Roland Berger Focus

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Finding a new business model

Corporate and investment banking in times of fundamental change

Roland Berger

Management summary

Corporate and investment banking cannot go on with business as usual. Digitalization and the onslaught of FinTechs and other new players put a question mark over the very business model and structure of traditional banks. So far, most firms have been confronting the challenge by incrementally introducing digital initiatives of three main types: sales enabling, efficiency increasing, and those that provide enhanced risk management.

These adjustments are taking place within the current setup. However, the entry of new players in the market, the impact of digitalization on the clients' businesses as well as the emergence of platform-based business models present challenges that require more than just incremental change. They alter the setup under which banks operate. New players usually attack via three anchor points: the client interface, the product offering, and the technology. To face this challenge head-on and deal with the all-round digital impact, banks need to refocus their offering along the lines of the attack and assume one of three positionings.

With this new alignment, they will be able to withstand the increased competition and take full advantage of their position as traditional banks with experience and in-depth knowledge of their clients. This transformation will require a thorough digital strategy, uncompromising implementation focus, and a raft of technical and cultural changes.

Contents

Cover photo: aluxum/iStockphoto

Chapter 1:

A good start, but not enough

Banks are adapting incrementally to digitalization.

In a recent Roland Berger survey[1] and in a series of interviews with representatives of 20 corporate & investment banks, most managers reckoned that digitalization is about incremental change and the optimization of existing business models. In this sense, banks are mostly developing and using digital solutions in three main fields:

1. Sales enabling
Here, banks focus on moving closer to their clients. They use new technology such as API interfaces that enable individual configuration of data sets or big data analytics to understand the underlying dynamics and adjust products and services accordingly. In doing so, banks can integrate ever more seamlessly in the client journey and offer products beyond core banking.

2. Efficiency increasing
The availability of data and corresponding analytics facilitates greater efficiency, quality, and process speed. Automation initiatives that employ new technologies such as robotics and machine learning (and prospectively AI and the blockchain) are now a frequently used means of process optimization. Besides this, digitalization enables the use of industry utilities such as Know Your Customer (KYC) platforms that can improve client relations by offering seamless processes.

Most banks are developing and using digital solutions in the fields of sales, efficiency and risk management. But will the incremental adaptation of their business model suffice?

3. Providing enhanced risk management
A range of initiatives can help banks reduce cost of risk. Data analytical capabilities are leading to new ways of risk assessment. New technologies such as the Internet of Things (IoT) enable real-time maintenance tracking. Enhanced analysis facilitates better risk decisions and advanced portfolio management. Enhanced risk management has an impact on all risk types: credit risk, market risk, and non-financial risk.
Most banks have begun to activate the three optimization levers mentioned above. But will the incremental adaptation of their business model suffice?

[1] Cf. Roland Berger Focus: Corporate Banking 2020, 2017 (in German) https://www.rolandberger.com/de/Publications/pub_corporate_banking_2020.html.

Chapter 2:

Danger ahead

Digitalization is disrupting the current corporate and investment banking model.

