaping the overall strategic aspects from the previous chapter into more precise formulations, the next four recommendations deal with the question of how to increase the efficiency of internal processes. This topic includes improvements in the core private banking layer—the front office. In this respect, a potential area of tension resulting from a more standardized supply side will be addressed and an approach to overcoming this issue will be presented. Additionally, it will be shown how banks will need to rethink all processes and instruments in order to equip their client relationship managers with the best devices and tools so that they can provide the highest quality services to their clients.

Recommendation 3: Complement automation and standardization by modularization.

Standardization and automation are basic requirements for industrialization. These two elements become more important and more sophisticated as the level of industrialization increases, since all other elements of industrialization are based on a lean and clear process structure. The goal of automation in particular has developed rapidly in recent years. Modern automation does not mean developing a standardized iterative process, but rather finding self-governing solutions. Taking the client onboarding process as an example, the goal of automation is to use existing data sources to—for example—verify a proper risk assessment automatically instead of going through a merely standardized, step-by-step catalogue with a client relationship manager. Furthermore, a continuously changing market and product environment, various fast-changing IT solutions, regulation time-to-market (i.e., regulation that must be implemented immediately), and a broad variety of client demands require that private banks develop a more agile structure in the future. Making the transition to more flexible processes and systems without constraining automation and standardization can be achieved by modularization. The goal of modularization is to merge sub-processes into useful process

combinations. In this way, a more standardized, but also a more efficient, use and iteration of processes is possible, as is a reduction in the number of interfaces.¹⁵ Moreover, this leads to more flexible replacement options for systems and sub-processes in what is a fast-changing environment. The existence of interface points that are more standardized contributes to having more efficient outsourcing options too.

Standardization and automation gain in importance as industrialization progresses—industrialization being based on lean, clear processes.

Modularization is also compatible with the front-office layer and service package offers for clients, which—once modularization has been achieved—can be adapted more individually or flexibly. Furthermore, providers highlight how modularization leads to a better process overview for management. Highly developed private banks already use modularization often, especially with respect to client advisory packages.¹⁶ Even if some banks see a downside due to the additional task of actively managing the modules, banks that use and providers that offer modularized systems and processes estimate that the benefits compensate for the additional workload. IT solutions may help to simplify efforts with regard to automation, standardization, and modularization, and the supervision of these areas.¹⁷ The last point is part of the next recommendation, as the supervision of industri-

¹⁵ Regarding interfaces, see also Netzer and Hilgert (2008).

¹⁶ Using modularization with respect to regulation issues (i.e., to modularize regulations into a package of other services or products in order to change them more easily) is not, however, recommended, as complexity tends to rise if one does so.

¹⁷ E.g., service-oriented architecture (SOA) or APIs. The first is an IT architecture especially conceived for business processes and is used to structure IT services. It is mainly used to simplify or standardize processes and to maintain flexibility. Morschheuser et al. (2014) detect a trend for SOA in banks in the DACH region. Beimborn and Joachim (2011) further find a positive impact on business process quality. For a definition of API, refer to this White Paper's glossary.

alized processes is likely to become more relevant due to the importance of maintaining high quality over time.

Recommendation 4: Conduct regular performance tests to monitor process efficiency, and implement internal interface management.

Internal and external interface management (i.e., managing connecting factors or points of contact between two systems, products, or even devices) and data generation for the monitoring of efficiency are hardly employed at all in private banks, even though they are fundamental to ensuring continuous system and process improvement and high quality over time. In general, data analysis concerning process optimization is rather poor in most of the banks surveyed—irrespective of their size or business model. Moreover, with a few exceptions, service providers also tend to have difficulties in providing data (i.e., they supply data in a less than optimal format) and thus in helping a bank to maintain a better overview of its own performance. Smaller banks in particular stress this point, given their own limited resources for conducting such analyses.

Process optimization-related data analysis is poor in most banks, irrespective of their size and business model.

Furthermore, banks should provide more process-related data to external providers for analysis purposes.¹⁸ However, and as a matter of course, in order to keep clients' data safe banks are required to separate client and operational process data. This also means that service providers are required to increase transparency in terms of their own performance and efficiency. Advanced training activities offered to bankers by service providers are also required, in particular with regard to process-oriented interface

improvements. This point came up many times in the interviews conducted for this White Paper and was particularly requested by smaller and medium-sized private banks. To conclude, it is most important to collect and analyze data, monitor progress continuously in order to reduce error rates, and increase the efficiency of a bank's day-to-day business operations, externally and internally.

