

CORPORATE BANKING INSIGHTS

ECOSYSTEM THINKING

HOW BANKS NEED TO ADAPT TO SURVIVE

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The traditional integrated corporate banking model is breaking apart. In its place, a diverse ecosystem of bank and non-bank players is emerging. We see \$100 billion to \$150 billion of global revenues at risk as a result of these changes. What could the end-state look like? How should incumbents position for advantage in the new landscape?

A SLEEP-WALKING GIANT?

The \$780 billion global corporate banking market has long been a stable source of earnings for banks. While a digital revolution is unfolding in consumer banking – and non-bank players extend their influence in the institutional business – the corporate banking market has been better protected. It is a relationship product rather than a commodity, "mission-critical" to the functioning of complex treasury operations, and requires deep system integration between corporates and their banks. Therefore, financial technology companies (fintechs) and other non-banks have made less headway into this market than others.

Today many of the largest corporates use multi-dealer foreign exchange platforms such as 360T for their currency risk management needs. Many also use treasury management systems (TMS) and enterprise resource planning (ERP) software for managing their payments, working capital and liquidity positions, rather than proprietary bank digital channels.

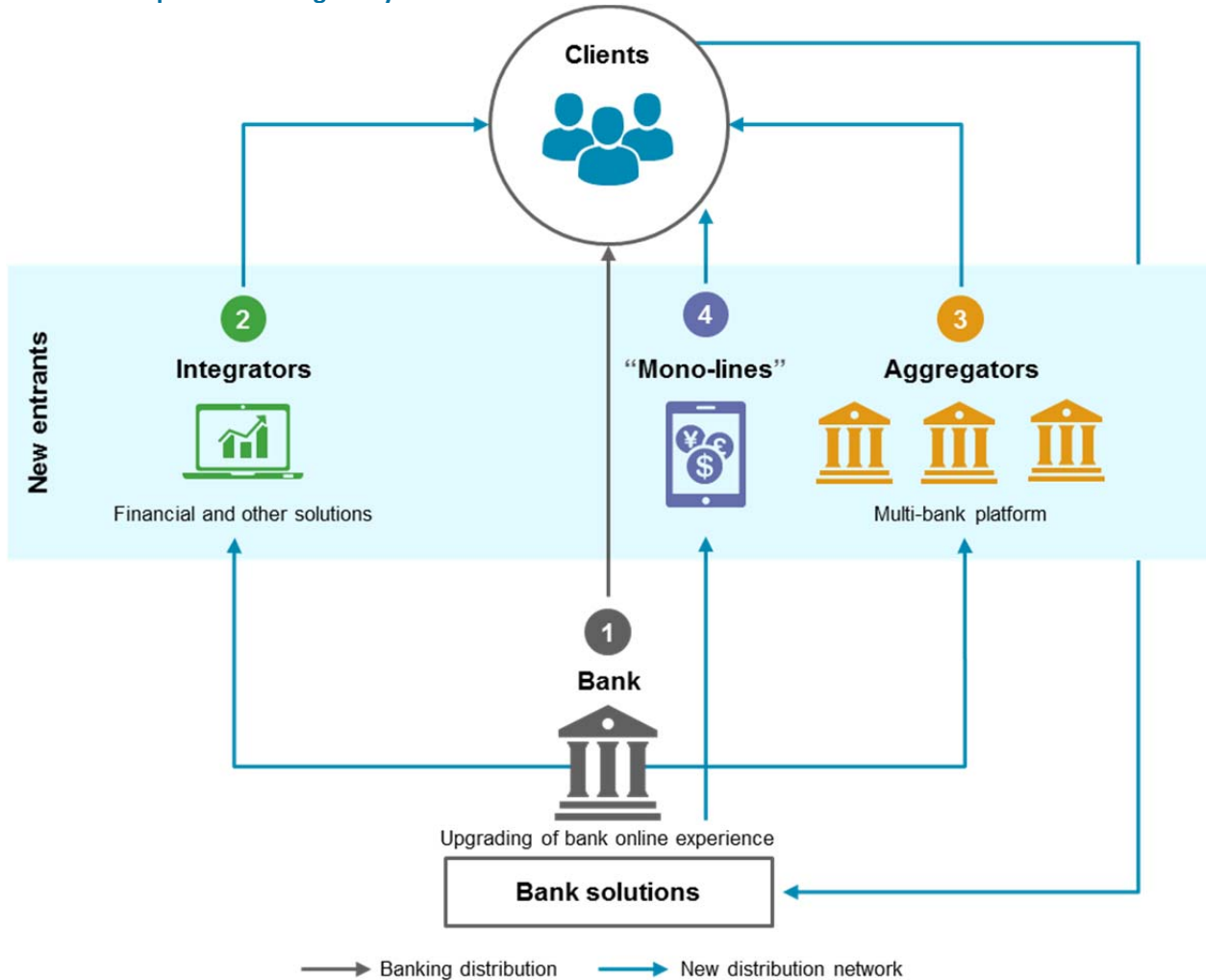
We now see a more profound shift occurring, which could give rise to an open and interconnected corporate banking "ecosystem". There are arguably parts of the market that are less exposed, in which we expect the evolution to an open ecosystem to be slower or less pronounced (for example, structured lending, large corporate payments). But that should be little comfort for incumbents: It is the highest-margin businesses that are most vulnerable – namely business with small and medium-sized enterprises (SMEs), payments, and foreign exchange (FX) – and even those products at the heart of the corporate banking relationship are likely to be impacted eventually.

