RESEARCH ABSTRACT

Will Wholesale Banks succeed in building Cost Elasticity in forthcoming uncertain times?

European CIBs have exhibited solid results in 2022 [Global Transaction Banking : solid (+10%); Global Finance: solid (+5-10%); Global Markets primary and Investment Banking: drop (-40%); Global Markets secondary: FICC solid (+15%) vs. Equities stable)]

Yet European Wholesale Banks results are inherently volatile (Global Market exposure) with a hard time matching US Banks' overall performance (e.g. regulatory playing unleveled, lack of scale), and mid-term outlook remain uncertain as "macro" effects kick in (e.g. reflation, interest rate rise, GDP growth drop > -1% in Europe, world still "VUCA").

In this context Wholesale Banks will look for "Cost Elasticity" to either accommodate growth protecting cost / income or improving cost base in legitimate areas.

Over the past decade, Wholesale Banks have partly cured their cost base with large, dedicated transformation programs but still exhibit very different Cost Elasticity "profiles". We have identified a few reasons for that, some of which are supported by our clients' verbatim:

- **Value creation / Cost structures are not known** well enough. These are often bipolarized (i.e. "scale" – fixed cost vs. "agile" – variable cost businesses or "low touch" vs. "high touch") calling for different optimization levers
- **Coupling of cost to serve and "client promise"** is often overlooked (e.g. perceived quality, influence of product mix)
- Cost / Productivity improvements **focus is often too much on support functions** and / or overlook cost improvement opportunities within revenue generating units (e.g. Coverage support)
- **"Cost maturities" are heterogenous across businesses** and value chains therefore requiring different optimization levers
- **Disruptive levers are marginally looked into** which leads to marginal optimization and / or no revisit of effectiveness levers (i.e. do the thing right differently including revisiting business models, offering, footprint, capitalizing on digital disruption). ["We optimized the manufacturing of a crappy wine", deputy CEO CIB Bank A]
- Optimization **levers are not enough reconciled with social and legal constraints** yielding only a fraction of productivity gains
- **Regulatory Compliance arbitrage is shy**. ["We should be more in a comply or explain mode", deputy CEO CIB Bank B]
- Governance is not enough involved in the nitty gritty of levers therefore putting **too much emphasis on "top-down benchmarking"** which is often hard to interpret (e.g. comparison across peer's environment)

As many other mature industries, we believe that Wholesale banks should accommodate uncertainty building cost elasticity with 4 levers:

1. Rethink where value lies from the client perspective. Coverage / Sales personnel often have a partial, potentially biased, vision of client true needs. One can measure this "perception asymmetry" by a) identifying "moments of truth" for clients (i.e. so called magical and critical moments that increase / decrease "Net Promoter Scores" or equivalent metrics), b) comparing them with the internal vision. Two clients of ours were exhibiting huge pricing difference in "prime servicing" as one had recognized ultra-responsiveness as a huge source of value for one of their Hedge Funds segments (pricing was 1 to 6 between players)

2. Think more in terms of industrial models. Jointly co-creating business and operational models together is sometimes a new sport for wholesale banks. It consists in translating moments of truth into non ambiguous operational performance metrics and adapting either the offering or the organization to make it happen. Global Transaction Banking is a good example where the "cost / workload" sensitivity to the product mix (e.g; "high touch" vs. "low touch") is huge. One of our clients measured that by tweaking their product mix toward "lower touch" products by 15%, 30% of workload was saved on "Operations"

3. Give a chance to "industrial" disruption. Although not all wholesale banking businesses exhibit the same "digital sensitivity" (e.g. low for Investment Banking, high for Global Transaction Banking and Global Markets), we believe there are several game changers to do "different". We have identified more 300+ digital use cases along the CIB value chains that are actionable (and counting). Many of them are based on AI which beyond operating costs may help manage cost of credit risk in the near future. Likewise, we believe that "cost competitiveness" will be gaping across players on bits of the value chain which should fuel inevitably partnerships on "scale" / commoditized businesses (cf. Uptevia)

4. Increase Industrial and Innovation culture and train / recruit talents to embody it. As Technology becomes more complex and powerful at the same time, talents are either lost in translation coping with [meaningful] trends and / or have trouble co-creating across silos (e.g. business / "Operations and IT", Risk and Compliance) and / or are not listened to at Board level. We believe that, more than ever, micro innovations may have macro impacts. This preaches for upskilled talents, shorter chains of command and continuous innovation scouting.

Let's get in touch to start the adventure