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Introduction

As banks struggle to meet investor expectations around return on equity, they are under pressure to cut costs and increase revenues. Transformational change is needed across the industry and within individual institutions if banks are to deliver sustainable returns. To assist banks as they consider how to respond, we have developed the Delivering sustainable returns series, which tackles a range of specific issues facing the industry. The series is based on industry and customer surveys, as well as EY analysis and experience across a range of markets.

Our first piece focuses on business banking, often referred to as small and medium-sized enterprise (SME) banking, and the opportunity for banks to redesign the front office to meet evolving customer needs more effectively. For the purpose of this report, we define the SME segment as any company with annual revenue of US$1 million to US$50 million.

We offer insight into the overall opportunity in the SME segment, the rapidly changing customer needs and the evolving competitive landscape, highlighting how redesigning the front office can help banks realize the opportunities this segment offers.

We will follow up later in the year with the results from our first global commercial banking survey, which we hope will provide further insight into companies across a broad range of developed and emerging markets.

We would welcome the opportunity to meet with you to discuss the issues raised in this paper and the implications for your organization. Please visit us at ey.com/banking for additional information, including insights on other topics affecting the industry.
Executive summary

Banks worldwide continue to report mixed revenue and profitability, resulting in increased pressure from stakeholders. Institutions face depressed returns on equity (ROE) and higher costs, yet the cost of equity (COE) has remained largely consistent with the levels preceding the global financial crisis. In response, banks continue to assess their customer segments to understand which ones can provide a much-needed boost to both revenue and profitability. The small and medium enterprise (SME) segment is often underserved but is potentially very profitable, and will remain a key segment for banks, regulators and national governments moving forward. Banks need to act now or else they risk seeing a previously static market disrupted by new competitors. However, banks will need to revamp service models (including both origination and post-acquisition servicing) to match evolving customer needs.

Banks have struggled to serve the SME business segment effectively as they have shifted their models back and forth, seeking ways to segment customers, assess risks, service accounts and manage relationships. The root cause of these model revisions is the complexity of the SME segment, not in terms of product or service needs, but because the segment is not homogeneous. Despite similarities in size and structure, SMEs may operate and behave very differently in terms of scope of business, risk appetite, growth potential, product needs and customer demands. Rapidly changing technology platforms and evolving global political agendas further complicate matters. How banks leverage innovative technology to provide transparent products and solutions in a convenient and competitively priced way will be the key as they move forward.

In order to serve the SME segment more effectively, banks must better understand

1) the opportunity and importance of the segment;
2) the highly variable needs and complexity of the customers; and
3) the evolving competitive threats.

SMEs are a vital cog in the global economy, accounting for more than 50% of GDP\(^1\) and private sector jobs created.\(^2\) They have proven to be an extremely sticky customer base that tends to utilize

2 IFC, *Assessing private sector contributions to job creation and poverty reduction*, 2013
* The term “advisor” is used in the context of providing general business advice. It doesn’t mean specific product or investment advice, as that would require other qualifications.

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Chart 1. Four elements necessary for front-office redesign

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<th>Pressures in SME banking space</th>
<th>Pressures are causing banks to reshape front-office service models</th>
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<td>• Bank profitability</td>
<td>1. Enhance customer service and value through redefined segmentation</td>
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<td>• Mixed results with current business models</td>
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<td>• Lack of trust</td>
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<td>• Evolving competitive threats</td>
<td>4. Initiate customer communication and incentives program</td>
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Four elements for redesigning the front office
To overcome internal challenges and take advantage of the growth opportunities from this segment, banks need to implement a strategic shift in how the front office serves SMEs. In redesigning the front office, banks must focus on increasing customer satisfaction, retention and profitability, instead of focusing only on operational efficiency. To enable this change, we have identified the four elements necessary for redesign (Chart 1).