THE END-STATE: AN OPEN ECOSYSTEM

So what does the end-game look like? We see an open ecosystem, with a number of different players participating and jostling to provide corporates with the services (financial and non-financial) that they need and value (see Exhibit 1). This is an example of "modular financial services" which Oliver Wyman first described in our State of Financial Services Industry report in 2016, and which is already visible in retail banking and insurance.

In corporate banking, we see four key battlegrounds emerging as the current market is disrupted and an open ecosystem takes shape:

Exhibit 1: Corporate banking ecosystem



1. DIGITIZATION OF THE CLIENT EXPERIENCE

Banks are investing heavily in their digital experience for corporate banking clients. Many are replacing legacy digital channels, with next-generation platforms leveraging the latest technologies. They feature intuitive user experience design, omnichannel services (across online, phone, and tablet), modular architecture, and the latest security features. Importantly, the leading banks are investing heavily in content and value-added services to ensure the stickiness of the platform, evidencing the value that the banks place on "owning" the customer interface.

2. VALUE CHAIN SOLUTIONS FROM INTEGRATORS

Incumbent software or service providers along the "procure to pay" value chain – for example, procurement, electronic invoicing, accounting, or logistics – are taking advantage of their position to provide financial services direct to clients, as part of an integrated offering. The potential disruptors in this space are diverse, ranging from e-commerce providers (Alibaba, Amazon), to procurement

platforms (SAP Ariba, Coupa), to accounting platforms (Oracle, SAP, Xero, Intuit). Equally, a range of fintechs are emerging with specific solutions to pain points along the value chain (TradeShift, MarketInvoice).

The threat for banks is that these players continue to extend into financing and are able to leverage their dominant position to provide an integrated (and aggregated) service in which multiple banks (and perhaps even non-banks) provide financing options. Several players have already made strides in this direction: Alibaba launched a financing proposition for buyers in 2015 and Xero has partnered with Wells Fargo to provide real-time feed integration for payments. The game changer will be when an "integrator" can offer a corporate treasurer seamless interoperability between providers of, say, working capital loans.

3. AGGREGATORS PROVIDING 360-DEGREE CLIENT VIEW (AND PRICE TRANSPARENCY)

Aggregators – multi-bank platforms that sit between customers and product providers – have the potential to break down the integrated model, and lead to margin compression and commoditization of corporate banking products. The rise of aggregators is underway in consumer banking and insurance markets. The regulatory-driven shift to "open banking" is likely to accelerate this trend, as customers can seamlessly port their data to alternative providers, and new non-bank payments businesses will emerge.

