

# IT cost survey for Swiss banks 2012

**Evaluation report (based on 2011 effective data and 2012 budget data)**

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## Introduction

- itopia**
- Small independent Swiss consulting company with 10 professionals
  - Specialized in IT governance, project services, risk management and information governance
- IT cost survey**
- Performed on a yearly basis since 2000
  - Participants are small to medium-sized retail and private banks
  - Pragmatic approach: questionnaire with eight raw data and profile for bank complexity
- participants 2011/2012**
- 38 banks: 21 (rather) retail banks, 17 (rather) private banks
  - High constancy and comparability:  $\frac{3}{4}$  of year 2000 participants are still participating today
- iR = itopia Ratio**
- Main coefficient used in the IT cost survey
  - Based on IT costs, balance assets and assets under management
  - We consider this coefficient to be better than volatile earning-based ratios (e.g. cost-income-ratio)

**iR<sub>raw</sub>**

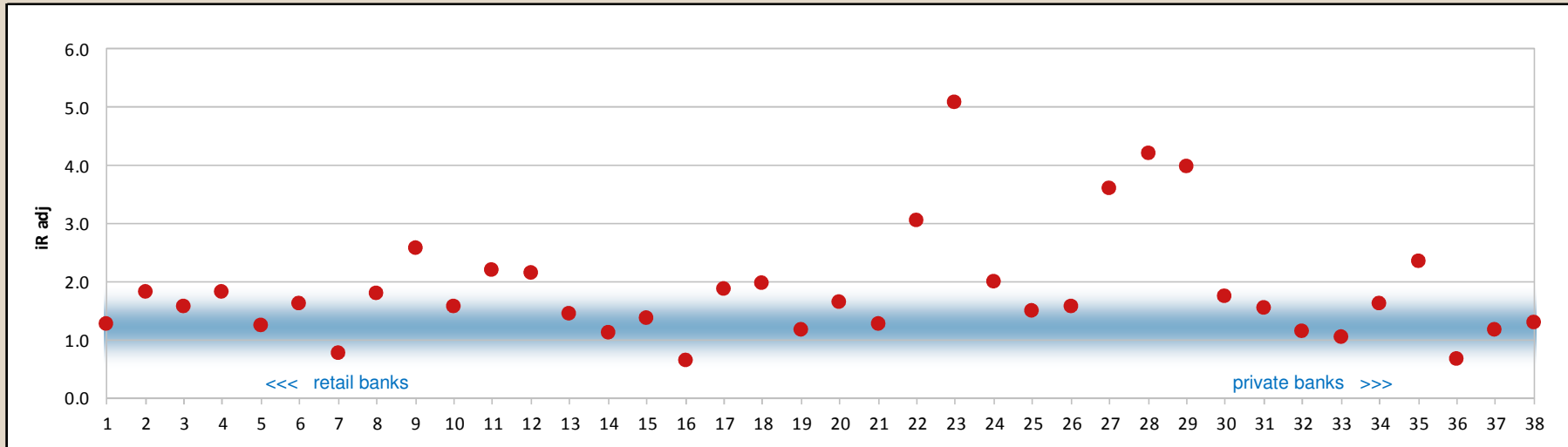
$$iR_{raw} = \frac{\text{IT costs}_{\text{excl. data feed}}}{1.1 \times (\text{balance\_assets}) + 0.3 \times (\text{assets\_under\_management})}$$

- iR<sub>adj</sub>**
- To allow comparability of banks, the bank complexity ( $f_{\text{Bank}}$ ) has to be considered in the formula
  - Bank complexity is derived from a profile assessed by the bank itself

$$iR_{adj} = \frac{\text{IT costs}_{\text{excl. data feed}}}{1.1 \times (\text{balance\_assets}) + 0.3 \times (\text{assets\_under\_management})} \times \frac{1}{f_{\text{Bank}}}$$

# Year 2011

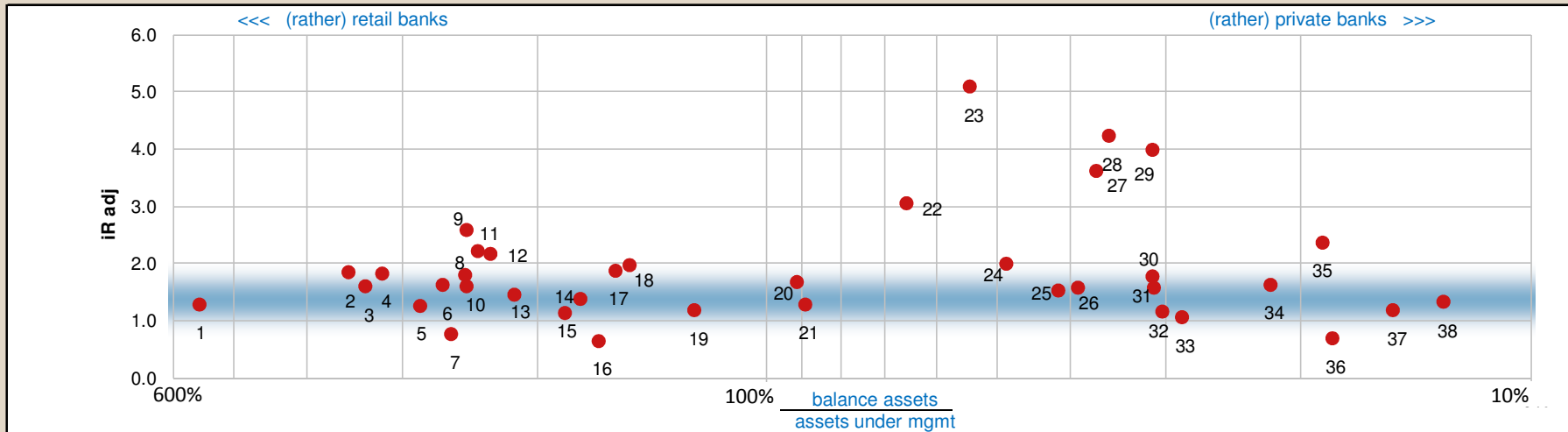
## IT cost coefficient iR adj (view 1)



- Each dot represents one bank (the anonymous bank id is listed on the horizontal axis). The sorting criteria is balance assets / assets under management. Thus you find retail banks at the left and private banks at the right side of the diagram
- The red dots represent the adjusted IT cost coefficient (iR adj) excl. costs for data feed
- The blue band represents the target zone for iR adj: an ideal-typical bank (iR adj = 1.0)
- A bank with an iR adj of 2.0 spends +100% more in IT costs than an ideal-typical bank (iR adj = 1.0)

