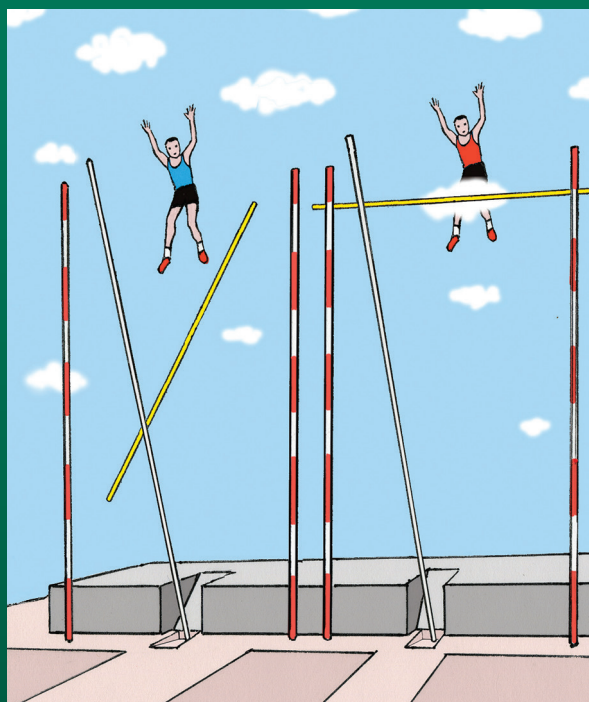


GLOBAL CORPORATE BANKING 2015

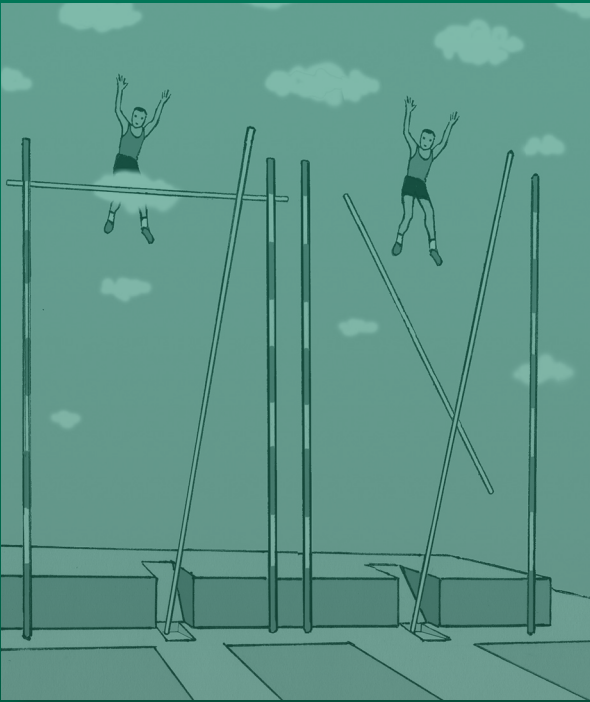
THE LOOK OF A WINNER



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GLOBAL CORPORATE BANKING 2015

THE LOOK OF A WINNER

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INTRODUCTION

TOP-PERFORMING CORPORATE BANKING DIVISIONS are profit engines for the banks that own them. The Boston Consulting Group's benchmarking database includes examples of corporate banking divisions with positive and growing economic profit, operating in every region and serving every client segment from small businesses to large corporations. Performing well in this domain is critical, given that corporate banking accounts for roughly half of the banking industry's global revenue pool and will grow by an estimated 7 to 8 percent annually through 2020.

Banks that miss out on this growth, or that underperform in such a large part of the banking business, will find it difficult to achieve their objectives in terms of market share and profitability. Yet the fact remains that more than half of the corporate banking divisions in BCG's most recent benchmarking study are suffering from declining economic profit—and the gap between the top and bottom players has grown by 50 percent.

Can underachieving corporate banks right their ships? In our view, they can, but changing their performance trajectory is an increasingly tall order. Long a relatively stable business, corporate banking is currently being transformed by a wave of disruptive megatrends. Although the 2007–2008 financial crisis was a major fault line that put many players on the precipice, crisis-era market gyrations camouflaged other, more far-reaching trends that have undermined traditional business models in corporate banking. Dynamics such as the impact of new regulation, shifting client needs, digitization, disintermediation, and globalization will continue to disrupt even as the crisis recedes into history.

It is also possible that we will witness the demise of the traditional multiproduct corporate banking model. Some regulators and politicians seem to be pushing for a simple “utility” model for basic lending, cash-management, and risk-management services. This model would presumably be supplemented by less-regulated shadow-banking entities that provide more complex services.

While it would be premature to write the obituary for corporate banking as we know it, today's players must markedly change how they do business if they hope to thrive in the future. The increasing divergence between the top and bottom performers shows that players adapting to the new environment can create significant value. Those that fail to adapt their business models run the risk of suffering prolonged, painful periods of underperformance.

On the basis of our work with leading players in every region and client segment, we see a number of critical moves in corporate banking. The first starts with a clear-eyed review of the current portfolio of client segments, products, and regions served. Banks no longer have the luxury of being all things to all clients in all places. Then there is a set of initiatives to undertake. These include identifying new value propositions for clients, improving specialization and differentiation, building new credit capabilities that are better suited to the postcrisis environment, and investing in value-based pricing initiatives. Finally, there is a set of enablers that banks should focus on from front to back. These include digital prowess, operating excellence, and a high-performance organization.

To be sure, most corporate banks have already spent significant time and resources trying to improve their performance along such lines. But results have often been disappointing. Relatively few top players are driving focused and well-resourced programs that steadily build competitive advantage.

Ultimately, the winning corporate banking divisions in 2020 will internalize elements such as the above and will be even bigger economic-profit engines for the banks that own them. But the time to act is now.

THE RECENT PERFORMANCE OF CORPORATE BANKS

SINCE THE START OF the 2007–2008 financial crisis, it has been a struggle to create value in corporate banking in many markets around the world. The 2014 edition of BCG’s Corporate Banking Performance benchmarking effort, with more than 250 participating corporate banking divisions serving small businesses, midmarket companies, and large corporations, showed that two-thirds of corporate banking divisions had returns on capital below the hurdle rate. (BCG’s methodology uses a 16 percent pretax hurdle rate, and assumes that regulatory capital is 10.5 percent of risk-weighted assets.)

