Delivering client value in transaction banking: Resetting the price-value conversation

Banking leaders are currently grappling with strategic decisions about how best to drive returns and deploy capital in a more tightly regulated environment. The transaction banking business has been likewise impacted and banks need to determine how to serve their corporate customers, including how much concentration of risk and credit they can accept and which products they may provide.[1]

But one aspect that has not received much attention is customer profitability in the "new normal" environment. The economic dynamics of transaction banking may be changing; forcing executives to reexamine the ways in which value is delivered to corporate clients, better understand the cost of serving them, and build a clearer picture of the profitability of these relationships.

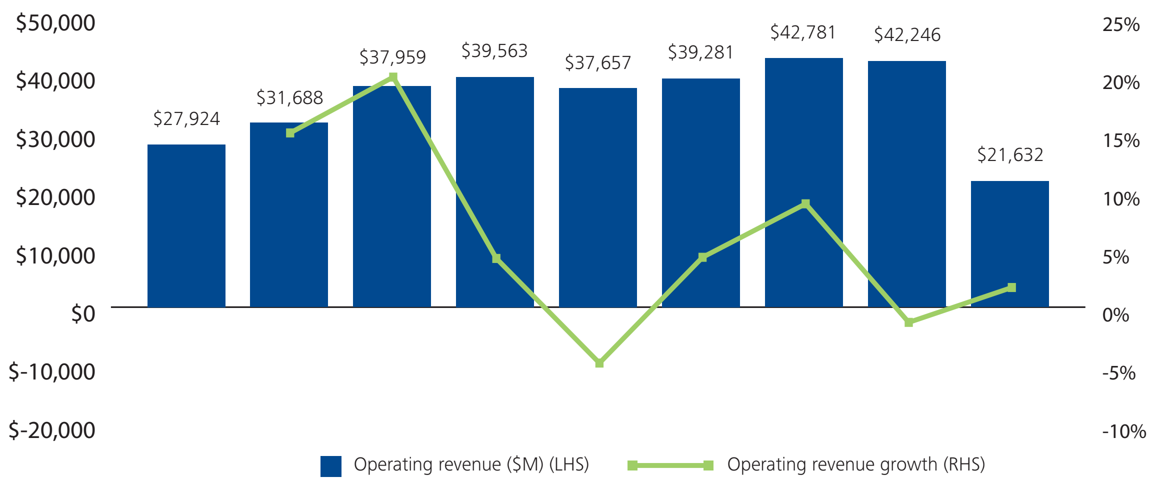
Banks have had to incur enormous new costs in regulatory compliance. What's more, many banks have not fully evaluated their sales and servicing models in the face of these cost pressures. As a result, banks have yet to entirely account for these costs in the pricing models for all types of transaction banking services. By developing a more disciplined approach to pricing and incorporating more rigorous data and analytics, banks can differentiate and drive better returns.

Transaction banking: Still the bright spot in the industry?

The transaction banking business enjoyed strong financial results in the early days of the financial crisis of 2008–2009. It could be said that this was one of the few bright spots in an otherwise dismal period of performance for the banking industry as a whole. Indeed, prospects were so optimistic that one major global bank, JPMorgan Chase, announced a $1 billion investment in its Treasury Services business in September of 2008.[2]

To put that investment in context, from 2006 to 2008, transaction banking revenues grew at an impressive clip — nearly 36 percent.[3] But, as Exhibit 1 shows, it has slowed appreciably since then; in 2013, revenues declined, and through first-half 2014, revenues are flat or down.

Exhibit 1: Transaction banking revenue performance



Source: Deloitte analysis and company financials; data for a representative set of institutions

Produced by the Deloitte Center for Financial Services

[1] Please note that transaction banking, as used in this paper, includes activities such as cash management, treasury services, trade finance, corporate payments, and securities services. However, the latter are not the focus in this paper.

[2] JPMorgan Chase & Co., "JPMorgan Treasury Services Unveils Global Expansion and Investment Plan," press release, September 16, 2008.

[3] Deloitte analysis and company financials. This estimate is based on analysis of some of the largest banks in the world.