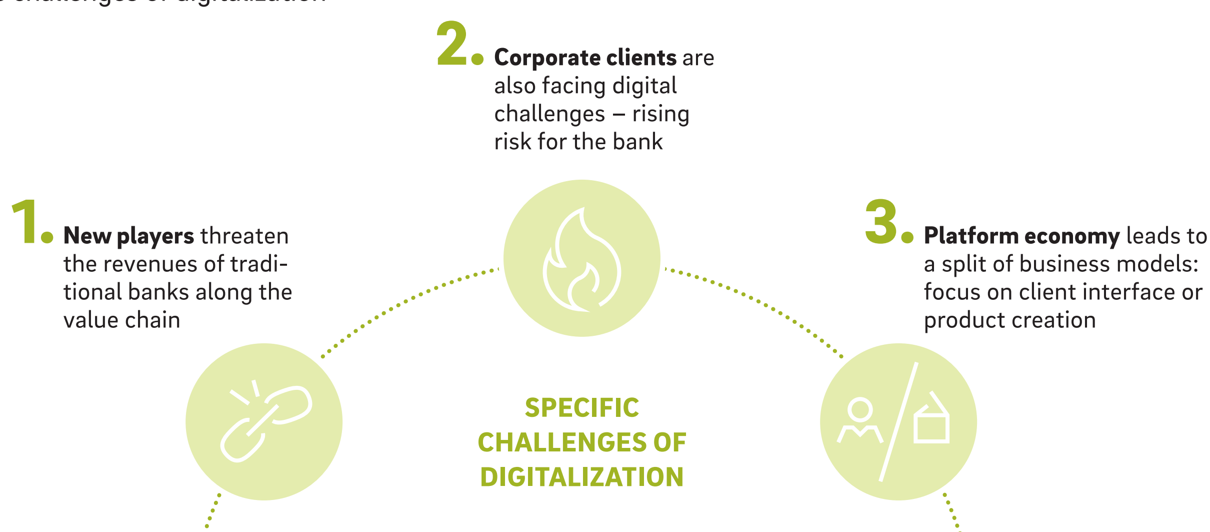
In corporate and investment banking, digitalization is much more than just a facilitator of the current business. As it progresses, digitalization will change the structure of the market and the business model. Banks are facing three serious challenges. → A

1st challenge:

ATTACK FROM NEW PLAYERS

New players are not limited by inflexible legacy systems and are able to react to client needs effectively and efficiently. The deployment of new, easy-to-use, value-adding functionalities is becoming a race against time for established players. In a recent Roland Berger survey[2] among corporate clients, 68% of respondents said they were planning to engage the services of FinTechs and non-banks in the future. These new players can be clustered according to their strategy for attacking traditional banks: aggregators and multi-dealer platforms, product specific intermediaries, and technology providers. Additional pressure arises from institutional investors who – on the lookout for profitable investments – are breaking into the credit business. Banks and their clients are increasingly cooperating with new players in their day-to-day business. This is diminishing the banks' revenue pool. Non-banks and FinTechs are altering the character of the CIB industry and increasing the pressure on banks to modify their business model more than just incrementally.

A: Disruption on many fronts
Three challenges of digitalization



Source: Roland Berger

[2] Cf. Roland Berger Focus: Corporate Banking 2020, 2017 (in German)
https://www.rolandberger.com/de/Publications/pub_corporate_banking_2020.html

2nd challenge:

IMPACT ON CLIENTS' BUSINESS MODELS

The business model of the banks is not the only area impacted by digitalization – the impact on the banks' clients is also significant. It yields benefits for them, yet it poses significant risks to companies across all industries and sizes. If clients cannot cope with the digital transformation and do not sufficiently adapt to it, other competitors that offer a better digital experience will step in and, in the medium to long term, push them out of the market. This also holds true for entire industries. The banks' concern in this case needs to be threefold: Banks need to understand client industry dynamics thoroughly in order to a) avoid being trapped with non-performing loans from clients who get left behind, b) be in a position to offer access to and solutions for new clients emerging as winners of industry transformation, and c) fully understand the changes to their clients' business models in order to be able to support and advise clients along their transformation journey. Different industries will be impacted by digitalization to different degrees.

Oil and gas, for example, will most likely be negatively affected in the long run by the reduced consumption brought about by electric vehicles and stronger competition from renewable energies. Commerce, on the other hand, can benefit from digitalization allowing banks to offer more tailored products to the customers in that area. With the experience that banks have, they could become even more relevant advisors and facilitators for their clients. Benchmarking based on the data collected from clients could be another inroad toward offering enhanced advisory solutions.

