

McKinsey Working Papers on Corporate & Investment Banking | No. 8



# Leveraging the Digital Potential In Corporate Banking

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## **McKinsey Working Papers on Corporate & Investment Banking**

are a series of publications presenting McKinsey's latest research and insights on corporate and investment banking. Incorporating a broad range of views from McKinsey partners and experts globally, the papers provide a leadership-level perspective on the opportunities and challenges facing corporate banking, investment banking and capital markets businesses worldwide. Their purpose is to encourage discussion about the future of the industry.

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## Executive Summary

Corporate clients represent 56 percent—or about \$1.85 trillion—of total annual global revenue for banks. However, in the increasingly important area of digital services, this client group is being overlooked. Even though corporate customers place a high value on digital banking solutions, nearly half of corporate banking franchises do not have a digital strategy. Those banks that have started digital transformations have seen positive impact including revenue increases of about 10 percent in digitized products and cost reductions of roughly 20 percent in different parts of the corporate banking value chain.

Big data and analytics play a role in this transformation, while better connectivity fuels efficiency and effectiveness in sales and onboarding. Leading banks have moved to deliver multichannel access to clients, significantly reducing cost-to-serve and improving customer-centricity. Automation of processes leads to faster processing times and reduced error rates.

At the same time, competition for the corporate banking revenue pool is intensifying, with non-bank technology-based firms seeking to make inroads. In a recent poll, 83 percent of corporate bankers said that they expect digital attackers will be a meaningful threat and that lending would be the next product area attackers focus on after cash management.

While less than 20 percent of corporate banks have started implementing a digital transformation, a number of banking leaders are increasing their investments in digital technology. As they embark on these efforts, corporate banks can learn from the experience of companies that are native to the digital business environment, and firms in other financial sectors, such as retail banking, that are further down the digital path.

## Corporate Banking Lags in Digital

Corporate services are a key component of the banking proposition. Companies ranging from small and medium-size enterprises (SMEs) to firms with annual revenues of up to \$1 billion represent an annual global revenue pool of around \$1.85 trillion. However, in the increasingly important area of digital services, these corporate clients have thus far been largely overlooked (Exhibit 1).

By contrast, the retail segment has seen significant digital investment, as banks respond to incursions on their turf from Internet companies, mobile network operators, supermarkets and other firms. Retail banks have launched apps and websites and offer digital downloads. Multichannel access for retail banking now enjoys significant penetration levels in many developed markets (e.g., 87 percent online banking penetration in parts of Northern Europe<sup>1</sup>).

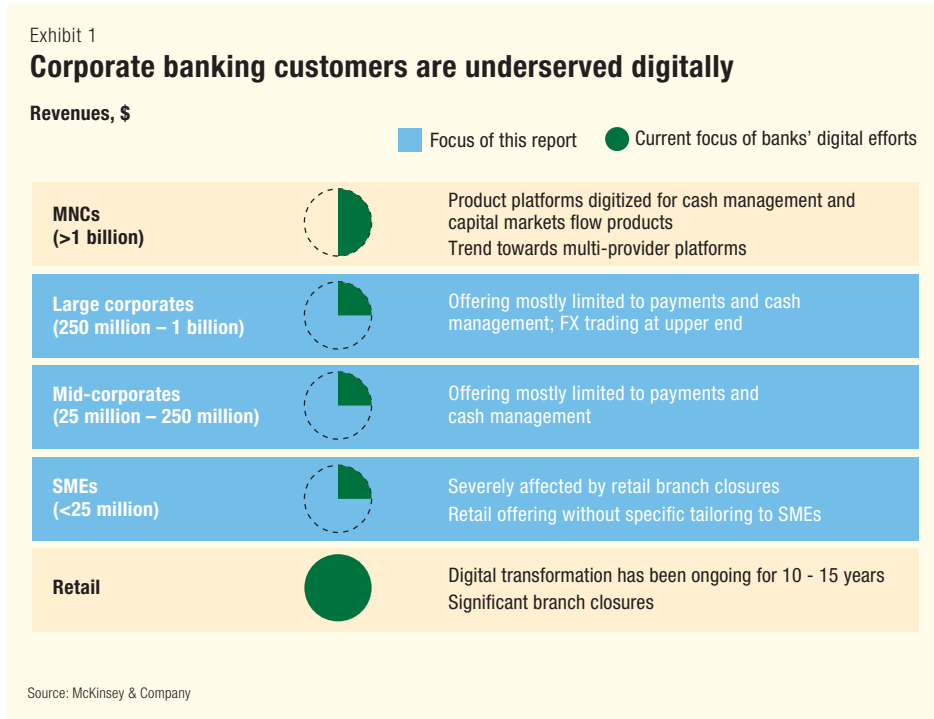
At the other end of the spectrum, global banks serving multinational corporations (MNCs) are establishing digital platforms, particularly for capital markets flow products and cash management. They compete for business across a range of digital offerings, including third-party solutions, and there is a move toward multibank functionality (e.g., Bolero in trade finance).

