

Market intelligence report – September 2008

The future of transaction banking



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Background

For any banks that can succeed in retaining and growing market share, transaction banking and cash management is a very attractive business. It is liability led, has low capital usage, earnings stability and return on equity – all valuable characteristics for banks today that are re-focusing on more stable business areas to deal with the current downturn in the financial industry.

In order to gain a deeper understanding of how banks are changing their approach to the transaction banking business to ensure it remains an effective source of revenue and liquidity, Misys commissioned an online questionnaire with Finextra Research, the respected information source for the worldwide financial technology community. The aim of the survey, which ran during August 2008, was to see what the industry views as the main strategic opportunities and challenges in transaction banking, what functionality they are adding to online channels, how cash management services are evolving and what IT budgets are being allocated in this area.

We received an overwhelming response from executive director and product management level respondents from banks ranging in size from large domestic players to regional and global financial groups. In total there were 100 respondents from 32 countries. This report summarises the findings.

About Misys

Misys provides integrated, comprehensive solutions that deliver significant results to organisations in the financial services and healthcare industries. We maximise value for our customers by combining our deep knowledge of their business with our commitment to their success.

In banking and treasury & capital markets, Misys is a market leader, with over 1,200 customers, including all of the world's top 50 banks. Misys employs around 4,500 people who serve customers in more than 120 countries.

We aspire to be the world's best application software and services company, delivering results for the most important industries in the world.

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About Finextra

Finextra Research is the leading newswire and online community for the global financial technology industry, with 3 million page views and 110,000 unique visitors per month. More than 26,000 financial technology professionals worldwide receive our free daily and weekly e-mail newsletters. Finextra additionally operates its own annual conference and exhibition for the capital markets industry, Finexpo, and collaborates with the Euro Banking Association to produce the annual pan-European payments conference EBAday. Finextra is also the official online news vendor for Swift's annual financial technology conference Sibos.

Finextra additionally hosts an online professional networking and blogging service for the global financial technology industry – www.finextra.com/community – and is the exclusive operator of the Finextra50 fintech stock index.

Executive summary

We have grouped the results of the survey into five main areas:

Organisational structure and strategic focus

- A majority (57%) of banks have already consolidated their product and development efforts in payments, cash management and trade finance into an overarching transaction banking group.
- But this trend is set to continue to filter down from the large tier-1 banks to smaller banking groups, with 19% of survey respondents saying they plan to create such a group in the near future.
- Banks' main priorities are to invest in new products and services delivered through an online channel, and to target the SME sector. 66% of respondents identified the introduction of new products as their number one or two goal, while 58% said it was targeting SMEs.

Challenges to growth in transaction banking

- 45% of banks say their ability to provide joined-up customer service to corporate customers today is average or worse than average.
- IT complexity and the domination of global banks are seen as the major challenges for banks seeking to grow their transaction banking business.
- Looking specifically at cross-border cash management services, regulation is seen as the number one obstacle to delivery, according to 39% of respondents.

Extending online functionality

- Cash flow forecasting tools, real-time payment tracking and invoice and payment reconciliation are the three hottest areas for investment in the online channel. Around one-third of banks will be adding this functionality in the next 12 months.
- 33% of banks also say they will be adding cash pooling and sweeping services in the near future (on top of the 51% that already do).
- But 20% of surveyed banks do not have a dedicated cash management portal today and 19% have no online trade finance portal.

Cross-border growth and meeting customer demands in cash management

- Retaining customers and increasing share of wallet are the main benefits from offering cross-border cash pooling and sweeping. Banks are seeing an average 14.4% increase in business from existing customers as a result of offering these services.

Technology spend priorities and 2009 budgets

- The main priorities for technology spending in 2009 are development of the online channel and corporate connectivity and integration.
- 45% of banks will see an increase in budget for transaction banking and cash management in 2009.
- Across the industry, IT spending on cash management related areas will rise by +7.96% in 2009.