1. Enhance customer service and value through redefined segmentation

A new approach to segmentation will allow banks to understand better the nature and complexity of different customer tranches, while enabling a more accurate assessment of a customer’s value to the bank. Segmenting SMEs by their behaviors and needs, rather than by their revenue, will best aid in this process. We’ve identified a series of attributes of an SME that would enable a bank to use data and portfolio analytics to their fullest potential:

- Value delivered to bank and cross-sell potential
- Annual revenue and demographics
- Market penetration, growth potential and competitive intensity
- Industry and sub-industry sector needs
- Customer treatment, attitudes, behaviors and profitability
- Current and future risk appetite
- Scope of business – purely local or mixed local and international

This new segmentation approach offers great potential for increasing SME revenue, lowering cost to serve and improving customer advocacy. But it comes with challenges around organization design, IT and implementation.

2. Revamp service models

Through the insights gleaned from redefining the segmentation model, banks can develop the most appropriate service model for each customer tranche. We have identified the following service models that will provide 24/7 customer support and properly allocate scarce relationship manager (RM) resources to the most valuable customers:

- Retail plus – Branch, digital and self-service only
- SME core – Digital/self-service with relationship manager pool
- SME premium – Digital/self-service with named relationship manager

3. Implement transformational change initiatives across the front office and support functions

A crucial step in implementing any new service model is to properly redefine roles and processes in the front office. Banks should focus on these key areas:

- Streamlining processes while creating common standards across the organization
- Releasing relationship manager capacity and enhancing managers’ capabilities
- Aligning front-office and non-customer-facing functions

Once the processes and roles are identified, investment in technology platforms will be required to help the bank deliver faster and more intuitive solutions while strengthening controls and improving efficiency. We have isolated the following change initiatives for banks to consider as they transform the front office and its interactions with other parts of the bank:

- Straight-through processing
- Customer relationship management
- Proactive and relevant covenant monitoring
- Sales force automation
- Target operating model architecture
- Data governance
- Business process automation

4. Initiate customer communication and incentives program

As banks reshape service models, they must involve customers in the process, communicating changes and educating them on the benefits. Banks should also consider which incentives (or additional charges) are required to instill the desired behavioral changes in customers, such as channel usage for particular activities. This process should also allow the customers to choose or pay for the model that best fits their specific needs.
The importance of the SME segment

The SME segment accounts for more than 50% of all jobs worldwide. Its scale and importance globally highlight the potential opportunity for banks. Within low-income countries (gross national income per capita below US$1,035), SME employment represents approximately two-thirds of all full-time employment. Not only do SMEs provide the largest proportion of jobs around the globe, they also contribute over 50% of GDP.

SMEs are also increasingly focused on expanding internationally, according to a recent SAP study conducted across 21 countries. In the study, 67% of participants said they already conducted business internationally, and the proportion of companies that operate

in six or more countries is expected to double over the next five years.

Supporting the SME segment is also a key priority for national governments, which have worked and will continue to work with the banking industry to improve access to funding. In 2011, the International Finance Corporation (IFC) and the Arab Monetary Fund launched the Arab Secured Transactions Initiative, which aids small businesses in the Middle East and North Africa in gaining access to loans. In the United Arab Emirates, the Emirate Development Bank was created to help support and target economic development within the SME sector. In 2013, two of Ireland’s top banks agreed to lend €4 billion each to the SME segment. Such initiatives are likely to continue as more governments encourage small business growth, which will also induce banks to increase their focus on this segment.

As these businesses expand domestically and abroad, banks are provided a significant opportunity to deepen relationships with them and increase fee income. However, how the SME segment is defined is critical to determining the service and product needs of the customers. Banks have varying definitions of what constitutes the SME segment, but fundamentally, the definitions fall between micro-finance and mid-corporates (Chart 2). For the purpose of this report, we will refer to the SME segment as companies ranging from US$1 million to US$50 million in annual revenue. Yet size is only one aspect of the segmentation as companies with the same annual revenues may

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3 IFC, Assessing private sector contributions to job creation and poverty reduction, 2013.
4 Ibid.
5 Edinburgh Group, Growing the global economy through SMEs, 2013.
6 Oxford Economics, SMEs: Equipped to compete – How successful SMEs are reinventing global business, 2013.
The importance of the SME segment

SMEs account for over 50% of all jobs and GDP worldwide.

have very different needs based on their business scope (domestic versus international focus), maturity (high-growth start-up versus mature company) or client base (niche segment or diverse). We will discuss segmentation in greater depth later.

