DELIVERING EXCELLENCE IN CORPORATE BANKING

HOW TO PROTECT THE BUSINESS MODEL AND IMPROVE PERFORMANCE
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The Oxford Dictionary defines “excellence” as the “quality of being outstanding or extremely good”. When we talk about excellence in Corporate Banking, we mean the capability of a bank to deliver the best possible products and services to their clients, at the lowest possible costs and with the lowest possible risk. In order to produce this result, banks need to be “outstanding or extremely good” along the entire value chain of Corporate Banking.
EXECUTIVE SUMMARY

Corporate banking is a key activity of banks globally and a raison d’être for the banking industry.

As is the case in other parts of financial services, regulation has placed added financial burdens on banks, increasing their financial resource requirements and operating costs and threatening the economics of corporate banking.

At the same time, digital competitors from the FinTech space and multi-dealer trading platforms are snapping at banks’ heels and looking for opportunities to unbundle the traditional value chain in which banks closely linked themselves with clients and investors.

Much has been written about this dual challenge of regulation and FinTech creating a doomsday scenario for corporate banks. This needn’t be the case. While there are clear threats visible across the value chain, by their nature, positioning and heritage, corporate banks are holding the keys to remain the prime provider of core corporate banking services to the real economy. However, there is no reason for complacency.

To remain relevant, corporate banks need to deliver excellence across the value chain – in the near term to preserve returns, while in the medium-term to protect their incumbent position from new types of competitors.

On average the sector currently returns 13% pre-tax RoE, with about 40% of banks returning 15% or above and the rest below, with low loan loss provisions in many parts of the world a major driver. This compares favorably with other segments of banking, particularly post-crisis investment banking and capital markets, but the differences in performance are wide. And while the achievable performance is strongly impacted by a bank’s home market, achieving excellence is a significant driver of returns. We see that the “spread to excellence” is worth 17 RoE-points. This can more than equalize any “location disadvantage”.

This report documents best practices across seven drivers of excellence which leading banks around the globe are implementing, and comments on the associated management challenges.
THREATS TO THE CORPORATE BANKING MODEL

Corporate banking is a core activity for banks and plays a pivotal role for the economies they serve. Roughly one-third of the total bank lending and 20% of the total asset base are dedicated to corporate banking activities. Similarly, the activities of corporate banks are a cornerstone of the economies in which they operate. Lending from banks still represents the largest source of debt funding in Europe and Asia; and even in the predominantly market-oriented US, bank lending still accounts for a significant 31% of all debt funding.

Exhibit 1: Relevance of corporate banking activities

CORPORATE BANKING PERIMETER

Our definition of corporate banking covers the business in which banks provide funding (e.g. lending products and liquidity lines), transaction services (e.g. payments, cash management and trade finance), risk management products (e.g. interest rates swaps, foreign exchange or commodities) and corporate finance services (e.g. intermediation to markets and investors for equity capital market [ECM] and debt capital market [DCM] products and mergers and acquisitions [M&A]). We focus on those corporate clients that have a full legal setup and where there is a clear distinction between the owner and the individuals handling the management of the financials of the company. As such, we treat business banking for smaller businesses, such as shops and small companies, as a separate business model that is often serviced out of the bank’s retail banking unit and hence not covered in this report.
For more than two decades, the traditional business model of corporate banking in developed markets was clearly defined and stable: Banks used their balance sheet to provide corporate clients with funding and liquidity and grew increasingly willing to lend money at low or even negative returns in the hope of establishing relationships that would enable them to sell higher-margin products to clients. This development led to the twin mantra of “relationship banking” and “cross-selling”.

And while the “lend and cross-sell” model has proven difficult to master for many banks, the role of the bank was clear and unquestioned: Balance sheet capacity and the ability to link clients to investors and products were the key sources of banks’ competitive advantage and acted as barriers against potential new entrants into the market.

However, as in other parts of the financial services industry, the twin forces of regulation and digitalization have led to worrying developments:

REGULATORY IMPACT

While corporate banking was not at the center of the recent financial crisis, nonetheless it has been impacted significantly by new regulation:

• **Increased requirements for capital and liquidity:** As many corporate banking services center around the use of balance sheet and the provision of liquidity, all those regulatory initiatives which require banks to either hold more capital, observe certain limits in their balance sheet structure or hold liquidity buffers, will increase the costs for corporate banking businesses and decrease profitability.

• **New scrutiny on client treatment:** Various regulatory initiatives aim to better protect clients from unfair treatment by financial service providers. The greater regulatory focus on conduct, stricter rules on cross-selling, harsh punishment for mis-selling and greater documentation requirements (e.g. anti-money laundering [AML] and know your customer [KYC] processes) has created operational barriers for banks at the same time as clients are complaining about too much red tape.

• **Market structural changes:** Changes in the overall market structure, such as the changed environment for derivative trading and clearing, have altered traditional corporate banking business models, as profit patterns of cross-selling products change and serving clients with these products becomes more challenging.
IS THE CORPORATE BANKING VALUE CHAIN UNBUNDLING?

Historically run on a vertically integrated basis, from client interface to product delivery and balance sheet provision to the link to investors, developments around digitalization create opportunities for new entrants targeting specific parts of the corporate banking value chain.