The challenge was particularly severe in Western Europe as well as in Central and Eastern Europe, with median pretax returns below 10 percent in both regions. But even in relatively fast-growing markets such as Latin America and Asia-Pacific, a significant number of players are battling against increasingly competitive margins, too much reliance on lending products, and rising loan losses.

Our 2014 benchmarking also found that more than half of corporate banking divisions worldwide showed declining economic profit over the previous three years. (See Exhibit 1.) North American banks stand out for above-average performance in terms of return on capital, but even their returns are trending downward as postcrisis competition intensifies. Western Europe, despite turnaround

initiatives at many banks, has a large number of players—some 65 percent—with negative and declining economic profit. More than half of Latin American players show declining economic profit.

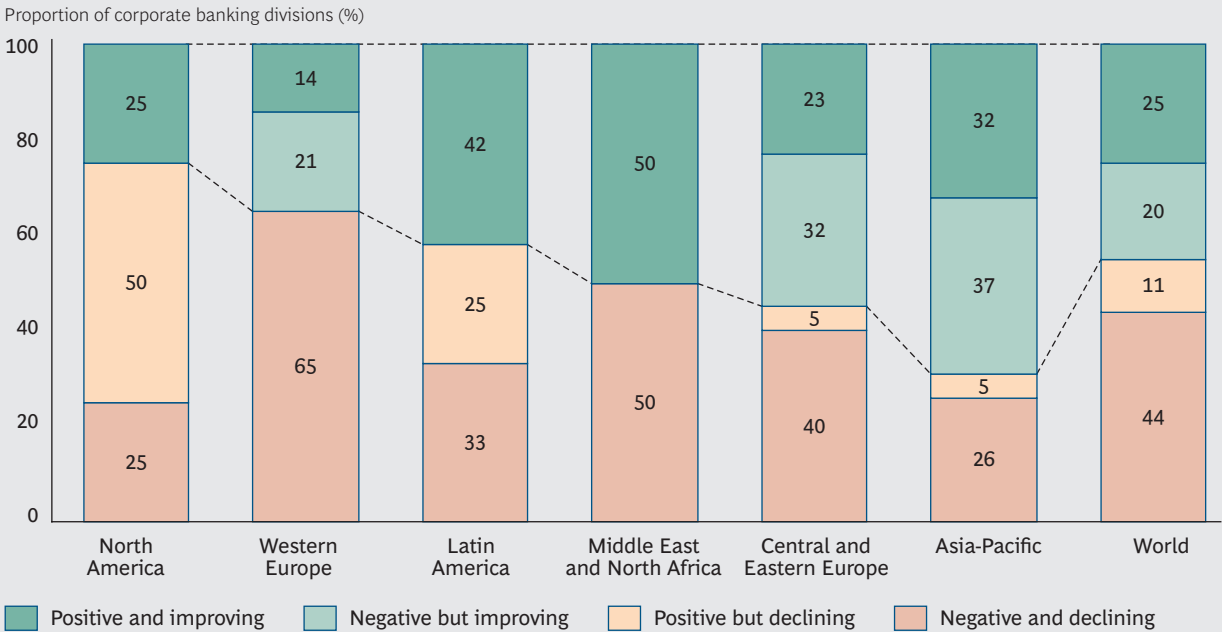
Two-thirds of corporate banking divisions have returns on capital below the hurdle rate.

The situation appears to be the reverse in Central and Eastern Europe, where more than half of corporate banking divisions show rising economic profit. Yet many started the period with severe profitability crises because of local macroeconomic factors and severe loan losses. In Asia-Pacific, about 70 percent of local players are on upward economic-profit trajectories.

It is also worth noting that, in most regions, the gap between the top and bottom players has widened in recent years. (See Exhibit 2.) In our 2007 study, for example, there was a 14-percentage-point gap in return on regulatory capital between the top-quartile and bottom-quartile players. In our 2014 study, this gap had increased to 21 percentage points and had widened in all regions except North America. Such divergence underlines a key

EXHIBIT 1 | The Trend in Corporate Banking Is Toward Lower Economic Profit, Although Some Players Are Bucking It

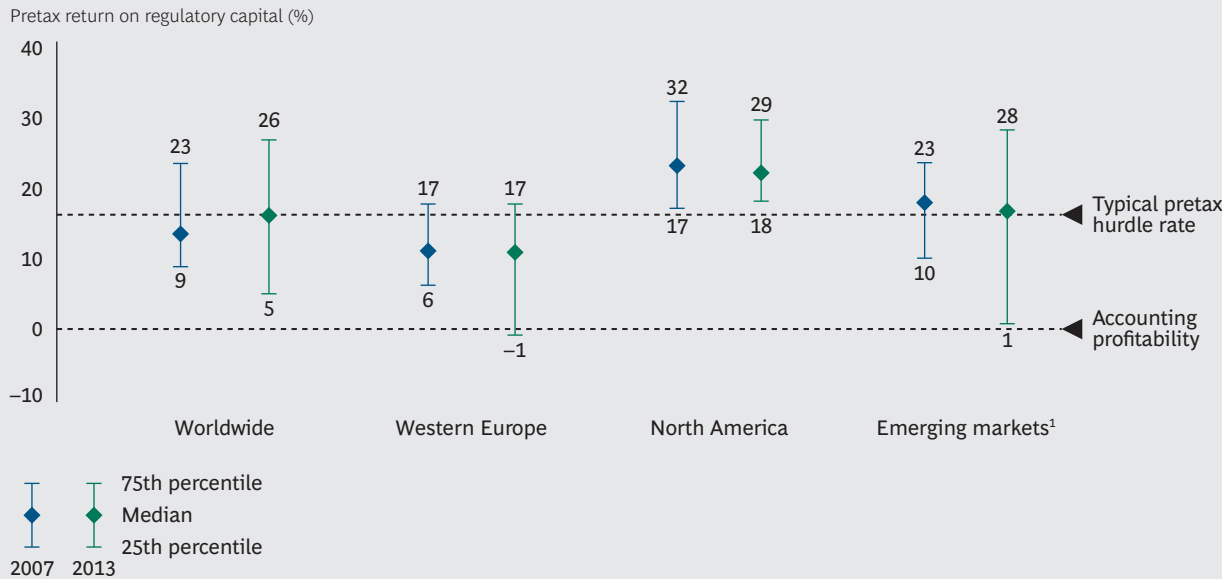
Three-year economic profit trends of corporate banking divisions globally, 2013



Sources: BCG Corporate Banking Performance Benchmarking database, 2014; BCG analysis.
Note: Economic profit is calculated on the basis of regulatory capital (assumed equal to 10.5 percent of risk-weighted assets), the lower of actual or expected loan losses, and a pretax capital hurdle rate of 16 percent. Includes corporate banking divisions serving small, midmarket, and large corporate clients.

