CAPCO

IN THE POST-2020 WORLD, HOW CAN CAPITAL MARKETS FIRMS GROW REVENUE AND MARKET SHARE FROM A TOP-LINE PERSPECTIVE?

SPEED READ

The core growth challenges now facing firms, such as shifting revenues, optimization of capital deployed, quality of client service and rising infrastructure costs, long predate 2020. Global markets firms should not wait until the global pandemic recedes to ramp up their efforts to tackle these issues in earnest.

We see three trends evolving as investment banks, exchanges, and other players head into the post-2020 world and position for growth. Firms must consider the following strategies and determine their optimal approach:

Smart Prioritization of the Core

- Liquidity and RWA optimization – having a flexible framework to deploy financial resources for greatest return.
- Which regions and markets require focused commitment, with capital deployment and management alignment to the relevant target areas. Asia is increasingly a key opportunity for many players.
- Which businesses to properly focus and scale – leveraging organizational strengths, and scaling from that position of strength.
- The emergence of cryptocurrencies and their move into the mainstream will present further opportunity and challenges. It is likely first movers will gain a significant advantage.
- Capitalize on the rise of retail investing strength in terms of new customer segments and tailored services. Expand 'institutional' products to unlock untapped client potential (e.g., retail, private).

Digitize Customer Journeys and Smart Leverage of Data

- Start with the customer experience in mind. Align customer-facing technology as far as practical with digital initiatives and digitize customer journeys end-to-end. Key examples are the deployment of technology to streamline customer onboarding or to modernize the IPO process.
- Use data and analytics to augment electronic customer-facing platforms to improve capabilities and automatically generate client leads or potential trades.
- Be agile and consider aligning business and technology change teams more closely to allow a more rapid response to key opportunities.

Acquire or Divest Decisively

- Where firms see an opportunity but are sub-scale, look to acquire via inorganic strategies. With a global glut of investible capital, we expect to see increased M&A activity in that regard in 2021 and 2022.
- Some businesses and markets will not generate sufficient returns, and therefore the organization's interests will be better served via divestment.

There is no doubt that 2020 stands as a year of disruption for the global capital markets industry, but the core growth challenges facing firms, such as shifting revenues, customer service and rising infrastructure costs,long pre-date 2020. In this paper, we highlight key trends and considerations when strategizing top-line growth for the near-future. We look 'inside' and 'outside' the firm and suggest key approaches and opportunities that will position financial institutions to grow over the next 12 months and beyond.

WITH 2020 NOW BEHIND US, WHAT IS NEXT FOR THE CAPITAL MARKETS INDUSTRY?

Current trends in the markets and the latest government actions suggest a global macroeconomic recovery in the medium to long-term (>6 months) with the short-term (<6 months) future remaining uncertain. Key macro-level trends include:

- Growing sentiment for the global economy to make a full recovery in 2021, rebounding from the 4.4% decline in 2020 to growth of 5.2% in 2021[1]. This is also reflected by the widening spread between the 10-year US Treasury note yield and Federal Reserve funds rate (i.e., a steeper yield curve).
- Signals from the US Federal Reserve that the low interest environment will persist beyond 2022 with declining, but still relatively high, credit spreads and equity market risks (global volatility index 'VIX' jumped by about 33% end-2020 following reports on a new strain of coronavirus in UK)[2].
- A rise in competition among capital markets firms, large and small in the areas of:
    - Technology – e.g., solutions to maximize client outcomes and profitability whilst managing risk appetite.
    - Talent – e.g., flexible working arrangements are no longer a perk, they are becoming table stakes.
- More consolidation as inorganic growth continues to be an important component of the playbook given the unprecedented levels of investable capital and the attractive economies of scale in key capital markets businesses.

