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Global transaction banking: The $1 trillion question

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Global transaction banking: The $1 trillion question

Global transaction banking (GTB) is not the kind of business to generate headlines or draw attention to itself. Over a long period, it has been seen as the workhorse of the banking world—a reliable performer that quietly goes about its business. Despite its sleepy image, however, GTB is a big hitter—generating around $1 trillion of revenues every year.

Notwithstanding its success, GTB is subject to the same challenges as the rest of the financial industry, including low interest rates, heavy regulations, and a technology revolution that is reshaping customer expectations and the competitive landscape. Market disruption is increasing, as clients demand sophisticated products and services that few players can deliver, and as the corporate world digitizes, banks are under pressure to keep pace.

McKinsey's most recent Global Transaction Banking Survey shows that many GTB banks are responding to these trends—assigning budget to digital and customer services, consolidating capabilities, and looking to take on new entrants in key areas such as payments and trade finance. In an era where partnerships will be important, they are also exploring ecosystems, rethinking connectivity, and eyeing the next wave of M&A and private equity investment.

The shifting industry landscape has put pressure on GTB margins. In documentary trade finance, for example, they are estimated to be falling by around 2 percent a year. Moreover, there is no guarantee the dynamic will shift anytime soon. Indeed, digitization and regulations such as Europe's Payment Services Directive 2 (PSD2)—which increases cost transparency—may exacerbate the trend. Given the challenges, GTB leaders must make astute decisions now, which could be the difference between winning and losing in the years ahead.

GTB executives expect liquidity management, documentary business, and supply-chain finance to drive growth

GTB is responsible for more than 40 percent of global banking revenues and its key growth drivers are reassuringly stable, McKinsey's latest global banking pools estimate shows (Exhibit 1, next page). Payments and documentary trade-related business have been the primary growth engines for most banks over the past three years. Some 71 percent of respondents cite payments as the number one growth driver in cash management and 67 percent cite documentary business in trade finance. In second place in cash management is accounts and deposits while in trade finance it is factoring (and reverse factoring). Transactional FX is also cited as an important driver of growth, with 57 percent of respondents saying it was a key revenue generator over the past three years.

Looking forward, however, there are signs that perspectives on growth drivers are starting to shift. A majority of bankers say liquidity management, documentary business, and supply-chain finance are the most promising product lines, with growth

Exhibit 1

Global transaction banking annual revenues are nearly $1 trillion.

Wholesale banking global transaction banking revenue pools, $ billion, 2018

Core products

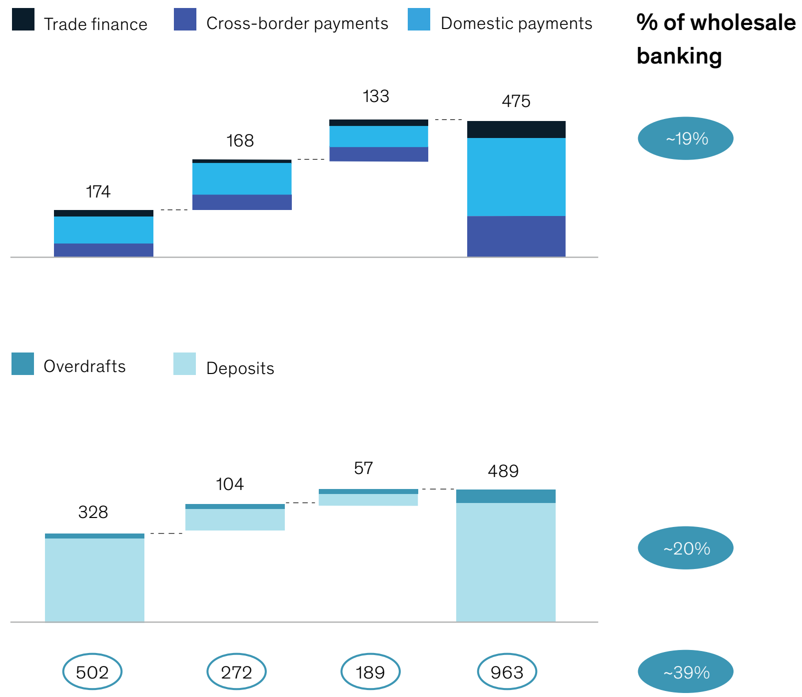
Trade finance: documentary business for international trade, supply-chain finance, and receivables finance