Organisational structure and strategic focus

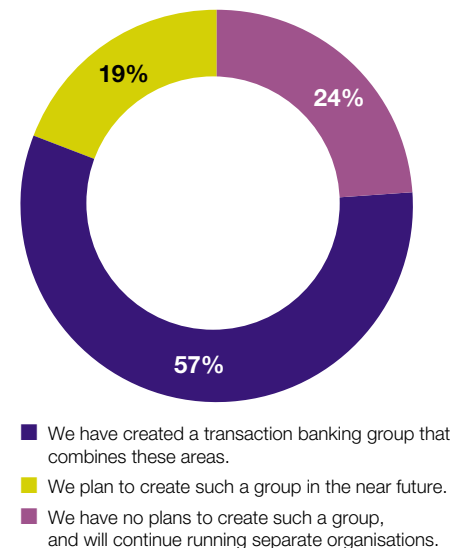
There has been a trend among large regional and global banks in recent years to concentrate product management and development activities in the payments and trade finance segments, across all countries where the bank operates, into a new global transaction banking organisation. This structural change is usually done with the aim of capturing all potential efficiencies of scale more effectively, and improving incremental returns on investments.

While most of the larger global banks have already undergone such a change, this internal consolidation trend is set to continue. Our survey revealed that 57% of banks today have such a structure, while 19% plan to create a transaction banking group in the near future.

45% of respondents say their customer service would be viewed by corporate customers as average or worse, in terms of a seamless offering of different transaction banking products and services. This includes just less than half (22 respondents) of the 57 who say they have already created a single organisation.

So either those organisations are still in a transition phase and are gradually improving as they move away from a siloed approach, or they have encountered cultural or structural difficulties that are stopping them from providing better customer service.

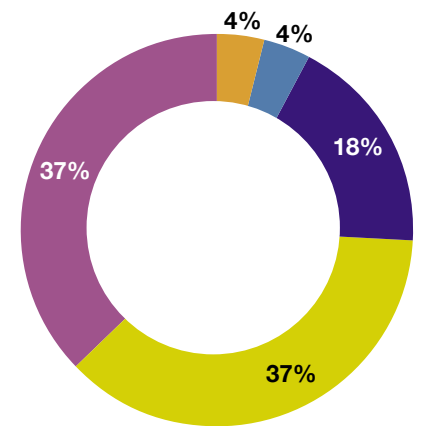
Please describe your organisational structure for transaction banking services



These kinds of problems should be addressed before banks go ahead with their top priorities for achieving growth in their transaction banking business – adding new products and services. 66% of respondents saw this as the first or second most important element of their growth strategy, followed closely by targeting more small and medium-sized enterprise (SME) customers (58%).

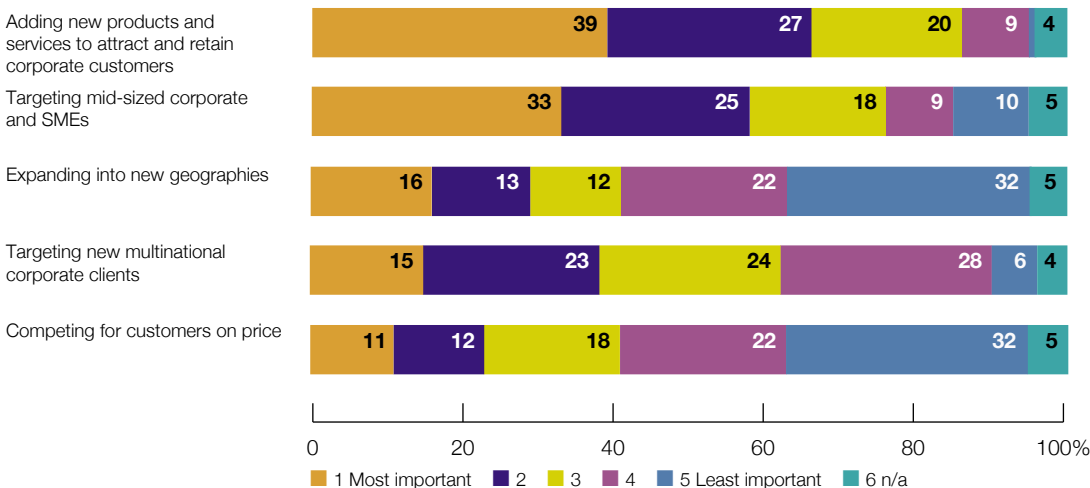
More and more SMEs are getting involved in sourcing internationally from low-cost countries, and so their cash management needs are becoming more sophisticated. These SMEs that are today predominantly customers of local banks are now becoming a rich target market for more sophisticated regional and global banks that can provide the cash pooling services they increasingly require. At the same time, local banks are developing their services to retain and attract customers in this segment, to fend off the competition. As local banks can't compete on price for global mandates from multinational corporates, their ability to serve the SME sector well will be key to their success in transaction banking.