By looking first at growth opportunity inside the firm and then from external factors, we see three key trends and several strategic opportunities evolving as investment banks, exchanges, and other players head through 2021 and position themselves for growth. Firms should consider the following strategies and determine their optimal approach:

- Smart prioritization of the core through flexible frameworks to deploy financial resources for greatest return, focused commitment on specific regions and markets and scaling from a position of strength.
- Digitization of customer journeys and use of data and analytics to augment these electronic client-facing platforms.
- With a global glut of investible capital, we expect to see increased M&A activity in that regard in 2021 and 2022. Some businesses and markets will not generate sufficient returns, and therefore the organization's interests will be better served via divestment.

In this paper we translate these trends into strategic growth opportunities for industry players, connecting the dots between the forces inside of capital markets organizations as well as the influence of the strategic external competitive landscape on the enterprise. Ultimately these trends, internal imperatives and external forces must be brought together in a firm's strategic planning. Capco's framework for growth strategy ultimately unlocks this complexity and can show organizations the way forward.

IN SEARCH FOR GROWTH: LOOK INSIDE THE ORGANIZATION

Capco has identified two primary opportunities for investment banks, exchanges, and other players to grow from the inside through simplification, cost take-out and smart leverage of digital strategies and data (including end-to-end digitization of customer journeys):

OPPORTUNITY 1 – CREATE MORE VALUE FOR TOP-LINE GROWTH THROUGH SMART COST TAKEOUT, DATA INSIGHTS AND REDUCED COMPLEXITY.

The capital markets industry incurs costs of roughly $700 billion each year which are largely attributed to overly complex legacy infrastructure and siloed business operations, partially in response to post-2008 crisis efforts to make the industry safer. Firms should combine digital and cost optimization objectives at the core of their strategy and carefully consider where they want to grow and become more efficient at the same time. To do so:

- **Confirm the optimal future vision and strip down the parts that do not align with it.** In deliberately assessing market and client needs, firms can rationalize the capabilities that make them stand out and find the right balance between investing into or divesting from the business infrastructure supporting it. Deutsche Bank's plan to exit the global equities business and cut 18,000 jobs[3] by 2022, and HSBC's announcement it is to reduce total adjusted assets and costs by $31 billion[4] in order to support core growth strategy (i.e., expansion into Asia) through similar means, are both examples of smart cost takeout for growth. We anticipate that resource rationalization (e.g., insourcing and outsourcing) and divestiture will grow as the industry looks to save and reinvest into capabilities that can position firms for better growth outcomes. However, we realize that some activities, especially those driven by risk appetite and regulations will need to be maintained, even if they are not profitable. We expect the entire industry ecosystem to continue evolving where several types of players will emerge; those who focus on core, revenue-generating products, and services, and those that offer capacity, scale, and product-driven execution services and operations.
- **Make better use of data insights to maximize customer outcomes and optimize the balance sheet.** Use data to gain visibility into client acquisition cost and the lifetime value of current partnerships. Data-driven insights into client behavior facilitates marketing to, benchmarking and acquiring new clients. In one example, JP Morgan launched a proprietary customer relationship management (CRM) and sales & trading analytics platform where the system mines corporate and institutional client data and its previous trades and behavior, helping the salesperson suggest trades that would be most suited to the client[5]. Firms are also just scratching the surface in terms of the growth and cost-cutting potential of analytics, including better liquidity, capital, and collateral management. Even larger revenue opportunities lie with real-time data access for corporate customers via open/API technologies (e.g., treasury, cash management), streamlining the existing legacy infrastructure/operations and providing more immediate decision-making on liquidity, risk, and investments.

