Getting back to basics for high performance
Revenue and growth opportunities in transaction banking
Banks have traditionally used credit products to drive the majority of their revenues and value from their customer base. While transaction services have long been talked about as a potential way to boost revenues and control more of the corporate value chain, the strong revenues from credit products have tended to make investment in transactional payments capabilities less of a priority. But now due to the increased need for banks to differentiate their corporate banking offering, forced investment through regulation and the indirect consequences of the credit crunch, there is an unprecedented opportunity for banks to focus on transaction services. If targeted and managed correctly, increased investment in transaction services could enable banks to maintain their revenues, achieve a better balance in their revenue mix, build deeper and more profitable whole-lifecycle relationships with customers, and meet their promises to their investors – despite the impact of the current market turmoil.

The key to achieving all this lies in repositioning the transaction services business to drive high performance. This requires transforming the operation to sustain and grow revenues by bundling services along an increasing proportion of the corporate treasury value chain, thereby enabling more effective cross-sell and up-sell of higher-margin services. In Accenture’s view, the banks that achieve this successfully will do so by transforming and industrialising their transaction services operating and sourcing model to achieve three key characteristics: simple on the inside, including the creation of global or regional ‘payments factories’; differentiated externally, by innovating across products, channels, bundling and customer service; and excellent in managing and executing change, to unlock the full potential of transaction services as a revenue growth engine.
Getting back to basics

Revenue opportunities in transaction banking
As a senior executive, take a look at how your bank generates its highest return on assets. The odds are that it has historically been via credit products – across the spectrum from credit cards and mortgages for retail customers, all the way up to lines of credit for corporates.

Then take a look at today’s prevailing market conditions. With the shockwaves from the credit crunch still reverberating through the industry worldwide, little sign of any freeing-up of liquidity, and a slowing global economy, banks’ revenues from credit products are under severe but as-yet unquantifiable threat.

The impact is already clear. Loans and financing revenues and profits are degrading. The lower availability of capital is reducing banks’ ability to drive returns on capital-intensive product sets. And with the cost of risk rising sharply, the rules of the lending game have suddenly become much tougher – and the downside much more daunting.

Rebalancing the revenue mix
All this points to the growing uncertainty over future revenues for the banking sector. Yet at the same time banks need to reassure investors and regulators of their long-term value and viability by strengthening their balance sheets and upgrading the quality of their portfolios and revenue mix.

So, with credit products fast losing their ability to generate growth, where can banks turn to make up for the shortfall in credit products and keep their investors happy? The answer lies in examining their entire portfolio of products and services, and identifying areas of maximum opportunity that are more insulated from the impact of the credit crunch.

Banks’ revenues essentially derive from three sources: credit products, which have tended to dominate the revenue mix in recent years but are now constrained; savings products such as deposit accounts; and transaction products and services, such as payments, cash management and trade. In a changing market, banks may need to rebalance their revenue mix away from the first of these, and towards the last two – savings and deposit products and transaction services.

Increasing revenues in these two areas will not only enable a bank to maintain its overall revenues. It will also generate low-cost liquidity to fund renewed lending, thereby helping the bank to revive its revenues from credit products. So it represents a win-win.

For many banks transaction services is an under-exploited business area where there are significant opportunities for revenue growth.
Transaction services and savings: weighing up the potential

In terms of savings products, there is currently clear potential for a rise in deposits and revenues as customers – especially corporates – respond to the currently gloomy interest rate and property environment by transferring their funds into lower-risk asset classes such as cash and bonds. Driven by banks’ own needs to expand their deposit bases and by consumers’ increasing propensity to save, banks have taken notice of the opportunity and are aggressively targeting the savings market. As a result, the margins are contracting in this segment.

For many banks, however, transaction services is an under-exploited business area where there are significant opportunities for revenue growth. The primarily fee-driven nature of transaction revenues brings the benefit of diversifying the bank’s cash flows away from interest-based income, thereby providing greater certainty and longevity to the revenue mix. And even when credit availability is low, customers still need to conduct basic transactions – including corporates managing their own liquidity, and retail customers making transfers and payments on their current accounts.

The accompanying information panel summarises the attractions of transaction banking (see Figure 1). For these reasons and more, Accenture’s view is that the credit crunch provides banks with an opportunity to shift their focus and revenues towards transaction services. We will now examine the scale of this opportunity and the drivers behind it.

Figure 1: Why focus on transaction services?

