Financial services firms will spend between USD 270 billion and USD 460 billion on IT in 2013 globally. IT cost figures in banking are estimates and differ substantially between different sources.

Measured as a percentage of revenues, financial services firms spend more on IT than any other industry. Banks’ IT costs equal 7.3% of their revenues, compared to an average of 3.7% across all other industries surveyed.

The structure of IT costs varies from market to market. For example, IT staff costs account for 26% of banks’ IT budget in the US, whereas UK banks spend 37% of their IT expenses on IT staff.

Some banking businesses seem to employ IT to a greater extent than others. Unsurprisingly, IT costs account for a large share of the total cost base in transaction banking.

The size of a bank’s IT budget seems to be only one factor in achieving good business performance. Rather, studies suggest that efficient IT management is crucial.
IT in banks: What does it cost?

Estimating total spending on IT by banks

There is only a small amount of official information available on IT expenses in the financial services sector. Firms do not have to publish IT expenses in their annual statements, and figures from official statistics agencies on technology spending are scarce. There are, however, private-sector estimates available, mostly compiled by consultancies.

Their estimates of banks' combined total IT costs differ substantially, though, ranging from USD 270 bn to USD 460 bn for their 2013 budgets.

These differences are probably explained by different methodologies and definitions used. Estimates can be based on market knowledge, market surveys of different sizes, or inclusion of official statistics available. Differences might also stem from the scope of costs factored in (e.g. staff, telecommunications, business lines). Unfortunately, even with these technical differences in mind, it is hard to explain the discrepancies.

Banking sector spends more on IT than others

Financial services firms spend more on IT than other industries do. Banks’ expenses for IT equal 7.3% of their revenues, as found by Forrester Research Inc. in a large survey covering firms in the Americas, Europe and Asia. On average, across all sectors polled, IT costs were equivalent to 3.7% of revenues. Other sources confirm the relatively high IT costs in banking. McKinsey sees banks’ IT costs at 4.7% to 9.4% of operating income. The reasons for a higher use of IT in the banking industry are manifold. Financial service firms have to fulfill exacting regulatory requirements which translate into IT costs that do not contribute to the firms’ earnings. Furthermore, banks rely heavily on IT in their back offices as well as their distribution channels.

1 In this report: excluding the insurance sector.
IT in banks: What does it cost?

Research by Boston Consulting Group finds that European banks incur somewhat higher IT costs relative to revenues (10.5%) than the global average (7.3%). BCG data is based on a sample of large European banks. US banks’ IT costs, in contrast, amounted to 6.2% of their revenues in 2010, according to calculations by Forrester Research Inc. These differences must not necessarily reflect IT cost levels, but may also reflect differences in the denominator, i.e. the fact that US banks, on average, are more profitable than their European peers.

Financial Services: Relatively high IT staff budget

Banks appear to spend a big share of their technology budgets on IT staff. US banks, for example, spend 26% of their IT expenses on IT personnel, whereas across all US businesses and government only 20% of IT costs are related to IT staff. This difference is even larger given the fact that one-third of the US industries’ and public total IT spending is paid by the financial and professional services sectors. Discounting these industries from the US average, all other sectors spend only 17% of their IT budgets on IT staff. Other industries which display proportionally high costs for IT staff are: education and social services (44%), industrial products (34%), insurance (29%) and pharmaceuticals (29%).

Sources: Forrester Research Inc., DB Research

4 Comprises e.g. legal, accounting, tax preparation, engineering, computer design, management services. See also United States Census Bureau, North American Industry Classification System.
IT in banks: What does it cost?

Different markets possess different cost structures

Data by Forrester Inc. show that relative IT staff expenses differ across locations. In contrast to US banks with 26% of their IT expenses relating to IT staff, UK banks spend 37% of their IT budget on IT personnel, compared to 34% in Germany and only 27% in France.5

Compared to their European competitors, French banks seem to rely more on services provided by external providers, as they employ 14% of their IT budget on contractors, compared to UK banks’ 8% and German banks’ 9%. In order to picture all costs for external IT services, “third-party IT services” and “XaaS” also should be taken into account. Thus, French banks spend 32% of their IT costs on purchasing services, in contrast to UK and German banks, which use 22% and 24% of their IT budgets for external services.

2009 figures by Boston Consulting Group show that costs for outsourcing ranged between 19% and 22% of the total IT budget for most of the 34 banks surveyed (excluding external employees). Only CEE banks, benefitting from low salary levels, hardly purchase any external IT services (2.1% of their IT budget).6

Different markets also appear to have different IT cost structures (charts 4 and 5). For example, financial services firms in the US spend more on telecommunications services (18%) than banks in Europe (6-10%). They also seem to spend somewhat more on software. Nevertheless, cost categories are not fully comparable.

IT salaries in banks vary across Europe

Staff costs will be influenced by salaries paid to IT specialists. Data by Boston Consulting Group suggest that German banks face the second highest cost per internal IT employee in Europe, second only to the average paid for IT employees by banks in France, the Netherlands and Switzerland. Nevertheless, total IT staff expenses will not only depend on costs per internal IT employee, but might also be influenced by the degree of outsourcing to external providers.

Notes:
6 Boston Consulting Group, IT Benchmarking in European Banks. 2010.
IT in banks: What does it cost?

Change-the-bank: IT costs as an investment

In Europe, banks invest almost one-third of their IT budgets in “change-the-bank” projects, i.e. mainly in application development. “Run-the-bank” costs account for about 70% of total IT expenses. Between 2003 and 2010, this figure remained more or less stable, according to Boston Consulting Group.

Different business segments – different IT costs

A bank’s IT costs can also be influenced by its business mix. According to a survey on large European banks by Boston Consulting Group, the portion of operating expenses that is dedicated to IT differs between business segments. Obviously, transaction banking uses IT to a great extent. Asset Management seems to make the least use of IT in terms of percentage of operating expenses (13.5% in 2011). IT costs amount to 16.5% of operating expenses in retail banking and 15.9% in private banking in 2011. All in all, European banks dedicated 16.5% of their operating expenses to information technology in 2011. Although the ratios for some business segments varied over time, the overall IT costs of European banks measured against operating costs remained largely stable at around 15%.

Sources: BCG, European IT Benchmarking in Banking 2004-2011

Note: IT costs exclude telecommunication

Sources: BCG, European IT Benchmarking in Banking, DB Research
What is the return on IT for banks?

It is difficult to collect and analyse data on IT costs – regardless of whether at the individual bank level or at the industry level. But it is even more challenging to evaluate how much banks get from the IT employed. In other words, how much output is generated by the IT input?

In a study on European banks, McKinsey found that high IT budgets did not increase the business value the bank gets from information technology. Amazingly, the top performing institutions derived the greatest business efficiency from a level of IT spending below that of their peers. According to this study, the quality of IT management is even more important than the spending level in achieving the desired results.7 McKinsey found similar results for Asian banks.8

A recent paper based on data from German savings banks reaches similar conclusions: IT efficiency and the competitiveness of banks are positively correlated. Increasing IT budgets only improves a bank’s competitiveness if IT management is sufficiently efficient.9

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7 McKinsey on IT, Smart IT spending: Insights from European banks, 2005.
8 McKinsey on Business Technology, Breakthrough IT banking, Spring 2012.