EXHIBIT 2 | The Performance Gap Between Top and Bottom Players Has Widened in Most Regions

Profitability for corporate banking divisions globally, 2007 and 2013



Sources: BCG Corporate Banking Performance Benchmarking database, 2008 and 2014; BCG analysis.
Note: The typical pretax capital hurdle rate is 16 percent. Regulatory capital is 8 percent of risk-weighted assets in 2007 and 10.5 percent of risk-weighted assets in 2013. Includes corporate banking divisions serving small, midmarket, and large corporate clients. The sample size is not the same in each year.
¹Includes Central and Eastern Europe, Latin America, the Middle East and Africa, and developing Asia-Pacific.

point: corporate banks with the right business model can create value in all segments and regions, despite local or segment-specific challenges. Even in Western Europe, which is one of the most difficult environments, top-quartile players consistently exceed typical hurdle rates.

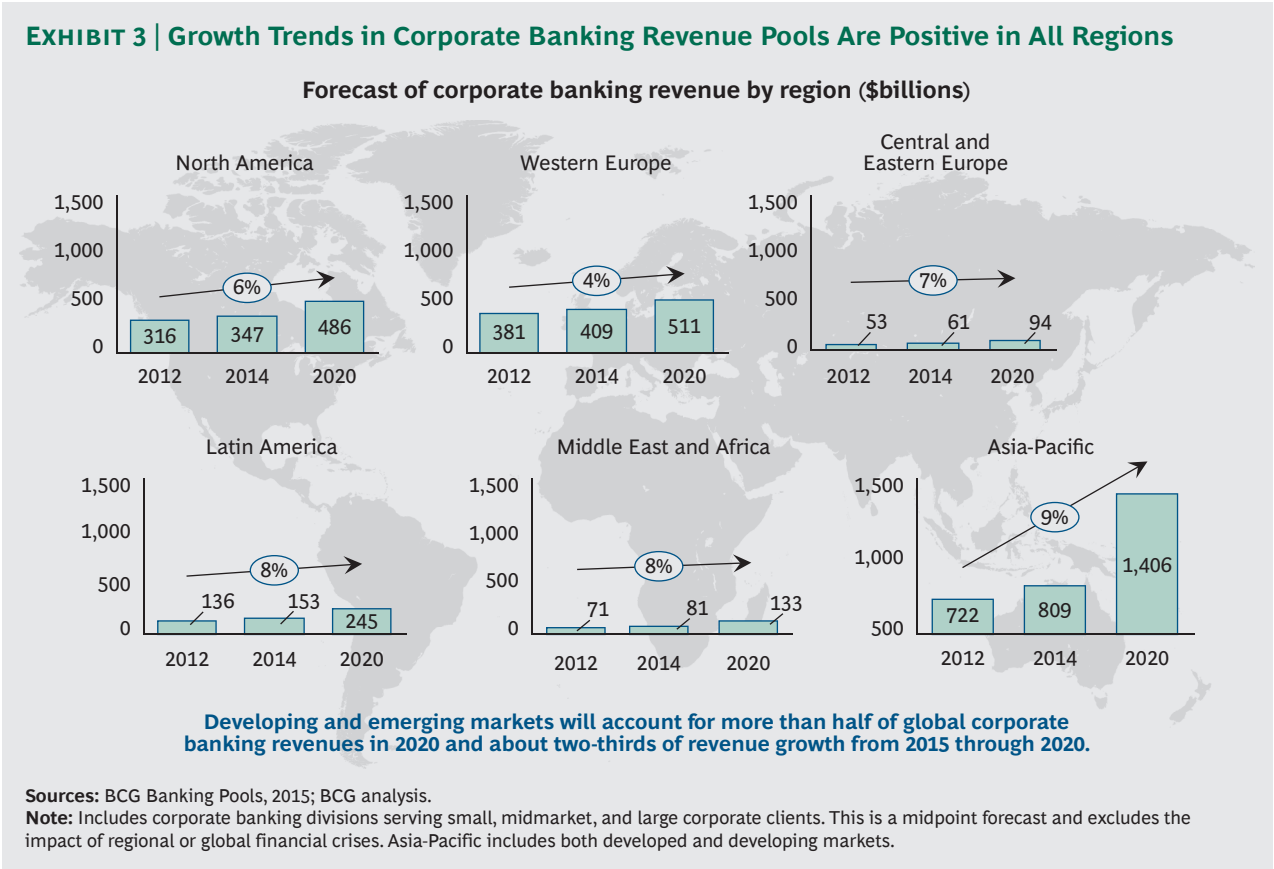
While corporate banking has experienced some challenges in many places, it remains more attractive than many other lines of business for the typical universal bank. But a critical question remains: where are the greatest prospects for growth?

The first point to be made—and a crucial one for senior executives wondering where to invest their resources—is that corporate banking represents one of the largest available revenue pools. BCG’s global financial institutions revenue-pool model projects that roughly half of the global banking market consists of financial services purchased by small, midmarket, and large businesses. In many developing and emerging markets, where retail banking (including mortgages) and capital markets businesses are still rela-

tively young, corporate banking is a particularly strong sector. Indeed, more than 40 percent of total global corporate banking revenues currently originate in developing and emerging markets. Moreover, BCG projects positive growth trends in corporate banking revenue pools in all regions through 2020. (See Exhibit 3.) While this forecast could be derailed by unexpected economic or geopolitical events, the growth outlook appears generally strong even in mature markets.

Given the higher growth rates projected for Asia-Pacific, Latin America, and the Middle East and Africa region, about two-thirds of total corporate banking revenue growth through 2020 will stem from developing and emerging nations.

While these global forecasts will be of interest to multinational banks and emerging challengers from developing economies, many corporate banks have refocused their regional footprints. This refocusing has been a good thing for most, allowing them to escape the value destruction caused by multi-



ple layers of regulation, subscale operating costs, and undifferentiated value propositions in foreign countries. To find growth pockets in their core markets, these players will have to drill deeper into their revenue pools.

We have found that leading corporate banks are increasing their focus on revenue-pool and customer-wallet analytics. This exercise can be illuminating, as our project experience shows—especially with the use of industry, segment, and product lenses:

- *Industry Lens.* In the United States, for example, the corporate banking wallet of the health care sector is four times larger than that of the media and film sector, and is growing twice as fast.
- *Segment Lens.* Exports by small and midmarket enterprises as a share of total

exports are expected to increase by more than 10 percentage points in both India and China through 2020, according to a BCG study on international trade flows.