Many corporate treasurers already use aggregators to source the most competitive pricing for foreign exchange. Enterprise resource management (ERM) software providers such as Oracle and SAP already perform an aggregation function for corporate treasurers, and could feasibly develop multi-bank marketplaces for products such as FX or payments. A number of transaction banks have positioned superior analytics as the driver of aggregation; for example, "Citi Interactive Solutions" includes an advanced analytics platform that allows corporate treasurers to aggregate balances across Citi and third-party accounts, and to run cash and liquidity optimization engines, and visualize the results. Large corporate clients are increasingly willing to aggregate their data across banks, and are using data and analytics to shape their buying behaviors.

4. MONO-LINES REACHING CLIENTS DIRECTLY

Finally, fintechs are developing direct client relationships and providing products to corporate clients, fully disintermediating banks. Compelling solutions have emerged in a number of parts of the market. In payments and FX, players such as Ebury, Kantox, and WorldFirst are capturing share from banks. In working capital finance, there is a proliferation of invoice discounting and financing marketplaces such as C2FO, PrimeRevenue, and Tungsten. These fintechs have clean and simple user experience and attractive pricing, and often focus on niches that are underserved by incumbent banks. The concern for the banks is that these mono-lines reach scale and extend into the mainstream, diluting economics in the highest-margin products for the banks.

TURNING THREAT INTO OPPORTUNITY

These anecdotes are the early-warning signals of disruption in corporate banking: we expect fintech business models to mature, and other non-bank players to capitalize on their value chain positioning. At best, this might lead to client attrition and margin pressure on some of the highest-margin products. At worst, this could lead to disaggregation of the market and a shift in the balance of power to alternative "owners" of the client interface such as procurement platforms or treasury management systems, with banks reduced to being "dumb pipes" for financing. We see \$100 billion to \$150 billion in bank revenues at risk as a result of value migration to new providers and margin compression for incumbents. The impacts will be starkest in SME lending, payments, and FX where banks could cede volume to the new entrants, as well as face margin compression on their core business. As a result, we expect the gap between SME and large corporate margins to compress materially.

Banks should respond on four fronts:

1. War-gaming potential industry scenarios. The first step is admitting the problem. The most advanced players are having open and honest debates about future market evolution, the potential impact on the bank, and how they would respond in these scenarios. Often this takes the form of interactive war-gaming, which enables management teams to engage in the issues and establish a credible action plan to respond. It is critical to resolve the fundamental debates to allow the bank to plan with confidence and know what options are in play. For example, would we be willing to distribute other banks' products to our clients? Would we be willing to distribute our products via third-party platforms? Are we comfortable distributing assets to third parties? When would we look to change our pricing strategy? Where do we create value today?

2. Investing in the customer interface. While the end-game is uncertain, it is clear that the customer interface is the most coveted part of the value chain, and incumbents need to invest to defend on multiple fronts. Many peers are building next-generation corporate portals and embracing mobile, intuitive user experience (UX) design, and application programming interface (API) technology. Others are looking to improve added value via advanced analytics suites, benchmarking tools, and optimization engines. And traditional relationship management and sales capabilities are also being brought into the digital age, with digital sales tools supporting high-impact, relevant discussions with clients. All of these investments aim to blunt the advantages of fintech or aggregator solutions.

3. Taking a leading role in shaping industry platforms. The most forward-looking institutions are looking beyond defence and are aiming to shape the future ecosystem. This can mean partnering with fintechs to plug their solutions into their existing product offering; others are taking proprietary stakes in some of the fintechs (for example, HSBC and TradeShift). Some are looking to become platforms or aggregators themselves, by launching proprietary platforms extending into non-financial services (such as Santander Trade Hub). And there are instances of the industry working together to develop solutions and new products, from the Digital Trade Chain solution for SME trade finance in Europe, to SWIFT-led initiatives. Regardless of approach, leading banks are taking proactive steps to influence market development and participate in the upside. For many, this is coming in the form of sector-specific solutions, bringing together financial (and non-financial) products from across the bank (and third parties) to address specific sector pain points.

4. Developing the "muscles" to compete in the new landscape. Succeeding in an ecosystem world will require a new set of capabilities, which are more common in other industries such as manufacturing than in today's vertically integrated corporate banking market. Corporate banks will need partnership teams to manage relationships with third parties; investment in data management layers and APIs to seamlessly transfer data with third parties; dynamic pricing capabilities; and a more integrated approach to channel management.

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