Corporate banking clients by contrast are presented with a relatively meager digital banking menu. Corporations have also been impacted by branch closures (one of two branches in Northern Europe has closed over the past decade), leaving a financial services gap into which non-banks are ready to jump.

Especially in Asia and North America, some banks are responding with digital front ends (single sign-on portals, web-based trade finance and cash management, and video conferencing) and extended offerings (payroll

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<sup>1</sup> Based on Eurostat statistics (April 2014), 87 percent of retail banking customers in Norway use online banking services.



management and financial tutorials). These banks appear to be a minority, however. A recent McKinsey poll of corporate bankers revealed that 45 percent of banks currently do not have a digital strategy in place and 36 percent have a digital strategy but have not moved to implementation. Just 18 percent have a digital strategy that is being implemented.<sup>2</sup>

### Who will meet the digital needs of corporate clients?

Eighty-three percent of the bankers McKinsey surveyed expect digital attackers to be a threat to their businesses.<sup>3</sup> For their part, corporate clients cite digital capabilities as one of the most important factors in making banking decisions. U.S. corporates with \$10 million to \$500 million in annual sales prefer online in four of seven common banking interactions. Similarly, a McKinsey panel of companies with revenues of up to €15 million revealed that online services are the second-most important satisfaction driver.<sup>4</sup>

<sup>2</sup> McKinsey's Corporate Banking Roundtable, October 2014.

<sup>3</sup> McKinsey's Corporate Banking Roundtable, October 2014.

<sup>4</sup> McKinsey European SME panel, 2013

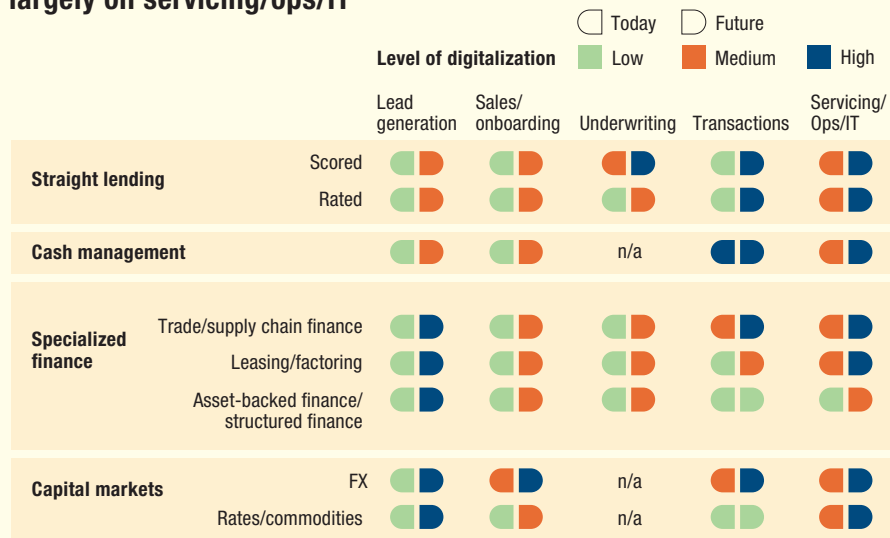
Banks that fail to provide compelling digital alternatives risk customer loss and revenue pool erosion. One European corporate bank made only limited investments in the digitization of cash management products and then experienced a significant reduction in customer satisfaction, along with a loss of market share to domestic peers that committed to more significant upgrades.

Companies such as Square and NCR Silver are offering alternative merchant acquiring and payments solutions, while innovators such as Bottomline Technologies are offering invoicing and processing services. MarketInvoice in the UK offers an alternative to bank factoring services, and there are numerous crowd-funding portals for SMEs, including Zopa, Funding Circle and Crowdcube.com. While it is too early to know which—if any—of these competitors will succeed in building significant market share, corporate banking executives should assess the potential for disruption in each market and product arena. They need to know where the value chain is vulnerable and respond decisively to the challenge.