- *Product Lens.* Specialized lending products (including asset-based lending and equipment finance) have grown faster than traditional corporate lending in many markets over the last decade, and we expect this trend to continue through 2020.

Capturing these growth opportunities will not be easy, however, given both tough competition and some fundamental disruptions hitting the industry.

FIVE TRENDS DISRUPTING THE CORPORATE BANKING LANDSCAPE

ALTHOUGH THE GLOBAL FINANCIAL crisis had a fundamental impact on the banking industry, the macroeconomic “noise” it generated helped conceal some fundamental forces that are still reshaping business models in corporate banking.

BCG has identified five of the most important dynamics: tighter regulation, shifting client needs, the digital revolution, disintermediation, and globalization.

Regulatory costs are undermining attractive businesses.

Tighter Regulation. Corporate bankers have been working steadily on compliance with Basel III and other new waves of regulation, including anti-money-laundering and anti-terrorist-financing measures. We are also seeing “know your client” initiatives, sanctions monitoring, and, in some countries, new requirements concerning business conduct and fair treatment of clients.

In the long run, new regulations may affect the corporate banking business even more than anticipated. While crisis-era margin increases are eroding, additional compliance costs are large and here to stay. Basel III capital and liquidity mandates are fundamentally

changing the economics of some core corporate banking products and customer segments. Our recent case work has revealed how regulatory costs are undermining previously attractive businesses, such as the following:

- Core corporate lending products such as medium- and long-term loans (as well as construction loans), which are major burdens on funding resources
- Public-sector banking in many countries, which is heavily affected by liquidity and funding measures
- Risk management products offered by Tier 2 banks, which have been hit hard by new risk-weighted asset, liquidity, and capital requirements as well as by rising operating costs

BCG believes that the industry has only partly adjusted to the new regulatory landscape. Indeed, few banks have figured out how to optimally manage new regulatory cost pressures. And only a few players have matched industry leaders in their ability to select clients and manage portfolios in an analytically robust way through the multiple lenses of risk, capital, funding, and liquidity.

Shifting Client Needs. Corporate bankers have often invested less time in fundamental customer research than have their colleagues

in retail banking. This trend is changing, however, as corporate clients increasingly demand solutions for specific needs. Examples include the following:

- *Customized Advice.* BCG's interviews with corporate clients show that these companies are increasingly looking for highly customized advice from their bankers as well as support in navigating through complex financial challenges, rather than simply seeking an institution from which to buy standard products.
- *End-to-End Solutions.* Corporate clients increasingly want solutions that help them run their businesses more efficiently, more effectively, and with lower risk. Financial supply-chain platforms such as Bolero and GT Nexus offer an integrated approach to managing purchase orders, transportation documents, invoices, payments, and working-capital financing.
- *Industry-Specific Solutions.* While some large corporate clients have enjoyed industry-specialized solutions for years, midmarket and even smaller clients are looking for products that suit their industry's payment cycles, balance-sheet structures, and risk profiles. The CFO of one U.S. health care company described how its bank's treasury-management offering—designed specifically for the health care industry—allowed the company to identify low-value activities, which in turn enabled the CFO to cut costs and reduce errors. The bank also developed a mobile-payments application that allowed the company to collect patient copayments more efficiently.
- *Faster and Simpler Solutions.* Corporate customers have usually invested internally in simplifying their own business processes—and they expect their banks to keep up. One U.S. corporate bank invested heavily in detailed end-user research to make sure its payments and cash-management workflow solutions made life simpler and easier for clients. This initiative has allowed the bank to attract and retain new clients and to generate valuable fee revenues.

The Digital Revolution. While some corporate banks have established leading positions in digital technology, many others have underinvested. And customers have taken notice, especially because they have been digitally transforming their own businesses and using the latest Web services in their personal lives. Client preferences about interacting with their corporate banks are changing rapidly, with fast-growing expectations of fully integrated solutions, lean processes, and 24/7 access via the Web and mobile devices. Clients are also expecting more than just the digitization of traditional corporate banking products. They want new, value-adding solutions. In a recent BCG survey of corporate clients, more than 70 percent indicated that digital capabilities were an important factor in assessing a corporate bank.

Meanwhile, other players have noticed the digital opportunity in corporate banking. Venture capitalists, large Internet companies, and others are backing a rapidly growing set of startups that can compete with corporate banks. Examples include payments and financial-supply-chain solutions (Square; Tungsten), financing (Google-backed OnDeck Capital; Amazon), and foreign exchange (OzForex).

Big data is also a key element of the digital revolution in corporate banking because many players gather vast troves of client data—especially via payments systems—yet often fail to leverage it. Our project work shows that bank relationship managers (RMs) can be much more productive if wallet-sizing analytical engines are used to identify the next product that will most likely be needed by each client in an RM's portfolio, on the basis of the behavior of similar companies. In addition, there are opportunities to share value-adding big-data analysis from bank datasets such as benchmarks on supplier or customer payment behavior. Predictive risk models driven by cash management data can identify new, low-risk lending opportunities that allow RMs to engage the client with proactive offers of tailored financing—and at the same time reduce the bank's credit losses and administrative costs.

Disintermediation. Not only is the digital wave spawning new rivals that are positioning themselves between traditional corporate

banks and their clients, but other competitors such as shadow banks and debt-capital-markets providers are also cutting incumbent corporate banks out of the picture by connecting borrowers directly with other sources of finance. A BCG study on shadow banking suggested that roughly 25 percent of U.S. middle market lending is now being provided by various shadow banking players.

Globalization. Despite being on trend lists for many years, globalization continues to drive major changes in corporate banking. More midmarket companies are becoming active in international supply chains, and their corporate banking needs are evolving in step. New trade corridors are emerging (such as from Brazil to China) that are not aligned with the networks of traditional corporate banks. Emerging challengers in industries from aerospace to agribusiness are stepping out of

their home markets to become the next generation of multinationals. Except for a few emerging challengers of its own, the banking industry seems to be going in the opposite direction. Under pressure from regulators and also in response to crisis-era losses, many banks are retrenching with regard to their international business footprints. Since their clients are at the same time becoming more active outside their own home markets, there is a new risk that clients will forge relationships with other providers that can serve their international needs.