GROW FROM INSIDE

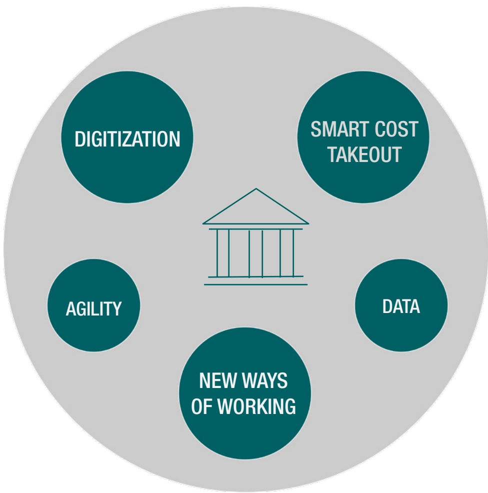


Exhibit 1

- **Simplify overly complex customer and employee experiences.** Intelligent automation and advanced analytics can create efficiencies, but also offer banks much-needed scalability to grow without detriment to the bottom line. Firms should explore building on existing Robotics Process Automation (RPA) capabilities with more intelligence while utilizing Artificial Intelligence (AI) techniques combined with the better use of data to automate a wider range of key customer journeys (e.g., onboarding) and critical business processes. Citi's most recent announcement about its in-house onboarding tool (BE)[6] refers to large-scale automation of legacy processes. The tool streamlines overly complex customer experiences by allowing institutional clients to onboard digitally, pre-populating the existing data from parent entities located in other geographies and the most recent client touch points (e.g., KYC renewals, product onboarding). It also positions the investment bank and its customers in a more proactive mode to anticipate and manage fraud and compliance risks, especially for complex, cross-border/international transactions. What cannot be automated can and should, in turn, be reengineered, streamlined, and digitized for improved growth outcomes.

OPPORTUNITY 2 – EMBRACE AGILITY, INNOVATION, AND SMARTER WAYS OF WORKING FOR BETTER GROWTH OUTCOMES.

The capital markets industry has proven the success in switching to remote working; however, concerns remain around the difficulty of maintaining client relationships absent of face-to-face contact and the absence of shared culture and information fostered by the office space environment. Capital markets firms need to embrace the "big tech" mindset when it comes to more rapid, agile, and customer-centric decisions for growth outcomes. We present the following rationales:

- **Infrastructure scalability and agility will continue to emerge as catalysts for growth.** The experience of elevated volatility and industry volumes over the past year accentuated the need for historic data (e.g., two years of daily data) for calibration and real-time decisions related to capital, liquidity, or risk management. The sheer scale and size of data volumes for such use cases will continue to pressure the industry into adopting Cloud computing and Big Data solutions to effectively retain, store, and make the data available on demand. Firms should move swiftly and consider privacy, security, and compliance issues, both in remote and office-based environments, to position themselves as winners in this race.

- **More agility in the ways of working will be required.** Agile as an approach applies to all levels of the organization and pushes for more collaborative, faster and end-user focused cultures. To be competitive in this digital age, firms need to achieve agility at scale and move away from their traditional, waterfall-style management and transformation approaches. JPMorgan's blockchain business (Onyx)[7], which takes its corporate clients through a high-impact proof of concept to rapid development sprints, is one of many great examples of an open, fully customer-driven and agile approach to product strategy and execution. Moreover, capital markets firms must also continuously challenge and upskill their business operations (from leadership to technology ownership and support) with an agile and product-focused mindset. This can break internal silos, reduce technical debt, and increase the speed required to deliver new revenue generating capabilities and implementing innovative, digital-first products for customers or end-users (e.g., traders, bankers).

- **Productivity enablers will need to evolve for a "distributed" workforce (see Exhibit 2).** Remote working in some form will be part of the fabric of the industry even once capital markets firms bring staff (e.g., traders, bankers, operations personnel) back to the office. The firms that can enable flexible work, optimize productivity, and ensure business continuity both technologically and culturally will likely be at a longer-term advantage. What was once seen as a space only for heads-down work, the office must also become a creative hub to offer face-to-face reconnection, drive collaboration, and attract talent. The formula and standards for a productive workstyle will need to evolve too, as employees seek better balance between office and remote work. We see flexible and varied spaces (e.g., physical and virtual) emerging that allow every employee to find a comfortable, productive place to work. The newly distributed environment will require talented people to be data/IT literate and capable of engaging with clients from wherever they operate.

