REBOUL & Co.

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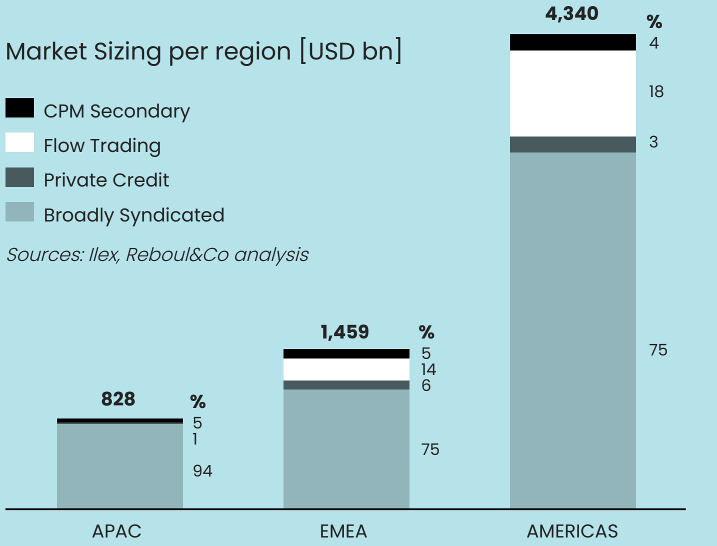
Will Wholesale Banks succeed in building Cost Elasticity in forthcoming uncertain times?

INNOVACTION #02 - MARCH 2023

Is Corporate Lending Electronic Distribution looming on the horizon?

We believe that, as other financial markets, corporate lending will slowly move to electronification. In this context, Banks should prepare for a) designing agnostic connectivity to emerging platforms, b) "piggy backing" the right set of accelerating features from these platforms, c) building complementary differentiating digital use cases on top.

Market Sizing per region [USD bn]



Part of the debt market which is distributed via electronic platforms is c. 45%

Will Digitization help European Mid-Caps fare turbulent times?

We believe that digitization could help Mid-Caps fare much better uncertain times embracing Digital Transformation with low hanging fruits on "non-core" pieces of the value chain (e.g. distribution, support functions). This can be achieved by a) Investigating meaningful use cases and data accessibility to land "quick wins" and initiate digital transformation in a more structural fashion, b) screen continuously Tech startups that are now recognized as key accelerators of digital transformation, c) raise awareness and train/recruit talents to support digital transformation from within.

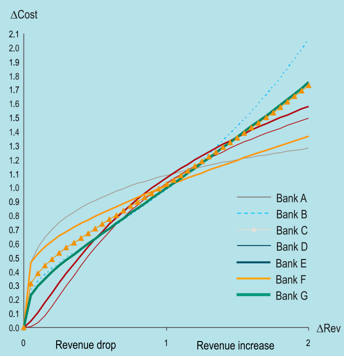
Mid Caps Digital Use Cases Library - Abstract

Value Chain		Use Cases [Selection]	Potential impacts	
Distribution	Marketing	> Client hyper segmentation > Smart pricing / real-time pricing	Revenue	5% to 15%
Distribution	Sales	> Leads generation / optimisation > Sales smart assistant > Predictor of next best offer to sell	Revenue	5% to 15%
Distribution	Client Services	> Dynamic FAQ, chatbots, voicebots, emails automation, search engine > Low touch customer delivery	Cost	10% to 20%
Production	Procurement	> Supply Chain optimisation through AI > Advanced inventory management	Cost	5% to 15%
Production	Manufacturing	> Mobile / collaborative autonomous Robots, augmented monitoring, digital twins > Forecasting models	Cost	5% to 10%
Production	Commercialisation	> Commercial network optimizer > Pricing wizard	Cost	5% to 15%
Support	Finance	> Clients reconciliation / dunning, automated consolidation, modelling tools	Cost	10% to 20%
Support	HR	> Process / workflows digitization, digital tools (e.g. payroll, recruitment, career management)	Cost	10% to 20%
Support	Purchasing	> Digital tools (e.g. purchase monitoring, catalogs)	Cost	5% to 15%
Support	R&D	> Simulation optimization tool, quantum computing	Cost	5% to 10%
Support	Risk & Compliance	> Automated fraud detection	Cost	10% to 20%

Source: Reboul&Co analysis

10 to 15% of profitability improvement

Cost Elasticity profiles



Source: Reboul&Co analysis

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

We believe that European CIBs will capitalize on strong results to prepare for upcoming bumpy times looking for "Cost Elasticity" to either accommodate growth protecting cost / income or improving cost base in legitimate areas. Many optimization techniques are now outdared for this timely quest. We believe CIBs should a) rethink where value lies from the client perspective, b) think more in terms of "industrial models" (i.e. business AND operating models), c) give a chance to "industrial" disruption, d) increase Industrial and Innovation culture

#01

Is Corporate Lending Electronic Distribution looming on the horizon?