Transaction banking is an attractive area for banks because it is:

Profitable
- it generates account balances – creating liquidity at low cost – and FX revenue
- it helps to build and sustain wider relationships with high-end customers.
- scale dynamics allow increased profit margins when driven by variable cost; keeping prices competitive

Stable
- significant revenue is diversified, predictable and fee-based, improving customer lifecycle value and long-term cash flows

Capital efficient
- risk exposure is significantly lower than credit business (primarily operating risk)
Realising the potential of transactions

Major changes are currently under way in the three key areas of transaction banking – cash management, trade and payments. As a result, the transaction services landscape will look very different in five years’ time. To be high performers in this new world, banks will need to achieve some competitive repositioning.

In cash management, the credit crunch has increased corporate customer demands on banks to improve their liquidity management capabilities due to the increased costs and scarcity of liquidity. While traditionally the customer’s inertia to move or consolidate these services to a single bank was high, now many are more open to look for other and better options. From a bank perspective, cash management is now seen as one of the suite of introductory products to win new clients, whereas previously credit products had reserved that position in most banks’ offerings.

Banks with a good cash management capability have the opportunity to cross-sell this service to existing clients not using the service, as well as winning new clients. In our experience, high performing banks have greater than 90% of their mid-cap corporate clients using their cash management offering while for low performers the penetration rate is as low as 30%. There is a similar wide spectrum in the value created per customer using cash management by different banks. Banks that are falling behind the leaders will need to adjust their proposition and sales focus to capture this value.

In trade, the credit crunch and changes in risk perceptions mean that security and certainty of deposits – primarily counterparty risk – is becoming more important, with customers focusing more stringently on issues such as credit ratings and counterparty limits. This effectively involves a move back to the first principles of banking from a corporate treasury perspective, and a requirement to prove counterparty risk management to senior corporate executives.

This shift creates opportunities, since banks will be able to differentiate from their competitors on the basis of these capabilities, rather than the previous tendency to focus on base point movement on deposits. It also creates openings for banks to assess their corporate customers across a broad spectrum of risk, credit and transaction fee bases.

Further, banks can improve their customer propositions in this space – particularly as electronic and internet based trade offerings can simplify, improve the security of, and speed up the trade finance processes from managing documentation to payments. The provision of value-added tools offer a route to both improve the customer experience and broaden the sales proposition.

In payments, the impact of the credit crunch is compounded by a blizzard of market, technological and regulatory change: The emerging forces driving significant changes in the global payments landscape (ie, the Single Euro Payments Area in Europe), the advent of mobile payments and ePayments (often provided by new entrants such as telecoms and internet companies), and consolidation among the payments industry’s infrastructure providers.

At the same time, corporate customers are also seeking to take the initiative and lead developments in payments, rather than being led by the banks as in the past. And market regulation creates opportunities for innovation and differentiation, with the winners likely to be those players positioned for changes across markets through having a simplified and flexible operating model.

A pessimistic view on payments may suggest that volumes may drop due to the current market turmoil and slowing economies. However, given that the volumes of electronic payments have been rising in double digits year on year, a slowdown will only marginally impact overall payments volumes, particularly if it an economic slump is short lived. Positive factors driven largely by regionalisation and globalisation, the adoption of electronic channels, and partly reflecting the advent of SEPA will continue to push the healthy growth in payment volumes. As banks increase their focus on transaction services as a revenue source, they will sell these more actively through their relationship managers and sales teams into the corporate and commercial marketplace – especially in an environment where sales of credit products are constrained by market conditions. As a result, this will increase the move from the paper instruments to electronic, pushing the overall electronic payments growth rate further.

While the volumes grow, as more banks focus on payments as a way of generating revenues and deepening relationships, and as regulations come into force (ie, Faster Payments and SEPA, in UK and Europe, respectively), there will inevitably be some downward pressure on margins and a further shift towards commoditisation for basic regulated payment services. To counteract this pressure banks will need to look to new and value added services to grow payments income. One way will be to innovate in bundling formerly distinct and unregulated offerings to match the customer’s needs.
Bundling innovation: avoiding commoditisation...

Alongside rising transaction volumes and reducing direct revenues, there will be revenue opportunities through increased bundling of transaction services with related and complementary offerings, ranging from information reporting to credit products. The integration of value-added services, including lending, into the traditional transaction banking offering will in turn enable banks to take a holistic lifecycle view of customer profitability and risk, and to differentiate and reposition themselves competitively in the marketplace. As Figure 2 illustrates, the result of these shifts is that income from new, higher-margin payment services will expand faster as a proportion of overall revenues than revenues from basic commoditised payment services.