Cash management: domestic and cross-border payments, including liquidity management

Other working capital products

Overdrafts: pre-arranged or unarranged overdrafts at domestic banks

Deposits: current accounts and savings deposits at domestics banks



Source: McKinsey Panorama Global Banking Pools; McKinsey Global Transaction Banking Service Line; McKinsey Global Payments Map

likely to reach 5 or 6 percent annually (Exhibit 2). Around one in five of those surveyed believe liquidity management and deposits could see growth of more than 10 percent, while around the same number see the same in supply-chain finance.

Investment to focus on platforms and the customer experience

Transaction banking leaders are aware that they will need to change the way they play to grab a bigger slice of the pie. The two areas pinpointed for investment are the customer experience (cited by 95 percent of respondents as an area to build competitive advantage) and platform innovation (cited by 89 percent). Products, pricing, and geographical footprint are lower, but still material, priorities. On barriers to growth, concern areas focus on capital/lending constraints, IT system/platform challenges, and counterparty risks.

Banks understand transformative change is impossible without a significant commitment of funding and resources. Half of respondents have set aside IT investment budgets in excess of $100 million for GTB over the next three years (Exhibit 3, page 5). In the past, a significant restraint has been the need to spend large sums of money on maintenance and regulatory compliance. Notably this year the emphasis is shifting to change-the-bank priorities, with the highest proportion of respondents saying 60 percent of their budget is earmarked for those purposes.

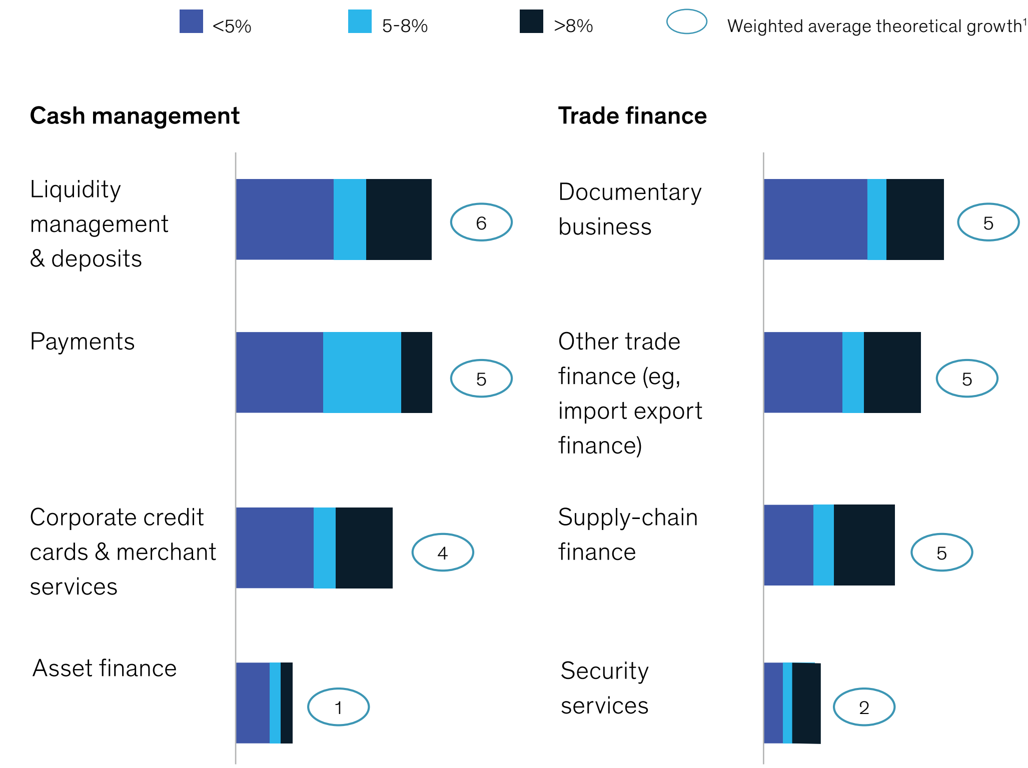
When it comes to cost cutting, there is a clear bifurcation of strategies. Around 40 percent of respondents aim to significantly cut their GTB budgets. However, many others do not see cost cutting as a priority. Where firms do plan to take out costs, commonly cited levers include automation and straight-through-processing, process consolidation, and standardization of

