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Boosting Front-Office Productivity In Capital Markets

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Capital markets and investment banks (CMIB) are facing a raft of pressures. Lucrative businesses such as credit derivatives and securitization took large hits after the financial crisis and are only now beginning to show signs of revival. Meanwhile, CMIB divisions are grappling with economic stagnation, falling leverage and a lower profit base.

In this environment, operating costs are under heavy scrutiny, and bank management is focused on productivity. Many banks have responded with large cost-reduction programs and efforts to optimize IT, back and middle offices. These initiatives are necessary, but overlook the fact that front-office compensation can represent half of an institution's capital markets cost base. By focusing on boosting the performance of the front office, banks can not only achieve productivity gains of as much as 10 to 30 percent, they can also deliver a higher level of service to clients and thereby sharpen their competitive edge. To reach these goals, management must be prepared to challenge entrenched behaviors and cultural norms and commit to a long-term effort. A number of leading banks are already seeing significant results from taking on this challenge.

Transforming front-office performance

Opportunities for improvement in the capital markets front office can be grouped into four areas: client management, steering, cooperation and skills. As with most institutional change initiatives, the journey begins with a clear-eyed self-appraisal and continues with a systematic approach to addressing root causes and making solutions stick.

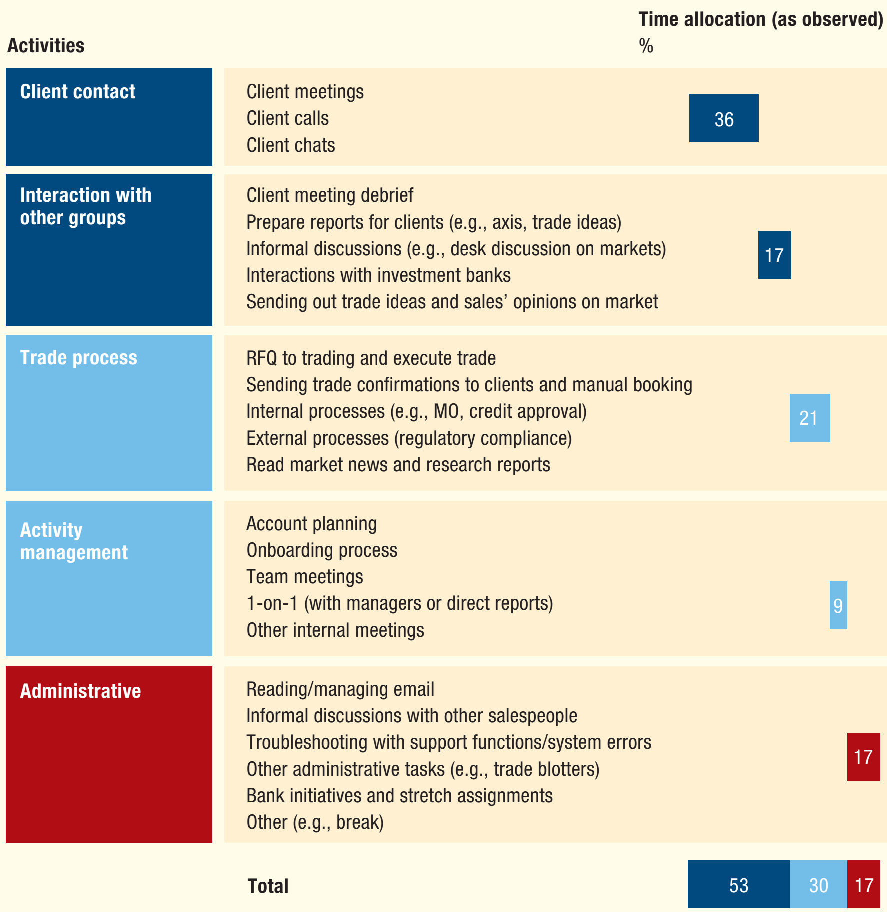
Client management

There is often a mismatch between what managers expect from producers (i.e., sales, traders, structurers, research analysts) and how producers actually spend their time. This is particularly true with regard to client-facing time: at one leading bank McKinsey found that salespeople spent only about 35 percent of their time with clients (Exhibit 1, page 2). In addition, many banks also lack effective tools for focusing resources on clients who most value high-touch service. In the absence of a coherent structure, salespeople often gravitate to the clients with whom they have strong relationships at the expense of those clients whose relationships need attention.