How well do you think your corporate customers would rank your ability to provide a joined-up service?



- 1 excellent
- 2
- 3 average
- 4
- 5 needs improvement

What will be the strategic focus for growing your transaction services or cash management business in the next three years?



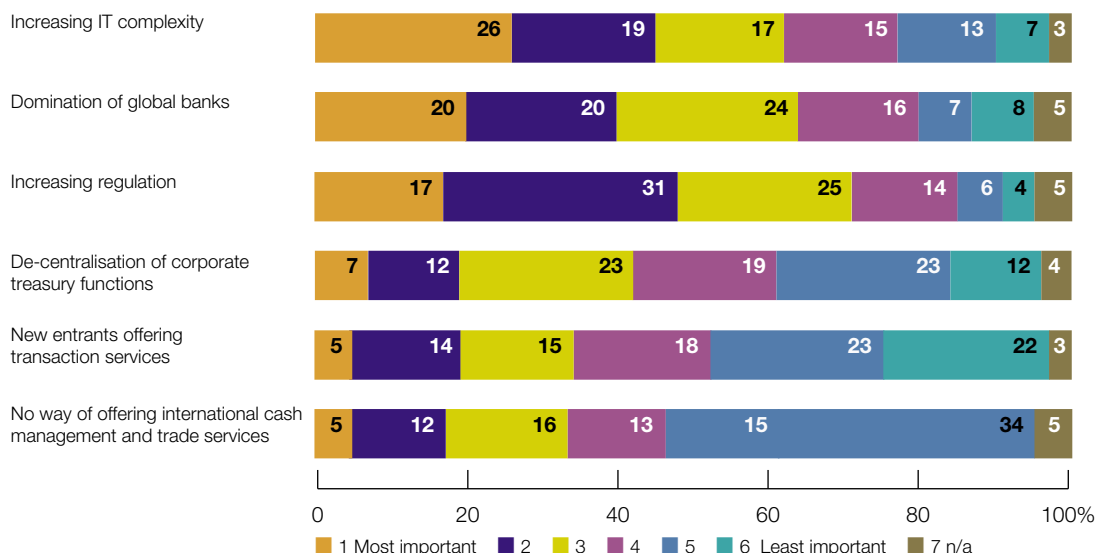
Challenges to growth in transaction banking

Increasing IT complexity is seen as the biggest challenge to growing revenue from transaction banking services. 26% of respondents saw this as the number one challenge, with 56% considering it the first or second biggest challenge.

40% of respondents considered the domination of global banks as the biggest or second-biggest challenge restricting growth. This includes 13 banks that have significant transaction banking businesses in 11 or more countries – so it's not just the small domestic banks that are feeling the competitive pressure. As more and more corporates consolidate their treasury operations and number of bank relationships, even the larger banks are feeling the squeeze.

Increasing regulation follows closely behind as a major challenge, and it's not surprising that most of those banks that hold this view come from Europe, where they are currently grappling with the impact of the Single Euro Payments Area (SEPA) and the EU Payments Services Directive. This challenge is closely linked to the issue of increasing IT complexity, as investment in new systems is a major component of compliance initiatives in this sector.

What do you see as the major challenges to growing revenue from your bank's transaction services or cash management business?