Exhibit 2

Future global transaction banking growth will be driven by elements of cash management and trade finance.

Products expected to drive future growth

Question: What is the revenue growth by products driven by customer business volumes that your bank can target to achieve over the next three years?; % of respondents



[1] Calculated using different growth brackets and percentage of respondents for each bracket.
Source: McKinsey Global Transaction Banking Survey 2018

operational processes. Slightly larger redundancies are predicted in trade finance than in cash management, probably because trade finance offers more opportunities for automation.

Digital and analytics are more critical than ever

Some 95 percent of respondents say they will invest more in digital and analytics to ensure clients get a better, more tailored, and more seamless service. Digitization of the middle and back offices is seen as almost as important. Many GTB units have already made progress—three quarters have digital platform propositions up and running, relying on a mix of self-build and vendor offerings. A related strategic trend is the intention to phase out legacy IT frameworks, which is the number one IT priority for almost half of survey respondents.

When it comes to innovation, the outstanding areas of focus are product and channel innovation, with the largest number of banks also set to prioritize big data and artificial intelligence capabilities (Exhibit 4, page 6). Among products and channels, the highest survey scores are assigned to domestic and cross-border real-time payments and mobile/tablet innovation. Bankers understand that the key to building data-led capabilities is relevant, standardized, and accessible data, and some 75 percent say they plan to invest in data lakes for big data applications over the next three years. When it comes to technologies, open APIs in cash management are top of the list for 90 percent of respondents.

In Europe, the impact of PSD2 began to make itself felt over the past year. Some 90 percent of respondents say they plan to invest in APIs to build their partnership networks and boost connectivity. Blockchain remains high on the agenda, with 60 percent seeing distributed ledgers as potentially useful tools, particularly in the trade finance context.

Many banks, meanwhile, have started exploring artificial intelligence, with half of respondents saying they are active in that area. Three in five banks plan to invest in machine learning, so that they can make the best use of data assets to offer smarter customer services. Right now, however, the primary use case for artificial intelligence is in operations, where applications such as optical character recognition are being used for standardized tasks and processes such as document reviews.

The majority of banks are also using advanced analytics to sharpen their offering and protect their data, with anti-money laundering and cybersecurity use cases at the vanguard (Exhibit 5, page 7). Respondents again indicate a shift towards improving customer service for future use cases. Lead generation is an increasingly favored application, and investment in that area is set to accelerate over the coming years, the survey shows.

Liquidity forecasting is seen by four in five banks as having significant analytics potential. Chat bots, meanwhile, are moving into the mainstream, and most banks say they will become a core element of the customer service proposition soon.

Organization and coverage: The winds of change

Given its prominence on the balance sheet, it is not surprising that most banks run GTB through a dedicated unit. More than nine in ten operate under that structure, according to our survey, albeit with some nuance around product coverage. Liquidity and traditional trade finance, for example, sit squarely within GTB, whereas cards/acquiring, asset finance, and transactional FX are often shared with other units or sit outside GTB (for example cards in retail and FX in the investment banking unit). A common ambition, however, is to bring these capabilities under the GTB umbrella.