To change this dynamic (of focusing limited client-facing time on the "wrong" clients), banks must develop a client view that incorporates unfiltered feedback on client needs, a frank assessment of where salespeople should be

Exhibit 1

Capital markets sales staff spend as little as 35% of their time in contact with clients



Source: McKinsey Global Corporate & Investment Banking Practice

focusing their time and how traders should be leveraged in the client relationship, and an unambiguous roadmap for building the relationship.

- **Listening to the voice of the customer.** Beyond broker reviews (usually in place only in the equities division), capital markets businesses rarely seek out structured feedback from their clients, even though the customer perspective is a crucial foundation for ensuring that resources (e.g., sales, research analysts) are used well. Even when broker reviews are in place, problems often originate in the way reviews are structured (with a focus on rankings and hit ratios versus crucial qualitative information), and in the fact that they are too frequently led by someone (e.g., salesperson in charge of the account) with dual agendas (i.e., gathering feedback and asking for more business). To avoid these pitfalls, one leading capital markets bank instituted a system in which an independent reviewer (from a dedicated client management unit) goes to the client armed with a set of questions that addresses both standard quantitative issues (e.g., "How do we rank with you on a product-by-product basis?") and more open-ended, qualitative areas (e.g., "Are you satisfied with the capability of your points of contact on the sales and research sides?"). The reviewer's sole agenda is to listen to the client's feedback. Afterward, the reviewer meets with the heads of sales and trading to deliver the feedback and to develop a plan for addressing shortcomings. Three months later, a return visit to the client is planned (this time including the salesperson in charge of the account) to describe the improvements made and to ask for additional business (which is a logical conclusion at this stage).

- **Consistency in client-tiering.** Ideally, client-tiering enables a capital markets bank to deliver the optimal level of service to a client. However, the reality is that most banks base their client tiers on historical sales credits (not taking into account potential revenues or the needs of the client); the level of service delivered to each tier (if defined) is mostly focused on pricing aggressiveness. A leading European bank setting out to revamp its approach began by clearly defining what each level of service entailed (down to the number of client meetings, phone calls and research team visits per year). When the time came to define which clients were entitled to a specific level of service, multiple criteria were used: current and potential profitability, including an assessment of the client's value from a trading perspective (e.g., does the sales credit generated lead to trading P&L?); client appetite for increased levels of service (to avoid delivering high-touch service to a client that does not value it); and the level of service provided in different areas of the bank (to avoid inconsistency from the client's perspective).
- **More focused account planning.** Frequently, account planning at capital markets institutions focuses on describing the current state of the relationship, rather than setting a forward-looking agenda. Upon reviewing its account planning practices, a leading bank found that meetings were burdened by having too many participants (from all products), no clear leader, and an overemphasis on cross-selling (without clear next steps).

The bank discovered that it was more effective to narrow the scope of account planning meetings to the product level and to focus on specific, tangible and measurable action steps (e.g., bring research analyst to the client's portfolio manager in the second quarter to discuss FX strategy). In addition, actions were reviewed over time by senior management (not just floor managers) who vigorously challenged their salespeople to be specific and ambitious about how they intended to build their relationships.