Thus far, digital transformation in corporate banking has been focused primarily on the back office, while the front office has seen less digital innovation beyond capital markets and cash management. No bank has yet

Exhibit 2

### For corporate banks, the digital transformation is currently focused largely on servicing/ops/IT



Source: McKinsey &amp; Company

successfully digitized the entire value chain in any product category or business area (Exhibit 2).

Of course, the impact of digitization will vary across product groups and links in the value chain. In addition, banks are at different starting positions, and generalized estimates of digital impact are necessarily inaccurate. Selective examples reveal, however, that digital initiatives across the value chain have the potential to increase revenues by about 10 percent and cut costs by roughly 20 percent (Exhibit 3).

Exhibit 3

**Digital initiatives can have a significant positive impact on both revenues and costs**

Observed impact in percent, main drivers (examples)

		Revenue increase	Cost decrease
<b>Straight lending</b>	Scored	<b>15-20</b> Online application with quick turnaround Digital direct marketing push	<b>25-35</b> Workflow/process automation Straight-through processing (STP)
	Rated	<b>5-10</b> Online application loan increases/renewals within certain limits	<b>20-25</b> Workflow/process automation (including rating support tools)
<b>Cash management</b>		<b>5-10</b> Improved functionality of cash management tools, better lead generation	<b>15-20</b> Continuous improvement of platforms Further increase of STP share
<b>Specialized finance</b>	Trade/supply chain finance	<b>15-20</b> Better lead generation and marketing push <sup>1</sup> Self service for standard letters of credit	<b>20-25</b> Workflow/process automation STP for standard letters of credit
	Leasing/factoring	<b>10-15</b> Better lead generation and marketing push Self service options for some products	<b>15-20</b> Workflow/process automation STP for some products
	Asset-backed finance/structured finance	<b>0-5</b> Better lead generation	<b>0-10</b> Digital workflow support tools
<b>Capital markets</b>	FX	<b>0-5</b> Better lead generation	<b>5-10</b> Continuous improvement of platforms
	Rates/Commodities	<b>5-10</b> Better lead generation Self service for trading	<b>10-20</b> Improved internal workflow/processing Increase of self-service share
<b>Average</b>		<b>10</b>	<b>20</b>

<sup>1</sup> Product-focused campaigns and leverage of community platforms

Source: McKinsey & Company

## Digitally Optimizing the Value Chain

The benefits of digitizing corporate banking include lower cost-to-serve through new coverage models, economies of scale and automation leading to reduced costs, as well as significant revenue opportunities. A digitized banking relationship increases customer touch points and cross-sell opportunities and provides a bank with a better understanding of client transaction behaviors. Digitization also improves the customer experience by enabling flexibility, tailored services and fast response times.

An effective approach to digitizing the corporate banking value chain across product groups can be charted in four steps: using big data and advanced analytics to improve lead generation; digitizing commercial routines to improve front-office effectiveness and efficiency; improving connectivity with clients and cost-to-serve through genuine multichannel banking; and automating processes end-to-end through rapid process digitization.

### **Improve lead generation through advanced analytics and big data**

Banks have access to vast stores of data through onboarding, accounts and transactions, far exceeding that available in other industries. The data can be used across a wide range of analytics applications, one of the most relevant of which is lead generation.

Banks can use advanced analytics to achieve significant revenue increases through effective up- and cross-sell (see sidebar “Next-product-to-buy”). Retail banks are already taking this approach, and a number of corporate banks apply it in the corporate segment with significant revenue impact.



### **Next-product-to-buy**

Advanced analytics can help banks tackle the problem of under-penetrated relationship manager (RM) portfolios. These tools identify cross-sell opportunities and suggest the next best product for a client, based on logic commonly used by online merchants. Leads with the highest potential and profitability are flagged for the RM (after filtering out the leads that do not comply with the bank's business and risk strategy) as a basis for discussions with clients.

Next-product-to-buy tools are particularly useful for the "long tail" of corporate banking RM portfolios, which are often underserved. Advanced analytics use algorithms, rather than regressions, to group clients with common underlying product needs. Recommendations are built on internal data (e.g., demographics, sector information, business maturity, credit risk profile, product usage, volumes and average balances) and require no additional external data and no major IT infrastructure investments.

Machine-learning prediction models typically lead to a more balanced penetration of RM portfolios and can significantly increase an RM's cross-sell ratios. The incremental revenue impact is typically 15 to 20 percent.