Most global transaction banks cover a full menu of services (Exhibit 6, page 8). On the cash management side that includes payments, accounts and deposits, and transactional FX, while in trade finance almost every bank offers documentary business and the majority are strong in factoring, and import and export finance.

The overwhelming majority of GTB units provide services to all corporate segments except small businesses and micro-enterprises, which are usually the preserve of retail units. Indeed, between 80 and 100 percent of banks cater to non-banking financial institutions, correspondent banks, banking financial institutions, multinational corporates, large corporates, and mid-corporates. On most counts there is very little variation between regional and domestic banks, though regional banks tend to focus more heavily on correspondent banks than their domestic peers.

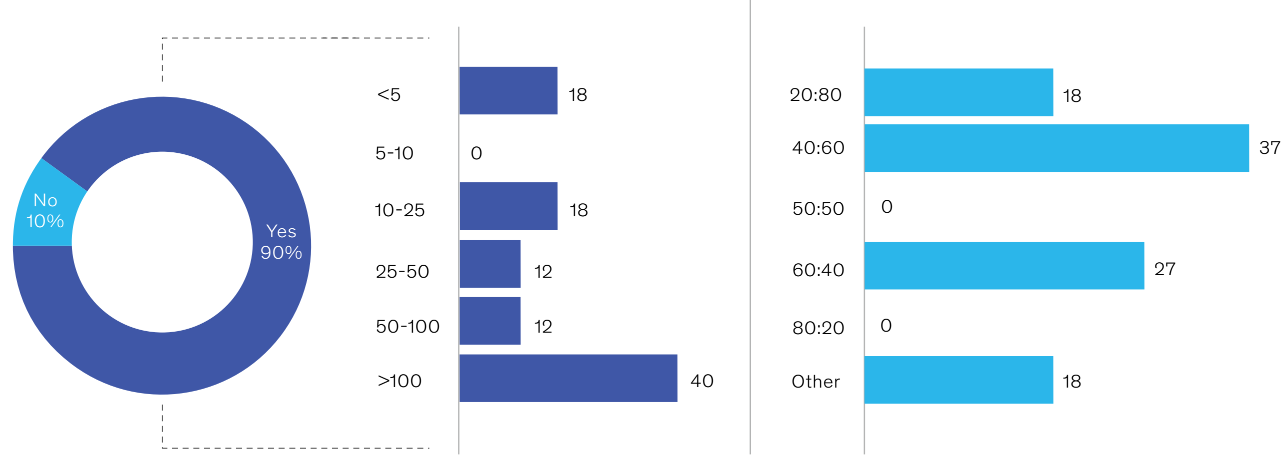
Exhibit 3

Half of respondents have an IT investment budget of more than €100 million for the global transaction banking unit; in most cases 60% is set aside for changing the bank.

IT investment budget ($ million)

Question:
Does GTB unit have a specific IT investment budget for the next 3 years? If yes, please pick a range to choose the average yearly IT budget; % of respondents

Question:
What is the approximate split of run versus change[1] the bank in terms of IT investment budget over the next 3 years?; % of respondents