We believe that the disruptive trends described here could badly damage corporate banks that do not adapt, while creating opportunities for those that do. (See the sidebar “Ignoring Current Trends Can Be Risky.”) These trends are already driving the growing divergence between top and bottom players.

IGNORING CURRENT TRENDS CAN BE RISKY

In order to estimate the effects of action versus inaction with regard to current market dynamics, we looked at typical performance metrics from our European benchmarking analysis and did some hypothetical scenario analysis. Let’s assume that Bank A and Bank B are identical at the beginning of the scenario. But Bank A does not believe that current trends call for major action, while Bank B does. How would the banks’ performance differ if just two or three disruptive factors affected them over the next several years? Let’s choose three trends:

- *Tighter Regulation.* By not actively steering its sales force and clients into capital- and liquidity-light products, Bank A could end up with a higher mix of capital- and liquidity-heavy clients, leading to lower overall profitability than its peers.
- *Shifting Client Needs.* By not investing in client-friendly solutions, Bank A’s win rate on competitive proposals for quality clients could slowly begin to decline.

- *The Digital Revolution.* By offering a mediocre digital-payments and cash-management platform, Bank A could end up slowly losing sophisticated (and deposit- and fee-generating) clients to competitors.

Suppose that Bank B gains 0.5 clients per RM per year and increases the cross-selling of nonlending products from all clients by 2 percent per year, while Bank A’s business erodes to an equal degree. After three years, the difference in pretax return on regulatory capital would widen to 4 percentage points. In other scenarios, including more aggressive, digitally enabled cost-cutting by Bank B, or improved risk management due to big-data predictive risk management, the gap would be even wider. A key point is that the impact on Bank A in these scenarios is not one of sudden catastrophe. Instead, the bank would likely witness a slow erosion of its franchise and suffer sustained lower growth and profitability than its competitors. Over the medium term, through 2020, Bank A would see a dramatic impact on its position in the market and on its economic profit potential.

WHAT THE WINNING CORPORATE BANK WILL LOOK LIKE IN 2020

WE HAVE IDENTIFIED EIGHT actions that winning corporate banks will need to embrace in the coming years in order to adapt to disruptive trends. (See Exhibit 4.) These actions include rethinking the corporate bank’s portfolio strategy, igniting a set of “business engines” to drive growth through 2020, and developing some key enablers.

Adopt a rigorous portfolio strategy. The first and most strategic initiative is a rigorous review of the corporate bank’s portfolio. There is often considerable variation in an institution’s performance in different segments, ranging from small businesses to large corporations, as well as in different product areas and regions of operation. Responding



to disruptive trends takes resources—and not just balance-sheet resources such as capital, funding, and risk capability, but also operating resources such as people, IT investment, and senior management capacity. Every bank has a unique starting point, and rare is the institution that can afford to invest simultaneously in every segment, product, and region. Furthermore, the relative attractiveness of each area will differ.

Top corporate banks are increasingly driving industry specialization.

To prepare for the future, corporate banks need to start with a pure strategic review, asking questions such as the following:

- Which clients are the most attractive from the perspectives of growth, product mix, and profitability (including liquidity, risk, and capital appetites)? How do the differences play out by client size? By industry? By some other dimension?
- Which products are the most attractive in light of Basel III, and which ones can the bank build to create competitive advantage?
- Which domestic and international regions are ultimately the most attractive, and what is required to win in each?

The answers to these questions will provide a strategic road map that will help the bank prioritize its investments and decide which clients, products, and regions it needs to pare back or exit. Early decisions about what *not* to focus on can release additional resources for investing in priority areas.

Enhance industry specialization. As mentioned above, top corporate banks are increasingly driving industry specialization, ranging from large corporations down to midmarket and even small-business clients. They use structured assessments to identify priority industries, examining fundamentals

such as size, growth, product mix, and risk, as well as the ability of the bank to build and deploy a product and service offering that is competitively advantaged. Such players also carefully think about which model of industry specialization is appropriate. These models include the following:

- No specialization, for the part of the client portfolio that remains “generalist” because of undifferentiated needs or a lack of sufficient attractiveness for a specialist offer
- Light specialization, where RMs may focus particularly on one or two industries but remain part of the generalist sales force
- Full specialization for a few targeted industry verticals, including dedicated RMs, risk officers, and, potentially, product development teams within a standalone organization

In planning the right path forward, it is critical to determine exactly how industry specialization provides an advantage to the bank versus its competitors. Do dedicated RMs understand client financial needs better—and tailor solutions that clients prefer? Are a certain industry’s risk characteristics unique, so that teams of specialized RMs and risk officers can make better decisions and offer better risk-based pricing? Are there functional product needs, perhaps related to payments and cash-management products and the industry’s payment cycles, that allow the bank to differentiate itself? Can industry-specialized transaction-banking solutions attract and lock in clients, generating capital-light fee revenues, deposits, and transaction data for improved risk management and pricing?

Essentially, industry RMs must be able to realize more revenue through client acquisition, cross-selling, and pricing in order to more than offset the additional cost and complexity that specialized industry models sometimes involve. BCG has observed successful industry specialization models even in small corporate banks. Indeed, in the U.S., there are a number of modest-sized players that have managed to differentiate themselves through focused offerings for industries such as ener-

gy, entertainment, health care, and professional services.

Develop new client solutions. Traditionally, competing corporate banks have provided relatively undifferentiated product offerings. This practice is now changing, thanks to a number of converging trends:

- Growing industry specialization (as already discussed)
- The pursuit of clients previously viewed as unattractive for cost or risk reasons, and the development of lower-cost digital platforms and products such as asset-based lending, equipment finance, or franchise lending that allow banks to serve such clients at an acceptable risk level
- Rising client demand for convenient, end-to-end solutions such as financial supply-chain services that integrate procurement, payment, and financing activities
- The emergence of new digital platforms that enable both banks and nonbank competitors to offer new services or combine traditional banking products with third-party services

Most corporate banks still need to do more to adapt to Basel III dynamics.

New client solutions can be very powerful. On the transaction banking side, for example, specialized health-care offerings have helped clients better manage complex revenue cycles and reduce administrative costs. Although national medical systems vary widely, there are always patients, doctors, hospitals, insurance providers, and other players that must exchange not only invoices and payments but also confidential information about treatments and payment plans. Banks that can build effective platforms and attract a critical mass of industry players become valuable

partners for clients, and make it difficult for banks with undifferentiated platforms to win these clients back.