**Digitize commercial routines to improve front-office effectiveness**

In corporate banking, RMs often spend less than 30 percent of their time on client-facing activities. Banks have attempted to tackle this problem through various front-office initiatives, but they now have access to digital tools that can enable the next wave of that effort. Digitization of banking processes can free up time for relationship managers to interact more with clients, and digital channels can provide more ways to connect with and serve those clients.

Next generation front-office software solutions or apps allow RMs to plan, prioritize and report weekly activities, efficiently complete other internal administrative tasks, link with colleagues and prepare for client interactions based on centrally managed profiles.

Product presentations and leads are generated by product experts and sales managers, allowing RMs more time for meeting preparation and ensuring the consistent quality of presentations, while client-facing apps allow immediate onboarding and transactions or help RMs move conversations toward fulfilling customer needs.

These apps significantly reduce onboarding and transaction times for customers and RMs and therefore significantly contribute to an improved customer experience. In addition, less time spent on administrative tasks allows RMs to focus more time on advisory and sales.

Banks are introducing additional features on RM apps, such as innovative incentive mechanisms (e.g., non-monetary incentives that are awarded based on team-wide adoption of processes typically overlooked or avoided by RMs). App-led team competitions have fostered internal competition among teams, increasing sales productivity. New digital sales routines have led to double-digit increases in customer facing time and enhanced revenues.

**Improve connectivity with clients and cost-to-serve through genuine multichannel banking**

Corporate banking coverage models have been focused on the RM as the key sales channel with little or no attention to multichannel support. Only minor variations related to the coverage ratios of RMs and the involvement of product specialists are observable in the market.

To a large extent, the reason for these more static RM-focused coverage models goes back to the relationship-driven nature of corporate banking and the management mindset. Most leading corporate banks would still see

the RM at the center of the corporate banking relationship, notably for key products and segments such as lending to upper mid and large corporates. However, several banks have started to embrace the benefits of multichannel banking and are experimenting with more differentiated coverage models and a genuine multichannel banking offer for corporates.

Multichannel banking in the corporate space allows customers to perform certain activities online, capture information online or via mobile and contact the RM for more complex questions. Surveys of corporate customers have shown that more than half prefer a more self-directed model leveraging direct channels.<sup>5</sup>

Multichannel models can also help banks reduce cost-to-serve for customer segments that fail to generate revenues justifying the cost-per-client incurred by the RM-focused model. New coverage models leverage remote RMs with higher coverage ratios and online channels for selected products and customer interactions. These models do not replace RMs or product specialists, but allow banks to be more flexible in meeting client needs. Especially in the SME space, where compressed margins and lower revenues per customer are undermining current coverage models, some banks are using remote teams and specialists along with digital-first coverage for smaller or less profitable clients.

### **Automation of processes end-to-end**

The aim of end-to-end process automation is to digitally transform customer journeys and reduce process complexity. For instance, digitization of client onboarding in corporate banking can reduce the duration of the process from several weeks to less than two working days. Beyond faster processing, the benefits also include significant cost reductions and reduced error rates. Operational cost reductions of more than 20 percent may be a reasonable initial target. Typically, less than 20 percent of a corporate bank's processes account for 90 percent of the work load. Optimizing and digitizing a bank's "heavy" processes, rigorously prioritized by potential cost impact, can achieve significant near-term cost savings.

A number of banks have set ambitious goals for automating core corporate banking processes in addition to onboarding, such as credit application, document and contract management, and reporting. (See sidebar "End-to-end process digitization.") Forty percent of the bankers who attended McKinsey's Corporate Banking Roundtable reported that their banks aspire to digitize more than 15 processes end-to-end over the next five years.

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<sup>5</sup> McKinsey European SME panel, 2013