Exhibit 2

LOOK OUTSIDE AS WELL FOR GROWTH OPPORTUNITIES

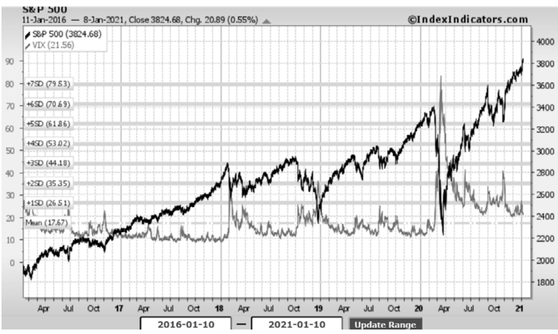
The short-term volatility and volumes of 2020 have benefitted many capital markets players. Investment banks across the world generated a record $124.5bn last year as companies raced to raise cash to survive the pandemic[8]. The hefty fees have not necessarily translated to a sustained share rally for all firms given the associated longer-term risks with capital markets focused businesses, although some have seen strong rallies. Of the five biggest US banks, only Morgan Stanley has outperformed the broader US stock market (circa 30% increase). In Europe, many banks are warning investors of future profitability concerns because of the unpredictable long-term impact of the pandemic. The low-interest rate environment is likely to remain present for some time, competition will be no less stiff, and firms will need to find innovative ways to hunt for yield and market share. What are potential opportunities leading to prioritization of the core?

Exhibit 3

OPPORTUNITY 1 – TAILOR OFFERINGS TO MARKET DEMAND, DIFFERENTIATE AND ENABLE SYNERGIES.

- **Consider structured products and services to meet the continued event-driven macro-environment.** Assuming short-term interest rates remain low and inflationary problems do not materialize, longer-end rates will fall short of long-term market expectations — most notably in the US and Europe. The rates will drive the ongoing hunt for yield and support asset class fundamentals. Structured products' ability to offer customized exposure, including to otherwise hard-to-reach asset classes and subclasses, will make them an important complement to traditional components within diversified portfolios. Banks may need to look at the role of cash and bonds in portfolios and consider being more active, increasing exposure to emerging markets, look at alternative source of yield like direct lending or commodity trading to maintain the revenues seen in 2020.

- **Continue to capitalize on elevated market volatility.** Transaction volumes and volatility levels are expected to remain elevated within the market, with settlement risks remaining higher than before and changing rapidly (see Exhibit – VIX vs S&P 500[9]).



Volatility has evolved into far more than the revenue opportunity to short an option: it has itself become a tradeable product. Financial engineering has paved the way for investment strategies to over-expose to countless volatility, interest rate and correlation-based risks. Such engineering should continue to be encouraged as more trillions of dollars' worth of fiscal stimulus are pumped into economies using volatility as a measurement for risk-taking, not for calculating risk.

- **Differentiate product and branding mix to attract new customers.** Capital markets must prioritize customer experience (simplicity, speed of deal structuring, etc.) and develop unique selling points (e.g., AI/data mining, scenario modelling, privacy, and security) to stand out from competition. For example, the Singapore-based Contour trade finance network has been joined by HSBC, Citi, BNP Paribas, and other players to develop a blockchain trade finance platform for corporates, reducing approval time for trade loans worth an estimated $9 trillion from 1.5 days to just 4 hours[10]. Capital markets firms are also increasingly recognized as stewards of capital, which today means they are stewards of sustainability, not just sources for cash. As a result of the growing discussion about a 'green' recovery from the pandemic, we expect an increasing focus on the broader environmental and social risks and opportunities facing companies, enabling new sectors to move to the forefront of ESG (Environmental, Social and Governance). That core purpose should come to the fore, especially as many of customers are in dire economic straits.

- **Find opportunities to cross-sell existing offerings.** Firms should offer consolidated services to clients while developing synergies between their lines of business to expand their traditional business prospects. We expect to see more corporate and commercial banking divisions (e.g., HSBC) merging into a combined unit, enabling internal synergies from cost perspective as well as simplifying and scaling experiences for all types of clients. This change can require restructuring and making some tough choices, including replacing 'lower-tier' (e.g., commercial, and small-cap bankers) or 'higher touch' (but low capital) intensive professional expertise with a new, broader coverage responsibilities of an 'Universal Banker' to simplify customers' view of the bank.