3rd challenge:

SEPARATION OF BUSINESS MODELS IN THE PLATFORM ECONOMY

As in other industries, the separation of the business between occupying the client interface (e.g. Uber, AirBnB) and offering the underlying product (taxis, private car owners, hotels, landlords, etc) is also taking place in the financial services industry. FinTechs and other competitors are establishing platform models and posing a serious threat to traditional banks by conquering the client interface and putting customers in contact with many different competitors and their products. Traditional banks selling almost indistinguishable corporate banking products will find it more and more difficult to compete in this platform-driven market with its enhanced client journeys, comparison and solution-selection features, and quick access to many vendors. Being just another provider of standardized products will not be enough. In the future, banks will need to specialize to charge a price premium or focus on the platform business themselves by providing broad access to products and advisory services from different sources. As such, they become more like coaches to their customers, concentrating on their needs and offering bespoke solutions from different solution providers. In both cases, it is important for banks to focus on high value-adding services along the value chain. For example, treasury subscription models for the operation of treasury departments by the bank can be a strategic option for certain steps in the value chain, with tangible advantages for both the bank and the corporate client.

Attack from new players

Changes in the setup of the CIB industry.

B2C banking has already seen major disruption through the emergence of FinTechs. Now it is the B2B segment's turn to be challenged. We have identified three main anchor points where FinTechs and other new players are attacking the incumbents in corporate banking.

Anchor point 1: CLIENT INTERFACE

FinTechs attacking banks at the client interface aim to have a direct business relationship with the corporate client. A bank relies on keeping control of the client interface in order to continually identify and satisfy the clients' needs and serve as a quality gatekeeper for a whole set of financial services. But now there are a range of non-banks and FinTechs beating a path to the client interface – through multi-bank platforms and solutions sitting directly at the bank-client interface. → B

Platforms are increasingly integrating the client coverage layer, especially for transaction banking and financing/credit solutions. Providing cross-banking and price comparison offerings, multi-bank aggregators could potentially replace banks completely at the client interface. A market leader for integrated accounting as well as commercial and sales management solutions, for example, developed a platform allowing the comparison of different banks (and their individual conditions). The client is therefore able to choose the bank with the best offer. The firm partners up with a FinTech for factoring and a FinTech for foreign exchange (FX) transactions. Without any banks involved, the client interface is completely covered by the FinTech.
Additionally, FinTechs are developing banking and compliance platform business models that are based on connecting a global network of partner banks with compa-

B: Conquering the client interface
New players offering multi-bank platforms and API solutions

	MULTI-BANK PLATFORMS/ INTERFACE AGGREGATORS	BANK-CLIENT DIGITAL INTERFACE OPTIMIZERS: CREATION OF APIs
Examples	*Sage; Compeon; Kyriba; 360T Trading Networks*	*Railsbank; treezor*
Value add & USP	Cross-banking offering Price comparison/ease of exchange for commoditized products	Improved integration services for corporates/links to banks More fluid information exchange and stronger agility than banks to adapt APIs
Implications for CIB	Danger of losing the client interface Potential to force banks into a "price war" (similar to comparison portals in retail)	Need for enhanced agility at the client interface: build specific support teams to help clients link their systems or leverage external teams

Source: Roland Berger, company website, Crunchbase nies that want access to global banking via an API. Banking services such as receiving money, issuing cards or managing credit can be granted.

Anchor point 2: FOCUSED PRODUCT OFFERING
While traditional banks often offer "everything" and try to keep up with a diversified product portfolio, new players provide single-purpose products focusing on specific customer groups.
One major trend facilitated by the emergence of digital solutions is the development of the private debt industry. Total assets under the management of private debt funds in Europe and North America reached about USD 600 bn in June 2016, which equates to an average growth rate of about 15% p.a. since 2006. Private debt funds are able to raise funds and offer direct lending without the involvement of fronting banks. Moreover, they do not have complex credit approval processes. → C
Borrowers today can get finance via lending platforms or other alternative non-bank sources, all without the involvement of banks. New players are also offering a wide variety of services historically occupied by traditional banks: launching bonds, trading of notes and loans, fundraising for municipal investment projects, commercial real estate financing, etc.