IT architecture concepts, such as application programming interfaces (APIs), enable software programs to manage technical interfaces in a very flexible and efficient manner, including directly in the front office. The use of such architecture concepts is a prerequisite of a state-of-the-art and efficient banking operation. IT architectures already manage technical interfaces, such as APIs, today. The integration of such IT architecture must be aligned with all other IT solutions/architectures, with the interconnectivity of processes and systems in the entire banking landscape, and with all relevant elements of external collaborations if best results are to be achieved. Smaller banks might delegate these tasks to external providers; larger banks mandate an internal team. In addition, it is important to maintain a well-organized database via which to monitor progress and efficiency over time.

In the case of outsourced services, managing these interfaces efficiently is even more important, systems often vary, and the connecting points differ. Many providers, however, claim that banks make too little effort to ensure such effective management. The result is unsatisfying for both sides. Banks receive an inadequate service, while providers are unable to increase efficiency due to the lack of interface management. Not surprisingly, both providers and banks complain that the general level of know-how in banks regarding process optimization and interface management is often too low. One of the reasons for this can be seen in the tendency of banks to reduce their workforce when opting for outsourcing, thus letting go know-how that was once in-house (see also Recommendation 8).

¹⁸ For legal requirements and restrictions, see FINMA (2009), in particular SN 37 to 39.

Recommendation 5: Solve a potential area of tension using modularization and digitalization.

Some banks fear that standardization will lead to a decrease in the number and quality of individualized services offered to wealth management clients. They argue that their clients would not accept the modifications that would accompany the industrialization process, such as standardization of processes for clients, the modularization of products, etc.

The research carried out for this White Paper reveals, however, a strong link between a bank not yet having modified (or broken up) its value chain and the fear of losing clients. This link seems to be independent of bank size and business model. In fact, those banks that have revised their processes to a significant extent see benefits for their clients, such as more efficient processing times (e.g., of clients' orders and transactions) and fewer administrative and regulation-related issues. The latter benefit, in particular, is important, since—according to many banks—administrative and regulation-related tasks and tax issues currently eat up most of the time spent in client meetings and most of the preparatory work carried out by client relationship managers. Banks that reduce this workload can then better use this time to provide better client advisory, or may opt to increase the number of clients per relationship manager. Hence, costs per client are expected to decrease, without a loss of qualitative and tailored services for clients.

It is fundamentally important for private banks to explain industrialization improvements to their staff and clients, and to show the benefits thereof.

Scrutinizing the high costs incurred per client, some banks also mentioned that the number of clients per relationship manager has grown too fast in recent years, thus canceling out the

benefits of industrialization. Overall, it is fundamentally important for private banks to start explaining industrialization improvements to their own staff and their clients, and to show the benefits thereof. Moreover, it is crucial to involve client requirements more and more in process and system development in order to maximize efficiency.

For this reason, private banks should consider further modularizing their service packages and digitalizing their front office. In some cases, banks may execute this first task based on client segmentation. Most banks applying modularization divide clients into the following groups (depending on clients' assets), only the last of which remains highly individualized: affluent-clients (mostly fund solutions or basic, modularized offers), high net worth individuals (the most frequently addressed group with regard to modularized solutions), and ultra-high net worth individuals. Modularized solutions are in line with standardized and automated basic services and additional service packages, which are standardized but individually assignable. If well managed, flexibility and individualized services can be retained, while cost reductions can be achieved, complexity decreased, and quality maintained. Modularization may also be the basis of a more transparent price model for clients. Pricing models may comprise standard fees including all services, on the one hand, or restriction pricing, on the other. With the latter, the bank charges a basic fee and a fee for the chosen modules.

Moreover, digitalization may help keep client-related solutions individualized. As explained in Chapter 3, digitalized services allow banks to optimize clients' digital user interfaces based on user experience, and modern front-office tools allow banks to provide tailored solutions in a timely manner. Both these strategies, however, require automated and standardized background solutions and fully industrialized services as prerequisites.

Recommendation 6: Focus on the core layer front office to increase service quality.

While the front office is the classical core layer of

a private bank's value chain, it is also the least analyzed and revised.¹⁹ As previously discussed, individual contact with clients and individuality in service offerings are key factors in the private banking business. The lack of good and sustainable products and systems for front-office services is still a problem, but there has been rapid progress and more service providers are expected to enter the market. In addition, Switzerland is home to a growing Fintech scene that has provided banking solutions that have already proved to be sustainable, such as mobile payment systems, compliance tools, and digital front-office user interfaces, as well as robo-advisory platforms. It remains to be seen, however, what kinds of solutions will become widely accepted.