OPPORTUNITY 2 – FOLLOW THE NEEDS OF RECOVERING AND UNDERSERVED CLIENTS.

- With vaccines for COVID-19 becoming widely available, and potential for new fiscal stimulus packages coming through and landing by mid-year 2021, the global economy should see a boost as sectors that have been held back start recovering. Having said that, we do not see a rapid recovery to 2019 GDP contributions in the most impacted sectors (e.g., aviation) due to ongoing concerns around the global public health and debt climate. Some sectors, especially those that are dominated by small-medium enterprises, are extremely dependent on consumer sentiment towards spending on goods and services and may require several years to recover (see Exhibit 4). Capital markets firms need to follow the needs of recovering industries and position for new opportunities in respective credit and equity markets.

Exhibit 4: It could take up to four years for the most affected sectors to get back to 2019-level contributions to GDP

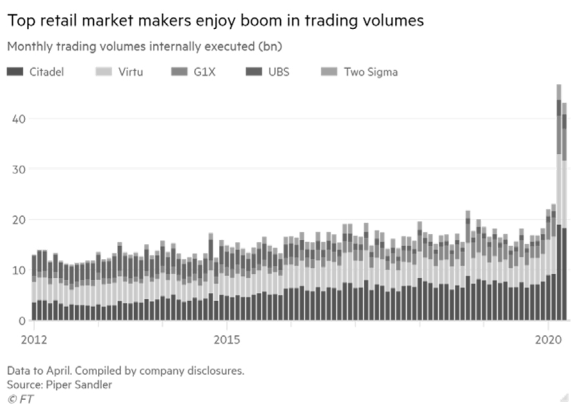
PROLONGED RECOVERY Before 2025	• **Arts, entertainment, and recreation** • **Accommodation and food services** • Educational services	• Transportation and warehousing • Manufacturing • Mining, oil and gas extraction
EXTENDED RECOVERY Before 2023	• **Construction** • Administrative and support services • Utilities	• Wholesale trade • Finance and insurance
ACCELERATED RECOVERY Before 2022	• **Real estate, rental, and leasing** • **Professional and technical services** • Management of companies and enterprises	• Retail trade • Information services • Healthcare and social assistance

Key: Sector dominated by Small-Medium Enterprises (+50% share of sector GDP, US)

Data as of Q3 2020 economic indicators
Sources: Oxford Economics / SIFMA

- **Expand alternative liquidity offerings to recovering industries, especially Small-Medium Enterprises (SMEs).** The recessionary environment has weighed on bank loan demand of corporates, as investment projects are shelved, and businesses in some cases are struggling to survive. Once government-supplied liquidity has dried up, markets will stimulate demand for bank loans, but maybe only to a limited extent. Firms should consider entering the SME market (e.g., Mid-West for the US) for fixed income offerings previously only available to large institutional clients (e.g., flexible credit revolvers, cheaper access to debt via securitization). In turn, firms can monetize SME direct lending further by creating structured products that can be sold to investors. This opens up opportunity for revenue growth and refreshing balance sheets with new, less-risky debt.

- **Expand 'institutionalized' products for underserved clients (e.g., retail, private).** The 2020 pandemic has seen retail investor activity double in the global stock markets (25% of total activity). This leads to opportunities for capital markets from the increasing trend of block retail trading market makers (see Exhibit) monetizing retail client order flow (e.g., such as the relationship of Citadel Securities and Robinhood)[11]. Increasing participation is expected to drive the demand for products that were not previously available to a retail investor too. 'Pre-IPO' trading products (e.g., VC-backed companies) are one of them, enabling investors to buy shares in start-ups, and providing liquidity to growing businesses at the same time. Furthermore, private-market trading is another area in demand lacking the liquidity seen in the public markets. JP Morgan, in setting up a new dedicated team to trade shares of private companies[12], is one of the first movers to capitalize on this trend.