Anchor point 3: TECHNOLOGY PROVIDER
New players increasingly offer specific CIB services to established banks through the use of new technologies. These services can be clustered into three main categories: data processing/aggregation, activity or functional optimization, and process optimization. → D

C: Rise in non-bank lenders
Development of the private debt industry in Europe and North America

1 As of June 2016
Source: 2017 Preqin global private debt report

For the first category of services, FinTechs provide support in predicting client behaviors and improving the efficiency of credit decisions. They provide additional data points for trading decisions, consider external factors impacting performance, and identify early warning indicators that are not systematically picked up by humans. One example is the detection of behavioral patterns in electronic communications indicative of suspicious and unlawful activity.

The second category of services includes offering improved functions across products, higher automation, and more transparency for regulatory interactions. FinTechs often find use cases in risk management, building their business models upon the development of software and the provision of open platforms for analytics and risk management for the financial services industry. With such technology, customers gain more insight into their underlying risk exposures, can assess the true costs of trading better, and significantly expand the capabilities of their in-house IT resources.

The third category of services has many areas that add value for CIBs, such as increased efficiency of post-trade/collateral management and the KYC process. Some FinTechs already provide sophisticated global solutions for process optimization in the banking industry. One FinTech joint venture, for example, launched KYC utility services for centralized client onboarding and KYC data management in 2014.

While banks might benefit from these services in the short run, they also pose a threat to their business in the medium and long run: outsourcing key processes to external service providers causes banks to become less relevant in key tasks such as the analysis of large data sets.

D: Data, function, process

New players offer technology to traditional banks

	DATA PROCESSING/ AGGREGATION	ACTIVITY OR FUNCTIONAL OPTIMIZATION	PROCESS OPTIMIZATION
Examples	*AYASDI; Orbital Insight; Leverton; Digital Reasoning; Kensho; NOVUS*	*Symphony; FUNDAPPS; OpenGamma*	*OPENLINK; blueprism; GENPACT; markit*
Value add & USP	Additional data points for trading decisions Consideration of external factors impacting performance Identification of early warnings not systematically picked up by humans	Improved function across products Higher speed/automation Transparency for regulatory interactions	Increased efficiency of selected processes: Post-trade/collateral management, KYC Allows/requires building of industry consortium
Implications for CIB	Predicts client behaviors and improves efficiency of credit decisions	Valuable option for "make or buy"	Increases productivity Reduces cycle time Scale is leveraged across participants in a utility model Can be supported/utilized across multiple banks (consortiums)

Source: Roland Berger, company website, Crunchbase

Chapter 3:

Reaction to the new market setup

Choose the right business model.

Banks need to develop competencies to understand digitalization's influence on their clients' business models. Most importantly, though, banks need to rethink their strategic positioning and rebuild their business model. To cope with the altered setup in the industry, banks increasingly need to focus on being one of three archetypes: the relationship expert, the product expert, or the technology service provider (for further insights regarding the application of these archetypes in the German market cf. Roland Berger Focus: Corporate Banking 2020, 2017). The discarded archetypes can still play a role in the banks' business model, but to a much lesser extent. → E
The relationship expert strongly focuses on understanding clients and offering the right products based on the individual client's needs. The relationship expert manages not only the client but also the providers of the products they offer since most of the products and services are sourced externally. The bank thereby generates provisioning and intermediation fees.
The product expert, on the other hand, focuses on providing specific best-in-class banking products to their network partners and the client directly. This goes hand in hand with a strong focus on efficiency: Each product has to be profitable in itself and should not need to rely on a cross-selling logic.
Lastly, the technology service provider supplies the infrastructure that the clients and their network partners need. To be successful with this positioning, the

E: Choosing a new business model
Banks should opt for one of three archetypes

Relationship expert	Product expert	Technology service provider
Positioning on the interface to the client	Positioning as specialist/ provider of certain products and services	Positioning close to the clients' technical systems
Focus on client service and identification of customer needs	Focus on production and provision of products and services	Focus on provisioning of the infrastructure
Third party offerings of services/ products		Standard setter and utilization of platforms

Source: Roland Berger

bank needs a good understanding of technological changes and the way these changes will impact their clients. It should furthermore identify automation possibilities and strive to automate to the largest extent possible. The bank can then realize licensing and provisioning fees.