Experience shows that corporate treasurers are attracted to banks that can provide a holistic lifecycle offering that matches their needs – even if each component of the integrated bundle may not be the cheapest available across the marketplace. So while margins may decline on some traditional payment products, there will be opportunities to offset the effect by moving progressively up the corporate value chain. A number of banks are already moving in this direction, including Citigroup (see information panel).
An example of sustained growth in transaction services: Citigroup Global Transaction Services

Citigroup is one of a number of banks that have long recognised the benefits of migrating up the value chain from basic transaction services and addressing the needs of the corporate treasurers from an end-to-end perspective. Through a combination of leveraging its global scale, deepening relationships and acquiring scale through partnerships, as well as a joined up view of processing, Citi has delivered strong growth in its Global Transaction Services (GTS) business over the past several years, even while other parts of the business have suffered.

Through the period 2004–7, GTS outperformed the overall Group results. While revenues at Citigroup were flat, growing at only 1% CAGR, GTS delivered consistent growth year on year at 24% CAGR. While profits at the Group were severely reduced by the fallout of the credit crunch and fell 40% CAGR over the period, GTS produced resilient net income growth at 28% CAGR, to contribute US$2.2bn in 2007.

Figure 3: Citigroup Global Transaction Services revenue and net income growth

![Figure 3: Citigroup Global Transaction Services revenue and net income growth](source: Company Accounts)
...and turning payments into a platform for deeper corporate relationships

This approach will not only help a bank to achieve a more balanced and sustainable revenue mix. It will also help transaction banks to extend the value they deliver to corporates customers and by offering better products and services that meet corporate customers’ changing needs they can gain control of an ever larger segment of the corporate value chain (see information panel).

To do this requires looking at the world from the viewpoint of the corporate treasurer. At each point in the treasurer’s value chain, there are issues that need to be addressed. Transaction banking is a very sticky offering – one where customers will only switch provider if they have a very good reason for doing so. So a bank that starts from transaction services and then progressively offers to bundle in workable and cost-effective solutions to other issues along the value chain will often find it is pushing on an open door. Ultimately, the bank may succeed in taking out and replacing the lion’s share of the original treasury function.

The opportunity to do this is generally at its greatest in mid-cap corporate customers. Many larger corporates and multinationals will already have moved to a shared service and have sophisticated treasury and liquidity management systems in place. However, mid-caps may not have been able to make such investments, creating opportunities for banks to offer efficiencies along the value chain.

With the onset of the credit crunch, the pace at which banks can drive these additional services into customer organisations has increased, not least because their salesforces may now have spare capacity to redirect their efforts from credit products to transaction services. A number of banks are doing this already – and some have plans in place to create a global transaction services unit to exploit this opportunity in a consistent way worldwide. One example already in the public domain, and described in the accompanying information panel, is RBS’s new Global Transaction Services unit, which capitalises on the global payments capability RBS acquired through the consortium purchase of ABN AMRO (see information panel).

An enhanced corporate transaction service offering

The role of the corporate treasurer has changed. Driven by increased globalisation and competition, regulation and increasing centralisation of operations, treasury activities have changed their focus from operational activities to value creation. However, in many cases transaction banking services have failed to keep up.

So what are the products and services that will create value for corporate customers and banks? Accenture has developed a solution architecture that details the enhanced capabilities banks should look to build; these include:

- SWIFT for Corporates connectivity solutions
- centralised payment processing capabilities
- automated matching and reconciliation services
- transaction cost optimisation tools
- automated trade finance and insurance products
- enhanced risk and performance management tools for liquidity management
- services providing direct access to financial market instruments

Through providing an integrated suite of products and services, banks have the opportunity to win a greater share of their customers’ business and increase their penetration of broader and higher value products. To provide an enhanced service offering, banks should move towards one integrated platform for corporate banking services that eases the operation for banks and provides corporates with seamless integrated access to all the important services and information they need.
Figura 4: RBS’s Global Transaction Services division

For many years, Royal Bank of Scotland (RBS) has used its position as a scale player in the transaction services business, and the resulting balanced mix of fee-based and interest-based revenues, to provide a global platform for growth. In the wake of its acquisition of ABN Amro via a consortium with Fortis and Santander, RBS has established a Global Transaction Services division (GTS) to drive continuing growth around its transactions services.

In its 2007 annual results statement, RBS commented: “GTS will combine ABN AMRO’s world class capability in international payments with our substantial existing corporate transaction banking and merchant acquiring activities. This new division ranks among the top five payments businesses in the world with pro forma operating profit of approximately £1.6 billion in 2007.” GTS’s synergies are estimated to amount to £128m net revenue and £25m cost savings.