RESEARCH ABSTRACT

Unlike equities and to a lesser extent fixed income markets that have become “digitized”, the corporate lending market has remained relatively bespoke and confidential without embracing electronic trading and digitization trends. We believe that, as other financial markets, **corporate lending will slowly move to electronification.** Term Loans B and Unitranches have been distributed in an electronic fashion for long now in the United States, but at the opposite end of the spectrum, Asia, a very intermediated market, has recently witnessed an **increase of non-bank lending (~10% in Asia vs. US ~75%). Thus, a fragmented landscape of electronic debt platforms** has emerged and structured around 3 dimensions:

- Functionality / Services (e.g. from origination to distribution for primary and secondary markets)
- Asset classes (e.g. corporate vanilla lending, structured commodity debt, short vs. long term)
- Client types / Geographies (e.g. Mid Caps vs. Large Caps, US vs. Asia vs. Europe)

Drivers of the emergence of these electronic debt platforms are threefold:

- **Revenues:** Gaining access to a larger pool of assets to distribute and providing higher liquidity
- **Costs:** Sharing and reducing distribution costs with improved underlying technologies bringing benefits to all participants (e.g. “non-proprietary” market and credit analytics)
- **Risks:** Increasing portfolio “rotation” and increasing business fees as induced by increasing regulatory capital pressure (e.g. Basel IV)

Yet several question marks remain:

- **Geographical specifics** and maturity of markets (cf. adoption in the US vs. Asia and Europe)
- **Threat of lower margins** (e.g. not enough volume on "vanilla" deals or potential cannibalization of pricey deals)
- **Leading technology to be embraced** (cf. Distributed Ledger Technology inroads / momentum in the US)

Regardless of the speed of convergence to a fully digitized corporate lending markets, we believe that a couple of markets are prone to become digitized: a few digits of a huge market (broadly syndicated loans, e.g. 3255 bUSD in the US) or a significant chunk of the fast growing emerging markets such as Private Credit (e.g. 174 bUSD in the US). We **believe institutional investors want to see loans converging with securities standards** in terms of price discovery mechanisms, best execution capabilities, and multilateral trading venues, but without the compliance hassle of publicly traded securities.

From a bank perspective, we believe a two-leg-strategy can be contemplated:

- Developing **Private Platfoms to leverage their portfolio of clients at reach** (including internal clients). This path has been recently followed by some European Banks (e.g. Santander, Natixis, Credit Agricole)
- Co-developing with a few banking partners and / or **connecting to a growing collection of Public Platforms.**

Whatever the strategic choice **we expect technology players** (e.g. Ilex, VC Trade, Oceanis [shipping], Loan Ecosystem Online, NPL Markets) **to play a key role in accelerating time to market** of banks in this area. Key functionality of these platforms that position themselves as technology enablers as opposed to [regulated market dealers] include:

- A marketplace (e.g. public and private listings and enquiries)
- A data and analytics warehouse (e.g. loan books characteristics, investors / borrowers appetite, market prices, ESG data) connected to the corporate lending community (e.g. DebtDomain, IHS Markit, Refinitiv, S&P / Moody's, Symphony)
- A dealing platform (e.g. from "match making" to execution)

In this framework, Banks should then focus on a) designing agnostic connectivity, b) "piggy backing" the right set of accelerating features from these platforms, c) building complementary differentiating digital use cases on top.

#02

Will Digitization help European Mid-Caps fare turbulent times?