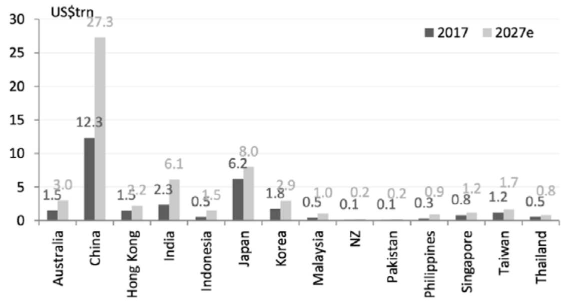


OPPORTUNITY 3 – GEOGRAPHIC REACH AND ACCESS TO MARKETS WILL CONTINUE TO OFFER REVENUE OPPORTUNITIES.

The global pandemic demonstrated the benefits of being a large and global capital markets player when it comes to offering scale services and client relevance that translate into effective results. Of the 13 US and European banks tracked by S&P Global Market Intelligence, eight of them achieved double digit YOY revenue growth in 2020 (FICC, equities)[13]. Assuming smooth vaccine rollouts, stabilization of forward-looking volatility suggests the industry will see its revenues falling below 2020 highs but still above 2019 levels. However, the advantage of being ‘global’ and having access to various markets will cushion concentration risks and open opportunities to new revenue. Here are some potential trends:

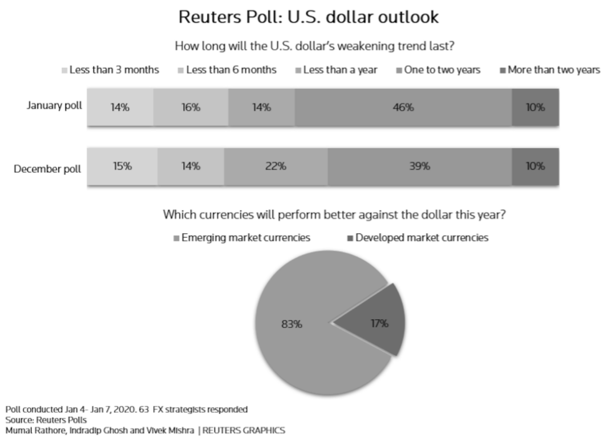
- **Capitalize in Asia and other emerging markets.** Rates remain lower in certain markets in Asia, and opportunities to sell a product such as derivatives to other geographies remain attractive. Increasing cost of entry into developed markets (i.e., Europe becoming expensive as a base of operations) is another driver for exploring a shift in capital to emerging markets. China continues to attract firms with the size of opportunity (see Exhibit – Equity Market Cap Projections for Asia below) and growing incentives – for example, China scrapped caps to foreign investment to credit and equity markets early last year[14].

Long-run equity market cap projections across Asia: China likely to achieve total market cap size of US$27 trillion by 2027



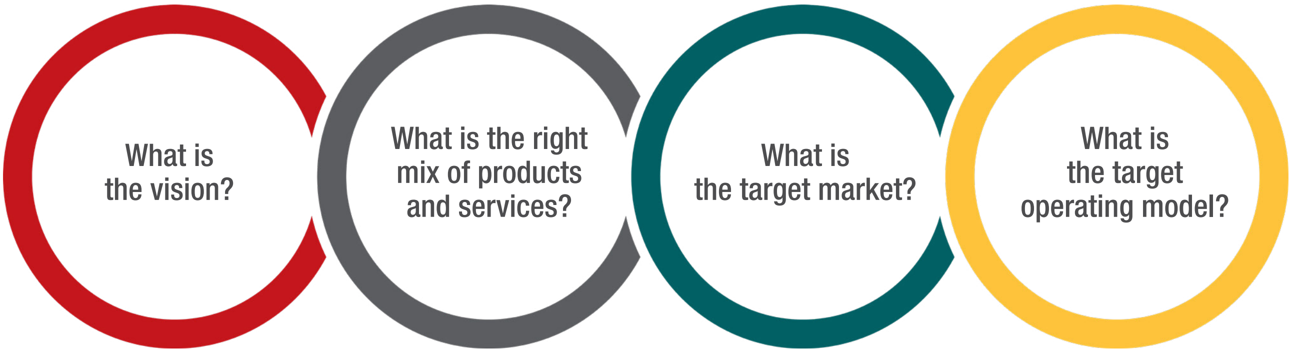
Source: CEIC, IMF, WFE, World Bank, Morgan Stanley Research projections