The situation is similar in lending. One major European bank developed a program that helped serve a large retailer's entire value chain, from supplier to franchisee. The key was a packaged product for franchisees that included working capital, leasing, cash management, and point-of-sale solutions. This offering enabled the bank to better understand its clients, deepen its client relationships, and manage risk through access to sales data from franchisees.

Build new credit capabilities. Despite crisis-era moves to adjust pricing and reduce low-productivity risk-weighted assets, most corporate banks still need to do more to adapt to Basel III and other corporate banking dynamics. The requirements include the following:

- Completely integrate Basel III into target setting, tools, and performance management from the executive level to the front line. The sales force must steer clients into products with sound economics, including the full cost of risk, liquidity, and capital charges. Despite recent efforts, many corporate banks have not fully incorporated the impact of Basel III into their business models and remain overly focused on traditional corporate lending volumes.
- Develop capabilities to deliver new capital-light financing solutions to clients, either through specialty lending products such as asset-based lending or more complex solutions involving areas such as debt capital markets.
- Create origination-to-distribution models that allow assets to be passed on to funding partners such as insurance companies and pension funds, enabling the corporate bank to rotate its balance sheet more quickly and generate additional fee revenues.

This last opportunity in particular requires that the corporate bank deepen its under-

standing of the kind of assets that its funding partners are looking for. European insurers, for example, have a strong interest in diversifying their investment mix to include more corporate assets. But they often lack the origination and credit-risk capabilities that are part of the corporate banking model. Building this business requires breaking down organizational silos between corporate lending and capital markets teams, reviewing revenue-sharing practices, updating credit portfolio management activities, and ensuring that the funds-transfer pricing system is sophisticated enough to support these activities.

Drive value-based pricing. Relationship managers often assume that they must offer discounts in order to win business, so actual pricing is often much lower than bank guidelines. On average, we see 30 to 40 percent discounting across products, with wide disparities in price realization per client. Such discounts can rarely be explained by rational criteria. Indeed, expected drivers such as client volumes, relationship size, number of products bought, or new-versus-renewal business *combined* typically explain less than 7 percent of the price variation. This circumstance holds true both for transaction banking and lending products, taking into account the differences in risk ratings across clients.

In light of this situation, pricing can give corporate banks an immediate and much-needed performance lift. Our experience suggests that the opportunity can often reach 10 percent or more of total revenue, with two-thirds of the increase obtainable within 12 months. Superior pricing capabilities also help steer both the bank and its clients toward a product mix that better reflects risk, capital, and liquidity characteristics, and forces banks to pay closer attention to the quality of their underlying client data. For example, the liquidity coverage ratio, net stable funding ratio, and capital and leverage ratios all have a significant impact on the relative attractiveness of different products. Most banks, however, have not fully reflected this impact in their pricing guidelines and funds-transfer pricing. Moreover, pricing in corporate banking often suffers from bank cultures that place a higher value on closing the deal than on optimized pricing performance.

To support better pricing decisions, banks should move from “pricing as an art,” driven by RM perceptions of required discounts, toward “pricing as a science,” where the RM is equipped with analytical tools that provide client-specific guidance on pricing. One North American bank, for example, built a detailed pricing algorithm into an RM tool to give pricing guidance based on specific client situations. If the RM wanted to deviate from the guidelines, the approval process was automated into the workflow, and specific tools made the impact of different price points on the RM’s incentives fully transparent.

Improve the digital model and big-data capabilities. Digital technology is already fundamentally changing how corporate banks do business along the entire value chain. It has had a significant impact on new ways to do many things: acquire clients, develop and sell products, manage pricing, integrate across channels, manage risk, and streamline internal and client-facing processes.

We see 30 to 40 percent discounting, with wide disparities in price realization.

Of course, some corporate banks have moved much faster than others on digital technology, which is both an enabler of other initiatives and a business opportunity in its own right. While some banks are simply moving traditional products online, digital leaders in corporate banking think about the technology differently. Taking the client perspective, they look to produce a steady stream of value-adding services and applications that clients will embed in their own business processes. Such banks are offering their customers new services that help them manage their working capital, reduce administrative costs, and manage risk better.

The change agenda is daunting, yet corporate banks must move quickly. Nimble nonbank competitors, often backed by leading venture investors or top Internet companies, are innovating rapidly. Examples in payments include

PayPal, Square, and Alibaba. In digital financing, big-data players such as OnDeck Capital and Kabbage, and even nonbank players such as Amazon, are competing. Product-specific monolines such as OzForex are proliferating. And companies like Ariba and PrimeRevenue are creating new end-to-end digital solutions in spaces such as financial supply chains.

Too many digital strategies are little more than hodgepodge approaches.

A deeper look can show just how new entrants are trying to compete against traditional corporate banks on both the functional value proposition and the customer experience. For example, we spoke with a U.S. Internet merchant who does business on Amazon's marketplace. He received a pre-approved loan offer from Amazon, and found that the lending process was much quicker and simpler than dealing with his bank. (He also noticed that Amazon had a significantly higher loan margin.)

Ariba, for its part, offers an end-to-end digital solution for business-to-business buying and selling. It has more than 1.6 million companies signed up and more than \$600 billion in annual transactions. It offers a wide array of services, including supplier management for buyers and invoice management for sellers, as well as payment and cash management services.

Meanwhile, some traditional competitors are moving forward aggressively. One well-known bank, for example, has been expanding the capabilities of its treasury-management portal for more than a decade and now offers dozens of online services, many of which its competitors offer either offline or not at all. Its number of portal users has increased dramatically and its corporate banking division now generates about twice as much transaction-banking fee revenue as our benchmark average. Slower-moving banks face an uphill battle against such competitors.

Ultimately, too many corporate banks have digital strategies that are little more than hodgepodge collections of minor Web initiatives and are unlikely to move the needle. To be well positioned in 2020, corporate banks need to take a step back and develop a robust digital strategy starting from the client's perspective, clearly defining how they can use digital technology to improve the client value proposition, reduce costs, and improve risk management. Banks may have to consider initiatives that could possibly cannibalize existing revenues, such as direct channels for small and midmarket clients.

Pursue operating excellence. In a recent BCG survey of corporate banking executives, 100 percent of the respondents agreed that operating excellence (OE) is a "critical" competitive lever. Yet less than half said that their corporate bank had a well-defined OE vision, and only a third thought that their bank was doing a good job defining and tracking OE metrics.