Until now, hardly any bank has entirely revised its front office using industrialization approaches. The legacy from back-end operations is still too complex for most of the banks surveyed to shift their entire focus to the front office. This has two consequences: First, banks lack state-of-the-art front-office solutions. Second, even if banks implement innovative solutions, they tend to build them on top of old operations and systems, without revising these. This increases complexity even further and contradicts the concept of industrialization. The consequences of this are not limited to efficiency problems and weaker services for clients; they also impact on regulatory issues. For instance, a single database covering client information and transactions is a prerequisite to ensuring the success of know-your-customer and anti-money-laundering policies.

Even if banks implement innovative solutions, they build them on top of old operations and systems—increasing complexity further.

¹⁹ Similar findings can be found in E&Y (2015) for IT in the front office.

To solve these problems and to meet clients' future expectations, the breakup of value chains and further improvements in the efficiency of the front office are current necessities. In order to maintain competitive positions, banks must additionally focus much more on clients' needs and on the efficiency of their systems and processes. Once they have understood their clients' aspirations, banks first need to standardize and automate processes related to administrative and regulatory issues, and to tax requirements and risk assessments. Second, banks must ensure that processes from the front end are aligned with the back and middle offices—as well as with the makeup of external collaborations—if the highest levels of efficiency are to be achieved. This applies in particular for digitalized products and services. Third, in order to improve investment strategies and products, banks must increase their efforts with respect to client relationship management tools (using background data and information that are well prepared to cover operative risks, such as controlling, risk, tax, and compliance assessments; see also Chapter 3²⁰). The fourth requirement is to pursue technical improvements to user interfaces and client relationship managers' tools. Relationship managers must have access to new forms of tools and devices if they are to handle their work more efficiently. In order to give a bank a competitive advantage, digitalization²¹ must be and Fintech solutions might be considered. Here, a stronger will to collaborate with external providers is required, as is more system flexibility to facilitate external collaborations.

Overall, banks will only be given credit for their services by operating as efficiently as possible and by concentrating on effective added value with features that reach beyond mere basic requirements. Furthermore, banks operating in different countries—that is to say, in different legal environments—have a special interest in professionally managing operations in diverse regulatory regimes and with respect to diverse national tax laws. Here, automated processes

²⁰ Similarly, E&Y (2015) point out four main application requirements: mobile, social media, advanced analytics, and cloud-based computing.

²¹ See also PwC Strategy& (2013) regarding digitalization in the wealth management sector.

are required if the services supplied are to be even sufficient.

4.3. Aspects of Successfully Outsourcing Parts of the Business

The service provider market in Switzerland has grown rapidly in the past decade, benefitting mainly from fast-developing IT and the Internet's penetration into the market. Solutions have become more comprehensive than ever before. Although only the larger players are well known, various smaller providers have established their businesses in a range of niches. And the authors expect that an increasing number of specialized providers (e.g., Fintech) offering services in diverse areas will enter the market in the near future.

As previously mentioned (see Chapter 2), most banks are by and large satisfied with the current service provider market situation. Successful outsourcing projects are still rare though. But an increasing number of banks have started to pursue outsourcing solutions in the past years, and also managed to outsource parts of their businesses successfully—mostly to back-office solution providers.

Banks must decide whether internal or external restructuring and optimization can be implemented more rapidly, and whether they would be more efficient and cheaper in the long run.

In general, banks need to analyze whether or not they are capable of creating better processes, systems, and (IT) services than external providers. Specifically, they need to estimate whether internal or external restructuring and optimization can be implemented more rapidly, and whether they would be more efficient, cheaper, and more sustainable in the long run. Providers may become enablers for innovation

and provide the required breadth on the supply side. Recommendations 7 to 10 provide four reference points regarding the decision to implement outsourcing and regarding the process, the risks, and form of outsourcing.

Recommendation 7: Consider support from external service providers regarding quality, efficiency, costs, and diversity of services.

