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Special Edition

Pursuing efficiencies to enhance competitive advantage

- Interview with Ulrich Hoffmann by Hajime Ueda -

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Executive Summary

Since the global financial crisis, a rapidly evolving environment has forced global financial institutions to rethink their business models and fundamentally review their operations. How should financial institutions go about reforming their business processes? What can they learn from companies in other sectors? We spoke with Ulrich Hoffmann, who supervises the worldwide operations of UBS Group.

Ulrich Hoffmann

Head of Group Operations, Group Managing Director
UBS

Joined Swiss Bank Corporation (SBC, current UBS AG) in 1987. Served as Global Service Products Head, Head of Operations Wealth Management and Swiss Bank, and assigned as current role from 2012.

Hajime Ueda

Senior Corporate Managing Director and
Financial Technology Solution Division Manager
Nomura Research Institute, Ltd.

Joined NRI in 1985. Attended Harvard Business School starting in 1988. Worked at NRI America in 1991. Appointed president of NRI Pacific (San Mateo) in 1996. Subsequently served as NRI's first Financial Division Manager and first Investor Relations Section Manager before being appointed Business Strategy Department Manager. Became Senior Managing Director in 2007 and Senior Corporate Managing Director in 2015.

UBS' post-financial-crisis business strategy

Ueda: The global banking environment has radically changed since the financial crisis, forcing global institutions to rethink their business lines and footprints. UBS has been a pioneer in transforming its strategy by focusing on downsizing its investment banking business while expanding its wealth management business.

Hoffmann: First, it's true that UBS is focusing on wealth management. We have a leading wealth management business in Switzerland, Asia-Pacific and Europe, and we also have the broker-dealer business in the US. Together these form our global wealth management business. Leveraging our long history in this business in Switzerland puts us in a leading position, and we intend to continue with this focus.

We also have global investment banking and asset management operations. We are engaged in retail and corporate banking only in Switzerland.

Ueda: For a company like UBS that places wealth management at its core, what are the greatest challenges in the current environment?

Hoffmann: The wealth management market is changing in a number of ways. First, I think clients have become more demanding. Information is more readily available, and many investors have become smarter in using that data. Human interaction still differentiates us from competitors, but greater sophistication via the use of technology is also required.

Second, the tools and the platforms needed to operate a wealth management business are changing. We used to have a very fragmented environment, but now we have opted for one global platform to enhance efficiency and improve the client experience.

Third, we need to respond to changes in the geographical weight of global markets now that more wealth is being created in emerging markets in Asia-Pacific, Latin America and Africa. And finally, in an age of automatic information exchange where information is available to tax authorities across the globe, we need to respond to the shift from offshore to onshore markets.

Ueda: Is the primary role of investment banking at UBS to complement the wealth management business?

Hoffmann: I would say we are a focused investment bank. Investment banking has undergone a major transformation that is still under way. We were early to react to that, because it is a risk business and increased regulations have given us a number of constraints. Success in investment banking requires being smart and being agile.

I think we also have a clear strategy for investment banking as a client-focused business, not one that is balance sheet driven.

Ueda: Over the last 10 years or so, the investment banking business has doubled or tripled in size as companies have tapped their huge balance sheets. Global regulatory agencies have grown more concerned about systemic risk due to these large balance sheets and have increased capital charges. For financial institutions, these enhanced requirements translate to a lower return on capital. Is this part of the reason why UBS decided to focus on services tailored to client needs, instead of those requiring a massive balance sheet?

Hoffmann: Yes, indeed. We have looked at all the investment banking businesses, including their capital requirements, and opted for businesses with an attractive return on investment and return on equity.

Ueda: Could you give an example of the kinds of businesses you have found to be attractive?

Hoffmann: First, there is the equities business, in both primary and secondary markets. We have a top franchise in equities that plays a key distribution role in wealth management as well.

Starting in 2012, we pared back in fixed income, reducing our exposure in quite a number of markets, especially in capital-intensive businesses. Certain derivatives categories are capital intensive, and we adjusted our exposure to these to ensure the best use of our capital.

Ueda: Was this comprehensive review of operations initiated by the CEO, Sergio Ermotti, or did it start before him?

Hoffmann: Rethinking was triggered to a certain extent by the events of 2008 as well as by subsequent events. Tougher capital rules and the global low-interest-rate environment have squeezed investment banking profits around the world and forced a review of business strategies. We were certainly a first mover on addressing these, and that is why we received quite a few accolades.

Ueda: I suspect everybody recognized the need for this, but perhaps the issue is not recognizing but executing.

Hoffmann: UBS always had a strong core business as a wealth manager, and this played a key role in the execution of our strategy.

Financial institutions need to learn from manufacturers

Ueda: What impact have growing regulations had on financial institutions' operations and IT?

Hoffmann: The need to ensure that systems and procedures are compliant with new rules resulted in greater requirements for operations and IT.

There is also a discussion about back office solutions as many financial institutions review their cost bases. To what extent can we lower costs by automating processes? Can we effectively utilize external utility services in the form of joint ventures or partnerships? These discussions have led to a variety of solutions, one of which is our very successful agreement with NRI on post-trade operations.

Ueda: We feel privileged to be your partners. Executing fundamental back office reforms cannot be easy. What challenges did you encounter?

