PROFIT RESOURCES INCORPORATED

# Hidden Costs in Digital Transformation

## Tackling Invisible Expenses

by John Chappelle

***Identify and address overlooked expenses in your bank's tech overhaul.***

## The Process of Digital Transformation

Financial institutions are now well aware of the potential benefits a successful digital transformation can provide in the areas of improved customer experience, enhanced operational efficiency and increased competitive advantage through differentiation. However, the fear of falling behind the competition can sometimes lead organizations to act in haste and at the expense of long-term, high value improvements for their customers and employees. To combat this common pitfall, financial institutions are wise to develop a sound digital strategy prior to embarking on a digital transformation journey, even if that means slowing things down at the outset. Customer expectations for streamlined, frictionless digital solutions to meet their banking needs continuously evolve and are influenced by all aspects of life – not just banking. Financial institutions should be mindful of and consider non-traditional competitors and incorporate lessons learned from digital successes and missteps of others in crafting their own digital strategy.

McKinsey & Company suggests that the ability to craft a clear strategy focused on business value is critical for successful digital transformation: "Companies should focus their transformations on specific domains (customer journeys, processes, or functions) that generate significant value for the business. The transformation should be guided by a road map that details the solutions and resources needed to deliver change to prioritized domains."

Digital transformation is a process that often comes with hidden expenses – some tangible and some intangible – that can significantly impact the overall budget and ultimate success of the project. A crucial part of developing a digital strategy is uncovering and addressing the hidden costs that can come with change. All investments a financial institution makes must be well thought out, include and account for the hidden costs, and be part of a larger organizational strategy. Financial Institutions need to invest ample time, focus on quality execution, and do it right the first time rather than rushing into something that will require additional efforts to clean up later.

## Common Tangible Costs

***Below are common tangible hidden costs that should be uncovered and addressed when taking on a digital transformation project:***

### Evaluate infrastructure upgrades

It's crucial to know whether the institution's current IT environment is best positioned to effectively implement the desired digital products. The organization may need to upgrade its systems and complete comprehensive customer data cleanup and restructuring to get the full benefit of new products or enhanced digital offerings. Some areas to consider include:

- **Legacy system integration with middleware.** Effective integration can be costly and may require an increased workload for employees.
- **Cloud migration.** There are tangible costs associated with proper data migration, storage and compliance, but it's important to get this piece right for meaningful long-term results and benefits.
- **Network and bandwidth upgrades.** New technology will often need more bandwidth to run properly. Check into the costs to upgrade the network and bandwidth to get the most benefit from the digital transformation.

### Review vendor expenses

Potentially significant costs are hidden in the relationships between financial institutions and vendors, and they must be considered and planned for in the digital transformation strategy.

- **Customization.** Any time the institution deviates from the vendor's standard offering, there will be an associated cost. Be sure the request for customization is necessary and beneficial to the organizational strategy or try to find another way to accomplish your goals. Determine if the customization request is a true differentiator, or merely an attempt to maintain the status quo.
- **Contract gaps and hidden terms.** It's helpful to have an expert advise the institution to identify where contract costs could creep up over time as the transformation is implemented. Fully understand and negotiate the contact terms at the outset of the project to avoid surprises down the line. Account for both the best case and worst case scenarios.
- **Ongoing support and scalability.** If the digital transformation takes off, there are likely pricing tiers built into the contract to support additional customers. The institution must be aware of these to incorporate them into its long-term planning.
- **Third- and fourth-party integrations**. Be aware that procuring parties may contract out with other vendors that will have their own hidden costs and pricing tiers.
- **Assess regulatory and compliance needs.** There will be costs associated with data security and audit risk assessments, which are crucial to comply with financial regulations.
- **Investigate increased cyber security and fraud mitigation needs.** Digital transformation products often require expansion of early detection fraud mitigation tools and enhanced incident response solutions to properly manage the increased propensity of fraud opportunities. New security protocols will be required to mitigate the risks of doing business in a new way, and it can be expensive.

## Common Intangible Costs

***The following intangible hidden costs have the potential to derail the success of a digital transformation project:***

### Cultural misalignment

The truth is, once an institution commits to a digital transformation journey, not everyone will be on board with the changes needed. Some employees will work against change, sometimes actively sabotaging progress to protect their jobs, influence or perception of value within the company which can be costly in terms of time, morale and money. Leadership must recognize the intangible costs of cultural misalignment and address it through recurring communication and training, thoughtfully managing employee attrition and making

strategic adjustments in personnel if necessary. Having the right people in the right spots will save money and increase the project's odds of success.