# Year 2011

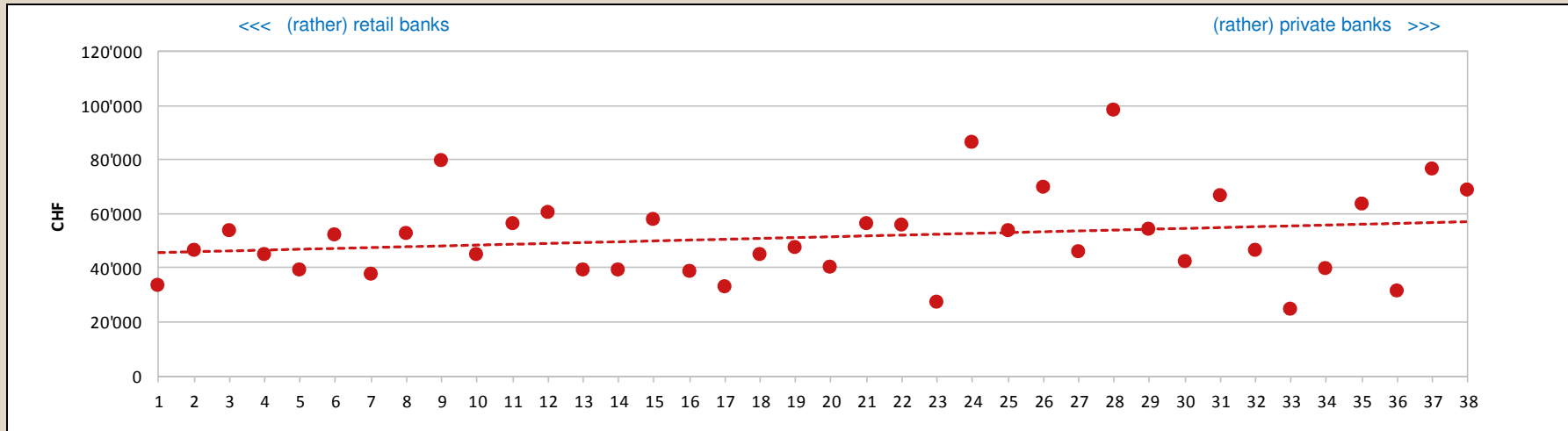
## IT cost coefficient iR adj (view 2)



- This diagram gives a different view on iR adj: Again, the banks are sorted according to their balance assets / assets under management. The horizontal distance is measured in percentages. Thus the closer two banks are, the similar is their ratio of balance assets / assets under management
- Two types of banks are identified:
  - (rather) retail banks: > approx. 80%-90% (banks with id's 1 to 21)
  - (rather) private banks: < approx. 80%-90% (banks with id's 22 to 38)

# Year 2011

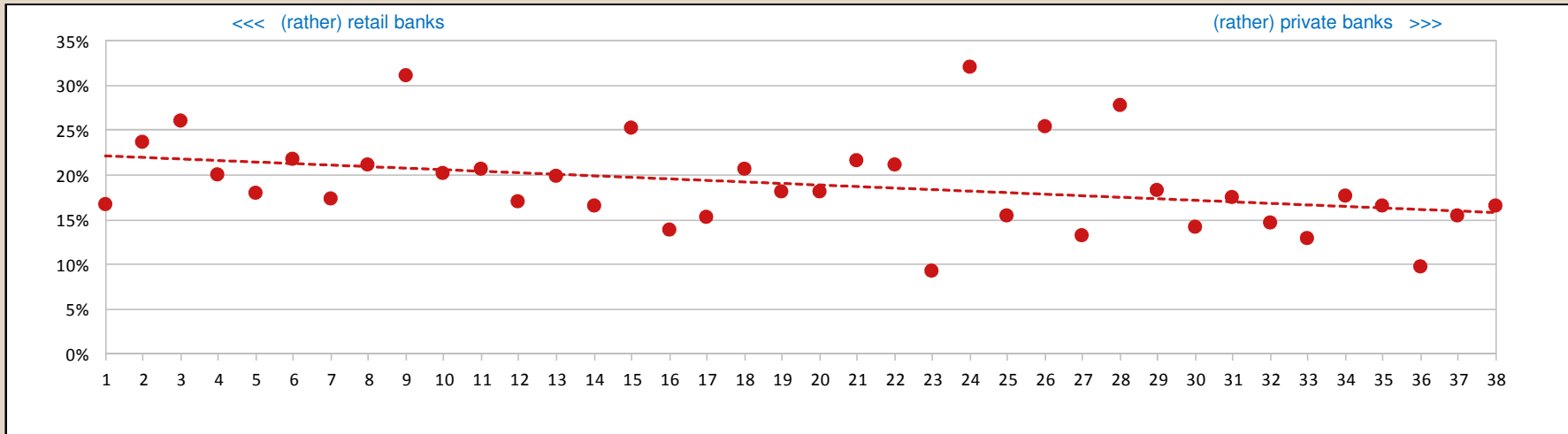
## IT costs per bank employee (excl. IT staff)



- Red dots: IT costs per bank employee (excl. IT staff, excl. costs for data feed)
- The IT cost spending has a large variance from just over CHF 20'000 up to almost CHF 100'000
- It seems that private banks spend more CHF per bank employee than retail banks (see red dotted trend line, starting at over CHF 40'000 and increasing to just under CHF 60'000)
- However, looking back to 2004 figures, the trend line then started at just over CHF 50'000 and were increasing to under CHF 60'000; this suggests that retail banks managed to lower their IT costs per bank employee over time, whereas private banks still experiencing increasing IT costs per bank employee over time

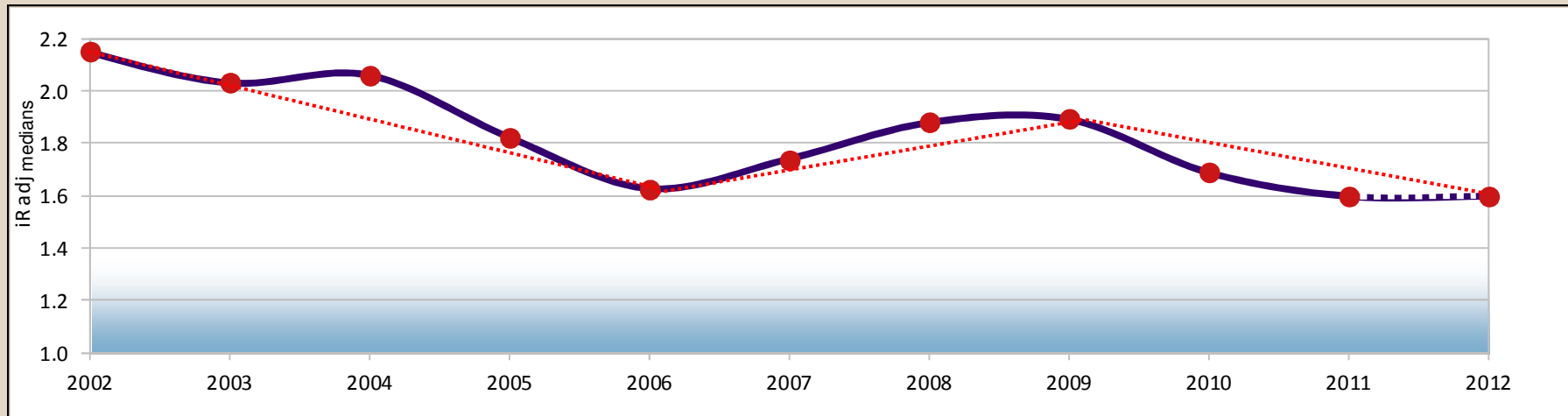
# Year 2011

## IT costs in percentage of operational expenses



- Red dots: IT costs in percentage of operational expenses (excl. costs for data feed)
- The percentage for retail banks is significantly higher than for private banks (see red dotted trend line, some 7% difference from left to right end). One reason for this observation may result from higher personnel expenses in private banks compared to retail banks
- Again, looking back to 2004 figures, the trend line then started at just over 25% and were decreasing to just above 15%; this suggests that retail banks managed to slightly lower the IT costs share within the overall operational expenses over time, whereas for private banks a 15% ratio seems to be a stable value for the IT costs share within the overall operational expenses
- Out of this diagram no conclusions can be drawn regarding
  - business benefits from IT spending or
  - the degree of IT automation and its influence on IT spending

