



PRUNING FOR GROWTH AND DISTINCTIVENESS

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01

IN THE POST-FINANCIAL CRISIS WORLD, REGULATION, MARKET STRUCTURE AND TECHNOLOGICAL POSSIBILITIES CONTINUE TO CHANGE AT AN ACCELERATED PACE.

In this new environment, investment banks of all sizes find themselves having to take a systematic view of how the market is evolving, where value is migrating, and how they can secure or regain competitive advantage. The time has come for investment banks to prune not only product offerings but also selected business lines. They need to identify and strengthen core businesses that will drive growth and increase competitiveness in a market featuring increased regulatory burdens and a shrinking revenue pool.

REINVENTING THE WHEEL ON A ROAD FULL OF OBSTACLES

In the past few years, investment banks have struggled to restore overall profitability. Revenues have fallen substantially from their post-financial crisis rebound as both volume and margin have declined across most products. In the meanwhile, higher compliance costs and capital requirements have been offsetting the effects of headcount and other cost-reduction measures.

The result: most of the “low-hanging fruit” seems to have been plucked on the cost side and hopes for a sustained near-term

revenue rebound are fading, leading more and more large players to conclude that this squeeze in profitability structurally impacts their business. (Beyond the choices presented in this paper around an investment bank’s business, please see Challenge 2 “Getting Fit: Aggressive Cost Reduction”—that links how banks could reposition cost reduction to achieve sustainable results and fuel growth choices.)

In response, a few players have begun making tough choices to prune their product offerings. These include UBS¹, which reduced its credit-trading universe to the most liquid spectrum; Credit Suisse², which announced to largely exit its macro business in EMEA and APAC; Morgan Stanley³, which retreated from commodities; and Standard Chartered⁴, which exited its equities business.

However, these efforts were mostly designed to eliminate what was deemed unsustainable. Investment banks are still faced with daunting challenges of new regulatory mandates, as well as other constraining factors such as rising client expectations.

Reigniting growth by identifying one’s strengths, aligning the business to those strengths, and developing business and operating models that build on and advance those strengths sounds deceptively simple. In reality, these steps are not that straightforward given the aforementioned uncertainties.

Traditionally, investment banks have shown a healthy appetite for strategic investment, but this track record of change came with newly created obstacles including fragmented and siloed business processes and technologies. Our industry insight and experience tells us that the next wave of strategic change has to transcend both these environmental challenges as well as the historical siloed management approach.

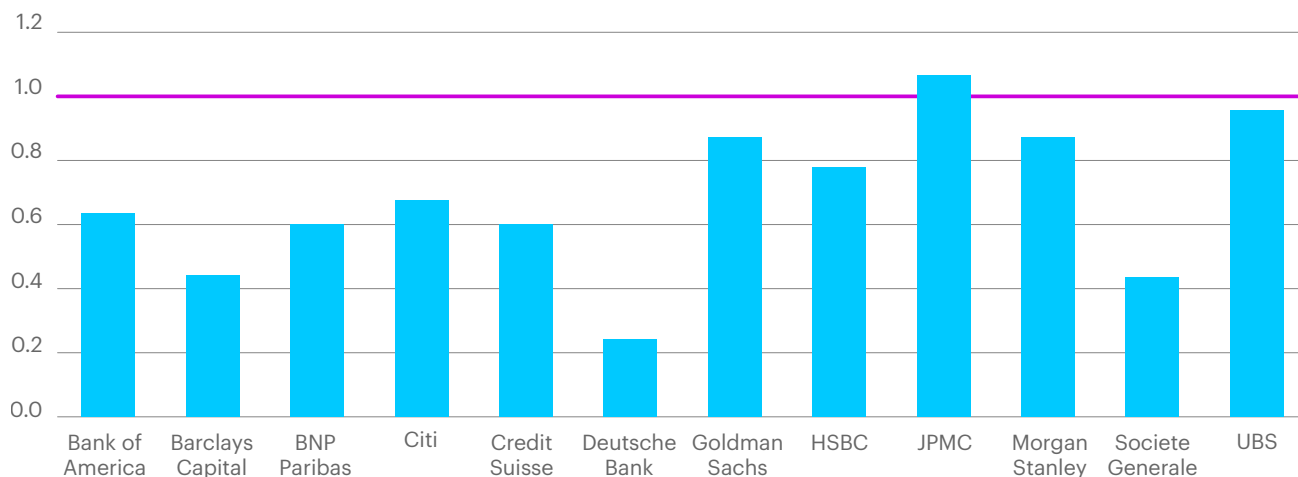
QUICK FACTS

- **REVENUES HAVE FALLEN SUBSTANTIALLY**
- **COMPLIANCE COSTS AND CAPITAL REQUIREMENTS KEEP CLIMBING**

A CLOSER LOOK

Traditionally, investment banks have focused on a limited core of professional investors, financial institutions, and corporates, and left servicing the broader universe of clients to commercial banks and asset and wealth managers. Leaders set themselves apart through product- and risk-driven innovation and fast followers rode the coattails of proliferating advances