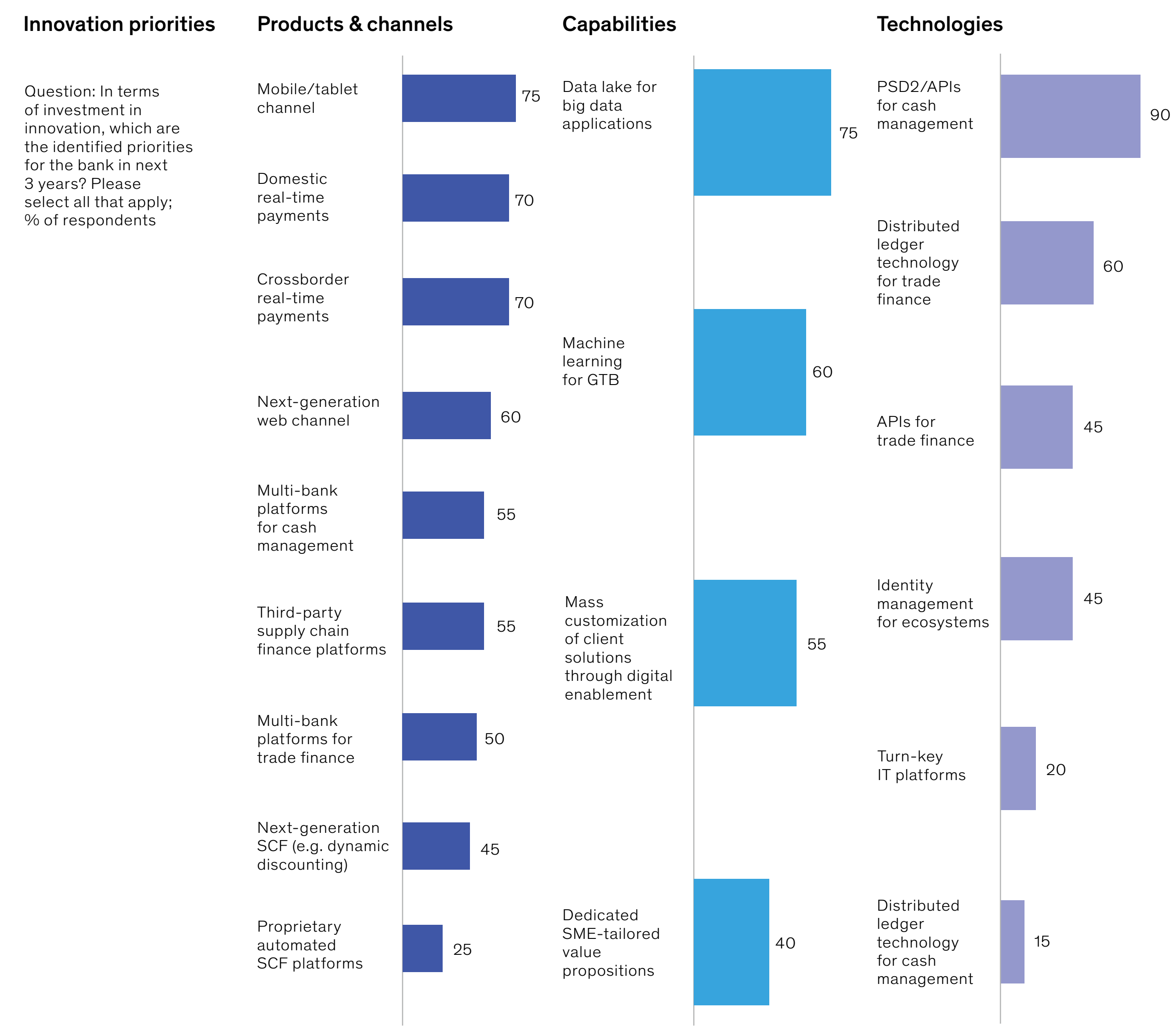


[1] Run the bank refers to day-to-day activities required to support ongoing activities within a bank. Change the bank refers to activity aimed at improving how the bank operates, including enhancements to IT, operations, customer service, sales and marketing, and other areas.

Source: McKinsey Global Transaction Banking Survey 2018

Exhibit 4

Priorities across innovation portfolio.



Source: McKinsey Global Transaction Banking Survey 2018

Contrary to the widely held perception, mid-corps remain a priority segment, while around half of banks say large corporates and multinational corporates are their dominant area of focus.

From a coverage perspective, GTB units tend to focus on product development and management, business development, sales, and implementation and onboarding, rather than customer support, IT, and delivery and operations, which are typically covered at bank level by centralized IT functions and shared service centers, often with dedicated GTB operations teams acting as "business partners" for the GTB unit. It is less usual to take on responsibility for the entire value chain.

