

Customers, Costs, and Compliance: IT Goals in Corporate Banking

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Introduction

Now is not the time for corporate banks to play it safe. The ability to roll out new initiatives and services now will largely govern which banks become market leaders in the near future — and which become also-rans and acquisition targets.

Many banking executives have found themselves in the position of wanting to make long-term technology investments, but also feeling gun-shy due to multiple sources of instability. However, investment will increase as banks see the opportunities that are available if they invest in technological upgrades.

In short, banks' IT focus is changing from cost-cutting to development and innovation. Most have trimmed the easily accessible fat, and are now looking at what IT can do for the business side. This combination represents a major opportunity for IT and services providers that can help banks:

1. Create a long-term plan addressing multiple needs
2. Improve profitability with initiatives based on customer service and retention
3. Reach regulatory compliance at a reasonable cost, without compromising customer experience.

Serving Customers

Corporate banking customers are beginning to expect more. The waves of consolidation, technological change, and regulation have led them to demand that large corporate banks offer them a growing range of services.

It is important that banks listen to their corporate customers. This means more than responding to requests for a specific service. Rather, banks must talk to customers about their overall business goals and how banking services could help them, then design services to meet these needs. Many of these services might lose

money in the short term, but will provide the foundation for future revenues and customer acquisition.

Corporate Customer eCare

Electronically assisted customer care, or ecare, has become the central aspect of many banks customer-facing efforts. ecare organizes financial information and makes it easily available to authorized users. Such services began with corporate portals that provide customers with services such as logging, monitoring, tracking, research, and case management capabilities. They have since moved into a variety of self-services tools, with an emphasis on transactions, visibility, and cost savings.

Many banks see ecare as part of a larger strategy of providing customer relationship management (CRM) services. As interest in ecare has grown — many banks report that three quarters of their corporate customers have shown interest — ecare has morphed from an add-on services to a customer retention strategy.

eCare initiatives have come in response to corporate demands for greater visibility into transactions. In order to provide such services, banks must organize customer information and then make it available in usable and secure formats. This is creating demand for standardization among different corporate banking silos, for instance, between deposit and investment arms. Customers have come to expect that they should be able to contact the bank through different means — phone, email, web and fax are the most common — and gain a consistent experience, complete with the ability to follow a particular inquiry. For banks that can make this integration happen, they will gain a deep insight into customer needs, allowing them to better sell add-on services.

New B2B Trade Services

Banks' trading services have evolved as a reflection of their new emphasis on customer care. Corporate customers have been looking for banks to help them solve trade process issues, but efforts to meet these demands have suffered from a lack of preparation and standards.

Over the next two years, major corporate banks will roll out a number of new initiatives to address this imbalance between expectations and reality, with an emphasis on providing trading services and greater visibility into the trading process. These efforts will depend on the creation of an advisory framework depending on integration to connect cash and trade processes, and between various trading partners. Trade services will also involve partnering with consultants and other outside IT providers to create trading services that address a wide range of needs while also being industry-specific, focusing on particular end-user trading needs.

Event-Based Banking

Event-based business banking (EBB), the electronic delivery of services through channels other than the branch or the Web, is emerging as a new service and retention model. EBB is characterized by the conjunction of self-service with flexible delivery models. EBB will be an important component the self-service components of corporate care, with features such as cash management, retail banking, and event-based notification. One goal of EBB is to focus on the business context of corporate services, allowing customers to access these services through multiple means.

While these are more pressing goals for large customers, who tend to need a wide variety of banking services, it will also be an important service delivery channel for smaller businesses. This will also be a key area in which banks seek help from outside IT providers with expertise in corporate portals, information sharing, and communications convergence.

Payment Infrastructure

This is an important service area, and one which presents banks with an opportunity to differentiate themselves. Payment systems are complex and prone to regional differences. In the United States, Check 21 will drive spending as banks invest in technology to support image clearing. Going into effect in October, this act removes the legal impediments to check truncation. In other words, it allows electronic checks to be presented to paying banks, rather than the paper originals. The goal of this act is to lower transaction costs, but for many banks, it will demand improvements in imaging systems and related security.

Meanwhile, demand for small value payments has caught on in Europe, if not in the United States. For multination banks, however, experience in Europe will give them a head start if U.S. corporate banking customers start to demand this service in large numbers. The STEP 2 regulations in Europe have also led banks to invest in cross-border payments. These services will likely lead to improved cash management and processing services by banks.

Ensuring Compliance

Regulatory compliance has swept across many different industries. Corporate customers are looking for banks that 1). can help them meet their own compliance needs and 2). are fully up to speed on all compliance issues. Important new regulations affecting financial institutions include the following.

- **Sarbanes-Oxley Act.** The most significant piece of financial regulation in years, this act governs financial reporting and auditing in public companies. It demands internal controls and certifications, including whistleblower protections. Sarbanes-Oxley has been seen as a response to some of the

more serious examples of corporate malfeasance in recent years, making compliance both a regulatory and public relations necessity for large companies.

- **SEC Rule 17a-3 and 4.** These sections demand that brokers and other financial institutions have the capacity to capture, index, archive, and search their electronic communications, with records kept for at least three years. This has led to IT spending in two thirds of affected institutions, with an emphasis on storage and the creation of metadata.
- **The New Basel Capital Accord.** This agreement between the United States and several other nations is an update to a 1988 Accord that created a risk-based framework for banks based on credit risk. The updated agreement, known as Basel II, will go into a effect on a phased-in basis between 2004 and 2006.

While such regulations are imposing a significant burden on banks, smart financial institutions see an opportunity in disguise. Companies that take the right steps will become more secure and efficient while gaining competitive differentiation. Compliance provides a starting point and unifying theme for several IT planning and infrastructure issues that banks are tackling.