RESEARCH ABSTRACT

European Mid-Caps have been impacted by a succession of recent unexpected events (e.g. Covid, Ukraine, with subsequent reflation, interest rate rise, and commodities / utilities price volatility). In France, Mid-Caps (i.e. companies with headcount from 250 to 5000 with turnover lower than 1,5 b€) have navigated a "V-shape" economic environment (-6,1% in '20 and +7,8% in '21) with different realities across sectors (e.g. Agriculture and [physical] Retail Distribution being the most impacted).
In such a volatile environment, **Mid-Caps are looking for strategic agility to accommodate uncertainty,** keeping profitable growth trajectories, sometimes turning around, or restructuring business and operating models to keep afloat.

We believe that digitization could help Mid-Caps fare much better, but one must admit that digital transformation has been marginally embraced by Mid-Caps for several reasons beyond the "data challenge":

- **Over-focus on "core business"/ production" from Top Management** (e.g. 74% of French Mid-Caps declare that they have started their digital transformation but only 13% of CEOs support them). Our recent experiences have shown that CEOs that have often founded their companies out of in-depth expertise on the "core" but have minimal exposure to technology on "non-core" pieces of the value chain (e.g. distribution, support functions).

- **Lack of knowledge and talents** being able to bridge the gap between latest technologies (e.g. Artificial Intelligence, Blockchain) and where it could be truly helpful within their value chains, sometimes being suspicious of these Technology hypes (cf. 2001 internet crisis and recent frauds on crypto-businesses).

Our research shows that digitization levers can a) boost financial performance, b) be a source of strategic agility.

Regarding financial performance, several [unfortunately not now well-known enough] use cases can help extract tangible gains:

REVENUES: For instance, with **AI-aided distribution** (e.g. Marketing/Sales/Client Services). Top use cases (i.e. hyper segmentation of client / prospect base, smart pricing, churn management, next best action proposals, dynamic FAQ with "bots") can yield from **5 to 20% additional revenues.**

COSTS: For instance, with enhanced **AI and Robot aided Supply Chain Management** within the "Production" or "Support function value chain). Top use cases (e.g. Supply Chain : smart forecasting/advanced inventory management, automated acquisition tools; Support functions : Finance and Management accounting production and reconciliations, HR processes automation) can yield from **10 to 20% cost gains on the addressable cost bases.**

RISKS: More over latest technologies (e.g. coupling between 3D drone-based dataviz and process mining such as Drishti solutions) can also help reduce operational risks (e.g. securing human and robots co-living).

Regarding strategic agility, our experience during the COVID period, has taught us that a) surprising as it may seem, **several use cases do travel well across sectors providing agility** de facto on "non-core", and the technology infrastructure that support these use cases can be redeployed onto new business models, b) **Restructuring funds have seen an opportunity in this "digital turnaround",** increasing investments in companies they deem "digitize-able" to extract value.

To enhance profitability and navigate turbulent times ahead with meaningful and achievable digital initiatives we believe "Mid-Caps" should work on three "invariants":

1. Investigate jointly meaningful use cases and data accessibility to land "quick wins" and initiate digital transformation in a more structural fashion.

2. Screen continuously Tech start-ups that are now recognized as a key accelerators of digital transformation.

3. Raise awareness and train/recruit talents to support digital transformation from within.

#03

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

RESEARCH ABSTRACT

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.

About Reboul&Co.

Reboul&Co. is an **"open strategy" to value extraction consulting firm** of new kind. We provide forward looking vision and contribute to tailor tomorrow's world. We are committed to make transformation happen and yield positive impact for all stakeholders.
We focus our shop on **two meta-industries** which correspond to key economical stakes of our territories: **Finance** including Sustainable Finance of Tomorrow and **Midcaps**.
We tackle **growth strategies, cost and expense optimization, scarce resource management** while innovating continuously by crossbreeding and cross-fertilizing our Research and Experimentations across sectors.
Our industrial model is built around a **true independent name Partnership** backed by scalable partnering companies of reference. Since we are not omniscient, we work in an **open architecture mode with partnering ecosystems** (e.g. scientific, technological, environmental) on a finite number of well-chosen differentiating topics.
We are a House of Consulting Taylors. Our brand is a wink at the eponymous French luxury suit company.

About our ecosystems

AIQ, Artificial Intelligence Quartermaster, is an AI Investment House. AIQ invests in deep-tech AI companies throughout their lifecycle, innovates by incubating novel AI-first businesses, and infuses corporates with AI technology, insights and expertise.

La Javaness is an Artitificial Intelligence factory. La Javaness helps large organizations to succeed by using machine intelligence responsibly and efficiently. Make AI at Scale

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