Exhibit 2: Defensibility of corporate banking value chain

<table>
<thead>
<tr>
<th>CORPORATE BANKING VALUE CHAIN</th>
</tr>
</thead>
<tbody>
<tr>
<td>Owning the customer relationship</td>
</tr>
<tr>
<td>Product design and solution structuring</td>
</tr>
<tr>
<td>Operations and transaction management</td>
</tr>
<tr>
<td>Balance sheet provision</td>
</tr>
<tr>
<td>Owning the investor relationship/understanding investor needs</td>
</tr>
</tbody>
</table>

Potential sample threats
- FinTechs acting as product aggregators and winning customer relationships by offering higher convenience
- Faster, higher-performance solutions for specific services (e.g., platforms for FX transactions)
- New solutions to generate, process and store data
- Industry-wide utilities to generate scale benefits
- Non-bank lenders providing balance sheet
- Lower demand
- Crowdfunding
- Direct links between corporates and investors resulting in bank disintermediation

“Built-in” corporate banking mitigants
- Relationships still mostly built face-to-face and based on trust and specific client knowledge acquired offline
- Banks offering bundles of businesses and full product spectrum rather than individual, specific services
- More efficient solutions will increase profitability
- Overall threat to business model limited
- Client preferences
- Risk appetite of non-bank lenders
- Applicability still limited to specific, vanilla lending
- Legal hurdles
- Limited investor risk appetite and experience beyond largest clients

The biggest threats for corporate banks are likely to emerge in three areas:

- Firstly, at the client interface, where new digital channels could crowd out banks’ direct access to clients. In retail banking, this has led to a massive reconfiguration of the overall channel constellation across the client relationship and all products. In corporate banking, this phenomenon currently still remains confined to specific parts of the business, such as corporate banking portals for FX transactions, cash management services or trade finance aimed typically at smaller clients.
Secondly, the emergence of new single-purpose services in combination with the regulation-induced decrease in profitability for corporate banking products could threaten the traditional “bundled” offering of banks, much as consumer finance companies have taken away market share amongst retail clients from full-service banks.

And thirdly, non-bank lending is growing fast, albeit from a very small basis. If banks were to lose this anchor, it could lead to a much broader disintermediation. In practice, however, non-bank players still find it challenging to provide finance solutions at scale, especially if they are non-vanilla/structured.

However, a number of factors mitigate against these threats:

- Banks enjoy unparalleled access to corporate clients and possess intimate knowledge and information about their clients; this is an asset built over decades which is hard to replicate.
- Banks have unrivalled experience in pricing, structuring and distributing assets to investors and in managing the risk associated with linking funding demand and supply.
- Banks have the ability to provide clients with access to various product categories, markets and investors, and perform an advisory function.
- Banks provide fundamental processing capabilities and payment and account infrastructure, which satisfies basic corporate needs.

As a consequence, the traction of alternative providers of corporate banking services and the degree of disruption has been lower than in other parts of financial services, such as retail banking, let alone other industries such as media.

While the immediate threat level may seem moderate today, corporate banking executives should not take comfort in a false sense of security. If banks do not actively respond to these threats, evolve constantly and continually develop the assets that have historically provided their competitive advantage, they risk an erosion of their privileged position.

Indeed our research shows that for banks to maintain their control over the value chain, as well as mitigate the profit impact of regulation, they have to strive for excellence. Not only will this effort produce satisfied, loyal clients but it also will ensure that key resources such as funding, liquidity and budgets continue to be available.

There is a wide disparity in the performance and level of excellence of corporate banks. Particularly for those at the lower end of the spectrum, much work needs to be done.
Corporate banking performance is skewed widely across and within regions. Our recent analysis of corporate banking segments across 20 countries demonstrates that the worldwide reported average RoE is 13% and values reach from below zero to over 30% and ca. 60% of banks are delivering returns below 15%.

Our analysis confirms a well known fact: location has a strong bearing on the achievable performance of banks in general and on corporate banking in particular. The most profitable regions achieve RoE levels that are 31 percentage-points higher than the worst performing ones. Banks in North America and Australia clearly mark the top end of the range, with average RoEs of ~20% and higher, while Southern Europe and Central Europe lag other geographies with RoEs below 10%. Asia, the Nordic nations and the UK have RoEs in the mid-range, between 12% and 15%.

Exhibit 3: RoE distribution of corporate banking segments

PRE-TAX RoE DISTRIBUTION OF CORPORATE BANKING SEGMENTS
AVERAGE 2012/2013; SHARE OF SEGMENTS WITH PRE-TAX ROE IN %

Source: Oliver Wyman Corporate Banking Database
### Exhibit 4: RoE levels by country

<table>
<thead>
<tr>
<th>Country</th>
<th>Pre-TAX RoE (IN %, AVERAGE 2012/2013)</th>
<th>LLP/ASSETS (IN BPS) AVERAGE 2012/2013</th>
<th>Pre-TAX RoE WITH NORMALIZED COST OF RISK (IN %, AVERAGE 2012/2013)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>-10% 0% 10% 20%</td>
<td>-10% 0% 10% 20%</td>
<td>-10% 0% 10% 20%</td>
</tr>
<tr>
<td><strong>Leading</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>North America</td>
<td>23%</td>
<td>19BPS</td>
<td>19%</td>
</tr>
<tr>
<td>Australia</td>
<td>17%</td>
<td>21BPS</td>
<td>14%</td>
</tr>
<tr>
<td><strong>Midfield</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>China</td>
<td>15%</td>
<td>35BPS</td>
<td>14%</td>
</tr>
<tr>
<td>Nordics</td>
<td>14%</td>
<td>22BPS</td>
<td>6%</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>12%</td>
<td>60BPS</td>
<td>12%</td>
</tr>
<tr>
<td>Rest of Asia(^1)</td>
<td>12%</td>
<td>58BPS</td>
<td>11%</td>
</tr>
<tr>
<td><strong>Lagging</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Western Europe(^3)</td>
<td>7%</td>
<td>55BPS</td>
<td>6%</td>
</tr>
<tr>
<td>Southern Europe(^4)</td>
<td>-8%</td>
<td>-288BPS</td>
<td>15%</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td>13%</td>
<td>-13%</td>
<td>13%</td>
</tr>
</tbody>
</table>

1. Assuming a LLP (Loan Loss Provisions) ratio of 55bps for all banks; 2. Includes South Korea, Indonesia, Thailand; 3. Includes Benelux, France, Germany, Ireland; 4. Includes Italy, Portugal, Greece

Source: Oliver Wyman Corporate Banking Database

A combination of three factors helps to explain a significant portion of the differences in RoE across markets:

1. **With the exception of Southern Europe**, loan-loss provisions around the world are low. The next economic crisis will lead to lower profitability for all banks in those markets, which today enjoy the benefits of low loan losses. The difference in performance shrinks when normalizing the cost of risk, but it still is significant.