GTB coverage models vary by customer segment, with banks tending to lead with RMs supported by specialists for clients with simple needs (model A in Exhibit 7, page 9) but to use services teams or specialist-led models for clients with more complex needs (models B and C in Exhibit 7).

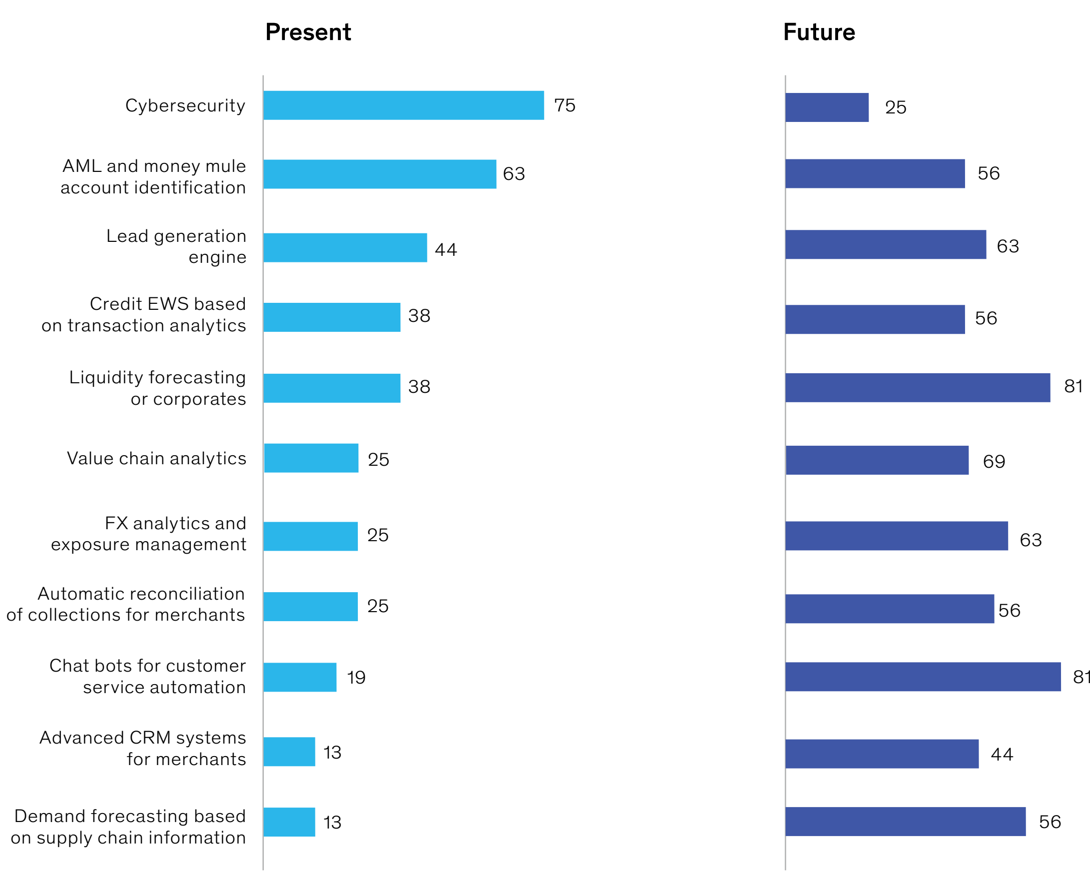
In some client segments the preferred service model may be set to change, while in others it is more stable. Where units serve small and medium size enterprises, a majority of banks (around 60 percent) prefer to run teams of RMs supported by specialists. Only around one in ten currently run client-services teams with RMs and GTB specialists, but executives say that model may become more popular in future. The mid-corps segment, meanwhile, appears to be on an even keel, with service teams accounting for around two-thirds of offerings, and RMs supported by specialists for around a third, amid little sign of change.