- The weakening of the dollar will last at least another year (longer than previously expected) according to a majority of foreign exchange strategists polled by Reuters[15], citing a hunt for yields in emerging market currencies as the main cause (see Exhibit above). We expect to see continued movement out of the dollar into emerging markets in the quest for higher yields. Furthermore, despite expectations that they would underperform against emerging market currencies, most major developed market currencies were predicted to post marginal gains against the greenback over the next 12 months. The dollar has been pushed to multi-year lows by low interest rates, massive budget and trade deficits, and expectations that rebounding world trade after a smooth coronavirus vaccine rollout would drive non-dollar currencies higher.



- **Improve global reach and far-reaching capabilities which remain critical to clients.** Expected consolidation and activity of deals (e.g., M&A, IPOs) will continue to rise, so international IB advisory expansion (i.e., Hong Kong, Japan, China, and other markets) remain attractive, especially for the largest global investment banks. Global or multinational firms and corporates continue to expand their coverage too, and expect their bankers to make their business fast, borderless, and safe. The use case for ‘real time’ client information on payments and cash management for large corporates has become a reality during the pandemic, for instance. Citi and JPMorgan, alongside a number of the largest global banks, are now offering solutions providing real-time insights into clients’ exposure and where their cash is at any given moment globally – something that was hard to imagine just two years ago. Continuous innovation and expansion of far-reaching global capabilities in the post-2020 world will remain key to satisfy more demanding customers globally.

STRATEGIC CHOICES TO POSITION FOR GROWTH



While the changing macroeconomic landscape offers opportunities and vistas for the capital markets industry to grow, the future remains far from certain. Firms will need to carefully assess and select 'inside' and 'outside' opportunities as there is limited margin for error. While capital markets firms should rightfully focus on navigating near-term decisions, they cannot abandon their longer-term strategies and should consider the following questions:

- **What is the vision?** Confirm the long-term financial and non-financial goals and evaluate the multi-year vision for organic or inorganic growth. Only after clarifying the vision can firms consider some of the more impactful and harder-hitting strategic decisions.
- **What is the right mix of products and services?** As explored in the previous sections, firms should gear up their products and services for a low interest rate environment and ensure sufficient internal capability (e.g., people, process) alignment to that scenario. Evaluate the existing product portfolio against those of key competitors and consider market conditions for each product opportunity.
- **What is the target market?** Geography, industry sector and asset class structure are just a few of the many parameters that will influence how each firm is ultimately positioned in a post-pandemic world. Analyzing client impacts will help capital markets firms understand the new market demands and help clarify where one should play in the changing competitive landscape.
- **What is the target operating model?** Operating models may need to be redesigned to support refreshed business priorities and strategies. This is the moment to reassess and reimagine operating models through new technology and smarter ways of working (e.g., remote, hybrid), tapping into the cost and risk benefits offered by digital enablement, data insights and automation, explored in the previous sections. The winners who emerge from the pandemic world will be those industry players that recognize and embrace the opportunities.

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ABOUT CAPCO

Capco is a global technology and management consultancy dedicated to the financial services industry. Our professionals combine innovative thinking with unrivalled industry knowledge to offer our clients consulting expertise, complex technology and package integration, transformation delivery, and managed services, to move their organizations forward.

Through our collaborative and efficient approach, we help our clients successfully innovate, increase revenue, manage risk and regulatory change, reduce costs, and enhance controls. We specialize primarily in banking, capital markets, wealth and asset management and insurance. We also have an energy consulting practice in the US. We serve our clients from offices in leading financial centers across the Americas, Europe, and Asia Pacific.

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