Bringing It All Together: IT Planning and Innovation

The combined demands of customers and compliance will push banks towards making several different types of innovations. These will affect customer-facing functions, but will be primarily focused on the back office. Banks are changing the way they approach their IT needs, both in terms of resources and organization.

Corporate Profitability Management

Corporate profitability management systems are used to formally assess institutional profitability and risk in relation to particular investments. These systems are also part of a larger shift within banking systems, reflected by changes in both payment systems and the outsourcing of certain business functions, particularly processing. They often sit on top of enterprise resource planning (ERP) systems.

Corporate profitability management systems aim to gain a holistic view of a company or investment, bringing together not just balance sheets but a view of future prospects in the form of regulations, competition, customers, and other hard-to-quantify qualities. Such systems will allow banks to become more disciplined and take a longer view when evaluating investments.

Outsourcing

The nature of outsourcing in the banking industry is changing. While some traditionally outsourced functions are moving in-house in large banks — credit card

processing comes to mind — the major trend is towards outsourcing repetitive and labor intensive functions. Increasingly, these are moving offshore, where the biggest savings can be found.

Outsourced work can include both core and non-core tasks. Two major areas will be payments and image-based check processing. This follows the model in Europe, where check processing is already the status quo. The biggest issue for banks with outsourcing is continuing to ensure security and compliance.

IT outsourcing is also on the rise, with about 20% of current IT spending by corporate banks going outside the company. Between 2003 and 2007, the outsourcing of back-office applications in the banking industry will rise from 16% to 35%. Off-shore software development will grow from 23% to 38%.

Integrated Information Management

Factors such as regulation, profitability, and a focus on customers are pushing banks to embrace integration information management. This term refers to the consolidation of customer and transaction information into a coherent system that functions between the front and back office and across previously separate information silos.

Banks are building centralized back-office data warehouses that can be accessed by both authorized users and automated software systems. Part of the goal is to unify disparate payments and record systems, allowing both regulatory compliance and improved ease of use by bank employees.

Business Process Automation (BPA)

BPA serves much the same function in banking as it does in other business: streamlining processes while reducing errors. Several major banks are currently laying the groundwork for a two-to-four year process to install BPA systems that will include diagnostic tools that monitor process flows, detect inconsistencies, and repair broken elements. By the end of these implementation, many of these institutions will have imbedded BPA in customer-facing processes, allowing banks to quickly provide customized services, decrease customer-related costs, and improve loyalty.

Automation is also central to compliance efforts. BPA allows banks to identify and categorize data and design appropriate workflows and storage. This normalizing and unifying of internal processes is known as exception management. By creating a framework for business rules now, banks will be able to more easily add new technologies and services.

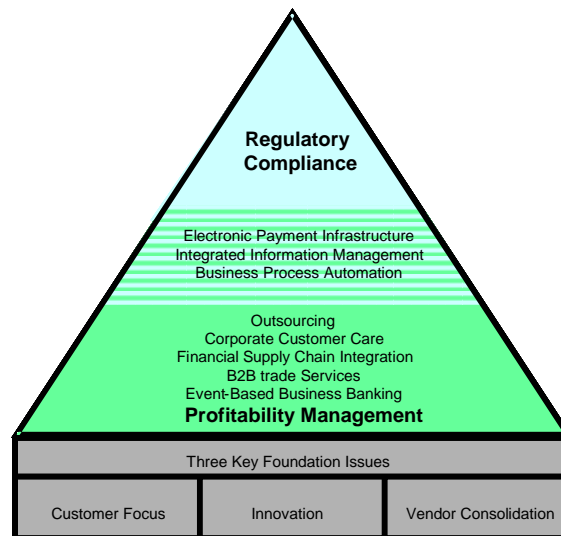
Financial Supply Chain Automation and Integration

To support integration via electronic data interchange (EDI), banks must eliminate manual processes. By implementing system-to-system integration in-house, banks can provide straight-through processing of payments and information, triggered by supply chain events. Such integration will allow banks to offer more sophisticated automated services directly to customers.

Perhaps more importantly, it will allow banks to turn potential competitors into partners by creating a framework for cooperative with outside firms. By taking advantage of synergies, banks can create marketing and customer service initiatives that leverage partners skills and customer bases.

The IT goal of banks is to fit all of these initiatives together into an infrastructure that supports customer and compliance needs. This model can be visualized in Figure A

Figure A: IT Framework for Corporate Banking



Source: *Financial Insights*

Considerations

The efforts mentioned above must be addressed within the context of the competitive pressures that banks currently face. Foremost among these is consolidation, both among banks themselves and the vendors that serve them. For banks, consolidation means that the pressure to add new services and exploit economies of scale is greater than ever. Bank customers, meanwhile are seeing their choice of banks as a competitive differentiator for their own businesses. In turn, they are demanding ever more sophisticated services. In other words, banks must either be big or act big.

Consolidation among IT vendors is forcing banks to do more due diligence, seeking out suppliers who adhere to industry standards and appear likely to survive for the foreseeable future. Providers are swallowing each other up in an effort to provide complete, best-of-breed solutions.

Finally, while it never makes sense to ignore security, Financial Insights believes that security issues are not paramount for most banks right now. Large corporate banks have already taken most of the security measures they need to, and will see a declining return on additional security dollars

Conclusion

Consolidation and regulatory compliance have taken away the option of doing nothing. It is now up to banks to seize the opportunity by addressing these issues within a larger context that improves efficiency and provides a framework for new corporate banking services. Over the short term, many banks might find themselves plugging gaps using short-term solutions, but even these initiatives should be rolled up within a larger, forward-looking IT plan.

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