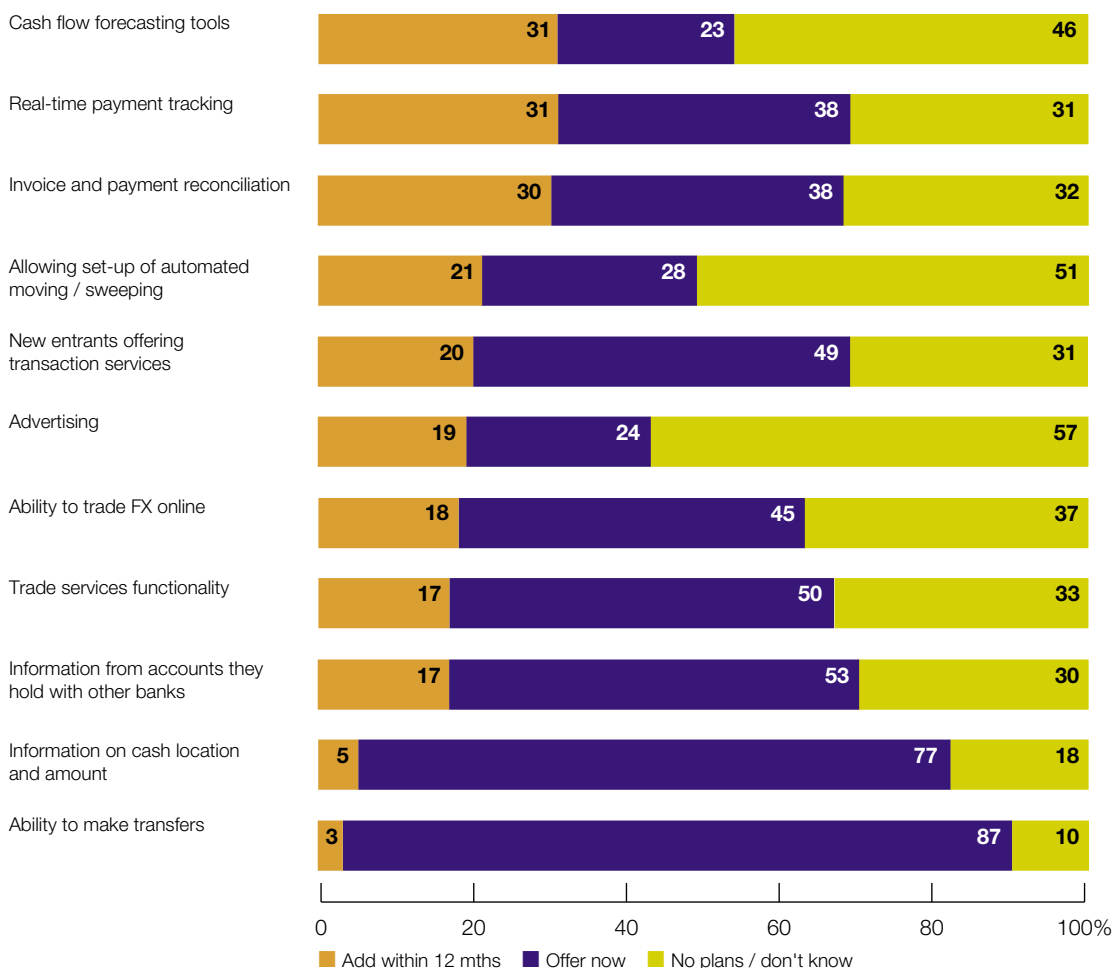
Extending online functionality

As banks look to add new products and services to attract and retain corporate customers (see previous page), their online channel is increasingly the focus for investment (see page 11 for details). But what are the new tools and capabilities that banks are investing in? We asked banks to tell us which functionality they offer corporate customers today, and what they plan to add in the next 12 months.

A background question first established that of the 100 respondents, 20% had no dedicated cash management portal, 19% had no online trade finance portal, and 35% had online portals for corporate clients, but they were separate sites for cash management, trade finance and other services, rather than a single integrated portal.

Cash-flow forecasting tools, real-time payment tracking and invoice and payment reconciliation are by far the three hottest areas for investment in the online channel, with close to a third of all respondents adding these capabilities over the next year. 38% of firms already offer the latter two, but only 23% of respondents say their bank offers cash-flow forecasting tools today.