## Time series IT cost coefficient iR adj

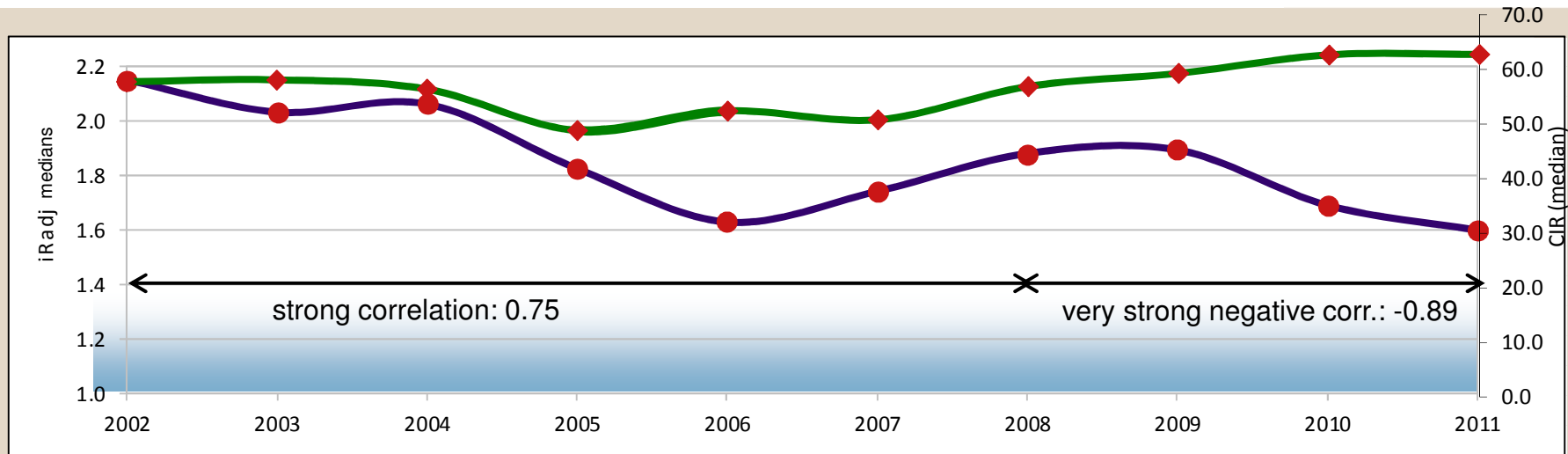


- Red dots: adjusted IT cost coefficient (iR adj) calculated as medians for all participating banks
- During the period 2002 to 2006 the iR improved at an average of 5.5% p.a.  
Between 2007 and 2009 the downward trend was broken: the IT cost efficiency (iR adj) deteriorates (increases).  
In 2009 the iR adj is even on a higher level than in the year 2005.  
In 2010 the upward trend could be stopped and even noticeably broken
- Now that we have 2012, we can not only confirm the downward trend of iR adj for 2011 with a value of 1.60, even better than the forecasted 1.65, but expecting also a stable trend into 2012 - based on available budget 2012 figures
- However, not all participating banks are enjoying this positive trend and outlook for their iR adj. Approx. 40% of the banks have still increasing IT costs in terms of iR adj, spread all over retail and private banks of all sizes
- The main reasons for the continuously falling IT spending are a) core banking system migrations are coming to an end, and b) IT Operations sourcing strategies (for more details see this year's Focus on pages 17 ff.)



## Time series

# IT cost coefficient & cost income ratio – a general statement

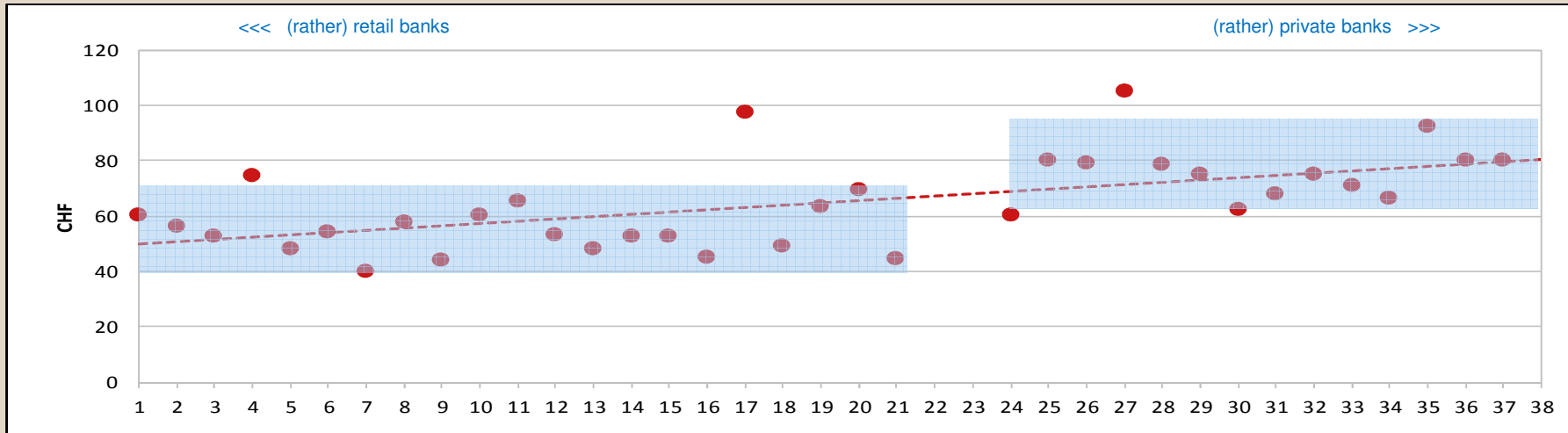


- The hypothesis “well managed IT costs<sup>\*)</sup> implies well managed overall operational costs” could only be proven correct until 2008. What happened then?
- As the cost income ratio (CIR) is also about income, the deteriorating margins in almost all banking products and services seem to have a more dominant impact than the efforts for effective IT governance
- However, not all banks are experiencing this dilemma: In 2011 approx. 30% of the banks could lower their cost income ratios, whereas 60% of the banks have seen their CIR rising, irrespective of their bank type, and 10% of the banks could keep their cost income ratios steady through 2011

<sup>\*)</sup> an IT governance is implemented that economically satisfies business demand

# Year 2011

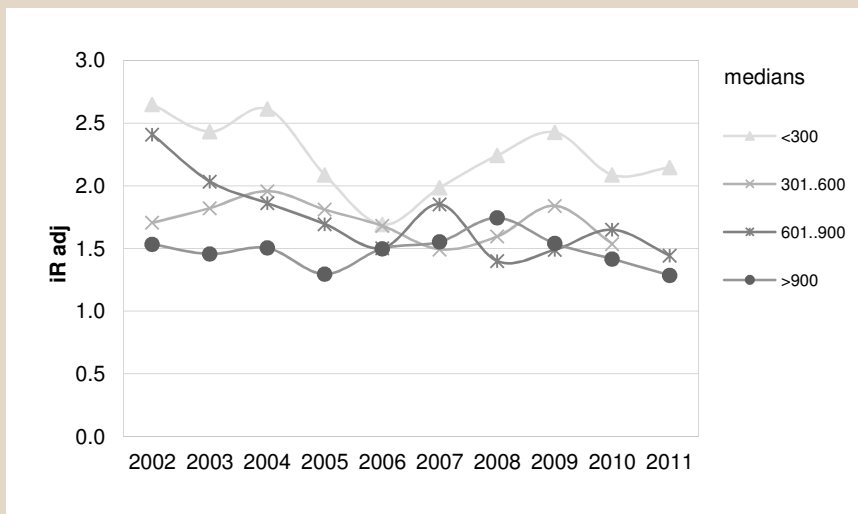
## Cost income ratio in relation to bank type



