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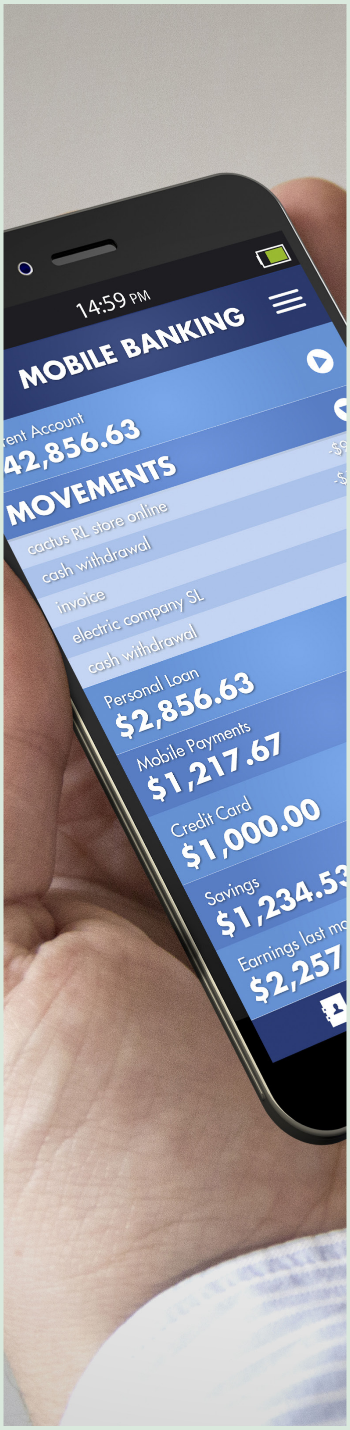

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Acknowledgements

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Introduction

Global Transaction Banking –A definition

Most banks use the term "global transaction banking" to refer to an umbrella of trade, cash and payment services offered to corporations. However, Deutsche Bank and HSBC also include Trust, Agency and Securities Services within their global transaction bank. To ensure consistency, the authors refer to **global transaction banking as a bank's capabilities to offer trade financing solutions, cash management and domestic as well as cross border payment capabilities.**

Global transaction banking is therefore key to core activities for which corporations enter into banking relationships with possibly the sole exception of lending. As corporations look to rationalize number of partner banks, long term transaction banking relationships are a source of competitive advantage for incumbents. Requiring significantly lower capital than lending, transaction banking is a key lever for improving return on equity for banks and is getting greater focus and recognition from senior management across all leading financial institutions.

"I think glamour is coming to this business[1]. People talk about the predictability of revenues within transaction banking as though it's an easy thing to achieve. It takes a tremendous amount of sustained effort and investment — and doesn't happen overnight[2]" – Naveed Sultan, Citigroup's global head of treasury and trade solutions, on transaction banking

In interviews, executives at HSBC, JP Morgan and Deutsche Bank have all echoed similar thoughts – **Samir Assaf**, chief executive of global banking[1] and markets **at HSBC** felt that transaction banking would possibly now be more important than big-ticket deal making.

Daniel Pinto, JP Morgan's investment banking head (elevated to co-president in 2018) and **John Gibbons, Deutsche Bank's** head of transaction banking have both[3] outlined the increasing importance of transaction banking in relation to traditional growth drivers such as investment banking or corporate lending.

Against this backdrop, in this point-of-view we examine the outlook for constituent parts of global transaction banks, assess the degree for integration required to deliver optimal outcomes from AS-IS stages and outline considerations for successful front-to-back transformations at banks.

Recent Market Trends

Global transaction banking revenues have witnessed strong growth against the backdrop of sluggish market conditions in both 2017 and 2018. According to research from Coalition released on April 4, 2019, transaction banking revenues increased by 9% from $ 28.8 Bn to $ 31.3 Bn between 2017 and 2018 across top ten largest transaction banks.

Citi occupied the top spot in the transaction banking league table for 2018, having recorded revenues of $9.4 Bn on the back of strong growth from treasury and trade solutions. HSBC and JP Morgan tied for the second spot and were followed by Bank of America Merrill Lynch, BNP Paribas, Deutsche Bank and Standard Chartered. Societe Generale and Wells Fargo were both ranked eighth. Barclays was the only bank to drop out of the 2017 top 10 list and was replaced by Credit Agricole, which was aided by strong growth in trade finance revenues. HSBC registered a 21% YoY growth[4] in cash management revenues in 2018, while transaction banking revenues at large US banks were aided by rising US interest rates. JP Morgan and Bank of America recorded the highest YoY transaction banking revenue growth[5] in America. JP Morgan was also among the top 2 performers in Europe, the Middle East and Africa.