BCG's latest corporate banking OE benchmarking analysis, which involved a deep, end-to-end review of corporate banking divisions around the world, revealed that even top corporate banks struggle to track and report their performance on key OE topics. In fact, the OE gaps are often in the areas that are most important to client satisfaction and sales force productivity—such as turnaround times on loans, account opening times, or the split of RM time between selling and internal administrative activities. Furthermore, our benchmarking revealed that even top performers have many gaps in key dimensions.

Such findings underscore the fact that the "industrialization" of key business processes is less advanced in corporate banking than in many other industries. This trend is changing, however, as corporate banks come under increasing pressure to simultaneously cut costs, improve client service, and release their sales forces from paperwork burdens. Indeed, the pressure on sales forces has never been more intense. (See the sidebar "Why Sales Force Effectiveness Is More Critical Than Ever.")

WHY SALES FORCE EFFECTIVENESS IS MORE CRITICAL THAN EVER

Sales force effectiveness is an “evergreen” topic in corporate banking, one that has been the objective of many improvement initiatives over the years. Yet each of our benchmarking studies over the past decade shows high variation in sales force performance among competitors.

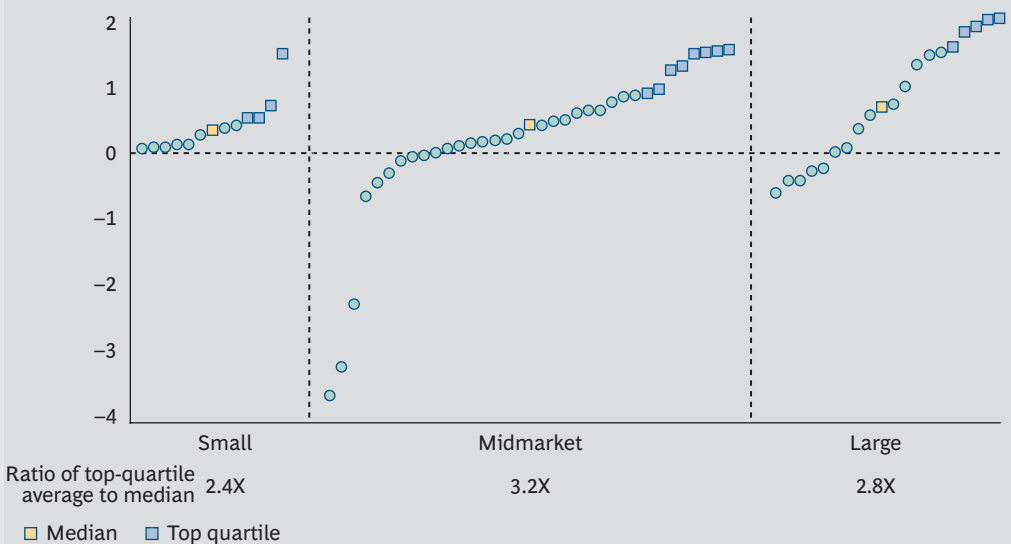
BCG’s latest study of value contribution per sales force FTE for corporate banking divisions from developed markets shows that for those serving small, midmarket, and large corporate clients alike, the average of the top-quartile players was two to three times the median. (See the exhibit below.) We observed similar variation in other standard metrics such as revenue per RM. Banks with struggling sales forces will find it very challenging to compete. Indeed, a strong sales force is a critical enabler for all of the 2020 strategies outlined in this report.

BCG’s casework shows that there are certain characteristics common to nearly all top-performing sales forces:

- *Deep client insight*, obtained from wallet-sizing analytics linked to account-planning tools that are both easy to use and implemented in a rigorous and disciplined way
- *Excellent pricing capabilities*, backed up by tools that both encourage the right RM behaviors and discipline the wrong ones
- *Rigorous talent-management strategies* that cover recruiting, engagement, and retention as well as performance coaching (including more discipline with regard to managing low performers)
- *A greater focus on operating excellence*, featuring leaner processes that allow

Value Performance Differs Significantly Among Corporate Banking Sales Forces

Value contribution per sales force FTE for corporate banking divisions, 2013 (\$millions)



Source: Corporate Banking Performance Benchmarking database, 2014; BCG analysis.

Note: Developed markets include North America, Western Europe, and developed Asia-Pacific (Australia, Hong Kong, Japan, Korea, Singapore, and Taiwan). Value contribution equals revenue in 2013 less three-year average loan losses less pretax capital charges, with pretax capital charges assessed at 16 percent of regulatory capital (assumed to be 10.5 percent of risk-weighted assets). The sales force comprises relationship managers, sales managers (with or without clients), sales assistants, credit analysts, and product specialists. Includes corporate banking divisions serving small, midmarket, and large corporate clients.

WHY SALES FORCE EFFECTIVENESS IS MORE CRITICAL THAN EVER (continued)

RMs to spend more time with clients and that improve discipline to reduce variation among RMs in such areas as client loadings

In our client work, we are increasingly leveraging big-data tools to enhance the predictive power of wallet sizing (such as identifying the client's "next best product") and to improve the effectiveness of account planning and sales-force prioritization.

Our client work has also revealed some variations in optimal approaches for sales forces dedicated to different client segments. With small business clients, individual RM productivity and the ability to independently sell a broad set of lending and nonlending products is especially critical. One reason is that the small ticket

size of this segment makes it uneconomical to have too many product specialists and sales support staff. Clean processes that maximize RM selling time are extremely important.

Serving midmarket and large clients requires a different logic. Overall, RMs play more of a quarterback role, coordinating a team selling approach that involves highly sophisticated products and the relevant product specialists. Large clients require the most complex approach, with a relatively high number of products and specialists. These segments also frequently present the challenge of a hard-to-navigate organizational boundary between the corporate banking division and the capital-markets products division.

In our view, the winning corporate banks in 2020 will have significantly improved their OE performance in four dimensions:

- Client excellence, which includes defining, tracking, and delivering an experience that drives not just client satisfaction but also client advocacy
- Efficient and effective processes, especially with regard to the classic pain points found in the corporate lending and account-opening processes
- Streamlined organizations, with fewer layers, a greater percentage of client-facing staff, and a more rational operating model along the value chain
- Underlying capabilities, including enhanced performance management, a culture of continuous improvement, and rigorous simplification initiatives

Some corporate banking executives may point out that other levers, such as loan loss-

es, pricing, and cross-selling, may have a bigger impact than OE. This is often true, but we believe that leading corporate banks in 2020 will have made dramatic progress in leaving behind the manual, paper-based, error-ridden processes that are so onerous today for many corporate clients and bank employees. OE is also critical in improving speed, quality, and transparency, all of which help corporate banking executives make robust decisions.