In your eBanking portal(s) for corporate customers, what functionality do you offer now, and what you plan to add within the next 12 months?



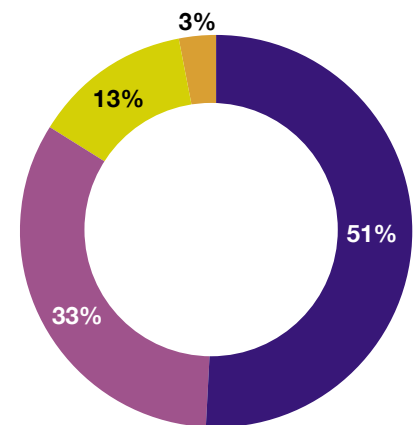
Achieving growth and meeting customer demands in cash management

The key to revenue growth is giving the corporate customer what they want. So what do banks think their customers want, and what challenges do they face in giving it to them? As this survey was directed at banks rather than corporate treasurers, we asked the banks what they thought were the main corporate demands. Leading the pack, with 39% of banks considering it the prime demand, is greater integration with corporate ERP systems, followed closely by cross-border and cross-currency pooling products.

On the latter point, we asked what the main challenges are to achieving cross-border cash management. IT-related issues were seen as a lesser challenge compared to regulation and budget/resources. It would seem that for most banks the technology is available in the market today to meet their needs, and although not insignificant, the challenge of achieving integration across the bank's systems can be overcome if enough resources are allocated to the project.

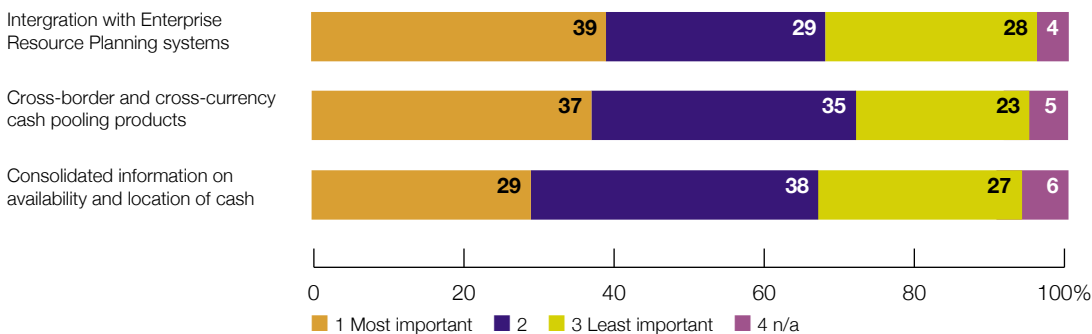
Looking specifically at the types of cash management service being offered, we asked the banks whether they offer or plan to offer sophisticated cash pooling and sweeping services to their clients. 51% of respondents say they already do, but a third (33%) say this is something that they will be adding in the near future. This points to these services becoming more and more commoditised and more broadly available worldwide, even from banks that have traditionally been domestically focused. It also demonstrates that there will be widespread investment in the industry in the short-term to enhance capabilities in this area.

Do you already offer complex cash pooling and sweeping products to your clients?