Most of the top ten global transactions had recorded strong financial performance in 2017 as well as is summarized below:

- Citi was the leader in global transaction banking for 2017 with a 7.3% YoY increase in revenues for its treasury and trade solutions business
- Revenues at Bank of America Merrill Lynch's global transaction services grew by 11.4% YoY in 2017
- Revenues at JP Morgan's Treasury Services grew 14.5% YoY in 2017
- Deutsche Bank recorded a 10.8% YoY decline in transaction banking revenues in 2017, largely due to the bank cutting down on clients and geographies

Transaction Banking Constituents Facing Challenges

On the face of it, running a successful transaction banking franchise would require a strong contribution from each of its constituent parts – namely cash management, trade finance and domestic and cross border payments. However, an assessment of each of these areas reveals significant short to medium term hurdles for banks as described next:

A. Silo-ed Trade, Cash and Payments

- Payments, Cash and Trade products exist in silos with no technological integration
- Blue-print for technology integration may be in the process of being drawn up
- No integrated view of customer's overall position
- Cash flow driven by individual product characteristics without any optimization

B. Technologically Integrated Trade, Cash and Payments

- Technologically integrated payments, cash and trade products
- Real time integrated view of customer's transaction banking position only based on data within the bank
- Business operations can manually allocate incoming and outbound cash flows to optimize customer's cash positions based on instructions from customer
- Basic transaction model with post-facto analysis capabilities
- No Real time cash flow routing capabilities
- Inadequate for multi-currency operations for multinational customers

C. Business rule driven transaction automation

- Technological and business process integration of payments, cash and trade
- Real time integrated multi-bank view of customer's overall transaction banking position
- Business rules can be configured to automatically route cash flows across the complex multi-bank cash aggregation structures
- Real time cash routing with limited or no manual intervention
- Meets multi-currency transaction needs
- However, business rules for payments, cash and trade integration require manual updates in case of changes or new scenarios

D. Analytics led predictive cash-flow routing

- Use of AI led Machine learning solutions to identify and continually adjust cash optimization across the payments, cash and trade triad in real time
- Predictive analytics to model and automatically respond to complex real world scenarios like currency rate changes, withholding requirement changes, movement of countries in and out of sanction lists, debt and deposit pricing updates
- End to end integration of technology and business operating models resulting in significant efficiency and cost gains
- Truly automated self-learning solution

Integrated Transaction Banking a Result of Evolving Customer Expectations

Given the still fragile nature of economic recovery in Europe, threats of protectionism, unilateral tariff imposition and threat of fundamental disruption by fintech challengers, it does appear that the hitherto stable transaction banking is subject to material downside risks. A potent mix of uneven growth in global trade volumes, payments disintermediation, high compliance costs for cash management businesses and nimble fintechs means that the transaction banking income pie is at real risk of shrinking rapidly.

Against this backdrop, customer service excellence is the standout differentiator for commercial banks – a finding corroborated by a Deutsche Bank study[6] on digitalization and the future of commercial banking

Evolving needs of corporate customers

As explained in below Table, different corporations often have widely different needs and expectations from banks:

Nature of Corporation	Business Priorities	Financial Priorities	Transaction Banking Needs
Small and Medium Enterprises	• Scale-up, aggressive product / service promotions • Track trade payable and receivable positions	• Cost effective access to working capital	**Payments:** Primarily domestic **Cash:** Day to day visibility of liquidity needs **Trade:** Limited appetite for traditional trade products. May resort to open account sales
Mid-sized corporations	• Optimum raw materials procurement with sales growth generated by new product lines and markets • Diversifying supplier and customer profiles	• Reducing financing costs	**Payments:** Both domestic and cross-border **Cash:** Vanilla cash concentration strategies **Trade:** Demand for LCs / BGs to procure and produce
Multinational large corporations	• Multi-country operations under parent subsidiary model to cater to localized markets • Limited operational supervision by parent (may vary by group strategy)	• Multi-country, multi-currency, multi-bank Payable and Receivable Forecasting • Meeting liquidity needs for all group subsidiaries • Reducing financing costs by optimizing and re-directing cash-flows	**Payments:** Both domestic and cross-border at both holding and operating company levels **Cash:** Complex cash concentration structures, with bespoke multi-bank cash concentration strategies including compliance with local country withholding and currency convertibility requirements. Near real-time updates to cash concentration rules based on forecasting **Trade:** Appetite for both Traditional trade as well as Supply Chain Financing solutions

Figure 1: *Differentiated priorities and needs of corporations*

Global transaction banks vie for lucrative transaction banking mandates from multinational large corporations. Multinational corporations expect bespoke multi-bank solutions that cater to their holistic trade (traditional as well as open account products) and liquidity needs. Banks are therefore looking to internally break down silos and achieve truly integrated transaction banking by front to back integration of trade, cash and payment capabilities. Banks are also looking to adopt solutions that provide customer account balance information across peer banks. This information is used to offer bank agnostic, unified views of a corporation's net cash position for cash-flow forecasting and optimization.

