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Transform or Tear Down? The Retail Banking Human Capital Identity Crisis

Insights from McLagan's Head of Consumer Banking Rob Northway

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It has been one full year since the retail banking crisis erupted. Consequently, regulators have been keenly focused on making sure inappropriate sales techniques and practices are examined and mitigated. In addition, economic demands are rapidly changing. Mobile apps, smart phones, and new digital avenues have redefined customer centric approaches to the retail banking business. How, then, do traditional retail banks remain attractive in the eyes of both customers and employees?

We recently sat down with Rob Northway, Global Head of Consumer Banking at McLagan, to obtain his perspective regarding several front of mind challenges retail and consumer banks are facing. Below, we explore some of his valuable insights concerning a variety of human capital topics that are impacting current and long-term strategies.

How have recent industry scandals and regulatory reviews impacted retail banks?

What we have observed in our retail banking clients is a continued evaluation and evolution of the proper balance of performance and reward for roles across the industry. This assessment of the reward programs isn't particularly new, but there has been a significant increase in the optics that firms must provide regarding the conceptualization, administration, and governance of incentive programs for these areas. What has occurred in the last 12 months may represent the catalyst for change versus the root cause of these adaptations. Shifting perspectives around customer experience, improvements on digital banking capabilities, high turnover, and a significant need for better program governance were always there. The challenges recently faced by many of the largest retail banks simply serve as the tipping point, causing firms to revolutionize their pay philosophy and rapidly adapt to the new landscape.

Clients often ask, "where do I start?" The answer can be summarized in two phases – (1) short-term changes to adjust to the current regulatory environment and (2) long-term changes that will help revolutionize the way you align performance and reward in the retail banking business. Here are some leading indicators we use when analyzing where issues might lie:

Short-Term and Regulatory Checks:

- What are your firm's checks and balances regarding the design and administration of the incentive program?
- Could your executive leadership answer questions on how these programs operate and mitigate risk?
- How complex is the compensation program? Can your lowest level employees explain how the programs work?
- Does the plan have avenues to reduce the risk of fraudulent activity?
- How does your firm back-test performance and reward results to ensure proper administration and auditing? How is the performance of the program and issue resolution communicated up through the chain of command?

Long-Term and Strategic Checks:

- As customers adapt how they utilize branches, how are you adapting staffing profiles and reward programs to fit this new model?
- Is this a fundamental compensation issue, or does the entire human capital system for retail banking need to be restructured?
- What is the role of variable pay in retail banks? How does the amount of variable pay available to employees influence the culture and behavior?
- What are the influences of the broadening labor market competition, and how does this affect your firm's philosophy regarding pay opportunities?
- How would you assess your total rewards strategy for these roles (including salaries, incentives, recognition, benefits, and other perks)? What changes are affordable?

We are in an unprecedented time of change in retail banking. We need to think broadly and learn from the past, react to the present, but also focus on where we are going to be in the future.

What tactics are banks using to strategically adjust to the new customer profile?

This has been a major challenge for most retail banks. Not really in terms of the concept, but rather the tactics for talent, performance, and rewards programs. Let's break this down:

- **Talent:** Firms now need to re-evaluate their talent profile and staffing mix in branches. With many over-the-counter transactions being digitalized, branch staff requires a new, broader set of skills in order to serve these customers. As one client stated, "the people in the branches will need to be more commercially focused and able to answer more complex questions that cannot be answered by a digital app." Improvement in assessment and recruitment of the proper type of talent that aligns with this new model is imperative.

- **Performance:** Customer centricity is essential. Yet, finding an approach to successfully set goals and track how branch employees interact with customers remains a struggle. Net Promoter Score (NPS), mystery shopper, JD Powers, and Gallop polls all have their strengths and weaknesses in effectively measuring success. The answer is two-fold. First, the employees will need to be aligned with the technical skills and culture necessary to deliver the highest level of customer value. Second, firms must build stronger management training and development programs that require something mind-blowing… *managers need to be managers!* All too often, managers are not trained and equipped for proper performance management. Rewards programs are relied upon to be the performance management system, which is not a wise choice.

- **Rewards:** Reduce the complexity. We have spent significant time working with clients on how to simplify the design of incentives. You should have no more than six measures that have a weighting of at least 10% of overall variable pay opportunity (otherwise it will have minimum impact). We must also reconsider how much incentive opportunity is enough. Most retail banking roles do not see a huge incentive payout (typically less than 10% of total pay). In the future, how much incentive and how much differentiation based upon performance will continue to be a discussion point. In certain cases, firms have eliminated variable pay programs all together for that specific reason.

How have emerging tech start-ups influenced retail banking's approach to human capital?

The addition of new challenger banks and lending firms is a healthy attribute to the current market. It requires firms to reinvigorate their approach to attract and retain talent. The significant resources and daily challenges found in operating a retail bank, have forced firms to embrace the "*just push through to year-end"* operating model. Firms need to focus on the basic elements of human capital. What is your business strategy? What is your culture and is it aligned to the strategy? What are the critical skills or behaviors you need to motivate to successfully meet your strategy? How can you align your performance and reward programs (and other HR components) to ensure they bring the best of the best to your organization?

The warning shot across the bow that these emerging firms have provided should not be dismissed by senior leadership. Similar to digitalization, those organizations who do not think more innovatively about human capital will be left in the dust.

What should banks do to avoid falling victim to using rewards systems as the main avenue for performance management?

Retail banks need to do a better job at talent assessment, role profiling, and job alignment. These are the elements that truly drive culture, performance management, and employee engagement. The reward programs should then be used as the back-test to see if they have been successful in building this profile. Given the dynamics of hiring in retail banking, this will require a significant shift in the current philosophy.

As a starting point, you should determine who would make a good manager, what tools are needed to make sure you are hiring the right talent, and how these roles can effectively drive culture and performance. Then you can build a proper reward program that provides incentives when the holistic success of the business is met, including financial, risk management, and customer centric successes.

When you build a house, you don't start with the roof. Most of our clients have been focused on the reward programs first—we would start with more of the foundational issues mentioned earlier, such as culture and talent.

As economic demands continue to change, how can banks and other financial services firms best align themselves to stay ahead of the curve?

The role of the retail bank financial services will continue to adapt. The leading indicators of what defines a productive branch will need to change. We have been partnering with our clients on analyzing everything from staffing mix and the return on investment (ROI) on incentive funding to introducing customer centric attributes, such as channel optimization. If we stop looking at the branch team members as purely an expense line item and instead view them as the best avenue for a customer to have a real-life experience with your bank (versus a virtual one), it will change the way we think about them from a human capital perspective.

A happier customer will do more business with you. A happier colleague will source more business for you. There are many solutions—we just have to be innovative. This isn't the end of retail banking, but it should, in fact, be the end of tired, overused HR programs for the industry.

To learn more about human capital strategies in retail banking, please contact Rob Northway.

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