2. **Higher levels of capital-markets based financing in the economy** are associated with higher non-interest income and higher profitability.

3. **Country-specific regulatory conditions such as the government-fixed interest rate levels in China and supply-demand dynamics create idiosyncratic market realities** which impact the various drivers of RoE in the markets. Particularly in the “Rest of Asia” region the differences between jurisdictions are reflecting a wide range of structural and economic market characteristics.
Exhibit 5: Performance drivers in corporate banking – net interest margin, product demand and loan-loss provisions heterogeneous by country

<table>
<thead>
<tr>
<th>Region</th>
<th>REVENUES/ASSETS IN BPS</th>
<th>LOSS-RATES/ASSETS IN BPS</th>
<th>OPEX/ASSETS IN BPS</th>
<th>ROA IN BPS</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>325</td>
<td>459</td>
<td>204</td>
<td>235</td>
</tr>
<tr>
<td>Australia</td>
<td>188</td>
<td>310</td>
<td>109</td>
<td>180</td>
</tr>
<tr>
<td>China</td>
<td>211</td>
<td>310</td>
<td>118</td>
<td>209</td>
</tr>
<tr>
<td>Nordics</td>
<td>124</td>
<td>201</td>
<td>84</td>
<td>96</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>355</td>
<td>48</td>
<td>162</td>
<td>134</td>
</tr>
<tr>
<td>Rest of Asia¹</td>
<td>322</td>
<td>162</td>
<td>162</td>
<td>192</td>
</tr>
<tr>
<td>Western Europe²</td>
<td>163</td>
<td>48</td>
<td>140</td>
<td>134</td>
</tr>
<tr>
<td>Southern Europe³</td>
<td>226</td>
<td>288</td>
<td>97</td>
<td>128</td>
</tr>
</tbody>
</table>

1. Includes South Korea, Indonesia, Thailand; 2. Includes Benelux, France, Germany, Ireland; 3. Includes Italy, Portugal, Greece

Source: Oliver Wyman Corporate Banking Database

But even though location has a strong influence on performance, there is a significant RoE difference between the best and the worst players within a region; the average being 17%.

Exhibit 6: RoE spread by region

<table>
<thead>
<tr>
<th>MARKET</th>
<th>ROE RANGES BY REGION IN %, AVERAGE 2012/2013</th>
<th>ROE SPREAD BEST VS. WORST PERFORMING BANKS IN %, AVERAGE 2012/2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>-30% -20% -10% 0% 10% 20% 30% 40%</td>
<td>0% 10% 20% 30% 40%</td>
</tr>
<tr>
<td>Australia</td>
<td>-30% -20% -10% 0% 10% 20% 30% 40%</td>
<td>0% 10% 20% 30% 40%</td>
</tr>
<tr>
<td>China</td>
<td>-30% -20% -10% 0% 10% 20% 30% 40%</td>
<td>0% 10% 20% 30% 40%</td>
</tr>
<tr>
<td>Nordics</td>
<td>-30% -20% -10% 0% 10% 20% 30% 40%</td>
<td>0% 10% 20% 30% 40%</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>-30% -20% -10% 0% 10% 20% 30% 40%</td>
<td>0% 10% 20% 30% 40%</td>
</tr>
<tr>
<td>Rest of Asia¹</td>
<td>-30% -20% -10% 0% 10% 20% 30% 40%</td>
<td>0% 10% 20% 30% 40%</td>
</tr>
<tr>
<td>Western Europe²</td>
<td>-30% -20% -10% 0% 10% 20% 30% 40%</td>
<td>0% 10% 20% 30% 40%</td>
</tr>
<tr>
<td>Southern Europe³</td>
<td>-30% -20% -10% 0% 10% 20% 30% 40%</td>
<td>0% 10% 20% 30% 40%</td>
</tr>
</tbody>
</table>

1. Includes South Korea, Indonesia, Thailand; 2. Includes Benelux, France, Germany, Ireland; 3. Includes Italy, Portugal, Greece

Source: Oliver Wyman Corporate Banking Database
The reason behind this is the level of excellence of the banks. We have quantified the impact of excellence by analyzing a set of seven drivers of excellence and estimating their impact on RoE.

After normalizing for country level factors, we operationalized the various drivers by translating them into proxy indicators, and then analyzed the impact on RoE. The benefits of being excellent, versus the costs of being mediocre, are significant.