The challenging revenue-growth environment is causing banks to spend increasing amounts on technology and operations to lower legacy costs and capture scale economies. But much of this spending is also driven by the demands of compliance with an array of new regulations, including anti-money laundering (AML) regulations, the Foreign Account Tax Compliance Act (FATCA), as well as capital and liquidity rules. For instance, the impact of Know Your Customer (KYC) and screening for products such as wire transfers, deposit/payment accounts, trade finance, corporate payments, and accounts payable/receivable has increased client-information reporting during new account opening/onboarding, and also increased costs for transaction-level reporting. Similarly, capital and leverage rules from Basel III and the Dodd-Frank Wall Street Reform and Consumer Protection Act are forcing banks to offer differentiated pricing for operating versus non-operating cash.

As a result, banks have adjusted their strategies to account for this "new normal" operating environment. With more focus on capital efficiency and increased demands for higher returns, bank executives have been making difficult decisions to hive off whole parts of their businesses that may not deliver returns, to focus on best-bet opportunities.[4] This applies to choices ranging from where to operate geographically, to product offerings, to client segments to focus upon, and in ways that go beyond the de-risking initiatives occurring in many banks today.

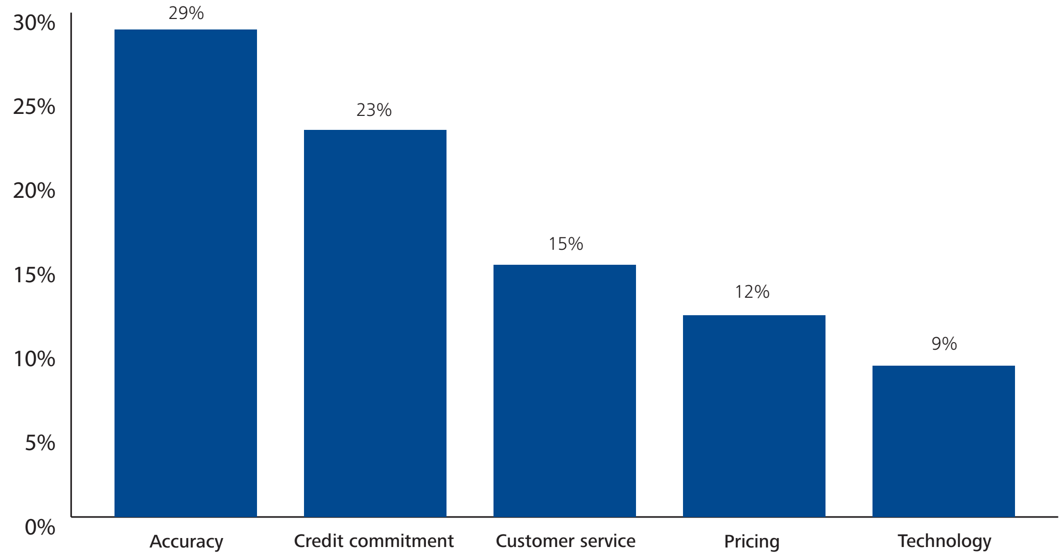
Therefore, the reality of scale economies is increasingly influencing parts of the transaction banking business, leading to an industry structure featuring a more specialized group of banks at the top of the global transaction banking pyramid. This in turn allows banks to differentiate, and may allow revenue growth to return to these scaled businesses.

Clients focused on service more than price

So where might differentiation make the most difference? The most effective strategies can be gleaned from clients' views on the state of their transaction banking relationships, and what they may require from banks going forward.

Several treasury client surveys suggest a moderate-to-high level of satisfaction among at least the plurality of transaction banking clients today (if not the majority). Given the rebounding economy in the United States, clients – from the middle market on up – are more optimistic about the economy, and are once again focused on growth.[5] As a result, many are likely reassessing their banking relationships to confirm that they have the right partner for the future to help them take advantage of opportunities both domestically and abroad.

Exhibit 2: Most important factors in choosing the primary cash management provider



Source: Treasury & Risk 2012 Cash Management Survey

[4] Deloitte Center for Financial Services, "Bank specialization: New strategies, new risks?," March 2013.
[5] Treasury Management International and Bank of America Merrill Lynch, "Transforming Treasury for Growth," 2014.