Figure 1: Snapshot of investment bank value creation (price-to-book ratio)



1) Indication only – B/B captures sentiment about entire bank business model and future potential not just IB (e.g. problematic loan book quality needs to be factored in, as in the case of Citi and BoA). Source: Accenture analysis, YCharts; data as of 09/30/2016

to profitable growth. That was yesterday. With post-crisis regulation in place and more on the horizon (including FRTB and MiFID II), that formula has lost appeal. Most differentiators that used to drive business value (for instance, bespoke products) no longer create any valuable distinction. With regulation standardizing processes and making niche, high-risk products unfavorable, most investment banks are left with just the basics—corporate access, distribution network, and market-leading support function capabilities (such as risk management)—to drive differentiation.

Recognizing the traditional route to differentiation is no longer an option, some players have taken a new track. They have not only pruned their core business but have also begun to integrate it much more closely with other businesses to deliver a superior proposition to a broader set of clients.

UBS⁵ and Credit Suisse⁶, for instance, have been strengthening the link between their wealth management and investment banking businesses for some time. This has enabled them to leverage and align their businesses with their broader franchise of high-net and ultra-high-net worth investors. Recently, Credit Suisse⁷ has gone further to fully integrate wealth management, global markets and investment banking origination into one business unit across Asia Pacific.

Likewise, other companies such as J.P.Morgan⁸ have merged their historically separate investment banking, treasury and securities services and global corporate banking businesses into one corporate investment banking business in order to build an even stronger and more complete institutional client

franchise. More closely integrating these businesses allows banks a more holistic offering (for example, integrated cash management and foreign exchange solutions) and also helps to better adapt as historically separate businesses—such as investor services, exchange-traded derivatives brokerage and prime—converge with client needs in a cleared world. Both thrusts combine elements of focus and growth, but head in different directions. While one strategy shifts toward a broader audience of individual investors, the other strengthens corporates and additional clients who could benefit from the integration of transaction banking and global markets.



THE WAY FORWARD

We believe this trend of integration could gain further momentum in a digital world. To help secure and regain competitive advantage, banks need to think through a number of difficult questions:

Question 1: Which elements of our offering do clients truly value and pay for?

As banks grapple with whether to focus on providing pre-trade ideas based on research or a sales perspective, they should keep in mind a critical fact. Regulation, especially MiFID II, will require a significant set of investor clients to actually pay for research services while sales' ability to add color on flows has become more limited. It is often valued less as the availability of information combined with advanced analytics commoditizes this function (please see Challenge 9 "Rethinking the Research Function" for further reading on research for investment banks).

On the trading side, banks likely need to determine how to distinguish themselves as more products move closer to quasi-agency territory in an increasingly cleared world. Progressively, more dealers have withdrawn liquidity on key products, and the street has relied more heavily on buy-side liquidity and platforms aggregating them. Banks may decide there is greater value in providing access to this world and managing counterparty credit risk.

They also need to identify the role that post-trade will play with superior end-to-end client experience, efficiency and connectivity.

The answers could vary by product. Depending on their size, banks should come to different conclusions about what their franchises require and what they could deliver. While most global investment banks have refocused their credit business to the most liquid end (such as frequent issuers), others might find their sweet spot at the other end—for example, regional or local currency credit.

Question 2: What does this mean for client focus and franchise?

Banks need to determine whether a top-end client franchise still offers enough value in the future, or if they need to broaden their footprint. For example, a combination of digital distribution and local partnerships could help absorb counterparty risk and support client service.

At the other end of the spectrum, banks should identify how much value could be unlocked from, for example,

corporates—which segments to focus on—and how the balance between corporates and investors might need to shift.

Question 3: How do we reconfigure the operating model and cooperate across the ecosystem?

This bifurcation between more corporate investment banks and investor-driven models will likely continue. However, it may be possible to step beyond the traditional core—especially when it comes to enabling smaller, regional players and leveraging fintech ideas and the power of the surrounding ecosystem without competing with them. There are two avenues to that objective: one is to provide such players with more advanced products and solutions (for example, effectively outsourcing foreign exchange and rates trading) that they can integrate with, and simplify their operating model. The more radical step is to become more of a platform player that offers a full chain of trade services on certain products as a service or utility, and allows other players to plug in their areas of value (such as counterparty risk and client service) without the complexity and cost. The latter strategy certainly implies a further step away from existing business models—and therefore poses a broader set of change obstacles. But it might also attract more players (including exchanges and custodians in certain areas), which would intensify its disruptive impact.