**Exhibit 7: RoE impact of performance drivers**

<table>
<thead>
<tr>
<th>PERFORMANCE DRIVERS OF CORPORATE BANKING EXCELLENCE</th>
<th>2012/2013 RoE SPREADS BETWEEN TOP AND WORST PLAYERS ON COUNTRY-LEVEL IN %</th>
<th>PROXY INDICATOR</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Client selection</td>
<td>3</td>
<td>(Net-interest income-LLP)/total assets - Net-interest Income/total assets</td>
</tr>
<tr>
<td>2. Pricing excellence</td>
<td>2</td>
<td>(Net-interest income -LLP)/total assets</td>
</tr>
<tr>
<td>3. Automation and service industrialization</td>
<td>3</td>
<td>Operational cost/total assets</td>
</tr>
<tr>
<td>4. Resource efficiency</td>
<td>3</td>
<td>Total revenues/total assets</td>
</tr>
<tr>
<td>5. Product platforms</td>
<td>4</td>
<td>Non-interest income/total assets</td>
</tr>
<tr>
<td>6. Strategic funding</td>
<td>1</td>
<td>RoE impact of Loan-to-deposit ratio</td>
</tr>
<tr>
<td>7. International presence</td>
<td>1</td>
<td>RoE international players vs. domestic players</td>
</tr>
<tr>
<td><strong>Total RoE-spread</strong></td>
<td><strong>17</strong></td>
<td></td>
</tr>
</tbody>
</table>

**Notes:** LLP = Loan loss provisions

**Source:** Oliver Wyman Corporate Banking Database
The Oxford Dictionary defines “excellence” as the “quality of being outstanding or extremely good”. When we talk about excellence in Corporate Banking, we mean the capability of a bank to deliver the best possible products and services to their clients, at the lowest possible costs and with the lowest possible risk. In order to produce this result, banks need to be “outstanding or extremely good” along the entire value chain of Corporate Banking.

Excellence is not simply a driver to improve current performance, it is the best chance for banks to ensure their role in corporate banking by maintaining their competitive advantage. Particularly in those areas which are likely to be most under threat, such as client access, product provision and balance sheet provision, excellence will help banks to further strengthen their position.

Leading banks are working hard to implement best practice around all available drivers of excellence. These efforts are generating higher returns and creating a defensible business model for the future. The remainder of this report looks at each of these drivers and highlights relevant developments and best practices.

1. CLIENT SELECTION

Excellence in client and segment selection is at the center of corporate banking skills and translates into higher return on capital, as a result of lower cost of risk and higher revenues over assets.

Excellent corporate banks master a number of underlying skills, covering full transparency over client value, sales force effectiveness and forward looking full-cycle risk selection skills:

• Understanding a “regulation-adjusted” client value is a prerequisite to optimizing client selection. While progress has been achieved in this area, technical and organizational challenges towards capturing full cross-product relationship profits remain. Even some of the largest and most sophisticated banks find it hard to move beyond the widely available product by product economics and determine the profitability of an individual client.

• A “continuous improvement process” in increasing the effectiveness of the sales force focuses on talent management. It seeks to ensure that the roles played by individuals in the client interface are matched with their skill profile, while simultaneously managing the delicate balance between relationship manager autonomy and disciplined steering from the top.

• Similarly, more advanced risk selection capabilities are crucial to selecting the best assets on a full-cycle perspective. A new approach that we have worked on with various banks is a forward-looking analysis that simulates the balance sheet of corporates in multiple economic scenarios, thus providing an early warning system of credit-quality deterioration among clients. Risk-conscious client selection will be particularly important as new rules for aligning loan-loss provisions with credit-risk-measurement techniques are put in place by IFRS 9 and BCBS 311.
IFRS 9 AND BCBS 311

Risk selection capabilities will grow in importance and affect performance more directly as a result of IFRS 9 rules on provisioning in combination with new regulatory guidance on the accounting for expected credit losses formulated in the BCBS 311 paper. These rules require banks to build a stronger link between the risk quantification tools used as standard elements in the credit process (in particular the instruments to determine probability of default, loss given default and exposure at default) and the provision numbers which appear on the balance sheet. In addition, the new rules are moving away from a principle of the “most likely” outcome towards the “expected” outcome. In practice, banks will need to build a provision equal to the size of a one-year expected loss level at the inception of every transaction. As assets deteriorate in credit quality from a “healthy” status, banks will need to build a provision equal to the lifetime expected loss value for the individual transaction. This seemingly technical change will have profound effects on at least three fronts:

• Firstly, profits on any lending portfolio will be realized much later than previously, as every transaction will carry a loss provision at inception. Under current rules, banks typically do not build provisions for new transactions, as the “most likely” outcome at the start of the transaction is that it will not default (otherwise the bank would not have extended the loan). Some banks estimate provisions could increase substantially by up to 100%.

• Secondly, provisions will become a much more volatile metric, as they are directly linked to changes in the risk assessment of the individual transaction. Previously, there were separate rules for building provisions, and banks typically used the discretion to manage their P&L. With the more “mechanistic” approach of IFRS 9, this flexibility is no longer available to management.

• Thirdly, the credit monitoring value chain and the recovery process have become much more integrated. Actions by a relationship manager (such as not providing all required data for risk analysis) or a change in methodology or parameters by the credit risk department may lead to large swings in the provision level in the balance sheet and hence in the overall equity position.

What seems at first to be a simple change in accounting poses a challenge not only from the perspective of implementation but from a strategic point of managing and steering a business with a strong credit component such as corporate banking.
To deliver excellent client selection, banks need to put in place appropriate structures and rules, both at the micro and macro level.

- On the micro level, excellent corporate banks use digitally enabled tools to support prioritization of leads for client opportunities and to steer relationship management activity to the most promising opportunities. Efficient coordination between the different sales channels is a precondition to getting this right.

- On the macro level, some banks have been very successful in focusing on specific sectors and their specific financial needs. Some players focus on the health care space, on new technology companies/innovative growth sectors or the real estate sector. For one bank, we have developed a “special-situations” strategy that focuses on corporates which find themselves in difficult circumstances but are not yet watchlist candidates.