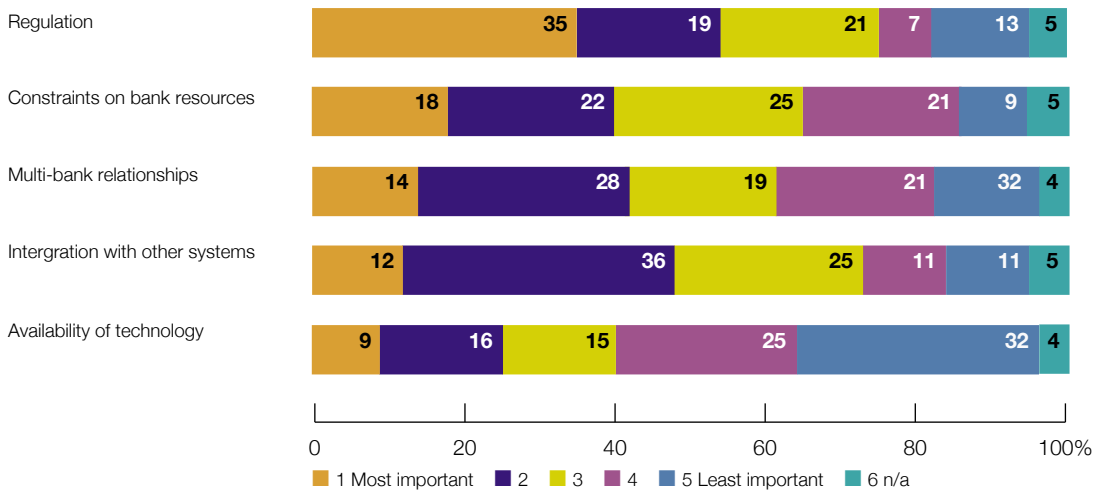


- Yes
- No, but plans to
- No, and no plans
- N/A

In cash management, what do you see as the biggest future demand for corporate treasurers from banks?



What are the current challenges to offering cash management on a cross-border basis?

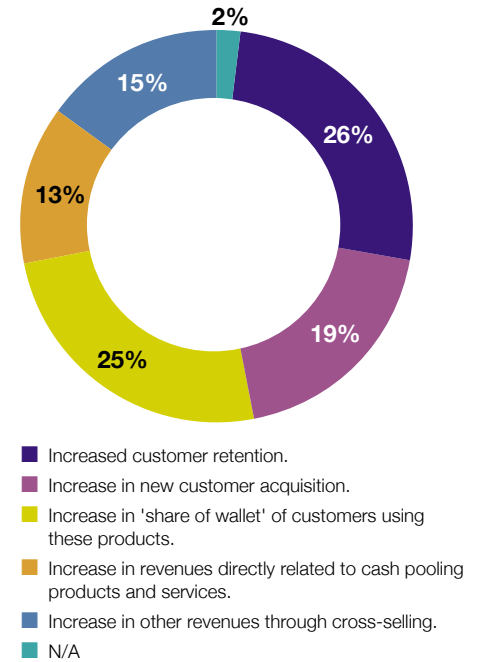


Revenue impact of cash management innovation

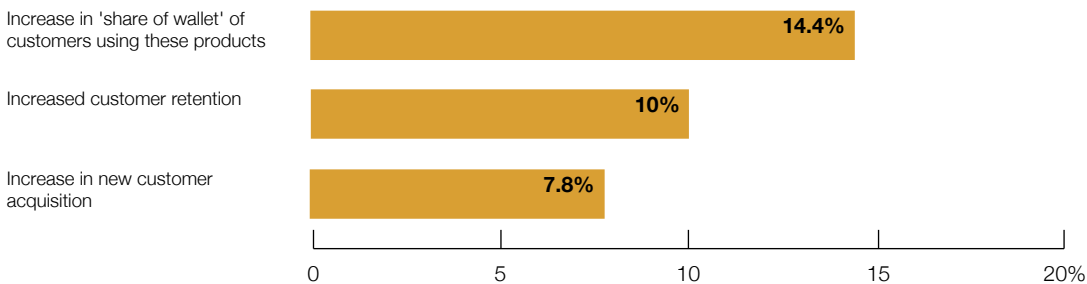
Of those organisations that offer or plan to offer cash pooling and sweeping products, we asked what impact they have seen (or expect to see) in terms of benefit to their business. The services appear to be being introduced largely as a customer retention strategy – to keep and enhance the profitability of customers who might otherwise be tempted to seek these services from another bank. But they do have secondary benefits in the winning of new customers (presumably away from banks that are yet to offer pooling and sweeping), and to a lesser extent cross-selling opportunities.

We asked those organisations who said increased share of wallet was the major impact (or expected impact) of introducing these services to quantify the average increase. Taking an average across all the respondents reveals that offering these services can result in a 14.4% increase in business from existing customers. Similar questions to those who selected customer retention and new customer acquisition as their number-one impact saw an average improvement of 10% and 7.8% respectively.