What exactly might these clients be looking for? According to one survey, respondents suggested that "accuracy" and "credit commitment" are by far the top two factors in choosing the primary cash management provider (see Exhibit 2).[6] Pricing is seen as the most important factor by only 12 percent of respondents, slightly ahead of technology at 9 percent.

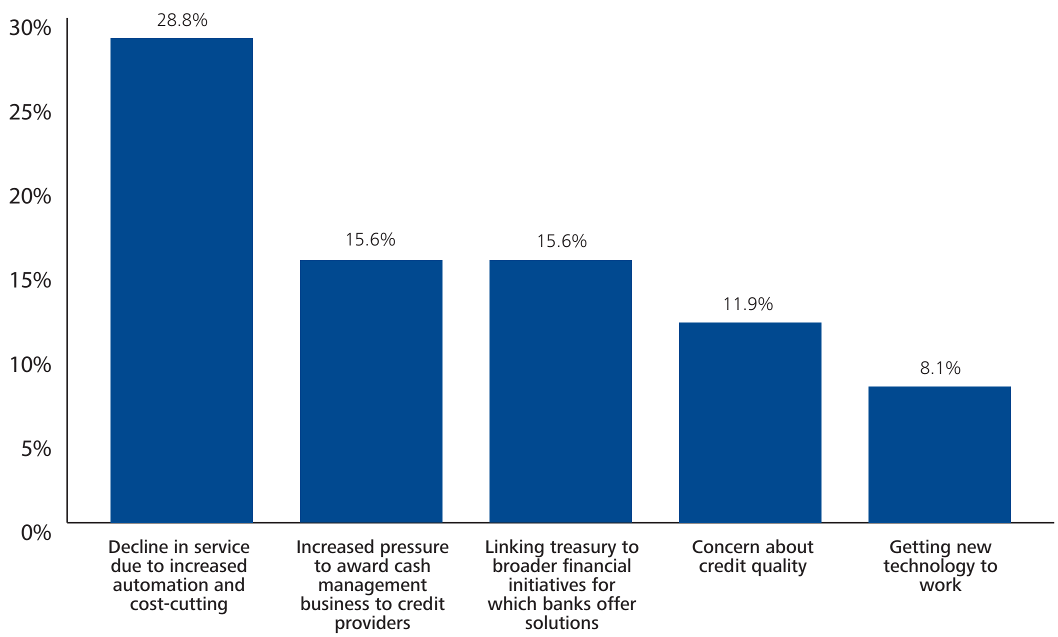
According to Aidene Walsh, formerly of Royal Bank of Scotland, "in our experience, while pricing is important, there are other priorities too for all companies, no matter their size. For example, service reliability, technology, the ability to provide an evolving range of products and services, and manage new regional requirements are all key factors in a company's decision to work with a bank. An increasingly important issue is the ability for a bank to provide guidance and thought leadership, particularly during difficult economic times."[7] Thus, as prospects for growth become more positive, banks are well advised to have a more disciplined approach to capturing the true value that their services offer lest they respond to increased client demand with a revenue model out of sync with client needs.

Between a rock and a hard place: Lower margins at higher cost

Transaction banks are likely finding that they are caught "between a rock and a hard place." Not only has it become more expensive to provide services to clients, but banks are also going to market with products that cannot command the margins they formerly did.

Thus far, from the clients' perspective, efforts to manage costs appear to have had a negative effect. According to a survey by Treasury & Risk, three in 10 companies felt that a decline in service due to automation and cost-cutting is the biggest issue they face with their cash management bank (Exhibit 3).[8]

Exhibit 3: The biggest issue with current cash management banks



Source: Treasury & Risk 2012 Cash Management Survey

[7] Helen Sanders, Editor, "The Treasurer's Voice: Bank Relationships," Treasury Management International, Issue 201.
[8] A Note of Caution: Treasury & Risk's 2012 Cash Management Survey," Treasury and Risk Magazine, September 24, 2012.