Chart 2. Bank segmentation hierarchy
The new normal

Bank profitability

Banks continue to report mixed revenue growth and profitability levels (Chart 3) as a result of weakened loan demand, compressed spreads and both the cost and business implications of new regulations. Our analysis suggests that approximately 35% of a bank’s total costs can be attributed to regulatory compliance activities. These heightened pressures have pushed bank executives to develop new income streams to improve revenues.

Evolving needs of customer base

The service offered to SMEs has sometimes been little more than an enhanced version of retail banking or a rudimentary version of commercial banking, but economic challenges and increasingly interconnected markets are driving more diverse and complex requirements. For example, SMEs have undergone and will continue to undergo the following experiences.

- High levels of default from their customers and suppliers, affecting the supply chain and increasing the need for banking solutions to manage customer and supplier risks
- Globalization of trade, which requires quick and safe international trade solutions, as well as simplified foreign exchange products
- Volatility of currencies and commodity prices, and more companies looking to hedge these risks to mitigate the impact on their bottom line
- Increased shareholder focus on cash, resulting in a need for more effective cash and liquidity management solutions
- In view of these experiences, many SMEs want more from their banking providers. There is a real demand for the banks to become more holistic advisors rather than historical “product pushers.”

Functional requirements have also changed. Customers now require real-time accessibility, especially related to problem resolution, credit applications, balances and fees. Expectations for faster, more customized solutions have led to a rise in the use of digital platforms. For example, SMEs in the UK have increased their use of online banking by 75% within the past five years, and 68% expect their usage of online payments to increase further over the next three years.7

Despite the recent growth in digital adoption, banks have an opportunity to improve further the functionality of digital tools. During EY’s recent global corporate banking survey, 30% of respondents noted that one of their top challenges in dealing with banks was bureaucracy and a lack of flexibility. Individuals at these companies have experienced considerable technology-driven innovation in their personal banking, but many have yet to see similar advances in business banking platforms.

The issue illustrates one of the challenges banks face — the need to design practices and procedures that maximize their own efficiency, without losing sight of customer satisfaction. Chart 5 illustrates how divergent customer and bank priorities have been. These findings are

7 BACS, Understanding SMEs’ attitudes to payment methods: Trends, preferences and behaviours, 2013.

Lack of trust

As for other segments, trust is also an issue for SMEs. For example, 87% of UK SMEs believe banks act only in their own best interests, not those of the customer.8

During the global financial crisis, SMEs across a number of developed markets, particularly Europe and the US, encountered stricter covenant enforcement and denial of credit, and some had their accounts closed completely. Poor customer service continues to be an issue in both developed and emerging markets and, coupled with the ongoing legal problems many banks face and the perceived lack of clarity on fees, banks remain vulnerable to competition from more innovative peers and from non-banks. This lack of trust in the banking industry and the increase of alternative banking competitors have left many customers more willing than ever to consider new providers.

Chart 3. Return on equity

Pre-crisis | Crisis | Post-crisis
---|---|---
Developed markets | 15.1% | 6.7% | 6.5%
Emerging markets | 18.5% | 16.9% | 16.9%

Source: SNL and Thomson Eikon, EY analysis
Note: Data shown is for the largest 200 banks globally, by assets


Source: SNL and Thomson Eikon, EY analysis
Note: Data shown is for the largest 200 banks globally, by assets
*Total operating costs are shown