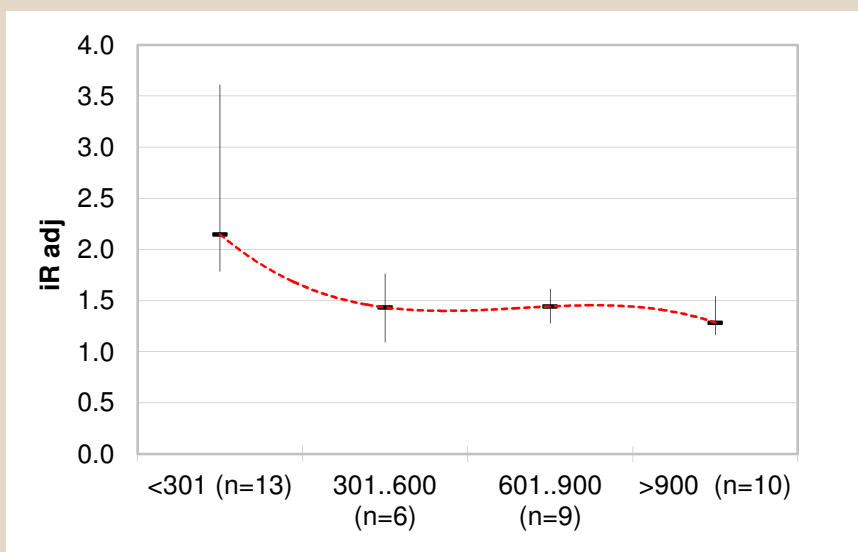
- Red dots: Cost income ratio (CIR) incl. depreciations/provisions  
some remarks: **3**'s CIR is without provisions, **22** and **38** are not disclosing their CIR, **23**'s CIR is out of range with 637,4
- It is remarkable that the variance in cost income ratios between bank types as well as between peers is quite high
- The cost income ratio for retail banks is significantly lower than for private banks (see red dotted trend line). This observation is in line with other ratios, i.e. IT costs per bank employee and data feed costs
- By clustering the (rather) retail banks and (rather) private banks we can work out the CIR range among peer banks (without going into details by factoring bank size, IT policy etc.):
  - The CIR range of (rather) retail banks is between 40.1 and 69.4 (without runaway values [of non-peers])
  - The CIR range of (rather) private banks is between 62.4 and 92.1 (without runaway values [of non-peers])

# Time series

## IT cost coefficient iR adj in relation to bank size



- Small banks (<300 bank employees/FTE) remain less IT cost efficient than larger banks, and experiencing a rising iR adj from 2010 to 2011. Large banks can realize economies of scale
- In 2011 all but the class `<300` -could improve their IT cost efficiency

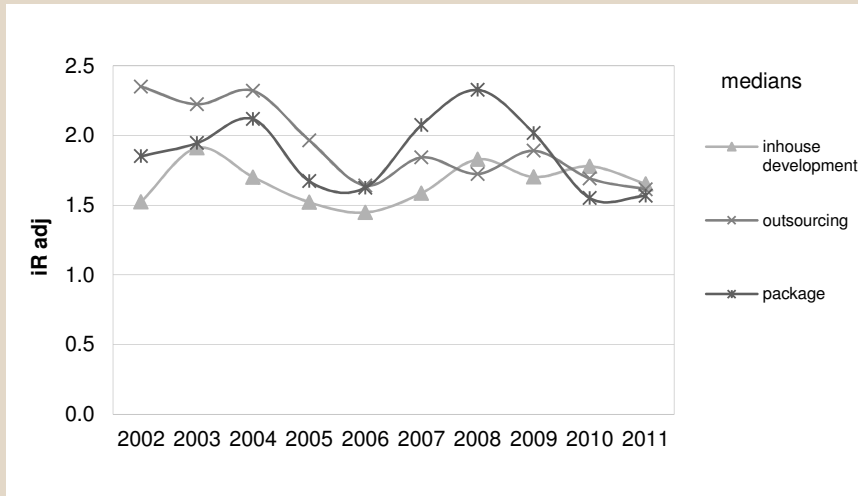


- Comparing all classes for year 2011 the typical bathtub graph of recent years has changed: the most IT cost efficient banks are now those in category >900.

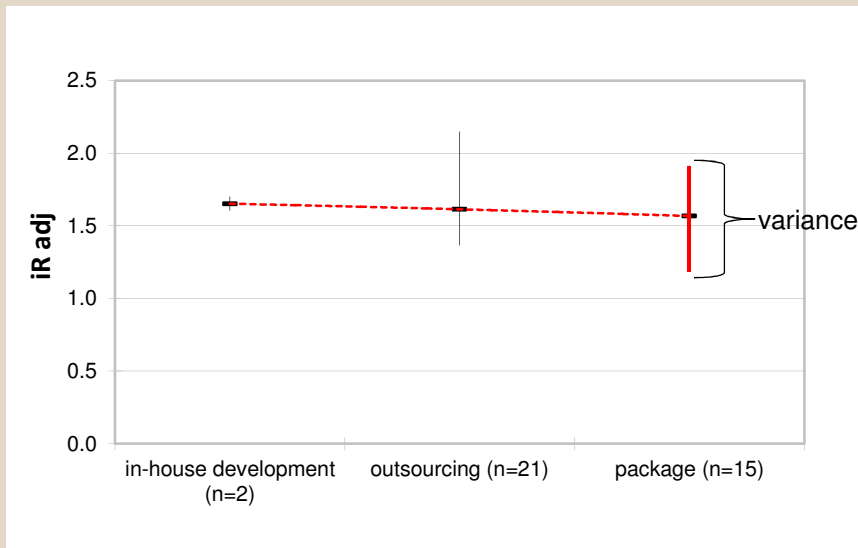
Larger banks seem to be better able to manage their more complex structures and processes

# Time series

## IT cost coefficient iR adj in relation to IT policy



- In 2011 ,in-house development' as the most efficient IT policy in 2009, continues to have a higher iR adj then both, ,outsourcing' and ,package'



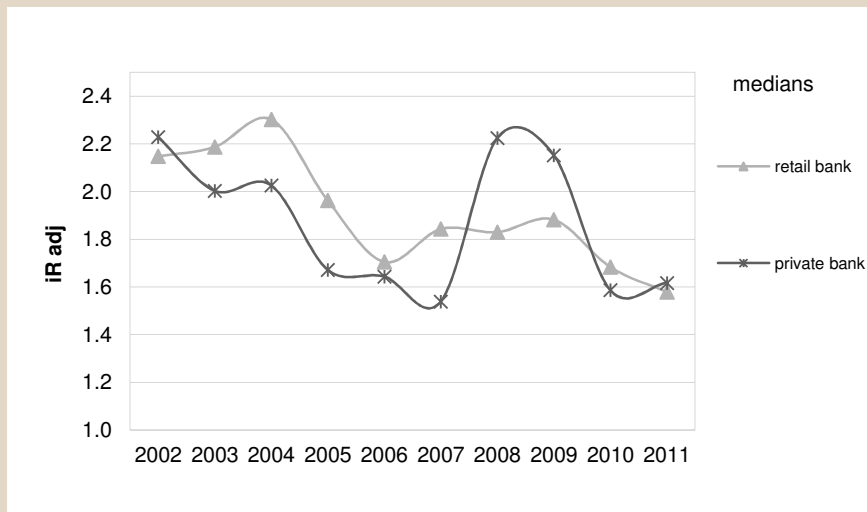
- The variance for both, ,outsourcing' and ,package' are still very high, with 0.78 and 0.71