Almost every bank that has implemented outsourcing solutions justifies its decision with reference to cost cutting. This, however, should not be the reason to outsource. It is often disregarded that service providers can optimize the systems they supply much better than banks can, and may become enablers of innovative processes and products—even of those tools and devices used by client relationship managers. On the one hand, service providers are able to allocate time and resources to delivering a given service in a more sustainable way—it is, after all, their core business activity. On the other hand, they are much more capable than their clients are of maintaining an overview of the market with regard to new trends and developments. Additionally, the task of maintaining and updating systems and processes is less (human-) resource intensive for providers thanks to economies of scale, and thus can be managed more efficiently. The authors expect the service provider market to increase its portfolio regarding new technological opportunities in the banking area.

An important advantage of an outsourcing arrangement is that providers have the opportunity to accumulate examples of best practice while working with several clients. For such providers, leveraging this information is crucial to their efforts to improve their own services and products. This information edge might be important above all for banks that need to catch up with regard to industrialization approaches in general. While providers dispose of significant information gleaned from their experience working with high-performance systems and concerning processes and their attendant potential problems, banks can only figure out their own processes and problems. Moreover, a given provider's service and solution line is

usually broader than that required by any single bank. Hence, service providers can offer additional input to increase the quality of systems, processes, services, and products. Cost reduction is, of course, important when it comes to the decision as to whether to outsource or not. But these other criteria should be the factors that actually drive that decision.

While outsourcing decisions are mostly based on comparing the direct fixed costs of provider services to internal costs, the long-term costs of internal solutions, including the costs of maintenance and updates, are often underestimated. Banks have to keep in mind that updates will become more costly and complex, in particular due to the acceleration of both technical development and regulation. This is particularly important for smaller banks, as capacities and human resources are limited and sometimes difficult to manage (e.g., in the case of temporary employees' absence).

The long-term costs of internal solutions, including maintenance, are often underestimated, and will rise further due to technical developments and regulation.

If a bank opts for outsourcing, the biggest challenge remaining is to pick the right external service provider(s) and to manage the external and internal connection points (interfaces) in the most efficient manner. Furthermore, the non-technical integration of a bank's own systems (e.g., the training of staff) is very important and requires sufficient attention. Many small banks interviewed in the preparation for this White Paper were asking service providers for more support in this respect.

With regard to their size, process complexity, and the amount of management needed, larger private banks still see some obstacles to the implementation of their processes on providers'

platforms. Nonetheless, recent examples show that even larger private banks have managed to be lifted onto service providers' banking platforms successfully. Although larger banks must take into consideration that more time will be needed regarding process and system interfaces. Well-structured, industrialized banks (in terms of processes and systems) have a big competitive advantage due to their lean structures and are easier to manage during the implementation process. Hence, they are also more agile when it comes to implementing new, innovative solutions.

Another alternative lies in the recent trend for sharing provider mandates, referred to as fragmented outsourcing. With this approach, IT and service platform interfaces require adjustment, both for providers and for banks; otherwise, complexity can even increase and the implementation process takes too long. The supply side for this alternative is still rather weak, and banks have reservations with respect to opening data access to outside companies. Considering the rather low level of industrialization of larger banks, they may benefit from entering into negotiations with providers and studying possible options more closely.

Recommendation 8: Retain broader internal know-how despite outsourcing.

One other aspect of outsourcing's efficiencies that is often undervalued is related to layoffs. Banks tend to dismiss some of their staff during the outsourcing process (and in the context of automation-related improvements). As a result, banks run the risks of having insufficient human resource capacities to maintain their processes and of not keeping enough know-how in-house to handle services provided by external providers efficiently. Instead, banks need not only to hire experts, but to keep and develop experts. And this is of particular importance when revising value chains. At least some in-house experts should be familiar with a bank's own systems and processes. External service providers claim that banks' internal know-how is too weak. And here one can observe what is a more general problem: even small banks need an increasing number of skilled experts to manage their oper-

ations efficiently; but for small banks the services of these experts are often too expensive. Banks should therefore consider investing more in their current staff in terms of advanced training, and should also consider collaborating with other banks, consultancies, and service providers.

Banks must hire experts, but also keep and develop them. When revising value chains, in-house expertise regarding own systems and processes is vital.

External consultants can only fill gaps as subject-matter experts, but internal know-how is required for coordination purposes within the bank. Moreover, outsourcing providers often focus purely on specific topics and do not offer consultancy services regarding internal process and system optimization. Providers and consultants should therefore also consider developing consulting activities together more often, thereby exploiting new market opportunities. The same applies to advisory for the implementation stages of the industrialization process, and to project- and strategy-related consultancy. Ideally, processes, project, and strategy elements should be combined. With regard to internal and external consulting and project management, teams should include experts from a range of areas in order to meet all the relevant requirements—so, IT experts, compliance officers, transaction experts, administrative officers, and so on. Furthermore, risk monitoring and failure analyses also have to be integrated. Overall, the relationship between banks and providers has to become more intense if inefficiencies are to be avoided and the quality of outsourcing projects improved. Better coordination, with or without a third party, leads to faster execution and may therefore solve one of the issues banks associate with outsourcing—slow implementation.