Steering

Even capital markets banks with clearly defined client management approaches can fail at the level of implementation, in large part owing to cultural issues that are specific to the industry. Lack of alignment between managers and producers about the bank's priorities, for instance, is frequently camouflaged by the appearance of robust communication. In most front-office environments, there is plenty of ad hoc and informal interaction between managers and producers, so it may look as though the level of communication is high. In reality, this communication rarely centers on cascading the bank's priorities from management to the front line. Capital markets businesses need a more structured approach to feedback and review, with both team and one-on-one meetings devoted specifically to ensuring that management's strategy is clear throughout the organization and to providing concrete feedback and coaching on performance. Resistance is common when banks implement this kind of approach, but it tends to dissipate once both front-line managers and their teams see the benefits of transparency (clear alignment on objectives and priorities) and structure (freed-up and prioritized use of time). At one bank, resistance declined when managers realized that their salespeople were not meeting with clients as frequently as they thought, a dialogue that could not have happened during daily ad hoc interactions.

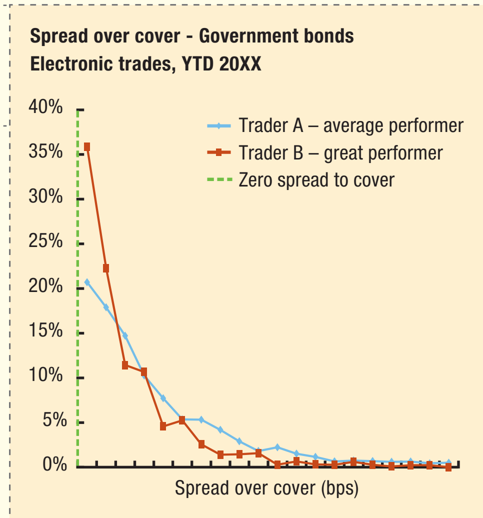
Ensuring that the bank's priorities are implemented is also made difficult by the fact that, compared to other industries, performance indicators in capital markets are only focused on outputs (i.e., P&L for traders, sales credits for sales). These indicators provide little insight into what the bank's management expects producers to do, which explains why producers are not necessarily aligned with the bank's priorities since they believe that they are evaluated only on their results (and not on how they achieve them).

A leading European bank decided to shift its mindset on performance and to include both outputs and inputs indicators in producers' evaluations. On the sales side, developing inputs-oriented indicators was a straightforward

Exhibit 2

Performance indicators should focus on the qualities that make an effective trader

P&L levers	Rationale
Market knowledge	Opportunity costs are reduced by limiting the difference between traded price and cover
Pricing consistency	Pricing in a consistent manner improves relationships with clients and helps internalize risk recycling
IDB slippage	Limiting transaction costs in the IDB markets increases P&L
Turnover	All things being equal, high book velocity limits risk of being "stuck" with a position



Note: Trading example

Source: McKinsey Global Corporate & Investment Banking Practice

exercise as client calls and meetings can easily be tracked. Defining input-oriented indicators for traders was more challenging due to the single focus on P&L. The bank found that exceptional traders were consistent in the service provided to clients, were turning their inventory efficiently, and were skilled negotiators in the brokers' market; when they won a client trade, it was by the smallest amount possible (to avoid leaving money on the table). The bank then decided to develop indicators to track these behaviors since they were key P&L levers (Exhibit 2).

Cooperation

Efforts to increase productivity in the capital markets front office also need to address the elephant in the room: the day-to-day friction between sales and traders. Because these two groups have very different responsibilities and degrees of specialization, they often have a hard time seeing where their opposite numbers add value. Each side perceives that incentives exist to withhold information from the other in the belief that this will improve its share of the bonus pool. Capital markets banks can take a number of approaches to improve the dynamics between sales and trading:

- **A more effective morning meeting.** Morning meetings are often seen as routine and obligatory (though with low attendance) rather than value-adding. At one bank, sales teams were working at their desks instead of listening to the meeting. The bank decided to try a more structured approach, making sure an agenda was sent out beforehand, encouraging traders to focus their intervention on the positions they wanted to offload (instead of repeating the market commentary from the day before), and requiring participants to stand up during the meeting. To show the importance of this moment, heads of trading and sales started to join the morning meetings for the different product areas.
- **Cooperation by contract.** One of the most effective practices McKinsey has seen a bank put in place was the drafting of a "contract" where traders and salespeople detailed what they expected from each other. As expectations became clearer to everyone, both sides could have fact-based discussions about real issues. In addition, adherence to the "contract" was tracked over time via surveys and discussed during Executive committee meetings to ensure real follow-up by both sides on what they signed off on.
- **A day in the life.** At a leading European bank, traders and salespeople committed to spending half a day sitting next to their counterparts to observe him/her. The objective of this exercise was to make everyone realize the challenges and constraints faced by the other team. The sales team was surprised to learn how quickly traders had to work, how stressful their environment was, and how much information they needed to digest throughout the day. Traders realized that salespeople had to cover a broad range of products for their customers, making it difficult for them to follow the market as closely as they expected.

Skills

Due to the nature of the industry and specialization in its workforce, important skills gaps exist at two different levels in many capital markets banks:

- **At the managerial level.** The most common route for advancement in the capital markets business is the promotion of star performers from a P&L or sales credit perspective. By default, this means that those promoted into managerial roles have not earned the promotion through excellence in management. This explains why front-line managers frequently feel at a loss when it comes time to coach and manage their teams. Even when these managers are given training, it is often training of the theoretical kind that provides little in the way of concrete guidance on getting the best performance from their teams. To help these important stakeholders maximize productivity, capital markets banks must invest in pragmatic, focused training that addresses the situations that managers face on a day-to-day basis.

- **At the producer level.** To understand the capability gaps that it was facing, a leading European bank decided to have all its managers fill out a matrix detailing, on an individual basis, which skills they still needed to be fully proficient. Based on this, the bank launched targeted initiatives to boost those skills. For example, because traders were not necessarily skilled presenters (explaining why salespeople were reluctant to involve them in client meetings), the bank put together a jury composed of senior managers from sales and trading and had all traders pitch a trade idea to the jury. This gave traders a low-risk opportunity to work on their presentation skills. Similarly, to improve the sales-pitching capabilities in structured products, a product manager was designated for each product launch. His role was to prepare the pitching material (including a detailed narrative) and to take on the part of the client in role-plays with salespeople to gauge the quality of their pitches.

Impact

A front-office transformation can achieve significant improvements in both the performance and the health of the organization, in areas including:

- **Effective management:** The increased visibility provided by steering dashboards and regular discussions with producers enables management to provide more systematic guidance and prioritization of resources. Managers feel empowered to engage in difficult but constructive conversations and feel more comfortable challenging their team members. And improved communication and alignment between management and producers is key to catching and avoiding potential conduct risks.
- **Productivity gains:** Front-office transformations can enhance productivity by 10 to 30 percent, savings that can be reinvested in value-adding activities or captured as reductions in staff. More efficient processes and an improved capacity-management system allow banks to shift time spent

on non-core activities (e.g., administrative tasks, troubleshooting) to more productive uses (e.g., cooperation between teams, increased client time for traders and additional prospecting or pitching to clients).

- **Team spirit and morale:** Sales, traders, structurers and research analysts may never be enthusiastic about minimum reporting requirements, but many acknowledge the need for stricter steering and management practices. They often find that clear individual business priorities boost the quality of discussions with their managers. Clarified roles and responsibilities within a team and across teams lead to a less tense atmosphere, especially in difficult times. Regular coaching and development opportunities are often highly appreciated.

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Productivity in the front office will be a competitive advantage in the challenging capital markets banking environment. The transformation, however, is a significant undertaking, not least because it demands changes in entrenched behaviors and habits. Capital markets banks that commit to this long-term effort will see sustained and significant improvements in productivity, organizational agility and morale.

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