2. PRICING EXCELLENCE

Top-performing corporate banks achieve on average a 29% risk-adjusted pricing advantage over their worst-performing local peers. And as margins contract further due to increasing competition, pricing capabilities will continue to play an important role for corporate banks. Big data will be a key enabler to enhance pricing discipline based on thorough use of all available information and structured decision processes. There are four main challenges in corporate banking pricing:

- **Balancing individual relationship manager (RM) discretion with stringent management of pricing guidelines:** We find that an individual relationship manager’s ability to profitably price credit explains half the differences in pricing performance. However, those “human factors” are rarely treated with the same level of focus and effort as other areas of pricing, such as tools and guidelines, pointing out a significant industry blind spot.

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### Exhibit 8: Factors explaining differences in credit pricing

<table>
<thead>
<tr>
<th>Category</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>External factors</td>
<td>26%</td>
</tr>
<tr>
<td>Bank specific factors</td>
<td>14%</td>
</tr>
<tr>
<td>Human factors</td>
<td>44%</td>
</tr>
<tr>
<td>Others</td>
<td>26%</td>
</tr>
</tbody>
</table>

*Source: Oliver Wyman analysis*
• **Being rational and disciplined in the use of cross-product subsidies and management of the lending shortfall:** The various forms of active credit portfolio management or “shortfall management,” which were developed around 15 years ago, have proven hard to implement but have been beneficial for those banks that have been successful in implementing them, particularly with large corporate clients. With a steady flow of demand for cross-selling products and low-yielding, often off-balance sheet lending products these clients represent the segment of the market for which rational decision making around investments in the client relationship via sub-par loans is particularly important.

• **Stopping leakage in transaction banking:** This stems not only from deviations from the standard fee schedule during sales negotiations but also from inconsistencies between contracted prices and billing systems, a lack of following up on temporary discounts and other low-discipline syndromes.

• **Understanding client sensitivities and profitability drivers:** Compared to other areas of banking and other industries such as retailing, the understanding of a client’s reaction to price changes remains underdeveloped. At the same time, banks need to ensure they treat clients fairly and demonstrate this commitment to their clients.

Most systematic pricing initiatives and frameworks have typically been established in retail banking. But our recent project work reveals that this is about to change. Corporate banks are increasingly seeking to leverage big data/digital solutions to build more intelligent pricing tools and strengthen sales process discipline. While improved algorithms to identify price sensitivities based on multiple available data sources (internal benchmarks, market benchmarks and client behavior) are an important feature, the real difference in the new tools is something else: their simplicity.

They make the sales and pricing process simple, instead of complicated. This is achieved through tailored tools that are fully integrated into the sales process and allow intuitive simulation of pricing opportunities.
Exhibit 9: Next generation of digital-enabled pricing tools – example of a B2B chemical distributor company

- **Deal scores to drive accountability**
  Each price assigned a “deal score” to drive accountability in reporting

- **Insights embedded directly into pricing decisions**
  Market pricing and benchmarking information delivered in real time

- **Immediate comparison with other relevant price points**
  - Over time
  - From market sources
  - Internal benchmarking

- **Easy workflow for accurate and fast quoting**
  - Additional price modifications
  - “Review and submit”
3. AUTOMATION AND SERVICE INDUSTRIALIZATION

Banks should aim to achieve two distinct capabilities in developing their processes and services portfolio:

- Automated and streamlined end-to-end processes
- Ability to deliver differentiated service models

AUTOMATED AND STREAMLINED END-TO-END PROCESSES

The credit process, which often represents more than 40% of the total operational cost basis of corporate banks, is the best known example of the benefits of process automation. Banks have spent significant effort to optimize this process, using various techniques such as a clear line of responsibilities together with a specialized workflow. These optimizations have achieved remarkable increases in process efficiency, with lower costs and higher customer satisfaction levels.

We see client onboarding processes, and especially KYC and AML processes, as the next process challenge for banks. We think these processes are now in a situation similar to that of the underwriting process circa 10 years ago and present a unique opportunity for banks to further drive process efficiency.

The onboarding of new clients is one of the most important and challenging processes that banks undertake. Best practice banks have begun to focus on selected elements of the onboarding value chain and outsourcing the rest, investing in a state-of-the-art document management solution and adopting a rules engine to drive workflow. In a recent example, we worked with a bank that, by using these measures, achieved significant improvements in the onboarding performance. The new end-to-end onboarding process contained two-thirds fewer steps and handovers, and unit costs decreased by 23% to 35%. In areas like KYC we may also see the development of industry utilities in order to bring down overall costs for the industry and reduce client hassles.

DIFFERENTIATED SERVICE MODELS

The second key capability of banks is to deliver a differentiated service portfolio to clients that is better tailored to clients’ specific needs. We see two major thrusts:

- Sophisticated banks use digitalization to enhance and differentiate their service model. Client needs as well as their revenue potential are highly heterogeneous, but corporate banks often apply the same standard service model to all corporate clients, leading to undifferentiated costs and frequent over- and underservice. In one example, we have worked with a best practice bank to unlock the value hidden in the onboarding processes by including a much more detailed, bespoke analysis of client needs. This involved the use of more precise segmentation information (all of which has already been collected as part of the due diligence process), as well as predictive analytical tools. Our experience shows that significant revenue can flow from getting this part of the onboarding process right. These revenue benefits come primarily from reducing attrition and increasing cross-sales during the first few months of the relationship. These benefits tend to persist over the life of the client relationship.
Exhibit 10: Profit profile – old vs. new RM onboarding methods

With effective onboarding:
- New customer revenue can be influenced through actively managing early customer interactions.
- The onboarding program needs to be both proactive and reactive, making the most of increased receptiveness within the first 90 days.
- Each interaction, inbound or outbound, must have a purpose; servicing customer needs whilst simultaneously steering customers through the intended onboarding strategy for their profile.
- New customer revenue can be influenced through actively managing early customer interactions.
- The onboarding program needs to be both proactive and reactive, making the most of increased receptiveness within the first 90 days.
- The addition of new products becomes difficult as the relationship matures.
- The onboarding program needs to be both proactive and reactive, making the most of increased receptiveness within the first 90 days.