Recommendation 9: Mitigate risk with respect to outsourcing activities.

The body of literature on outsourcing is by far the largest in the field of industrialization. Nevertheless, fundamental risks are rarely discussed in that literature. For banks, two main challenges accompany the decision to outsource: monitoring the efficiency of externally provided services and maintaining flexibility in terms of changing a provider if necessary. Providers may need to be replaced due to performance issues, due to the fact that the services they provide do not conform to the contractual terms in force, or because they become insolvent. While the last point is a general business risk and is therefore not the focus here, the need to change providers—irrespective of the reason for doing so—is an obvious risk. Since each provider's systems and interfaces differ from those of their competitors, banks have barely any opportunity to switch. Once installed (or lifted onto a platform), such systems are hard to move (to another platform). A system re-upload onto a competitor's platform is costly and requires huge capacities in terms of time, in particular during the implementation stage. Most banks that have not yet outsourced their systems or processes highlight this point as being one of the most influential reasons why they still operate purely internally. Some providers agree with this point, but say that similar interfaces (i.e., connecting points from external to internal processes or systems) for providers and banks would resolve these issues by making interconnection more homogeneous and problem free.

The efficiency required of systems and services should encourage institutions to show an active interest in the performance of providers. The problem, however, is banks' limited capacity to do this. Banks often claim that data furnished by external service providers is either insufficient in quantity or too complex to be understood and used effectively. In general, the authors recommend that banks invest in an appropriate middle management layer capable of performing this task.

Even more important is the—often underestimated or overlooked—need for well-organized contract management and a person in charge of it internally or externally. Whereas most larger

banks have internal legal or contract management teams to fulfill this task, smaller banks rarely do. As such, the latter are often unable to cope with sustained contracting-out in an efficient manner. Thus, while banks may see the short-term cost-cutting benefits of outsourcing, they may underestimate the long-term constraints imposed by such contracts. The negative consequences of such misjudgment can be a high level of dependency over a long period of time and unforeseen costs; low quality and low levels of efficiency can also result.²²

Recommendation 10: Consider shared services rather than other partnerships.

Partnerships or collaborations between private banks are rarely discussed in the Swiss financial market. Since private banks essentially focus on the same business as each other, competition rather than collaboration is the watchword. Nevertheless, the interviews carried out for this White Paper indicate that there is room for partnerships—even though such opportunities, which will be explained in the following, are limited.

The benefit of entering into joint ventures and partnerships in order to develop one's own service provider to which one may outsource processes and systems is questioned by most banks, since the drawbacks of such an approach seem to outweigh the advantages. Several banks argue that external providers have already achieved relatively high quality standards, and thus that most banks do not see an advantage in building up their own providers. Others stress that, compared to engaging with external providers, the additional effort required by partnerships is not compensated for by the higher quality of services obtained, but does bind more internal resources than would be the case if the

²² Outsourcing and the long-term constraints imposed by providers' contracts may also prevent collaboration and consolidation. Banks, as a target for acquisition, are less attractive if they have signed long-term contracts with external providers (and are thus facing long-term constraints) and have already implemented these systems. Prior implementation limits the buyer in terms of how it may integrate the acquired bank or at least of how it might, post-acquisition, unify systems—integration and unification that could be expected to generate synergy effects and provide the purchaser with a leaner process structure.

bank simply engaged with an external provider. Furthermore, banks seemingly do not see any future for strategic partnerships with other banks. The main hazard of such partnerships lies in direct data or information exchange and how either may lead to competitive disadvantage. This is particularly an issue when a bank combines forces with another bank of a similar size and with a similar business model.

Two other models, however, tend to be appreciated more by at least some banks—namely, insourcing and shared services.

As mentioned in Recommendation 1, larger banks in particular may have the capacities to provide services to other banks or to offer other banks a place on their platforms and systems. This is known as insourcing. Interviews conducted for this White Paper show that even medium-sized banks offer such services. It is important, though, when considering such an option, to ensure the right cost-profit-effort balance. It is even more crucial to industrialize these processes when offering insourcing to other banks, given the requirements of interface management, data analysis, and lean processes.