Exhibit 5

Advanced analytics will play an increasingly important role in global transaction banking.

Advanced analytics

Question: Please choose which AA use case your bank is currently using and which are interesting for future (please choose all that apply); % of respondents



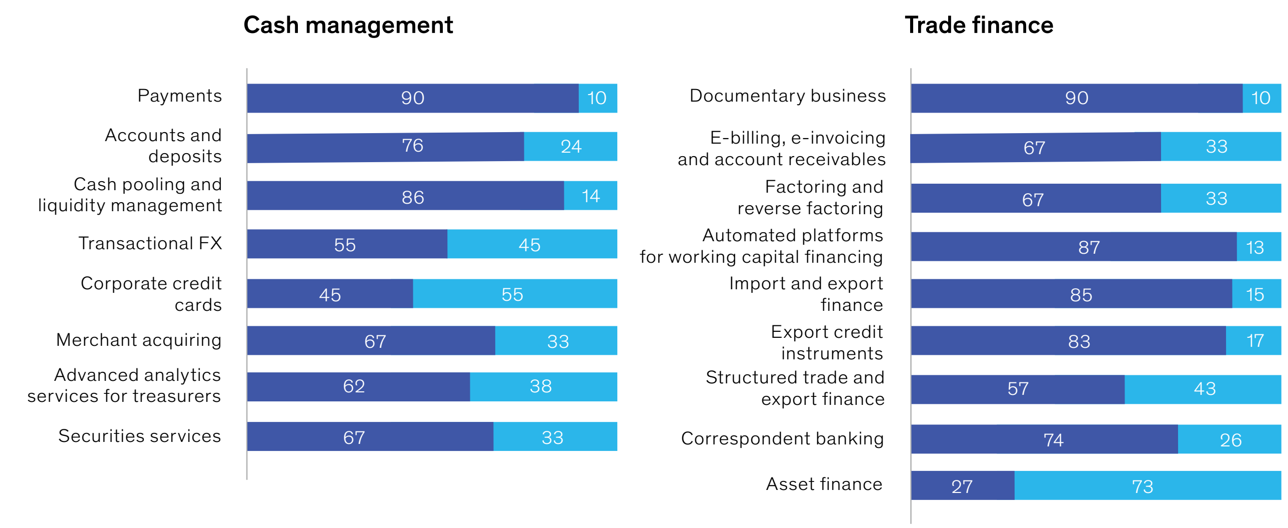
Source: McKinsey Global Transaction Banking Survey 2018

Exhibit 6

Most banks offer a wide range of transaction banking products.

Transaction banking product offerings

Question: Please choose all the global transaction banking products offered by your bank; % of respondents



[1] Coverage implies either revenue responsibilities lies with the unit and/ or resources within the unit dedicated to this particular product; refers to hierarchical reporting.
Source: McKinsey Global Transaction Banking Survey 2018

Large corporate services are a different matter. Our survey suggests that a regime change is imminent (based on executive preferences), with the RM/specialist model potentially becoming obsolete as banks operate with client-service teams or specialist-led models. The majority currently employ client-service teams and around 70 percent of respondents see it as the most favored model for the future.

A similar pattern plays out in the multinational corporate segment, with RMs and specialists increasingly likely to be replaced over time by client-service teams supported by RMs and specialists or by specialist-led models. The latter model is emerging as the fastest-growing option for GTB executives and may account for around 40 percent of coverage models in future, compared with around 15 percent at present.