- However, the variance for ,package' came down from 0.92 in 2010 to 0.71 in 2011

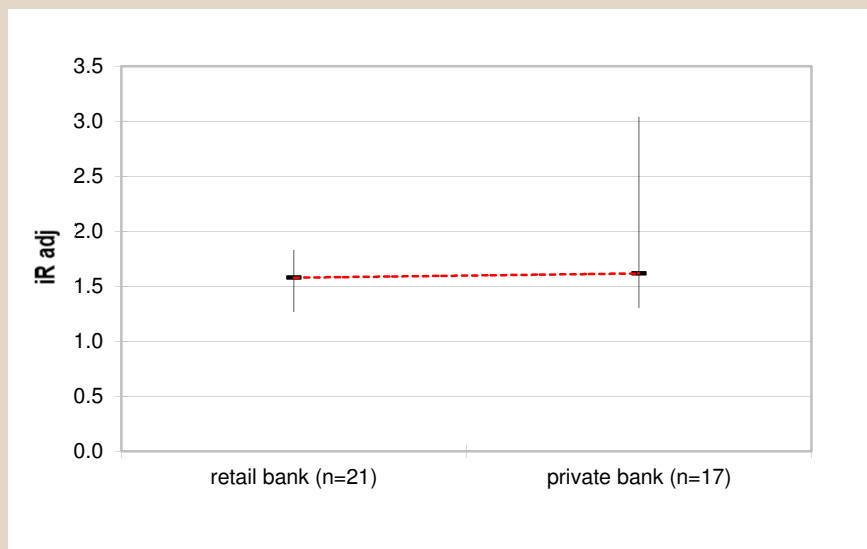
This still suggests that the management of a heterogeneous IT landscape and its complexity is the silver bullet (the so called best-of-breed approach implies that the ,best' peripheral systems are chosen within a ,package' policy which leads to a heterogeneous IT landscape)

# Time series

## IT cost coefficient iR adj in relation to bank type



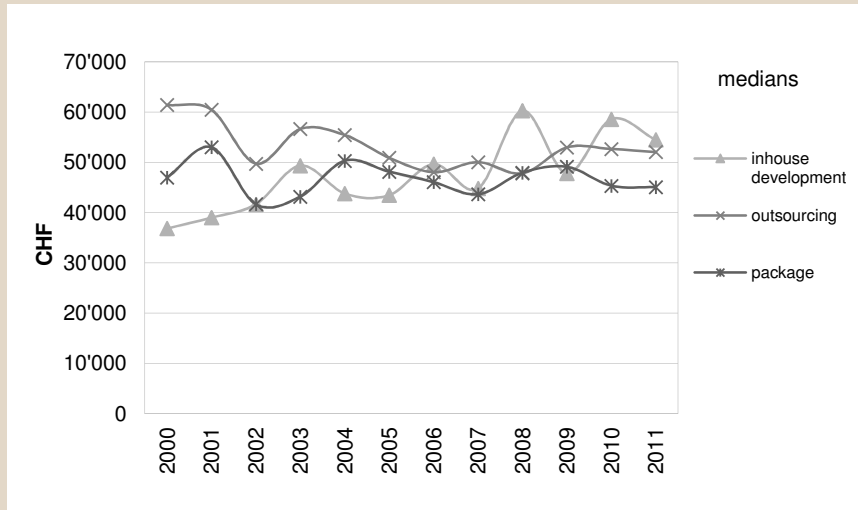
- The iR adj values for the bank type class ,retail bank' have continued to improve downwards compared to 2009 and 2010 (from 1.88 in 2009 to 1.58 in 2011)
- The iR adj values for the bank type class ,private bank' have reversed the downward trend and increased from 1.59 in 2010 to 1.62 in 2011



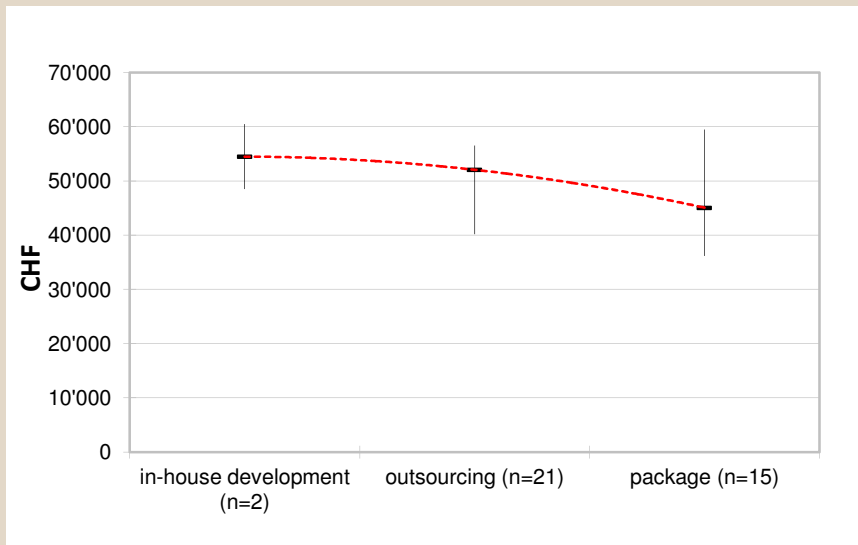
- The iR adj values for private banks have a huge variance from 1.30 up to 3.04; this is mostly because of some runaway values and is just not representative. By eliminating these runaway values (of start-up banks) the range comes down to 1.20-1.93 with a variance of 0.73
- The iR adj values for retail banks remain in a narrow variance rising slightly from 0.43 in 2010 to 0.56 in 2011

# Time series

## IT costs per bank employee in relation to IT policy



- IT costs per bank employee have developed differently among the IT policies. Whereas for 'inhouse development' IT costs per bank employee were sinking considerably, for 'outsourcing' and 'package' they declined only slightly

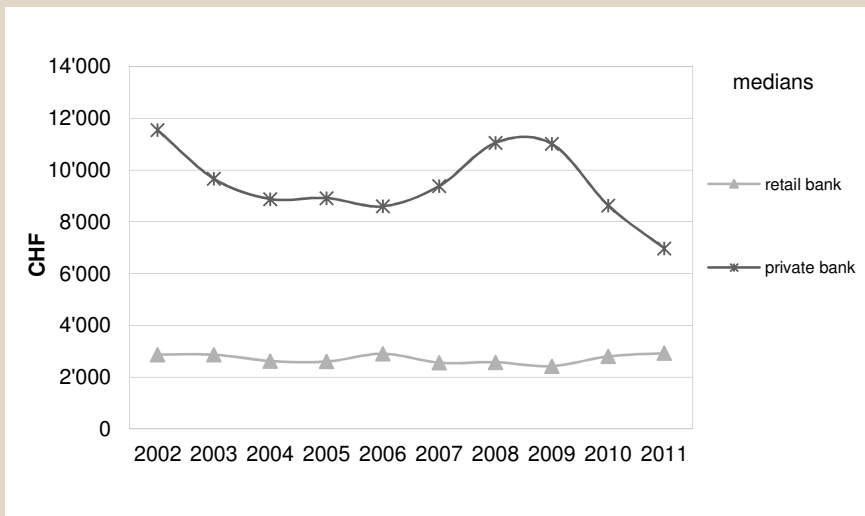


- The median IT costs per bank employee for all three IT policies were between CHF 40'000 and CHF 48'000 CHF, coming down from 45'000 and CHF 59'000. Compared to prior years the variance has become again wider