"Integration" may mean different things to different banks

Integration may seem to be the logical target of all transaction banks. However, not all transaction banks are created equal, as their business operating models might not be equally mature. All global transaction banks can be classified into one of the categories in Figure 1.

Moderate recovery at risk as trade wars break out

- While trade growth has historically outpaced GDP growth, the elasticity ratio of trade to GDP growth had slipped to 0.8 in 2016 before rebounding to 1.5 in 2017
- For 2018, WTO had forecast an elasticity ratio of 1.4 with possible downside risk arising out of potentially restrictive trade measures and unanticipated inflationary pressures. The forecast was borne out of strong growth estimates led by Asia and North America while Europe was also likely to grow albeit at a slower rate
- However, reciprocal tariff impositions between US and China and US and the European Union poses downside risks to global trade volumes and by extension trade income for global banks

Near commoditized cash management offerings

- With near identical cash management offerings transferring pricing power to customers over time, banks are looking to differentiate by including virtual accounts to support Payment On Behalf Of (POBO) / Receivables on Behalf Of (ROBO) structures especially for group treasury customers in the Eurozone
- Basel III norms on liquidity coverage computation has led to bank accounts having debit balance being treated as overdrafts and inviting provisioning, even if they form part of notional cash pools – This makes notional pooling products financially unviable for most bank-customer relationships
- Most banks are struggling to offer standalone cost effective cash and liquidity management solutions to corporate customers

Payment Services Directive 2 and the threat of payments disintermediation

- The second European payment services directive is operative effective January 13, 2018. With this development, European corporate banking customers are now likely to perceive payments as a commoditized service with minimal barriers to switching over to fintechs or challenger banks
- While this is a wake-up call for many European banks in itself, problems could be further accentuated as customers shift entirely instead of just moving the payments piece by pie.

Fintechs dramatically disrupting the Trade-Cash-Payment triad

- Supply chain financing Fintech Taulia recorded $6 Bn release of cash flows on its early trade payables platform in Q2 2018
- Tradeshift, another supply chain financing platform directly connects buyers and sellers and has more than 1.5 MM companies on its platform across 190 countries
- Ripple, a blockchain driven money transfer platform allows for real time global payments across 27 countries Many banks and corporations have joined the "RippleNet" platform to enable real time processing of cross border payments. Ripple uses its own crypto-currency to help make cross-border payments. Some of the members on Ripple include MUFG Bank, Santander, Standard Chartered and Westpac

***Figure 2:** As-Is bank maturity categories for integrated transaction banking*

While state D represents the aspired "To-Be" state, it is important to note that a bank's transformation need not be linear. If done right, a well thought out strategy to directly transform a silo-ed transaction bank to fully integrated transaction bank can happen faster and at lower cost, as this bypasses legacy bank processes, controls and technology. Similarly, instead of linear transformation to state C, a rudimentarily integrated bank in state B can plan for and successfully move to state D.