Without effective onboarding:
- New customer revenue increases within the first 90 days as existing cross-selling approaches succeed on a small percentage of customers.
- The risk of doing nothing is even greater, as banks stand to lose client contact and information to new intermediaries/aggregators that position themselves between banks and their corporate customers. Accounting and tax software providers, startup companies and IT providers are moving in this direction.

The main challenge in automation is for banks to optimize the level of investments. Particularly for smaller banks, investments in digital portals and digitalized processes do not always pay off, given heterogeneous client requests/digital affinities and lack of scale. Yet the risk of doing nothing is even greater, as banks stand to lose client contact and information to new intermediaries/aggregators that position themselves between banks and their corporate customers. Accounting and tax software providers, startup companies and IT providers are moving in this direction.

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4. RESOURCE EFFICIENCY

As regulatory requirements on capital and liquidity increase and the need to manage scarce resources across business lines becomes more acute, the ability to deploy resources efficiently will become a mission-critical skill for banks. Leading corporate banks have reacted with a combination of advanced metrics/resource-steering mechanisms and a move towards a model where banks aim to increase the distribution of assets.

Multiple metrics around capital, balance sheet structure and liquidity need to be taken into account simultaneously. While the job of managing these different resources typically resides with the CFO, corporate bankers need to understand how each metric affects their overall business mix and how sensitive it is to changes in the outside world. Otherwise, executives of corporate banks run the risk of losing in the “war for resources”, particularly as resource usage comes under the scrutiny of bank management and regulators.

Similarly, there is a clear trend towards more distribution to investors in many asset classes. The search for yield in the current low interest rate environment has helped establish bank-originated corporate debt as a recognized asset class among institutional investors. Banks are building up privileged partnerships with certain investors and are beginning to use the entire spectrum of alternative distribution options, including direct loan sales, partnerships with loan funds, capital relief trades and collateralized loan obligations (CLOs). While this has already had an impact in the structured finance space, best-practice banks are increasingly using these models to plain vanilla corporate loans and even revolving credit facilities (RCFs) to better leverage scarce resources. To make this successful, a strong alignment between origination and distribution teams is necessary in terms of client contact, product structuring, incentives systems and organizational setups.

Exhibit 11: Integrated financial resource management

- **1. RWAs**
  - Minimum capital requirement against Risk Weighted Assets

- **2. Liquidity**
  - Minimum liquidity requirements for sources of liquidity and funding against use of liquidity

- **3. Leverage ratio**
  - Minimum capital requirement against total “leverage” exposure (adjusted on- and off-balance sheet volume)
5. PRODUCT PLATFORMS

The influence of the availability and delivery of product platforms is significant. Best performing corporate banks, on average, achieve 30% more profitable cross-selling relative to their peers. Being a top-tier league table player can help, but it is not a prerequisite: only in three out of eight geographies (Australia, US and Nordics) does the most profitable bank hold a top three DCM league table position, and the impact is even smaller for ECM and M&A. Instead, it is the ability to bring a solid and integrated set of products to clients that is the key driver for profitability.

The shift of product profit patterns will force corporate banks to think more rationally (and perhaps more radically) about the “make-or-buy” decision, particularly for transaction banking and alternative execution and trading models for capital markets products, such as fixed income, currencies and commodities (FICC).

- **Transaction Banking**: Retaining sticky operational cash management mandates is a positive for the overall corporate client relationship and important for NSFR/LCR considerations. However, maintaining and building competitive offerings has become very expensive for smaller domestic banks. Small banks are forced to act as followers relative to global banks, which are investing heavily in multi-product, multi-country and multi-bank platform capabilities. In addition, FinTech companies and accounting and tax software firms are moving into the aggregation space, de facto integrating the client coverage layer. In trade finance, the challenge for small banks is similar: they cannot afford to implement a full end-to-end process digitalization especially since more and more business is moving towards open account solutions. Timing will be a key skill for corporate banks to ensure they continue to capture attractive returns for clients that stick to a non-digital approach. As a result, we see banks increasingly looking for smart ways to provide these capabilities to clients by insourcing or partnering.

- **Alternative Execution and Trading Models**: The economics of operating a capital markets trading and execution platform are becoming more difficult. Together with lending, these platforms, particularly in fixed income, are heavy users of balance sheet, liquidity and capital resources. In addition, many products are becoming standardized and commoditized and increasingly are moving towards multibank electronic platforms. There is an opportunity for mid-tier banks to rethink their overall approach to providing these products to their corporate clients, as they are less able to realize scale benefits. Rather than offering a fully-fledged execution and trading platform, agency (instead of principal) trading models can provide the ability to offer products, while not consuming balance sheet resources. In contrast to existing initiatives to mutualize only parts of the post-trade value chain (such as clearing, custody or other back-office activities), these models lead to a significant change in how banks perform capital market, front office activities and risk taking.
However, such a move is very significant from a structural perspective. While it reduces balance sheet usage, it also means that banks must forego trading related revenues and may lose strategic flexibility. In particular, the implications for the business with institutional clients may be severe as they may well prefer to work with a banking partner willing to provide its own balance sheet and provide execution on a principal basis. Plus, the most sophisticated corporate clients may be uncomfortable with a bank that is not able to fully cover all product requirements on its own, and may choose to bring their business elsewhere. Such a change is particularly relevant for regional mid-tier banks, which will feel the pressure on costs and profitability the most. Finally, it will also have implications for a bank’s capabilities in managing its own risk and treasury operations.