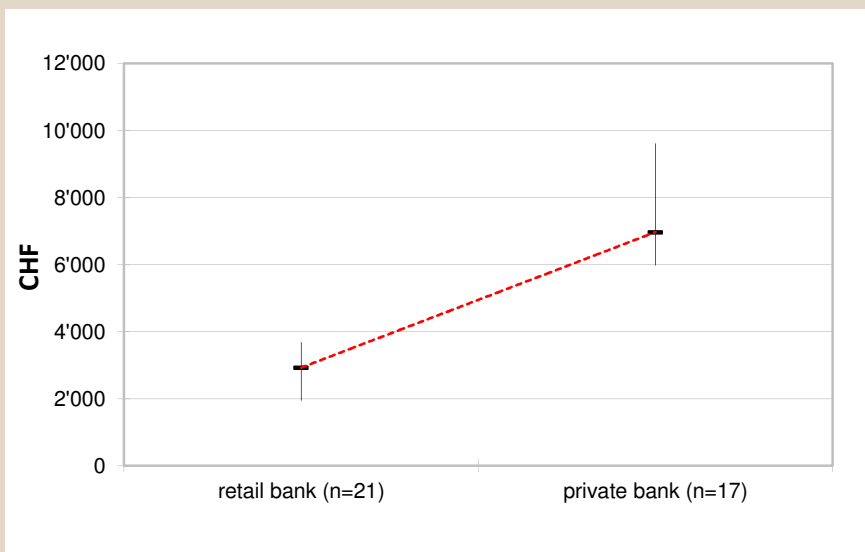
- For all IT policy types however, the overall variance has narrowed to CHF 36'000 and CHF 60'000, compared to CHF 36'000 to CHF 77'000 in 2010

# Time series

## Costs for data feed in relation to bank type

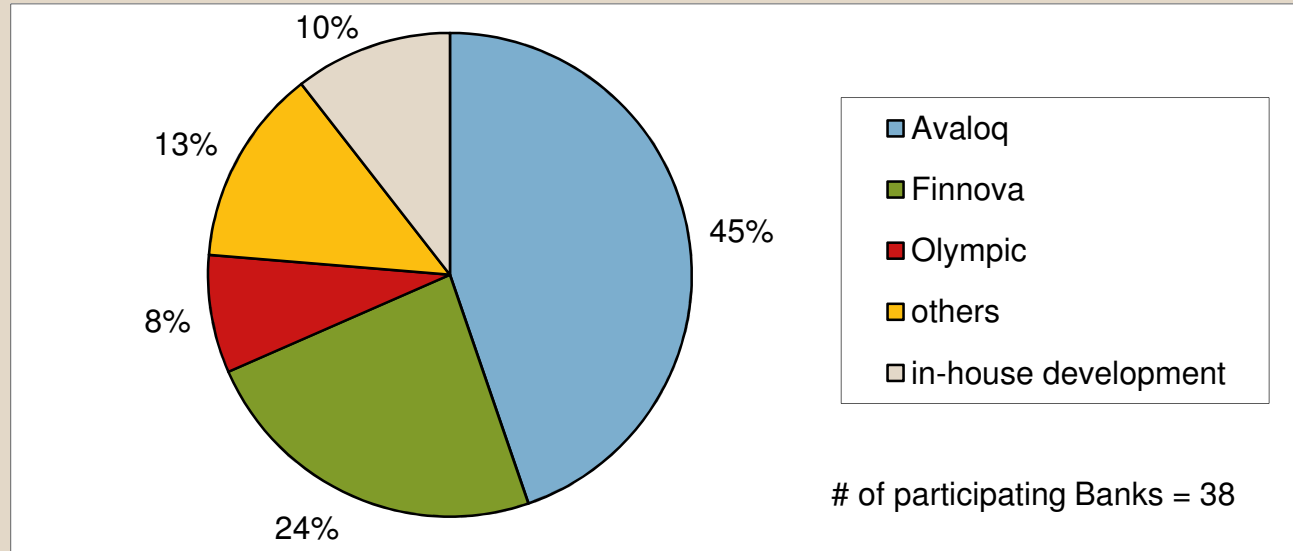


- Retail banks spend approx. CHF 3'000 (remaining at some levels as in 2010) per bank employee for data feed, whereas private banks spend CHF 7'000 (once again down from 9'000 in 2010)
- The data feed costs for private banks are clearly coming down year per year, confirming our predictions from 2009 "the consolidation cycle for data feed terminals is expected soon"

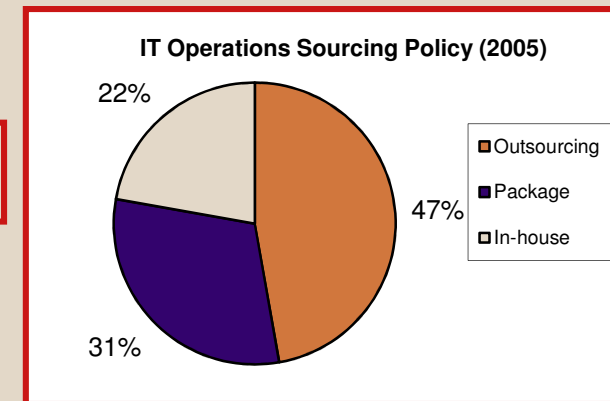


# Focus: Core banking systems & IT Operations sourcing strategies

## Core banking systems in 2011



- **Avaloq** and **Finnova** are leading the list of core banking systems implemented at the participating banks
- There are 5 **other** core banking systems which have only 1 occurrence each
- **In-house development** seems to be a species in danger of extinction
- 7 years back, in-house development and – in most cases – in-hose operation was in place for almost 1/4 of the participating banks<sup>\*)</sup>

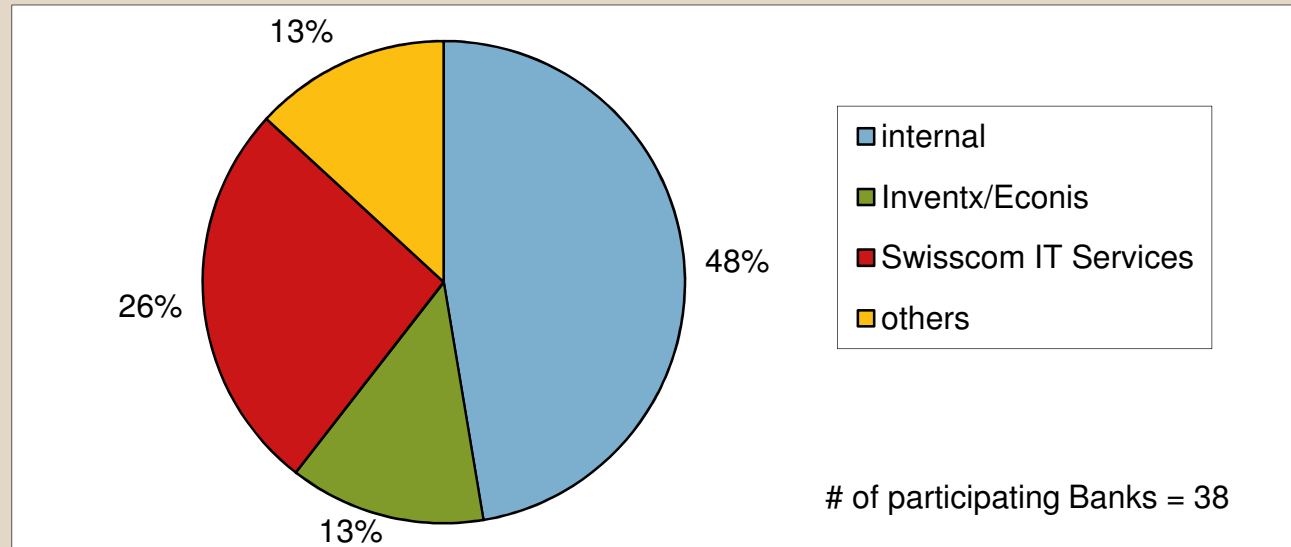


<sup>\*)</sup> please refer to previous page for itopia's definitions of Package, Outsourcing and In-house



