



FINANCIAL SERVICES PRACTICE

Asian wholesale banking:

Winning in the new battleground

Banks that serve midmarket and overseas companies will have opportunities to grow revenues and improve skills.

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The appeal of Asia has seldom been stronger for corporate and investment banks. Supported by financial systems that proved resilient during the recent financial crisis, the region continues to enjoy rates of economic growth superior to those of more developed Western markets. And the prospects for new revenues for most banking businesses look enticing over the next two to three years.

As of 2009, Asia accounted for 36 percent of global corporate banking revenues and 21 percent of global capital market and investment-banking revenues. McKinsey's global research, which identified opportunities worth \$200 billion to \$220 billion over the next five years, suggests these proportions may be set to rise (exhibit).

We estimate, for example, that 45 percent of all new growth in global wholesale banking revenues up to 2014 will take place in the region, and that emerging Asia¹ will grow about three times faster than developed Asia.²

All the major global firms have established beachheads or are evaluating multiple options for doing so. Some are opting to grow organically; for example, Morgan Stanley set up a joint venture with Mitsubishi UFJ Financial Group. Others are taking the acquisition route—Merrill Lynch, for instance, took over its local partner in India.

The big battalions see Asia as an important battleground in the struggle for global supremacy in wholesale banking. But ambitious local players,

¹ "Emerging Asia" includes China, India, and members of the Association of Southeast Asian Nations (ASEAN), with the exception of Singapore.

² "Developed Asia" comprises Australia, Hong Kong, Japan, Korea, Singapore, and Taiwan.



no longer content to settle for the relatively low-margin commodity-lending business, are also looking for an increased share of the more glamorous capital market and investment-banking action, with competition intensifying on all sides.

Based on our work with leading institutions, as well as our proprietary research, we believe future opportunities will most likely be captured by institutions that can:

- Position themselves as the primary bank for midcorporates that are currently underserved, notably in lending, transaction banking,

and simple fixed-income, currency, and commodities products

- Develop the skills to earn fees from activities like treasury and capital markets
- Target Asian companies expanding beyond their domestic bases, initially through financing and trade-related services
- Adapt their organization to opportunities and segments rather than product and client “silos,” and develop an employee “prop-osition” that provides more than just financial compensation

Exhibit

Asian wholesale banking offers a slate of opportunities.

Risk-adjusted revenue, 2014, \$ billion

		■ 0–5 ■ 5–15 ■ 15–25 ■ >25			
Products		Developed Asia ¹	Emerging Asia ²	Total	
Large corporates	Lending	10	108	118	
	Deposits and CMS ³	29	79	108	
	Trade finance ⁴	2	2	4	
Small and midsize enterprises/ midcorporates	Lending	34	92	126	
	Deposits and CMS ³	32	27	59	
	Trade finance ⁴	4	2	6	
Capital markets and investment banking	Equity capital markets	8	4	12	
	Debt capital markets	4	4	8	
	M&A	4	6	10	
	Sales and trading	48	19	67	
Total wholesale		175	343	518	

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²“Emerging Asia” includes China, India, and members of the Association of Southeast Asian Nations (ASEAN), with the exception of Singapore.

³Cash-management services.

⁴Only documentary fee—income due to trade-related lending included in “lending” category (~25% of total).

Winning the primaries

Banks in Asia invariably have dedicated units for large and very large businesses, but not always for midcorporates. Midsize customers are often served peripherally by the corporate bank, or worse still by the consumer arm. Relationship managers of corporate banks with a mixed portfolio of large and midsize clients tend in our experience to earn just 10 percent to 15 percent of their revenues from the latter.

This is a missed opportunity. Revenues from midcorporate clients across Asia could amount to as much as \$185 billion by 2014, according to our estimates. But the pie is not divided evenly. There is a significant difference between the return on equity (ROE) and share of wallet of the primary bank and that of other banks serving the midcorporate segment.

Take Hong Kong, for example, where the share of wallet of the primary bank is 40 percent and ROE is 33 percent; for secondary banks, share of wallet is 20 percent and ROE is 24 percent, while for the tertiary banks that only rarely serve the client, share of wallet is 6 percent and ROE is 16 percent. The winners would appear to take most, if not all.

To move into pole position will require challengers to analyze how the client interacts with different levels of the bank's organization and possibly rebuild the relationship model; challengers must also find ways to efficiently offer nonlending products, work out how best to customize

credit, and ensure that they overcome organizational friction to capture accompanying private banking opportunities.

Relationship management

Midcorporates typically rely on bank credit to finance their growth, since most are not large enough to obtain capital market financing. The relationship-cum-credit manager of the bank therefore plays a pivotal role in interactions with its midcorporate clients. However, the approach needed is quite different from, and in some ways more demanding than, that used to serve large corporates: for example, relationship managers in the midcorporate segment will most likely differentiate themselves from rivals by the amount of "touch time" they devote to customers, as well as by the ideas and solutions they can proactively bring forward to help solve client problems. That's different from the approach to serving large companies that many banks use, in which the relationship manager is often a mere gatekeeper for the product specialists.