Exhibit 12: Agency trading for FICC products

<table>
<thead>
<tr>
<th>BUSINESS MODEL</th>
<th>SOURCE OF ADVANTAGE</th>
</tr>
</thead>
</table>
| TRADITIONAL PRINCIPAL | • Depth of liquidity  
|                      | • Breadth of distribution  
|                      | • Ability to warehouse risk |
| 1. AUTOMATED PRINCIPAL | • Scale of flows  
|                      | • High rates of internalization  
|                      | • Quality of liquidity (blocks, end-user flows) |
| 2. AGENCY | • Sourcing liquidity intelligently – electronically or manually  
| Potential evolution for mid-sized, regional banks | • Wider relationship: content, calendar, related principal execution  
|                      | • Ancillary services (e.g. bundled client clearing, collateral/financing) |
6. STRATEGIC FUNDING

Having a clear understanding of how balance sheet structure affects their potential to make money and manage liquidity and funding has become a critical skill for corporate banks – particularly in an environment of increased balance sheet regulations and low interest rates. New regulations treat various deposits differently based on how likely they are to be withdrawn in an adverse scenario. Retail deposits are viewed as less likely to be pulled out, so banks are only required to hold small reserves against them. On the contrary, banks are required to hold in excess of 40% against certain corporate deposits.

As such, there is an increasing need to manage corporate deposits at a more granular level. Sophisticated banks apply a rigorous approach to managing deposits from a holistic perspective based on analytical insights. These banks take a view beyond the traditional contractual outlook to understand the impact of the behavioral tenor on funding costs and have found the presence of a substantial differentiation in value across various deposit products. Consequently, managing and pricing deposits in a more sophisticated manner can help the bank achieve its objectives, from balance sheet stability to superior performance. The figure below shows a pricing framework that has helped some of our clients realize improvements in economic performance in the tens of millions of dollars (US) per year.

There is an additional, more strategic game changer in the debate about funding. If ring fencing becomes a reality, then most certainly there will be an extended debate over whether corporate banking should be in the fence, outside of the fence, or split across the two. Whatever the outcome, it will significantly affect the ability of corporate banks to generate economic performance. If corporate banking activities are “within the fence”, they will enjoy the benefits of being able to use retail funding and hence realize lower overall funding costs. On the downside, the provision of capital markets products will become much more difficult as they will need to be handed “over the fence”. On the other hand, if corporate banking

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**Exhibit 13: Deposit pricing decision framework**

- **1. Define strategic goals**
  - e.g. optimize funding value, minimize balance impact, minimize internal churn
- **2. Identify target segments based on strategic objectives**
  - e.g. target bottom 50% segments based on funding value
- **3. Assess current pricing levels**
  - e.g. target segments where pricing generating lowest funding value
- **4. Analyze elasticity of segments**
  - e.g. probability of internal churn, probability of customer elastic behavior, elasticity of current price positioning
- **5. Generate pricing recommendations**
  - e.g. decrease customer rate on business unit A 3m TDs by 5bps

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[Diagram showing the pricing decision framework with examples of balance, revenue, liquidity risk, and customer elasticity bands for segments x and y.]
is located “outside of the fence”, then traditional funding structures for corporate banking activities will no longer be viable. The need to match long term financing with long term funding will require banks to review their funding structure for their corporate banking activities. In this scenario, generating sticky deposits via a strong transaction banking franchise will also be a critical differentiator.

7. INTERNATIONAL PRESENCE

The ability to provide cross-border services is one of the capabilities that non-banks struggle to emulate and thus will continue to be a relevant asset and differentiator for corporates with an international footprint.

At the same time, the impact of an international footprint on the corporate banking segment’s profitability is not uniform across banks. For the largest players, it can provide a way to create scale/amortize fixed costs across countries, and it allows them to differentiate themselves relative to the local competition. But along with this capability comes additional complexities of operating in different jurisdictions/languages and higher coordination costs. For smaller single-country domestic banks, an international presence can often represent a drag on profitability, as banks move from providing international services to their home country clients to stumbling into local business in international markets as a sub scale provider with limited expertise.

The question for the optimal international model has resurfaced as one of the key business model choices for banks. The moves under considerations depend as much on a bank’s starting point as on their ambition and overarching strategy. Using international expansion to drive growth has been out of fashion for many banks in mature markets, which instead try to focus on, and consolidate, a specific footprint. For banks in developing markets, on the other hand, international expansion is often a key element of their growth strategy.

Beyond growth considerations, an international footprint has clear implications for the client franchise value of a bank. As more and more corporate clients demand international connectivity and services, the ability of banks to satisfy these requirements can become a differentiating factor for corporates when selecting their bank.

Hence, when designing their international strategy and structure, banks need to consider an efficient combination across the following five dimensions to ensure they achieve their goals:

- **Clients**: Banks need to create a meaningful scale in their cross-border client activities (inbound/outbound customers are in most cases not sufficient) to achieve above-hurdle profitability, while avoiding excessive unknown local risks.

- **Products**: Banks need to focus on a clear product set which leverages international scale for cross-border product platforms (e.g. in trade, but also cash management portals, etc.).