Embed a high-performance organization.

Corporate banks have challenging matrix organizations that require collaboration across product, client segment, regional, and functional boundaries. Initiatives that sound simple on paper, such as boosting cross-selling or streamlining the corporate lending process, often get mired in organizational complexity.

Corporate banks that can lead and engage their staffs to collaborate and resolve issues in today's enormously complex financial environment will have a significant advantage. In fact, we believe that the winning corporate

banks of 2020 will be distinguished by what outside observers might call strong, positive cultures.

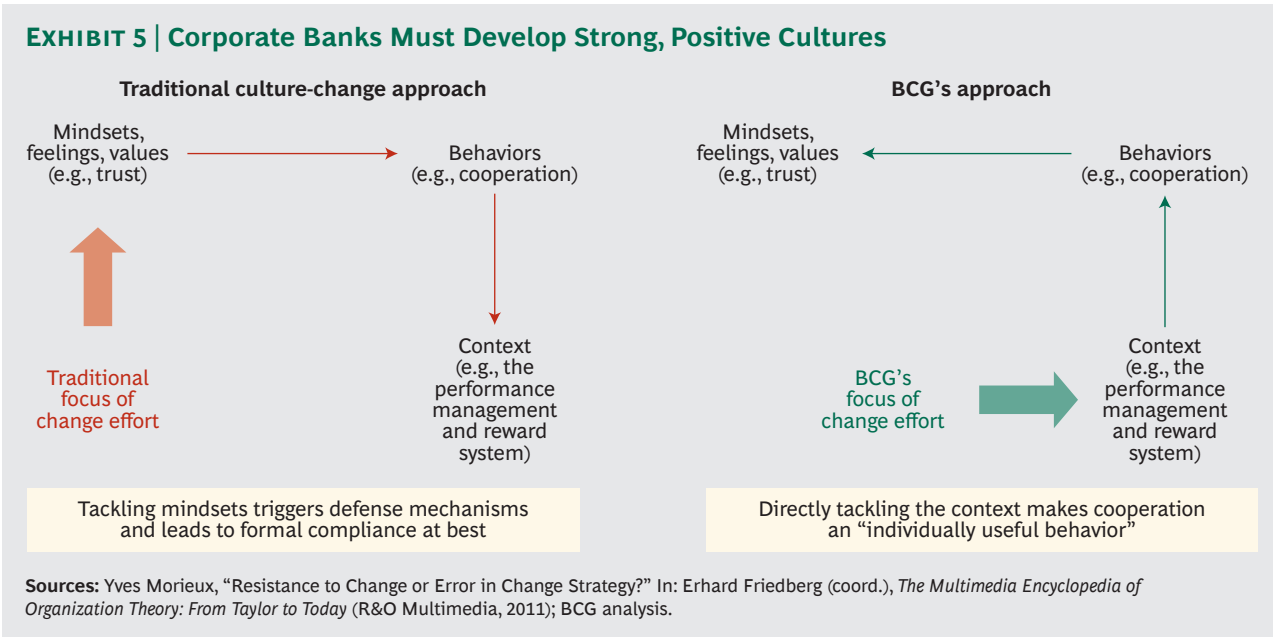
Traditional culture-change efforts have often used levers such as executive messaging and team-building events to try to change the mindsets and values of employees. (See Exhibit 5.) But such initiatives often fall short of the hoped-for impact because the well-meaning intentions of colleagues collide directly with the “same old” organizational blockers such as conflicting or unclear objectives, vague accountabilities, multilayered organizations, an excess of KPIs, performance management without teeth, and misaligned incentives.

BCG recommends a different approach to this challenge. Corporate bankers who want to make a fundamental change in their organization’s culture must first understand why people do what they do and then change what we call the organizational “context.” This means changing the business system in which corporate bank employees operate. Few people go to work with the objective of *not* cross-selling, or *adding* roadblocks to the corporate lending process. But the behaviors that cause these problems are typically the result of rational individuals acting according to the logic of their organizational context.

Consider an example from the corporate and investment banking division of a large Euro-

pean banking group. Although the company posted solid performance during the worst crisis years, growth slowed significantly thereafter. There was weak cooperation between RMs and product specialists and between regions and functions. Business managers, removed from the front lines, lacked the institutional clout to enforce accountability. That left employees with no clear direction—and ample freedom to set and pursue their own goals. With limited incentive to collaborate, teams focused on optimizing their own P&L or deal base, in some cases going so far as to hide deals from other teams and build alliances that helped funnel business their way. And those with the largest informal networks were the most successful in business and career terms.

As growth faltered, it became clear that a different approach was needed. The bank worked to create an organizational environment in which cooperation was supported by appropriate coaching, professional-development recognition, and incentives—elements that made cooperation an individually useful behavior. By stripping away complexity and management layers, employees gained more decision-making authority, which helped them feel that they had a greater stake in outcomes. Management cut the number of KPIs, moving to just four “what” KPIs (such as sales targets and loan-processing times) and three “how” KPIs (such as feedback from colleagues). The



bank also enforced a requirement to differentiate employee performance evaluations—rather than ending up with everyone clustered around the average—and linked both monetary and nonmonetary recognition more tightly to KPIs. The institution also created a series of joint accountabilities among RMs and product specialists by introducing clear role mandates, ensuring that teams shared interlocked targets. Such measures helped employees understand what they were expected to accomplish and what their rewards or consequences would potentially be, and fostered a culture in which collaboration was in the employees' best interest.

ULTIMATELY, corporate banking is entering a period of unprecedented flux as multiple disruptive trends collide with traditional business models. Current industry dynamics will accelerate the trend of a widening performance gap between the top and bottom players. The winning corporate banks of 2020 will undoubtedly have charted a unique path to success. They will also have drawn heavily on the concepts that we have discussed in this report. Corporate banks that avoid fundamental change will continue to struggle, playing catch-up to faster-moving and more forward-thinking rivals. Courageous decisions will be required—and sooner rather than later.

FOR FURTHER READING

The Boston Consulting Group has published other reports and articles that may be of interest to senior financial executives. Recent examples include those listed here.

Overcoming the Digital Dilemma in Wealth Management

An article by The Boston Consulting Group, February 2015

The Emerging Equilibrium in Banking: A Tool Kit for Success

A Focus by The Boston Consulting Group, December 2014

Time for Rebalancing: Insights from BCG's Treasury Benchmarking Survey 2014

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A report by The Boston Consulting Group, May 2014

NOTE TO THE READER

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