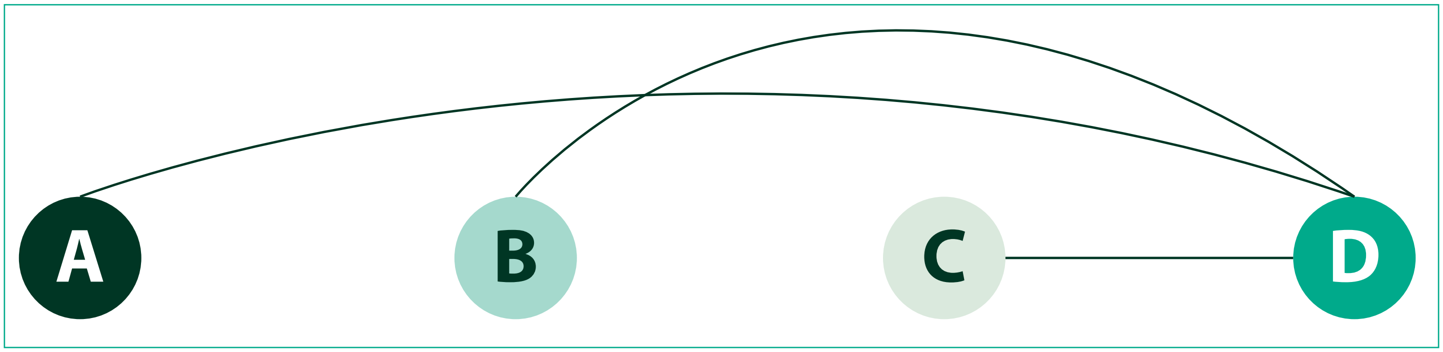

Figure 3: *Non-linear transformations possible*

Banks in state C includes most of the incumbent modern global transaction banks. However, attributes listed in state D represent the "To Be" state for truly differentiated transaction banking franchises. Predictive models for banks in state D would continue to evolve over time. Category C and D transaction banks are likely to enjoy significant competitive advantages over the rest, as explained next:

- **Market share gains:** Global transaction banks in these categories are poised to gain market share at the expense of laggards in the short term. Over a medium to long term horizon, Mid-sized corporations starting multi-country operations would soon follow their large corporate peers to category C and D banks
- **Cost and efficiency gains:** Category C & D banks will have lower operating costs arising out of leaner operations and reconciliation teams. Business rule led cash-flow routing will reduce the need of manual intervention in category C banks. Self-learning models in category D banks would allow for extreme automation with real time cash flow routing
- **Cross sell gains:** Stickiness of transaction banking relation over a long term horizon, would potentially allow banks to make further inroads in lending , merchant banking mandates including debt / equity issuances and advising on mergers and acquisitions

Front to back transaction banking transformations come with their share of quirks

While clearly being the way forward for global transaction banks, there is no denying that front to back transformations are not easy to accomplish. Some of the most common challenges that banks encounter are as follows:

Disjointed Legacy technology stack

Most large banks are saddled with fragmented technology silos, reflective of past mergers and acquisitions, which do not integrate with each other. There is no straight through processing of information across systems. Since replacing multiple systems with unified technology platforms require significant upfront investment, many banks choose to retain systems which could be 20 – 30 years old, but are cheaper to run in the short term. In several cases, the User Interfaces may be given a facelift but the same legacy systems continue under the hood. Compelling business cases for lumpy upfront capital expenditure offset by subsequently sharply lower operating expenses and incremental revenue streams are often sacrificed at the altar of "predictable" operating expenses.

Fragmented business processes

Business operating models and processes are specific to silos with limited meaningful information cross-over. Absence of overarching processes, spanning inter-departmental boundaries, results in limited information hand-off. Goals and decision-making is reflective of the immediate needs of the department in question and at times can be at odds to what is good for overall bank.

Lack of executive commitment

Ultimately, C-level executives must buy into the rationale of front to back transformations. They must evangelize the benefits of such transformations to business-line personnel, who would not have sight of the overall picture. Lack of commitment on part of bank leadership will lead to decision-making delays, wrangling over scope and significant time and cost over-runs.

Conclusion

Despite challenges, the compelling rationale must drive global transaction banks to plan for end-to-end integration. Risks must be uncovered, documented and mitigating measures need to be put forth. A successful high level blue-print for transformation should include the below elements:

a. Defining To - Be state of the Global Transaction Bank in terms of product and service offerings to customers

b. Ascertaining if current organization structure can support the desired state set out in step a. If not, C-level executives to re-align organization to enable delivery

c. Assessing existing technology capabilities to deliver aspired goals. Undertaking technology portfolio rationalization. Deciding on systems to be phased out while identifying technology investments required to support aspired goals. Planning API led integration with peer banks to present unified customer views.

d. Executing technology and business realignment in an agile fashion with iterative and incremental delivery.

All global transaction banks would do well to remember that only true front-to-back transformations will allow for integrated global transaction banking delivery. Half-baked attempts at transformation would consume scarce technology budgets without delivering desired objectives and waste time.

With several banks already running strategic transformation programs, today's leaders should be especially wary about competition – the gap to the chasing pack could be closer than they think. They must maintain sharp focus on mainstreaming machine-learning led models to predict cash inflow / outflow patterns and then automatically route funds for optimal outcomes.

Banks that successfully transform will offer irresistible value to corporations. They will benefit from growth in market share at the expense of competition even during challenging economic conditions. This will translate into corresponding increases in revenues and profitability. For such banks, firm-wide profitability metrics like Return on Capital Employed or Return on Equity will consistently outperform the aggregated line-of-business profitability metrics in constituent trade, cash or payment businesses components as a direct consequence of integration synergies, thereby ensuring that the whole is greater than sum of parts.

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