Source: RBS Annual Report and Accounts 2007
In Accenture’s view, the combination of sweeping change and rising opportunity in the transaction businesses makes it a key area of focus for banks worldwide. Now the credit crunch has turned this focus from a strategic option into an imperative.

But how can banks achieve the necessary competitive re-invention and repositioning of their transactions services business in the face of global competition and commoditising revenues? Our experience suggests the answer to finding a winning strategy lies in industrialising the transaction services operating model and developing information-based propositions for customers.

Banks that successfully industrialise their transaction services operations will share three core characteristics. They will be more simplified on the inside in terms of their operating model, helping to optimise their efficiency and flexibility. They will be more differentiated on the outside than their competitors in the eyes of their customers, enabling them to build a unique franchise. And they will be outstanding at execution, demonstrating not only higher operational performance but also excellence in the delivery of complex business change.

Towards industrialisation

If a bank is looking to realise all these benefits through industrialisation of its payments business, how should it plan its route? Depending on a bank’s current positioning, strategy and legacy payments business, these three characteristics can be created through a range of approaches. In Accenture’s view, the programme is likely to involve four key areas of focus:

- Re-aligning the corporate value chain – based on an understanding of where and how the corporate treasurer is seeking to drive value. This will require banks to examine the end-to-end corporate payments process, reduce costs, and provide higher-value product sets.
- Re-visiting the configuration of front, middle and back office – this may lead to decisions such as payments processing outsourcing to specialist providers or other banks.
- Using regulatory directives as enablers of marketplace re-positioning and new services – examples in Europe include SEPA and the Payments Services Directive (PSD) or the e-invoicing directive; Sarbanes-Oxley in the US, etcetera.
- Transforming operating model and cost base – today, transactions services typically represents 30% to 40% of a bank’s cost base, with costs offset against asset management and credit products. Many banks have an urgent to re-visit the operating model and move towards low fixed-price ratchet mechanisms characterised by a high proportion of variable costs, standardisation and process improvements.
In addition, the banks that choose to become transaction specialists should consider two key steps:

- Implementing payments factories – consolidating payment infrastructure and routing all payments to a central pool can improve liquidity management and increase free cash. This approach can reduce costs through scale and global sourcing strategies, including creating regional or global hubs, and outsourcing or offshoring capabilities. In our experience, this approach can lead up to a 40% improvement in operating expenses and up to a 30% reduction in operating risk capital.

- Differentiated customer offerings – by looking to innovate transaction products, bundling services, and designing products around the needs of different customer segments, transaction specialists have the opportunity to increase customer revenue through cross-selling and winning more of a customer's share of wallet, as well as enhancing and prolonging relationships.

Unlocking the full potential value of the transaction banking operation may mean running transaction services as a business and engine of growth in its own right. Transaction operations are often viewed as a cost-centre, rather than the revenue generator that they have the opportunity to become.

Banks should consider how they structure their organisation to optimise how they sell transaction services. Creating the organisation and management focus to develop and sell the right propositions to meet customer needs across the three business areas of cash, trade and payments enhances the opportunity to rapidly grow this business, and gives greater flexibility to adapt to the emerging market landscape. Focusing on developing efficient and high quality payment operations and infrastructure, with world class manufacturing techniques, gives the organisation the capability to reduce costs and seize new opportunities. Just as important is ensuring that the bank’s people are trained and incentivised to sell and deliver these services effectively to their customer base.

Next steps
The advent of the credit crunch and changing economic conditions, in combination with the ongoing change and opportunity in the transaction services – and especially payments – arena, has created a defining moment in the payments landscape. As a result, banks have an outstanding one-off opportunity to re-examine and redesign the ways they operate and differentiate their payments services, helping to position them for high performance in the future, regardless of how deep or how long the credit crunch goes on.

If you would like to hear more about how Accenture could help you drive growth and move towards high performance by transforming your transaction services business, please talk to us.

Authors

Christopher Geldard, Accenture

Christopher is a partner in Accenture. His 15 year career has been closely aligned to the UK Banking and Payments Industry, both in terms of strategic and delivery based initiatives involving cost reduction, revenue generation and regulatory compliance.

Christopher is also a lead partner in Accenture’s global payments practice, with a specialised focus on transaction services

Sulabh Agarwal, Accenture

Sulabh is a Senior Manager in Accenture. He works with the UK Banking strategy practice and has led several transaction banking strategy projects for European banks and payments processors.

Andrés Bernad, Accenture

Andrés is Senior Manager in Accenture. He has been working in Global Transaction Banking for more than 10 years for major banks in Europe and Latin America.

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