### **End-to-end process digitization**

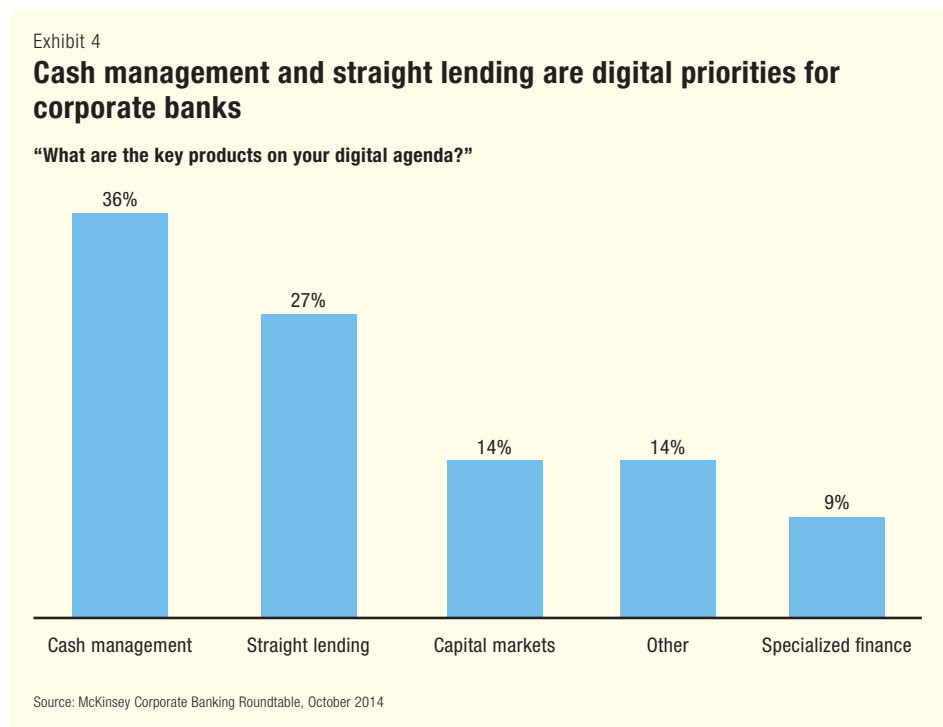
In seeking to digitize and automate processes end-to-end, a number of corporate banks have taken an approach that combines lean methodology (e.g., reducing waste, continuous improvement) and automation. Digitization is implemented through agile IT “sprints” rather than traditional multi-month or multi-year projects, with significant results in 14 to 16 weeks. One bank streamlined its credit processes by using electronic forms containing auto-correct and error detection functions for initial information capture. Digital solutions cut down on physical interactions (clients may provide information through self-service tools beforehand) and eliminated multiple iterations of the application process. In addition, initial risk and credit scoring and pricing were partially automated so that applications could run without prolonged checks by credit officers, freeing up time for higher-risk cases. The result was reduced amounts of processing, shorter cycle times from application to cash payout and increased RM and operational capacity.

A European bank serving the SME sector achieved significant gains through end-to-end transformation of the commercial lending process. RM time spent was reduced by 20 percent, while quality customer appointments rose by 20 percent. Over a 13-week period the four-week rolling average of sales of new loans rose by 40 percent, while time-to-cash was halved.

### Threats to product revenue pools

While mid- and back-office digitization will help banks lower their costs, the change will be gradual and in most cases will not be felt directly by corporate customers.

In some product areas, such as cash management, lending, trade finance, leasing and factoring, and capital markets, where banks face increased competition from non-bank attackers or new delivery models, banks will need to take steps to digitize the front office, to protect revenues and create differentiation. While no standout non-bank competitor has emerged, banks should take preemptive action. Almost all product areas in corporate banking, from straight lending and specialized finance (with trade finance, leasing and factoring as largest subcategories) to cash management and capital markets, should be seen as targets for digitization efforts. Accordingly, a poll of attendees at McKinsey’s Corporate Banking Roundtable revealed that the focus of digitization has shifted beyond cash management and that lending as the product anchor in corporate banking is now increasingly the focus of digitization (Exhibit 4).



# Digital Corporate Banking: Making It Happen

Success in corporate digital banking must be underpinned by a strong strategic agenda. Banks should first evaluate where digitization is most likely to drive value and take a step-by-step approach, with individual business cases made at each step. The strategy should lead to speedy change and tangible results, but keep transformation costs under control.