Banks that decide to move toward capturing the client interface or providing technical systems to their customers (archetypes 1 and 3) can consequently extend their offering by moving beyond traditional banking and offering integrated solutions to their corporate clients. If software providers and tech companies enter areas formerly claimed by banks, the banks should – to some extent – enter areas formerly claimed by software/tech companies. Software, cloud solutions, cyber security, digital ID, or data analytics are fields beyond banking that banks might consider developing and offering. The basic idea for banks is to bundle these services with their financial products and leverage banks' strengths in IT and IT security. These services not only enlarge the service offering of banks but also raise banks' importance in their clients' ecosystem. In general, developing financial services into integrated services beyond CIB can help banks capture a larger share of the client's wallet and make sure banks remain meaningful partners to their clients. → F

F: Services beyond banking

Digitalization opens up new fields of activity for traditional banks

SITUATION

Lack of stand-alone customer value threatens to make banks easily exchangeable

How can banks move further away from being mere FS providers?

Offering cross-functional integrated solutions and services beyond banking

POSSIBLE ENABLERS OF SERVICES BEYOND BANKING

1. Software
Corporate information systems, office apps, treasury management software, multi-banking apps

2. Cloud
Infrastructure, interfaces and operational framework

3. Cyber security
Industrial solutions – IT security, protection, threat intelligence, etc.

4. Digital ID
Single sign-on services, digital identity

5. Data analytics
Advanced analytics and optimization services

Source: Roland Berger

G: Shifting the focus
Measures for the creation of the digitally enabled bank

DIGITAL STRATEGY

- Formulate an ambitious vision and strategy to shape strategic risk-taking within the organization
- Reinforce R&D capabilities to keep pace with innovation
- Utilize scenario planning and war gaming to shape own future strategy

ROADMAP TO A LEADING BANK OF THE DIGITAL AGE

- Draw up a detailed roadmap to the future target state of a digitalized bank
- Formulate clear milestones and deliverables along the way

CULTURAL AND TECHNICAL LEVERS

- Create a digital mindset in the organization
- Reinforce technology expertise in the organization by setting up dedicated teams (e.g. "power users") to create positive impact

Source: Roland Berger

HOW TO MANAGE THE ADJUSTMENT OF THE BUSINESS MODEL

In order to successfully manage the transition toward a digitally enabled company, banks not only need to change their strategy, but also ensure their transformation by defining a challenging and realistic roadmap and following through with its implementation. Furthermore, they have to work on the mindset and the technology expertise within the organization. → G

When it comes to drafting a digital strategy, the bank should first develop an ambitious vision taking into account the three archetypes mentioned before. Whatever the outcome of this, banks will need to focus more on their research & development (R&D) capabilities as this is an integral success factor in a more digitalized world. Otherwise banks will not be able to keep pace with their innovative competition, namely tech giants and FinTechs. Scenario planning and war gaming will provide an understanding of market dynamics. Based on their overall vision, each bank must formulate a detailed roadmap on how to achieve the transformation with milestones and deliverables. The bank needs to adjust its culture and organization to facilitate the transformation process.

This will be a challenging process that calls for vision and bold strategic decisions. But it would be riskier still not to act, as the future demands a modern bank ready for the digital age. The winners will not be those waiting and watching from the sidelines.

WE WELCOME YOUR QUESTIONS, COMMENTS AND SUGGESTIONS

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