THE JOURNEY AHEAD

As banks work to determine what their businesses look like, they need to remember that the decision won't be black and white. A select few players might still conclude they can truly excel at the core; others might move closer to an investor-, corporate- or platform-driven business model.

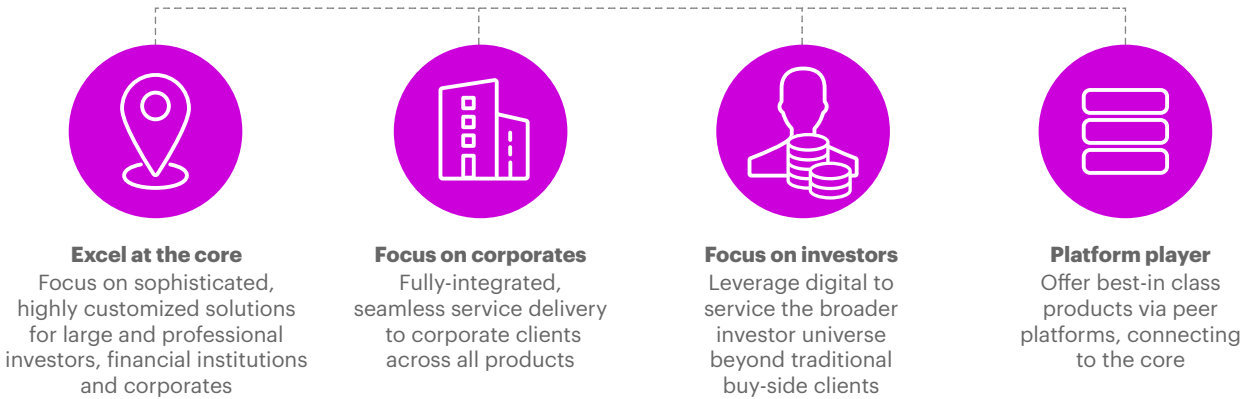
The largest players could combine multiple elements, while the smaller ones likely will need to focus. Regardless of where they end up, banks will need to pair further pruning with a strategy that identifies a clear direction and additional pockets of value. That's the key to a successful journey to renewed profitability in a challenging environment.

A FRAMEWORK FOR ACTION

While it is beyond the scope of this paper to fully define the steps that an investment bank would need to execute to sort through these choices and their implications, we can offer the following framework as a potential aide to C-Suite executives that are analyzing their choices and the capabilities required to enable them.

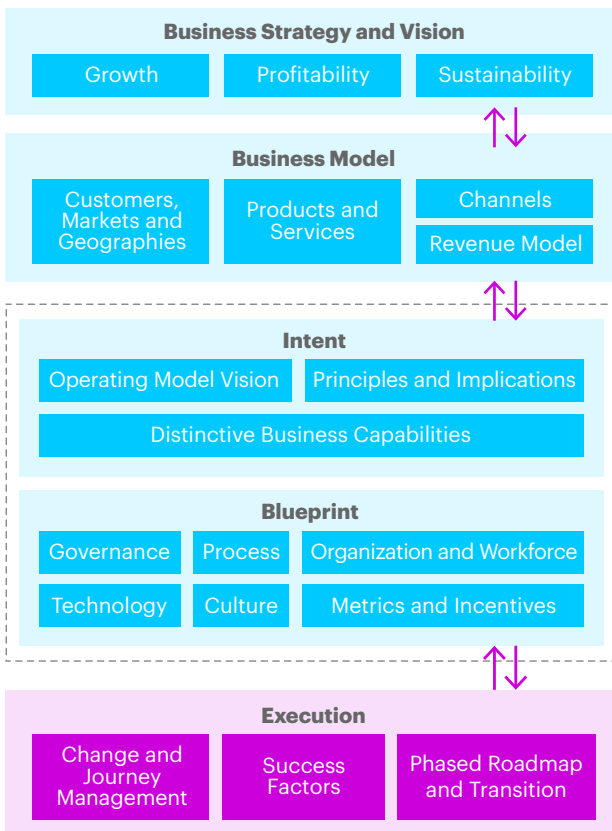
Figure 2: Repositioning at the macro level

Emphasis on client value: investment banks need to decide “where to play” and radically simplify their operating models accordingly



Source: Accenture

Figure 3: Business and operating model framework



Source: Accenture

“ REIGNITING GROWTH BY IDENTIFYING ONE’S STRENGTHS, ALIGNING THE BUSINESS TO THOSE STRENGTHS, AND DEVELOPING BUSINESS AND OPERATING MODELS THAT BUILD ON AND ADVANCE THOSE STRENGTHS SOUNDS DECEPTIVELY SIMPLE. ”

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