A more appropriate credit model

Plain-vanilla credit is no longer enough to satisfy most midsize customers; banks must develop new custom products and services and get away from the all-too-common one-size-fits-all product basket. This requires balancing centralized decision making, which is essential to manage the complexity of products, with the sort of local inputs appropriate for firms that may not yet be national champions but aspire to be so. Successful

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banking players have developed a variety of tools and approaches, including a qualitative credit assessment to help the front line screen applications for final authorization by central committees, clear sector-based guidelines to save time and provide minimum lending standards, and innovative policies such as inviting frontline managers to join select meetings of the central credit committee.

Nonlending products

While midcorporate clients rely on bank credit for their core needs, they increasingly need other services such as capital market and treasury products. Given the low volumes, however, the bank's product specialists are often disinclined to work on nonlending propositions; if their incentive is to maximize revenue, they are naturally likely to devote their energies and time to larger clients.

There are several ways to resolve the issue: some institutions might even consider building a mid-cap-focused investment bank to meet the capital market financing needs of clients—but others can find organizational mechanisms to encourage product units to focus on this opportunity. The key is to emphasize the potential of these revenue sources rather than the immediate—and not necessarily very appealing—prize.

Don't forget the private bank

Targeting senior executives with sizable private portfolios might seem obvious, but in practice, banks often struggle to capture these synergies. Internal organizational issues include incentive conflicts among relationship managers and disputes over “named credit” allocations (for example, should the individual who arranged the corporate credit also be recognized and rewarded for any business from a senior executive

in his or her individual capacity?). There are two main ways to tackle the problem: institutions should weigh the merits of a more integrated organization structure against simple referral and incentive schemes. Our experience of working with two banks that got this integrated approach right in the Association of Southeast Asian Nations (ASEAN) region was that the prize is significant—an increase of at least 4 percent to 5 percent in ROE.

Playing in the premier fees league

Across Asian markets, foreign players tend to dominate the high-ROE fee-income pools in treasury and capital markets, while local players focus more on providing low-margin credit and payments products. Throughout most of the ASEAN region, excluding Singapore, and in India, local banks claim just 10 percent to 15 percent of the available investment-banking revenues (against 85 percent to 90 percent of lending revenues).

As a consequence, the ROE of the locals' midcorporate portfolio is just 10 percent to 15 percent, compared with the 20 percent to 30 percent that foreign players earn from their Asian wholesale banking activities. Local players should start to leverage their strong balance sheets and extensive relationships to boost their share of fee-income revenues. They can do this by instituting more systematic account planning, taking account of the skills needed for specific product markets, and improving their negotiating capabilities.

Systematic account planning

Banks that are serious about this opportunity must set targets and budgets across the banking product range—not just on lending and deposit advances. They should analyze clients' needs so as

to assess their likely demand for these financial products. The process starts with a current client-product map that shows product usage by client, identifies those banks that provide each product at the moment, and indicates their respective share of the customer's wallet—the total that the customer spends on banking products and services. The second step pinpoints the key client executives responsible for product decisions and the people at the bank charged with maintaining the relationship. Next, banks take a view of the client's future needs, based on any knowledge of, say, the company's expansion plans, M&A ambitions, and operational changes—perhaps a new factory that has put pressure on working capital. The final step is to draw up an action plan and product-specific budgets for the client account, complete with clear accountabilities and timelines. In our experience, the entire process takes one to two weeks and involves analysis, client discussions, and one joint session of relationship managers and product specialists.

New capabilities for product markets

Successful local players have used a combination of internal resources and external support to build competitive positions in niches (for instance, transaction banking, derivatives, and project advisory). One leading state-owned bank in India, for example, partnered with a European bank to provide foreign-exchange derivatives solutions to clients: the local player focused on client acquisition and servicing, and the foreign bank provided a “white labeled,” back-to-back product arrangement that enabled the local bank to capture a share of the derivatives wallet it could not get on its own. The foreign player was happy because it was able to sell derivatives in the Indian market, something that had not been possible earlier because it did not have the requisite client relationships.

New capabilities for selling and negotiating

Developing negotiating and selling skills is critical if a bank is to price fee products accurately and bundle them with its lending offering. The relationship managers of local players frequently bundle products for a given customer so as to capture a larger share of his or her business—but in so doing, they give up too much upside to the client. This happens for a number of reasons: an inadequate understanding of each product's ROE, an inability to understand the local market and the bank's pricing power, and a failure to use the influence of hierarchy in negotiations. Relationship managers need to understand the full economics of the overall customer relationship and leverage this knowledge to extract the best deals from the bank's perspective.

Targeting the globally ambitious

Domestic Asian companies readying themselves for international expansion represent another lucrative customer for investment banks. Our research suggests that by 2015, Asia will have up to 30 percent of the world's 100 largest



companies and up to 40 percent of the world's 500 largest. The financial opportunities they offer include trade finance, foreign exchange, international capital raising, M&A, remittance flows, and foreign-country banking.