Digital transformation is uniquely challenging because of its scale and the need to rapidly acquire new skills in the digital arena. Banks that adopt a principles-based approach are more likely to succeed. In particular, there are seven traits that drive successful digital transformation.<sup>6</sup>

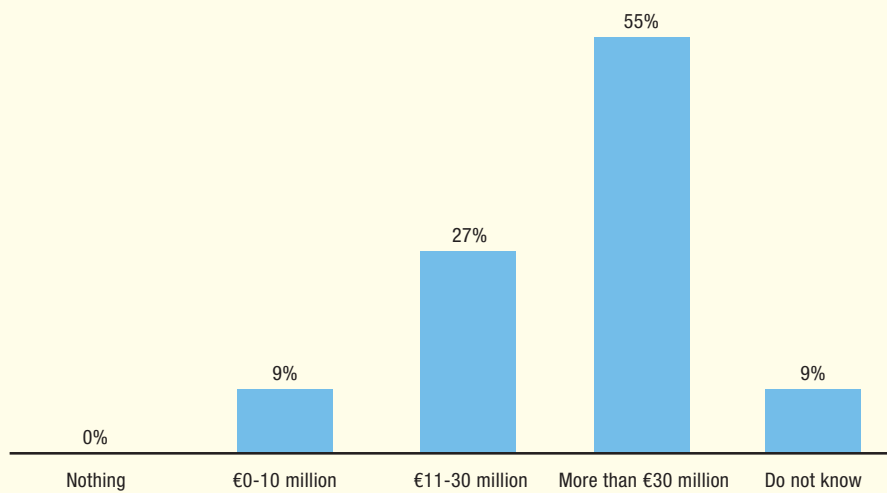
- 1) Be unreasonably aspirational.** Banks embarking on a digital transformation should set goals that are aspirational enough to demand new ways of thinking about the business. This “stretch vision” can help an organization see digital as a value creator, not just a channel extension. To this end, digital aspirations should be underpinned by value-oriented targets. Market share growth or transaction volumes in digital channels are effective benchmarks for measuring progress. Ideally, a digital P&L should be overseen by a board-level digital owner.
- 2) Acquire new capabilities.** Banks must acquire the right capabilities to build a compelling digital offering. In addition to fostering skills in-house, they should consider buying talent through targeted digital acquisitions, and hiring for digital skill rather than (direct) banking experience (e.g., mobile app developers or social media specialists).

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<sup>6</sup> “The seven habits of highly effective digital enterprises,” Tune Olanrewaju, Kate Smaje and Paul Willmott, McKinsey Insights, 2014.

- 3) Ring-fence and cultivate talent.** Success cases in other industries show that digital transformation works best when digital talent is ring-fenced, as opposed to integrated into existing IT or business teams. While this approach may not work for every bank, it is important to give new digital talent room to develop and work without being hindered by more traditional approaches.
- 4) Challenge everything.** Successful digital transformation requires banks to challenge the status quo. Incumbent banks are typically at a disadvantage versus attackers, which tend to be on the lookout for radical new ways of operating and servicing customers. However, banks should resist the urge to transform everything by themselves; digital leaders often partner with players from other industries.
- 5) Be quick and data-driven.** Rapid development of solutions is critical in the digital environment. In place of year-long product or feature release cycles, banks must shift to a mode of continuous delivery and improvement, adopting methods such as agile development (an iterative approach in which small teams work in short “sprints” to develop software) and rapid prototyping, supported by big data analytics. Continuous improvement requires ongoing experimentation and review.
- 6) Follow the money.** The digital budget should be zero-based and aligned with value at stake. The greatest savings will often result from the most costly processes (e.g., account opening), so it makes sense to start there. Transformation should be phased on a pay-as-you-go basis, so that impact can be closely monitored. Early success cases are critical for digital transformation, to convince leadership and the rest of the organization of the value. According to a McKinsey poll of corporate bankers, over 50 percent of banks are planning to dedicate more than €30 million over the next three years to digitizing (Exhibit 5, page 14).
- 7) Be obsessed with the customer.** Most banks acknowledge that digital can help improve the customer experience. However, many discussions around digitization quickly move on to the review of short-term business cases. While it is important that digitization rigorously follows the pay-as-you-go rule, banks need to put the customer first when assessing the redesign of individual processes. Once they look at a process through the customer lens, they can then assess whether the solution has a sufficient business case.

Exhibit 5

**More than half of corporate banks expect to invest over €30 million digital over the next three years****“How much do you plan to invest in digital in the next three years?”**

Source: McKinsey Corporate Banking Roundtable, October 2014

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Thus far, corporate banks have not leveraged the full power of digital to serve their clients. Less than one in five report having implemented a digital strategy. This leaves the corporate banking value chain vulnerable to digitally savvy attackers. But it also represents a large opportunity for corporate banks that can seize the moment. Leaders have already realized significant cost savings and revenue growth through digital initiatives, and McKinsey expects that tomorrow's winning corporate banks will commit fully to digital transformation today.



### **Further insights**

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(a joint report from McKinsey and Greenwich Associates)

**August 2013**

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