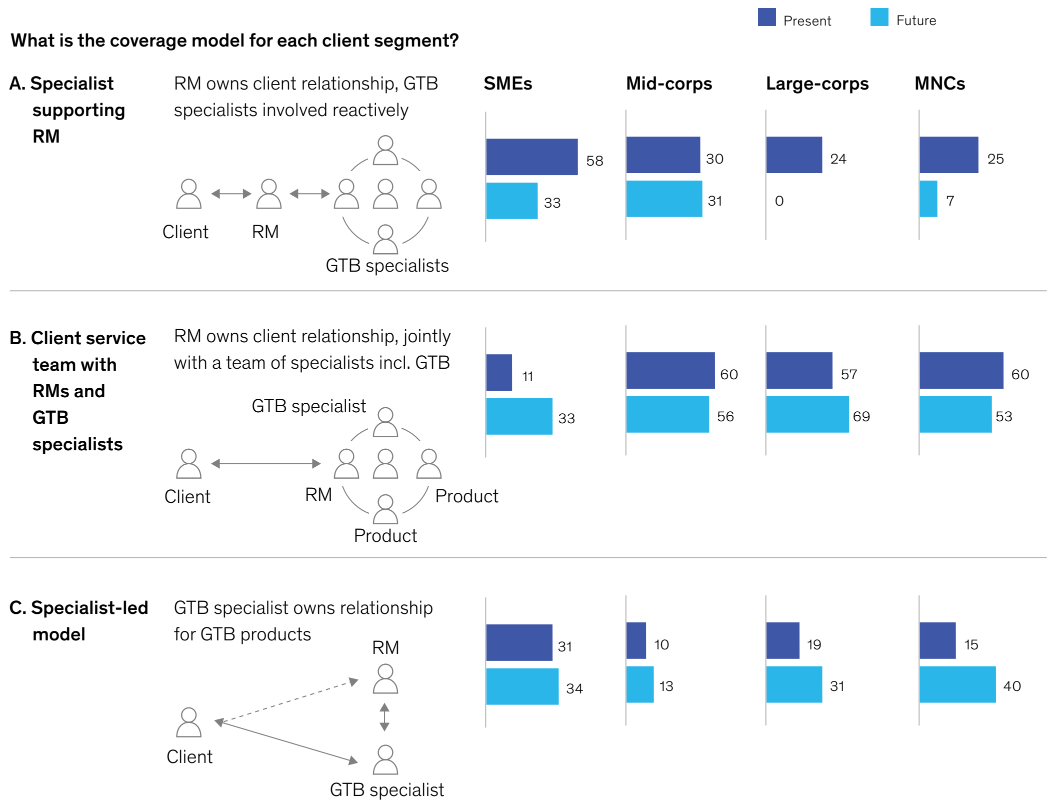
There is some geographical variation, with more than half of banks leveraging centralized capabilities for product development but tailoring coverage models to individual countries. Around one in three banks surveyed run the same coverage model globally.

Navigating a shifting landscape

GTB is set over the coming years to continue to make a significant contribution to the banking industry bottom line. The quantum of that contribution will depend on multiple factors; not least the trajectory of interest rates in core GTB markets. Assuming interest rates recover in the next three years and moderate pressure on margins, we expect annual growth (CAGR) of as much as 7 percent in cash management and 6 percent in trade finance. Under a gloomier scenario of flat interest rates and significant margin pressure we still expect to see annual growth in cash management of around 5 percent, but a slightly more moderate 2 percent

Exhibit 7

Global transaction banking service models are set to change depending on client size.



Source: McKinsey Global Transaction Banking Survey 2018

expansion in trade finance. Under both scenarios we expect deposit and overdraft businesses to perform reasonably well.

GTB executives in our survey echo these views. In particular, they highlight liquidity management, payments, documentary business, and supply-chain finance as areas of outstanding opportunity.

Still, as executives plan to move forward, they should take into account several key trends. These include the rising influence of nontraditional players with new models (such as tech giants and fintechs, which may be enablers or competitors), and technology innovation, likely to be manifested in new channels, increased connectivity, and opportunities in data and analytics and artificial intelligence (as well as blockchain). We also see a new needs-based approach to client segmentation taking center stage, leading to reformed operating and service models. (For a more in-depth discussion please refer to McKinsey's 2019 Global Payments Report). As these trends play out, leaders must make strategic choices to ensure the business can perform to its maximum potential in the years ahead.

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