Shared services could become an even more promising and acceptable model. The goal of this approach is to pool human resource capacities and to lower costs by sharing employees or responsibilities for specific areas among a group of banks. This may include—for instance—joint work on administrative, reporting, and regulatory requirements. The concept is especially applicable to smaller banks, given their limited human resource capacities and comparatively constrained financial resources. Even today, internal IT departments often struggle to get reporting and regulation solutions implemented on time for their own banks. They could address this—and reduce costs—by sharing soft- and hardware, unifying tax reporting and liquidity management, and sharing the solutions they develop. With the fast-changing environment

and the demand for such solutions in mind, technology platforms could be an important backbone for banks. In addition, special services and products could be provided by specialized banks. Hence, the concept of shared services involves both a reduction of workload and complexity, and the opening up of new opportunities with regard to the services collaborating banks can offer.

The major barrier to the implementation of shared-services models identified in this White Paper is the rather poor communication between banks and their lack of willingness to engage in potential partnerships. Yet at least some banks are already sharing resources and costs with regard to the administrative procedures related to regulatory requirements. These complex, time-consuming, and expensive issues affect smaller banks more severely in terms of costs and employee capacity. Another aspect of knowledge (and resources) that could be shared concerns the tax-reporting demands on cross-border private banking clients. This, in particular, is time consuming as tax laws and regulators' recommendations are likely to change fast and are different throughout the world. In this context, the sharing of services would—ideally—involve not only two organizations but many. In summary, it is important that banks exploit the opportunity that shared services represents, as it is one of the easier ways for them to share costs, resources, and know-how.

5. Conclusion

Private banks are facing fundamental strategic and operational challenges in a disruptive environment. The most predominant of these include changing client needs and regulatory requirements in the wake of the most recent financial crisis, a loss of trust due to the quasi-abolition of banking secrecy, the growing number of IT-based operations and transactions, and the emergence of digitalization and innovative banking services. The high level of complexity of banking processes has contributed to structures that are cost intensive and extremely difficult to assess. Moreover, many banks have missed the opportunity to adjust to this changing environment. Some tried to maintain their old business models and operational structures for too long.

As a consequence, banks are increasingly addressing these problems by applying a holistic approach and by industrializing their value chains. Besides revising their operational setups, banks are being forced to introduce state-of-the-art innovation—such as disruptive technologies or digitalization—in order to increase their attractiveness. And industrialization is the foundation upon which to do so efficiently and effectively. Summarizing, less complex structures with automated but agile processes and innovative, state-of-the-art services should be industrialization's main goals.

The analysis carried out for this White Paper suggests that the role of the client relationship manager will change. More and more, front-office tools will integrate risk and portfolio analyses, and provide diverse information regarding investment opportunities and the

client in which risk, tax, compliance, and regulatory constraints are already included. The client relationship manager, as a pool of information, will need to focus more on the client than on administrative and data-related tasks. To do so, leaner structures will be necessary to manage the information and data that arrives from the client relationship manager in the front-office tool more efficiently and effectively.

In order to achieve sustainable results, private banks must first revise their business strategies and focus on their specific strengths. Serving all clients from all over the world is no longer a realistic approach. Depending on their size, private banks will further be obliged to specialize in specific business models, and to pool their resources. Nevertheless, all banks must concentrate more on efficiency gains in order to enable smooth processes and systems along the value chain, rather than purely limiting themselves to cost-cutting exercises.

In addition, the relationship between banks and service providers must be intensified as the latter will play a crucial role as enablers for systems, tools, devices, and technological innovation. Switzerland could benefit from establishing a service network cluster among banks—a cluster that would foster the sharing of knowledge and tasks and the professional management of regulatory requirements. The current Fintech scene is a first and positive starting point in this respect.

Despite the opportunities outlined in this White Paper, the general perspective for Swiss private banks is challenging, and staying competitive

will require a great deal of effort. Some private banks have already begun, but the next three years will witness the fundamental transformation of most banks that are willing to seize this opportunity to industrialize their value chains. The number of banks is likely to shrink, although small operators may have opportunities to remain profitable as long as they concentrate on their main strengths and divest themselves of all non-core activities and processes. Latest developments in banking indicate that wealth management will be one of the key elements of the industry in the future, and the authors believe that Swiss private banks have a genuine opportunity in this regard—and that this applies to cross-border wealth management to a special degree. While the environment in Switzerland is still very attractive, banks' willingness to change will prove a prerequisite to survival.

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