The Asian globalizers will no doubt be courted by local institutions eager to play on their domestic banking relationships and by foreign players positioned to leverage their global network. Local institutions can capture their share of the pie by carefully identifying their strategic approach and choosing the appropriate implementation and organization model.

Pick the most realistic strategy

Banks will have to decide whether to pursue a “follow the customer” strategy, targeting select countries outside of the region with bilateral trade relationships and strong cultural links, or create regional “hub and spoke” models for adjacent countries. State Bank of India's thrust into geographies where Indian entrepreneurs are expanding, Banco Santander's focus on Spain

and Latin America, and Malaysia-based CIMB Group's regional model for ASEAN markets illustrate the different approaches. Banks will be influenced by their own distinctive capabilities and the risk-return profile of the chosen approach.

Define the international business model

The business model for operating in foreign countries is likely to be different from the domestic model for a range of issues: products, credit, service proposition, account coverage, financing and funding of the balance sheet, and delivery capabilities. Should there, for example, be a single lead relationship manager for each major country, or should there be multiple relationship managers? Should credit assessment be localized or centralized? Should credit pricing be based on home-country risk norms or adjusted for local-country conditions? How much emphasis should be put on building a local-country balance sheet? Or should the emphasis be on alternative structures, such as lines of credit, in addition to swaps and offshore financing?



Each of these choices involves legitimate and critical trade-offs that will reflect the bank's specific context and its stage of evolution. It might seem expedient to choose more conservative home-country risk norms, for example, but not if international market conditions drive pricing.

Identify international implications for the organization

Local players typically either move home-country talent to foreign locations or hire local personnel to manage the new foreign operations. Without relationships and networks, however, home-country talent is usually ineffective, while newly hired locals lack oversight and struggle to adapt to the organization's culture. A combination of local and foreign talent is often the best bet, enabling the bank to retain its core institutional culture.

One local ASEAN player has struck a good balance—in foreign locations, the CEO is always a home-country person, and the COO is a local hire. The rest of the staff varies, depending on the specific needs and requirements. In this way, the bank has preserved its home culture and mode of working, simultaneously ensuring that it is able to adapt to and embrace the foreign banking environment.

Adapting the organization

The new opportunities in wholesale banking will require local banks to organize themselves in some respects around opportunities and segments rather than using traditional structures. New ways of attracting and retaining talent must also be considered.

New structures

Several of the new markets are complex and cut across clients, geographies, and products.

As a result, the traditional wholesale structures of product groups and client teams, used by both global banks and local players, will be inadequate to capture future revenue opportunities. More integrated structures, however, can mitigate the risks.

Several Indian power companies, for instance, buy coal from Indonesian mines using “take or pay” structures. The coal is transported to India, and the power produced is sold through fixed contracts or the trading markets. This chain generates several opportunities for financial institutions: on the Indonesian side, coal financing structures, forward rate agreements for shipping, and treasury products; on the Indian side, project financing, working-capital management, liability insurance, transaction banking, power contracts, and possibly even private-equity investment in the power plants.

Traditionally, different business units would have focused on each of these opportunities in isolation, capturing some and missing out on others. An integrated understanding of the value chain and consequent adjustments to the organization can increase share of wallet, improve pricing, and mitigate risk.

Institutions will want to evaluate several organizational options, including “virtual opportunity organizations” (a group of individuals pooled together from different parts of the bank, for example, treasury, debt servicing, and custody services, to tap a specific opportunity, such as bullion flows into Asia), a redefinition of profit and loss centers around specific opportunities (say, end-to-end commodity chains), and “thematic verticals” extending across clients, products, and geographies. One example

might be an infrastructure vertical, organized around offerings in debt finance, equity funds management, and fund-raising.

Talent

Changing opportunities also call for changes in the talent-management model. The existing model at most banks, focused primarily on compensation, is insufficient for the new competitive environment. Many of the new opportunities are long term in nature, and shrewd institutions are starting to realize that an exclusive P&L focus that ignores franchise building is shortsighted.

The compensation philosophy in wholesale banking has shifted from an “eat what you kill” approach to a system based on the team and the institution. Bonuses linked to annual performance are giving way to a long-term wealth-creation philosophy.

Institutions building new franchises must also balance recruiting and developing local talent with the former approach of hiring laterally, including experienced international bankers.

Finally, senior management must devote time to mentoring next-generation leaders and creating personal career-development plans that include international exposure, cross-product rotation, and an improved understanding of compliance.



Competition will intensify in Asian wholesale banking as global and local players alike seek to raise their game in the coming era of high stakes and lucrative opportunities. Several revenue pools of more than \$100 billion are up for grabs; the winners will be those that position themselves as a primary bank for midcorporates, develop new capital market skills, successfully target Asian companies expanding beyond their domestic base, and adapt more flexible organizational structures. 