For many banks, the first problem to address is that they may not fully appreciate how their cost structure has changed. Beyond a lack of transparency surrounding the new costs of compliance, the way that transaction banks deploy human capital to serve clients has not seen much change. Client service models are still as complex and expensive as ever – with relationship bankers, sales specialists, product managers, and operational leadership – but often not right-sized to reflect this new environment. Many of these individuals are still supporting products that are commoditized, offering thin margins and little in the way of relationship value beyond the onboarding process.

Banks will likely benefit from a better understanding of their current cost base, but this may not compensate for a lack of more rigorous pricing models. Pricing in transaction banking is today driven largely by crude techniques supplemented by gut instinct.

One consequence of this approach is that clients perceive price as neither important nor differentiating when choosing a banking relationship. Increased commoditization driven by regulatory forces and investment in automation has further exacerbated the problem. And this may become a bigger challenge as the economy continues to rebound and clients look for sophisticated solutions. Banks need to do a better job communicating the value they bring to the relationship in fulfilling these new demands.

Unfortunately, many banks are still lacking the data required to make effective calls on pricing based on value delivered, and ultimately on the value of the entire relationship. A new pricing competency may help in increasing client value perceptions and competitive differentiation.

Achieving balance to deliver value

How can transaction banking leaders address these challenges? For many, the path to a more profitable future lies in an improved ability to understand client profitability, and to take advantage of improving conditions to reset the price-value conversation.

Relationship management focused on a single coverage model: Too often transaction banks have continued to deploy an array of individuals charged with managing a portion of the client relationship throughout its lifecycle: sales, product management, and relationship management. Just as often, these managed areas are siloed by product. Transaction banks should conduct an assessment of where ongoing client value makes a difference in the relationship, beyond account opening and onboarding, and emphasize a single coverage model for that client to provide both a broader perspective and more strategic advisory support. This concept could extend to helping the client with the regulatory reporting and other compliance mandates that they themselves are facing.

Conduct a thorough analysis of the new operating environment: Transaction bank leadership should embark upon a thorough review and update of the cost and revenue drivers of their business. Costing analyses, such as activity-based costing and lean management, could help uncover the changes in client support expenses that have occurred with the development of new regulatory and compliance mandates. They should also determine where customized support can deliver the greatest value – and therefore improved margins – so that they can make more informed decisions about where to invest in customer relationships based on where they can most effectively compete.

Develop a robust pricing strategy: Ultimately, the methods above can be successful if the bank invests in a more robust pricing strategy to support a thorough understanding of emerging market opportunities. Several steps are involved in strategy development; an appropriate governance model and standards are the foundation to create consistency and accountability in their approach.

Technology plays an important role as well. Over time an evolution from the basics to a more sophisticated ability to model pricing based on client behavior will likely be necessary. As transaction-banking units realign around a single coverage model (in essence, from product first to client first – not an easy journey), these analytics could support a more holistic view of the relationship and its value to the bank, leading to more effective pricing either at the individual product level or as part of a cross-sold, bundled array of services.

Making this transition to a more robust, transparent, and comprehensive view of costs will not be easy, but with the right tone at the top and some investments in data and analytics, it is within reach of most banks. Contrary to doing it all in "big bang" fashion, success may be measured with a deliberate approach, with the ability to capture small "wins" along the way.

It is not necessary to implement these actions sequentially, nor is waiting for one step to be completed before moving on to the next. Rather, banks should attempt to work on these three areas in parallel. As they do so, it is important to understand how these changes may impact the client. Transaction banking relationships typically have a long lifecycle; bankers will likely need to work closely with their clients on these changes as they are rolled out.

Shift in thinking required to differentiate

As transaction banks move to the new normal environment, they may need to shift their thinking from the notion of customized products to perhaps a customized relationship package that collectively drives value for the client, and for the bank. A more holistic, less siloed relationship and product management approach has the potential to reach beyond the notion that banks become more strategic and "C-level" in their go-to-market approach. Ultimately, as banks become experienced in these new competencies, refined operating models and pricing strategies will enable them to take on more complexity, and perhaps additional risk, potentially leading back to greater profitability.

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