# Focus: Core banking systems & IT Operations sourcing strategies

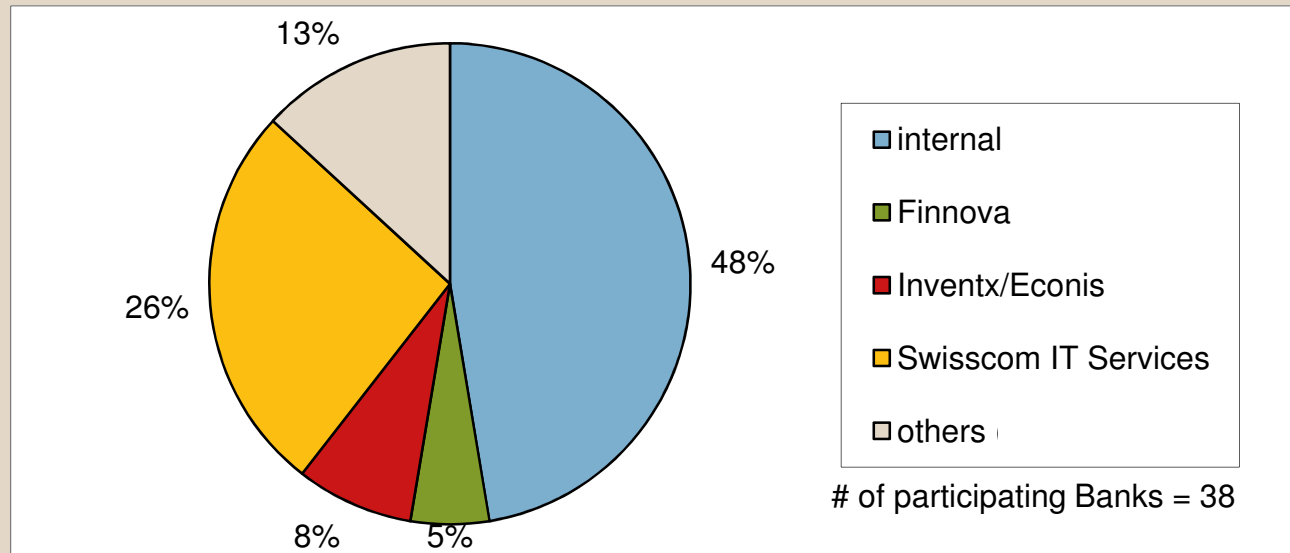
## IT Operations sourcing policy - ITO



- ITO is defined as ICT Infrastructure Management (IT Operations Control, IT Facilities Management; according to ITIL)
- An overwhelming majority of the participating banks run their IT internally
- The outsourcing market itself is still immature in terms of being scattered and consolidating at the same time; a total of 8 outsourcers are running the IT of the participating banks
- Swisscom IT Services Finance is the predominantly chosen ITO service provider, followed by the Inventx and Econis companies

# Focus: Core banking systems & IT Operations sourcing strategies

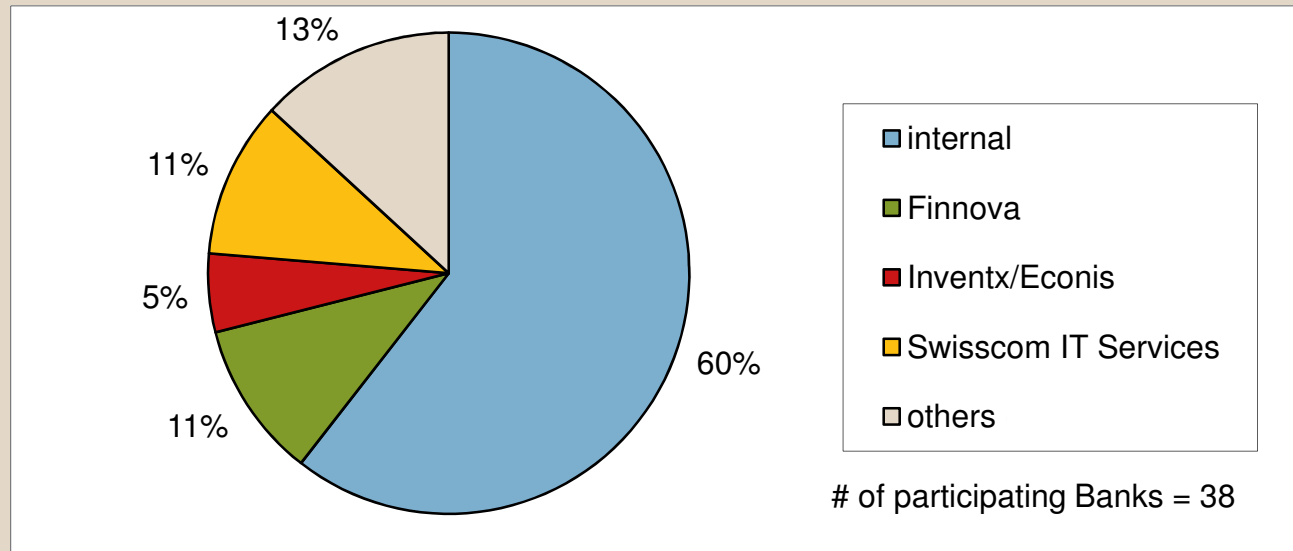
## IT Operations sourcing policy - Application Operations



- Application Operations is defined as application services required to provide for the day-to-day operations, support, and maintenance of – in our case – the core banking applications.
- Again, an overwhelming majority of the participating banks take care of their applications internally, outsourcing mostly dedicated areas such as output management to i.e. SPS (Swiss Post Solutions)
- Swisscom IT Services Finance is still leading the list of the external service providers, followed by the Inventx and Econis companies
- Finnova is being chosen in some cases where Econis is in charge of ITO