Hoffmann: First, there was the question of what to do with our legacy systems. Operations and IT can be regarded as the engine room within every financial institution. That engine room has been in place for a long period of time, so institutions have a legacy environment driving how we operate our processes, platforms, and applications. As we prepare to get leaner and operate in a different cost environment, we first need to think about these processes and platforms.

Second is our response to the digital age. New technologies such as AI and blockchain have the potential to create vastly different operating environment for financial businesses, and we need to prepare for that. Technology can give us totally new perspectives. If you come from a legacy environment in processes and systems and want to make a quantum leap into the new digital age, a fundamental reengineering and revamping of the engine room may be required. I think all financial institutions face this challenge.

Other industries that were under cost pressures and have already gone through such transformations include manufacturing, telecoms and healthcare. Toyota is an excellent example. The way that company continuously forces itself to go to the next level of efficiency is something that has become embedded in its culture. We need to learn these skills as financial institutions.

Ueda: I find your view—that financial institutions need to learn from manufacturers like Toyota—to be very insightful. At the same time, our industry faces regulations that are not imposed on the auto industry, and that makes it more difficult to make changes in operations.

Hoffmann: This is true. Financial affairs are sensitive, and that is why you see a lot of regulation. But if you leave aside the issue of regulation and look at the way we operate, banks are still quite fragmented. For example, we have a lot of bespoke, specialized offerings to individual clients without really trying to standardize and streamline.

Financial institutions have lagged in applying systematic management techniques like

Lean Six Sigma, so I think there is room to improve our processes.

Standardizing while customizing

Ueda: The question of how to customize services for clients while moving ahead with standardization will become increasingly important, in my view. While these two goals are not necessarily contradictory, it is not easy to pursue both at the same time.

Hoffmann: World-class banking institutions like Goldman Sachs and BlackRock all have very standardized, powerful engines. Yet despite high levels of automation and standardization, they have great client feedback. Why is that? They run the underlying business very efficiently and then allow for dedicated customization on top of that. They have highly standardized and automated back-office processes but customize the client experience.

Ueda: Perhaps we need to redefine “back office” and “front office” and redraw the line between them.

Hoffmann: That is exactly what we are doing. We have decided at UBS to build what I call “big horizontals” where we bring together certain activities, like payments and reconciliations for funds and securities, for the whole firm and even beyond the borders of our institution, in conjunction with outside partners.

Ueda: What approach have you taken toward middle office operations?

Hoffmann: If you just have front office and back office, you miss the glue that bonds generic back office capabilities with the unique services required by clients or specific businesses. Of course, you will always try to apply automation technologies, but if you are trying to deliver true value you need dedicated middle office services that are tailored to the client. For example, client life-cycle management is very different for retail customers on the one hand and private banking or wealth management clients on the other.

Rethinking business processes end-to-end

Ueda: That is very interesting, inasmuch as I have read articles where people talk about back-end efficiency, front-end customization, and value added, but I have never heard anything about the glue that holds them together.

Hoffmann: Once financial institutions started to see the cost problem, organizational units started to optimize their processes. The front office did it, operations did it, risk and compliance did it, and finance did it, but ultimately if you want to take efficiencies to the next level you need to look at processes end-to-end, from front to back. You have to reengineer the whole process instead of looking at individual units. End-to-end reform of business processes is something that other industries do better than we do.

Ueda: Toyota doesn't just think about how to build good cars. They also give a great deal of thought to how after-sales service, insurance, and leasing might lead to the next purchase or the sale of other services. They try to offer a total car experience, a lifestyle of sorts that incorporates these supplemental factors. In that sense, I think the changes you just discussed represent a "reframing" of the discussion.

Hoffmann: Indeed. We need to think this way because FinTech companies, which are "outside-the-box" providers with no legacies, have suddenly emerged with vastly different frameworks. Their operations are different from ours inasmuch as they look at the client's requirements and try to come up with digital solutions tailored to those needs. If we don't reconsider our own processes from an end-to-end perspective, we could find ourselves left by the wayside.

Ueda: As many of those FinTech companies are niche players, I think they are positioned very differently from financial institutions.

Hoffmann: This is true. However, they target a certain part of financial institutions' value chains, forcing us to take a step back and think about how we can reinvent ourselves.

We examine the entire value proposition we can provide to a client. We look at the end-to-end process and systematically think about where we want to be and where we would rather work with a partner. In those areas where we decide we want to be, we arrange the process in a much smarter manner, because that allows us not only to provide a better client experience but also to enhance our cost management and risk management.

Ueda: Client experience, cost management, and risk management are all equally important.

Hoffmann: Right. You miss something if you optimize your environment with an exclusive focus on costs. If you focus on creating value and eliminating costs that do not add value—for instance using automation to become more agile—you can create an environment where the operational risks are much better controlled.

Ueda: It sounds as though the end-to-end approach will play a key role as financial institutions review their business processes going forward.

Thank you very much for your time today.

about NRI

Nomura Research Institute, Ltd. ("NRI", TYO: 4307) is a leading global provider of system solutions and consulting services, including management consulting, system integration, and IT management and solutions for financial, manufacturing and service industries. Clients partner with NRI to expand businesses, design corporate structures and create new business strategies. NRI has 10,000 employees in 35 offices globally and reports annual sales above $3.7 billion.
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