- **Locations**: Granular trade corridor analyses, combined with matching of product skills/local product needs, are replacing country-by-country level logic in prioritizing areas of presence and investment.
• **Format of presence**: Best practice banks search balance sheet light propositions in countries and balance lighter fly-in models or partnerships with single or multiple branch presences. As branches attract more scrutiny from local regulators and are treated increasingly in a similar fashion to subsidiaries, the costs of fulfilling local liquidity, capital and funding requirements, as well as the decreasing cross-border mobility of these resources, add to the costs of a traditional branch model.

• **Viability of the correspondence banking network**: As part of reviewing the FIG (financial institutions) strategy most of the largest banks have significantly cut their correspondent banking relationships; smaller banks therefore need to carefully investigate to what extent they can rely on other banks acting as service providers in other geographies and what service levels they can realistically expect.

Efficiently combining an integrated strategy across these five dimensions is the key performance driver for best performing corporate banks with their international operations.

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Exhibit 14: Trade and financial corridors

1. Payments excludes Argentina,
2. Payments excludes New Zealand
3. Payments excludes Japan, Hong Kong

Sources: Trade of goods, export volumes (source: ITC/TradeMap); Payments refer to total value of payment transactions by non-banks (source: BIS); FDI refers to stock of investment (source: UNCTAD); Oliver Wyman analysis
THE MANAGEMENT JOURNEY

While its relative attractiveness has already increased since the global financial crisis, corporate banking has an opportunity to take center stage as an engine of stable economic bank performance. Our analysis shows that even in economically disadvantaged locations it is possible to produce a solid, double digit return by being excellent – at least while provision levels remain low. In addition, being excellent is the best chance banks have to maintain their competitive advantages in the value chain.

However, becoming excellent is by no means a simple or trivial matter. The management bandwidth, investment budgets and focused implementation capacities required are substantial, and in our experience, the ambition to work on these drivers of excellence is often lost or pushed aside by other seemingly urgent and important topics.

In order to create enough activation energy to start the process of becoming excellent, corporate banks must go through a three step process. While the concept behind the process may be simple, executing it is transformative:

• **Understand your starting position.** Understand the size of any gaps across all dimensions of excellence relative to your peers and observe best practices.

• **Formulate an ambitious yet realistic change agenda.** Ensure executive bandwidth and balance operational quick wins with more tactical and strategic moves, and invest in the areas of future strategic differentiation. Prioritization and conscious decisions will be key.

• **Make change stick with the bank and the clients.** To make change stick, banks will need to set up an integrated program that transforms the organization and evolves client relationships by convincing them of the value of change. Too often we see clients’ acceptance of change is only an afterthought, rather than being central, and the reluctance of clients to embrace change is underestimated.

In a recent project for a leading regional bank, we assisted a corporate bank to overhaul their coverage function and synchronize their overall operating model with the new strategy: we have introduced a sector based coverage approach, upgraded relationship management practices from account planning to developing integrated solutions and redesigned the management framework around this. In total, the transformation touched more than 30,000 people and took three years. Our key learnings from this work were that it is imperative to have a fully integrated perspective which includes the clients, the employees and the broader bank and that short term wins need to be in focus while the long term platform is being built. Small steps in various pilots allowed the organization to learn how to transform itself and achieve a lasting impact.
Whether corporate banks will remain relevant and avoid disruption lies largely in their own hands. Delivering excellence should shape the management agenda and be the strategic guideline for corporate banking businesses around the world.

### Exhibit 15: Change agenda for building corporate banking excellence

<table>
<thead>
<tr>
<th>DRIVER</th>
<th>SHORT-TERM REQUIREMENT/QUICK WIN</th>
<th>LONG-TERM STRATEGIC PRIORITIES</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Client selection</td>
<td>• Establish post-regulation client value transparency</td>
<td>• Review niche strategies</td>
</tr>
<tr>
<td></td>
<td>• Implement forward looking risk assessment tools</td>
<td>• Foster cultural change/skill building to establish top performing RM population</td>
</tr>
<tr>
<td></td>
<td>• Build predictive analytics of client development (balance sheet, buying behavior etc.)</td>
<td></td>
</tr>
<tr>
<td>2. Pricing</td>
<td>• Identify and stop revenue leakage</td>
<td>• Set up change program to evolutionize RM pricing behavior</td>
</tr>
<tr>
<td></td>
<td>• Rationalize use of shortfall in lending</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Upgrade and simplify pricing tools and processes</td>
<td></td>
</tr>
<tr>
<td>3. Automation and service industrialization</td>
<td>• Optimize client onboarding process</td>
<td>• Design and build a suite of value added data based services</td>
</tr>
<tr>
<td></td>
<td>• Differentiate service approach by relevant client segment</td>
<td></td>
</tr>
<tr>
<td>4. Resource efficiency</td>
<td>• Build “management cock pit” to understand current and planned resource requirements</td>
<td>• Review distribution model, including origination process, product structuring and mechanisms for efficient collaboration</td>
</tr>
<tr>
<td>5. Product platforms</td>
<td>• Introduce fully loaded product profitability transparency</td>
<td>• Make-or-buy decisions for transaction banking services</td>
</tr>
<tr>
<td></td>
<td>• Build integrated debt/DCM offering capabilities</td>
<td>• Make-or-buy decisions for FICC trading platforms</td>
</tr>
<tr>
<td>6. Strategic funding</td>
<td>• Improve deposit pricing and management based on behavioral insights and facts</td>
<td>• Analyze options for ring fencing responses for different scenarios</td>
</tr>
<tr>
<td>7. International presence</td>
<td>• Assess profitability and value add of current footprint including evaluation of complexities</td>
<td>• Make focussed participation choices balancing growth, franchise value and complexity</td>
</tr>
<tr>
<td></td>
<td>• Use trade corridor analysis to prioritize international growth opportunities</td>
<td></td>
</tr>
</tbody>
</table>
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