What has been (or do you expect to be) the most important impact of introducing these products?



Average business increase resulting from introduction of cash pooling/sweeping



Technology spend priorities and 2009 budgets

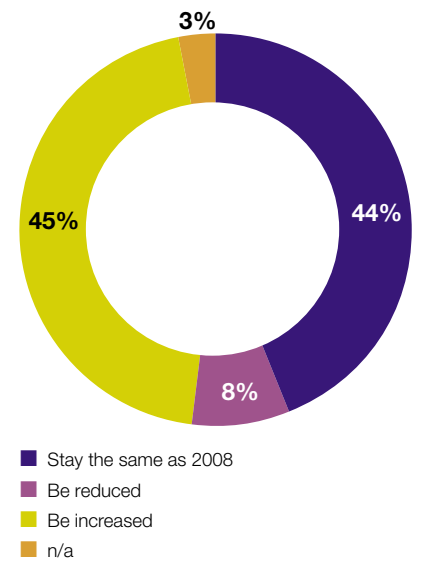
Given the strategic perspective, major challenges and priorities identified by transaction services banks in the earlier questions, we were interested to find out how this is shaping technology spend priorities. Particularly as IT complexity is seen as a major challenge to growth, better integration is the number one demand from corporates, and new product delivery is forcing investment in the online channel, we wanted to know if this is reflected in budget size and allocation.

Perhaps not surprisingly, development of the online channel and better corporate connectivity and integration were the top two spending priorities. Despite the many priorities competing for IT investment budgets, 44% of respondents say their business units will be making do with a frozen budget in 2009. Although perhaps in the current climate this could be seen as a positive result.

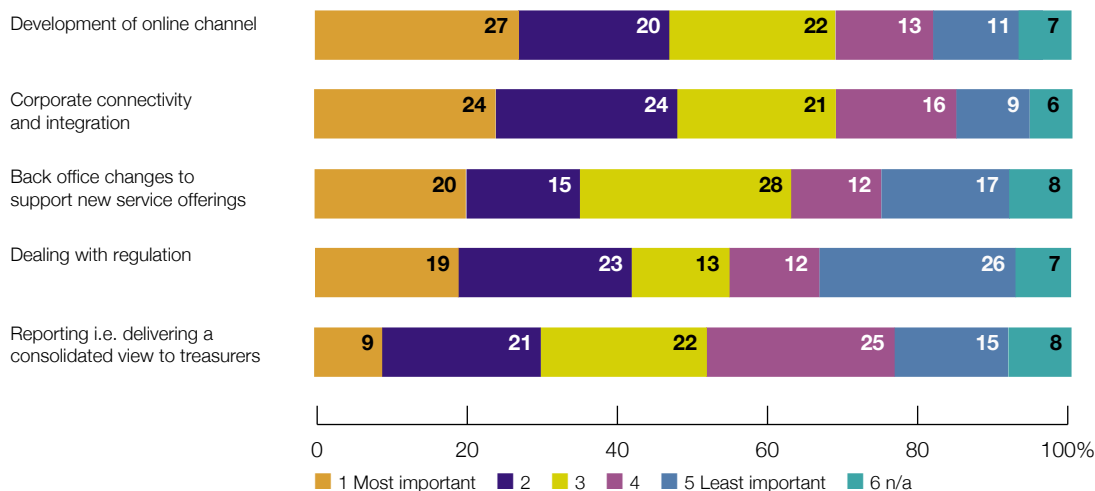
But 45% of banks are seeing a budget increase for transaction banking and cash management, reflecting its importance to the balance sheet for banks that are refocusing their disparate activities in light of the current credit crisis. Only 8% of respondents say their budgets are being cut.

Across all those seeing an increase, the average budget rise expected is 20%. Of those few who expect to be receiving less money to invest, the average decrease is 13%. Extrapolating these figures to a single industry figure for cash management related IT spending in 2009, Finextra predicts total industry spend will rise by 7.96% in 2009.

To support your cash management strategy, do you expect your budget for IT related projects in cash management in 2009 will:



What are your technology spend priorities in cash management for next year?





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