**Change management and employee training.** An unexpected and hidden intangible cost of a digital transformation initiative is the cost of implementing an effective change management plan and training employees how to utilize the new solution(s). However, doing a good job with these items will pay dividends down the line, and the benefits include:

- **Obtaining employee buy-in and good will.** Making employees aware of the benefits to themselves, their customers and the organization goes a long way in helping them get on board with the changes.
- **Combating resistance.** People are more likely to support the organization's efforts if they can clearly see the role they have to play in the success of a shared project.
- **Getting the full benefit of the solution.** Training employees how to use the digital transformation solutions helps them become more invested in the journey and gives them the necessary tools and experiences to train and convert customers. Their feedback can be invaluable when making tweaks to the product, the process or the implementation, saving the organization from stumbles and helping it pivot when needed.

### Business disruption and productivity slumps

Plan for intangible costs to show up in the form of business disruption and productivity slumps. A digital transformation is a just that – a complex change that affects many parts of the organization at once. Determine in advance how you will handle:

- **Down time.** It will not always be "business as usual" as the organization tackles a large project. Are there ways to minimize down time or to use it for another purpose?
- **Resource availability.** How will the institution handle pulling people and resources from one area of the business to another to accomplish the goals of the digital transformation project? How will leaders reprioritize their pending goals that conflict with project timing?
- **New processes and procedures.** It will take time to implement new processes and procedures, which is an upfront cost that will hopefully pay dividends later as your organization becomes more efficient and serves customers (and employees!) better.

### Customer awareness and adoption

When taking on a digital transformation project, never forget the customer and their role in your strategic plan! Do your customers want the changes you are proposing and are they aware of the benefits? There are intangible costs associated with customer awareness and adoption that include:

- **Effective marketing and communication.** The institution will need to let customers know about the changes and the benefits to them, and the customer will need to know where to go for help and how to plug into the solution. An effective marketing and communications plan will reach customers in the channels where they are, and it will be consistent and repeated over time.
- **Increased support service demand.** Whenever

there is a change in the way a financial institution does business, customers will require increased support services until they incorporate the change fully into their unique banking experience.

- **Onboarding needs.** Customers will need to be onboarded to the new solution, which will likely require both a technological and human response.

### Maintenance and ongoing investment

One intangible cost institution leaders may not consider is associated with maintenance and updates. Simply launching a new solution does not end the organization's commitment – it just begins it. There will be recurring expenses to maintain the product and to invest in updates and expansions during its life cycle.

## Tips

***Apply the following tips to overcome or mitigate hidden, tangible and intangible, expenses:***

### Use proven vendors with transparent pricing

Proven vendors are easier to work with and more likely to be responsive to questions and concerns. Transparent pricing ensures the financial institution can plan accurately for the future and navigate decision points with all the information available.

### Plan thoroughly and don't just wing it!

Thorough planning includes preparing a formal cost benefit analysis and a risk assessment. The plan should be evaluated periodically to assess successes and failures and to decide where to adjust. The planning process should have a defined exit strategy based on predetermined metrics. A defined exit strategy is often overlooked. Not all initiatives will deliver as expected and knowing when, and how, to cease a given pursuit will prevent the organization from spending valuable resources to salvage an underperforming project.

### Always plan for problems, delays and added costs

No plan is perfect, and there will be unexpected detours. Be prepared to pivot.

### Implement incrementally

You will be more successful if you don't try to do everything at once. Implementing in stages allows you to better allocate resources and spread costs out over time.

### Leverage resources from across the organization

Digital is not a department. It must live and breathe with the full organization, and there should be buy-in from all corners of the institution if it's to be successful.

Digital transformation is necessary to level the playing field for community banks competing with larger institutions with big budgets for future innovation. Understanding the hidden, tangible and intangible, costs associated with digital transformation is critical to position the organization to best execute and achieve its desired outcomes and expected return on investment.

### Resources

What is Digital Transformation? – McKinsey & Company

## About John Chappelle

With over 15 years of banking experience, John brings a wealth of knowledge to PRI from his tenure with community banks. He excels in leading organizational change, digital transformation, IT, bank operations, fraud and loss prevention, strategic planning and execution, sales management, and data-driven decision-making to achieve strategic goals. Adept at leading cross-functional teams, John has expertise in managing treasury management sales and servicing, digital banking, and fostering horizontal alignment across business units to drive non-interest income growth and deposit acquisition. He has a proven track record of creating digital-first customer and employee experiences that securely automate transactional needs, reduce expenses, increase efficiency, and enable employees to focus on relationship building and business development.

## About Profit Resources, Inc

Profit Resources Incorporated (PRI) strengthens financial institutions by improving profitability and efficiency, so that they can best serve customers, employees, and shareholders. By taking a hands-on approach to consulting, the PRI team of seasoned banking professionals makes a measurable impact on the bottom line through income enhancement and expense reduction. Established in 1990, PRI's expertise covers most areas of the financial institution including:

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- Digital Transformation
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