# Focus: Core banking systems & IT Operations sourcing strategies

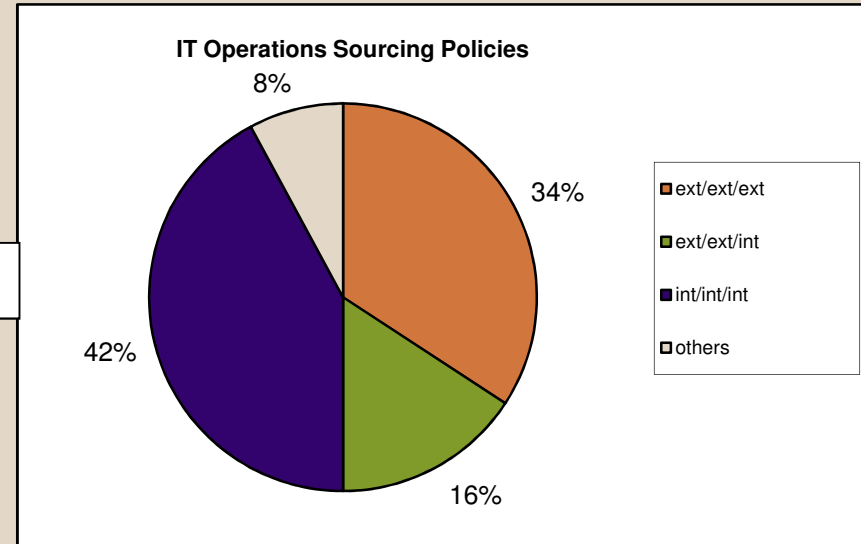
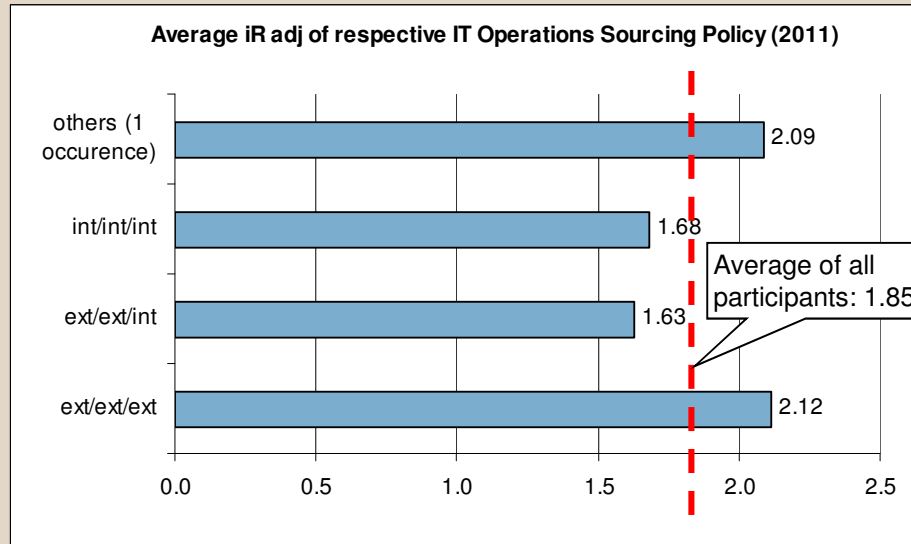
## IT Operations sourcing policy - Application Management



- Application Management is defined as application services required to keep the applications aligned with the bank's business strategy and legal and compliance obligations
- Once again, and this time an astonishing 60% of all participating banks running their application management internally
- Swisscom IT Services Finance is still leading the list of the external service providers together with Finnova, which has increased its market share at the charge of Econis, in case of application management
- Application management seems not to be fully in focus of the IT outsourcing industry
- Or, is there another reason for this? Read more on next 2 pages

# Focus: Core banking systems & IT Operations sourcing strategies

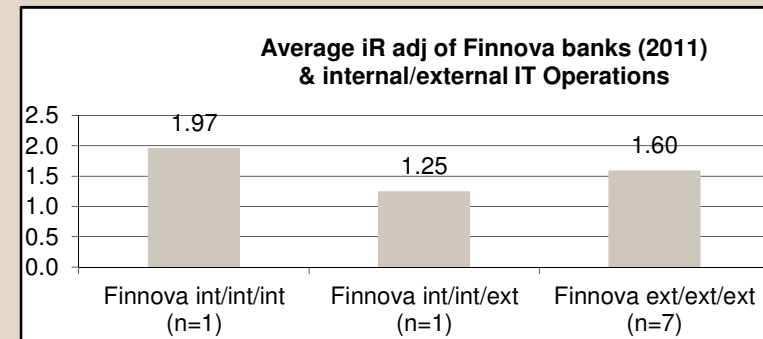
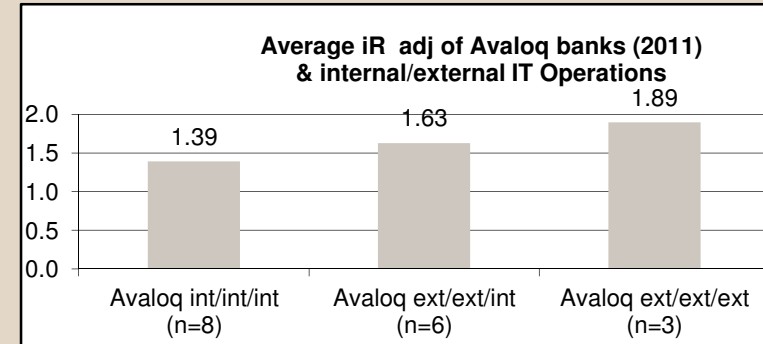
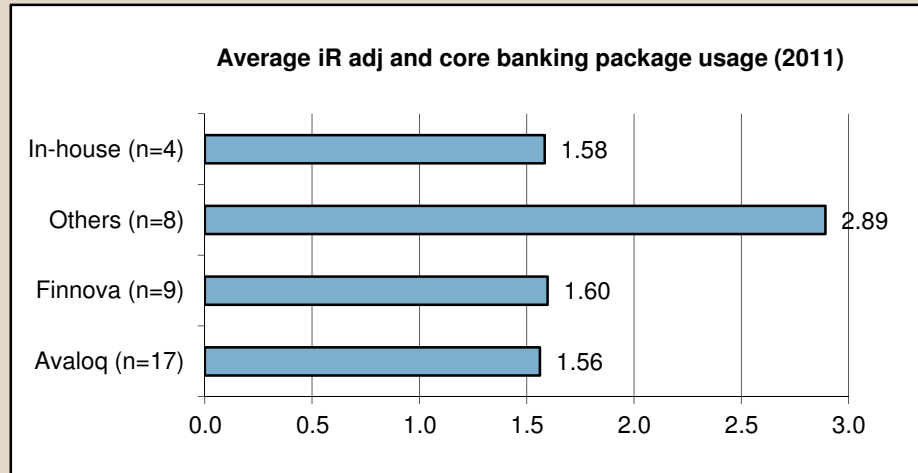
## IT Operations sourcing policy & iR adj



- ITO, application operations and application management are the areas to decide on when defining an IT Operations sourcing strategy
- Out of the possible options, 3 combinations of sourcing policies seem to have proven viable, covering more than 90% of implemented strategies:
  - Complete IT Outsourcing (ext/ext/ext)
  - Keeping application management internally (ext/ext/int)
  - Managing IT internally (int/int/int)
- The majority of the participating banks prefer to manage their applications internally (58%), and 42% prefer even a fully internally managed IT. These two sourcing policy options have in average the lowest iR adj
- This might – at least for all banks that have outsourced their IT Operations – be an unexpected outcome and should be looked at in more detail

# Focus: Core banking systems & IT Operations sourcing strategies

## IT Operations sourcing policy & iR adj (cont.)



- When looking at the predominantly used core banking system from an IT efficiency (iR adj) perspective then Avaloq banks and Finnova banks seem to have no significant differences and have similar iR adj as banks using in-house developed core banking systems
- When combining the core banking system used and the IT Operations strategy the observation is that banks running their IT (rather) internally have lower iR adj values
- This observation is being backed by the fact that Avaloq banks with (mostly) internally managed IT's have a lower iR adj than Avaloq banks with externally managed IT's
- The same observation can not be seen with Finnova banks as the number of samples for internally managed IT's is too low

Thank you