Chart 5. Banks’ priorities typically do not align to customers’ priorities

<table>
<thead>
<tr>
<th>Bank priorities</th>
<th>Customer priorities</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Products</td>
</tr>
<tr>
<td>2</td>
<td>Put customers first</td>
</tr>
<tr>
<td>3</td>
<td>Find and keep talented employees</td>
</tr>
<tr>
<td>4</td>
<td>Customer-facing technology (mobile/digital)</td>
</tr>
<tr>
<td>5</td>
<td>Acting on feedback/improving service</td>
</tr>
<tr>
<td>6</td>
<td>VoC/asking for feedback</td>
</tr>
<tr>
<td>7</td>
<td>Internal technology (customer-facing processes)</td>
</tr>
<tr>
<td>8</td>
<td>Physical branches</td>
</tr>
</tbody>
</table>

Competitive threats increasing

Product innovation has fueled increased competition in the SME segment, with competitors now ranging from the incumbents (e.g., commercial banks, credit unions, and specialty banks) to the rapidly evolving non-bank institutions (e.g., technology providers, telecommunications providers, alternative asset managers, and insurance companies). This competition poses a threat to banks’ fee and non-fee income. Over the past 24-36 months, non-banks have begun to make inroads by focusing on two main products that have allowed them to leverage their high-technology savvy: payments and peer-to-peer (P2P) lending.

These new entrants and alternative lenders may not be considered “niche alternatives” for much longer. As Chart 6 illustrates, the number of mobile payment transactions globally has accelerated exponentially, and non-banks’ share of those transactions has also increased at a furious pace.

Across several different markets, there are a number of new competitors with unique business models that have gained significant global market share in the mobile payment segment.

P2P lending has also grown exponentially over the last few years, albeit from a small base. Based on companies that report their lending portfolios, estimates for the size of the global P2P market (which includes both retail and business loans) range from US$3 billion to US$6 billion. The same estimates have the market doubling in size every two years. In addition to P2P lending, SMEs that struggle to access financing from banks have turned to larger companies for supply chain finance, as well as to private equity firms and venture capitalists.

Building on this momentum, non-banks have begun to focus on other product clusters that match their competitive advantage, such as business checking/current accounts and mobile marketing. For example, Cashplus offers companies a prepaid card as an alternative to a business banking account, with 1% cash-back. To win new business, many of the non-banks rely on three main attributes:

1. Strong customer service
2. Innovative technology platforms (unencumbered by legacy systems)
3. Efficient and speedy decision-making processes

These qualities allow non-banks to have an intuitive and easy-to-use online interface, as well as high efficiency in completing large volumes of customer transactions.
There is little doubt that the battle for SME clients will continue to intensify. In search of new revenue and a greater share of wallet from this segment, traditional providers must worry about both non-bank institutions and the more innovative incumbents. One example of a bank combining technology with product innovation to better serve the SME segment is in Turkey, where a leading bank has developed a fast-track loan application and approval process for SMEs using its nationwide point-of-sale network.

As banks continue to refine their business strategies to compete directly with new rivals and develop more sophisticated product offerings to capture higher fees and margins, they will need to be increasingly mindful of their customers’ needs, attitudes, behaviors, risk appetites and future plans. It is these factors, among others, that banks must consider as they develop their new front-office service model.

Since 2010, non-banks have had a 92.3% compound annual growth rate (CAGR) in global mobile payment transactions.
Redesigning the front office

To respond effectively to the current challenges in the SME banking environment, banks must look to implement fundamental changes to their front office. We have separated these into four key elements (Chart 7).

It is important to note that when executing any redesign, banks must continually reinforce reforms with the right governance and behaviors, to discourage people from reverting to old habits.

1. Enhance customer service and value through redefined segmentation

The first aspect of reworking a bank’s front-office model is developing a segmentation strategy that clearly identifies the various customer groups. For the strategy to deliver more customized solutions for the customer and increased profitability for the bank, it will need to avoid focusing solely on the revenue metric, as this single variable fails to contextualize the market overall or the unique characteristics of individual customers.

Data and portfolio analytics will enable the bank to improve its understanding of a customer’s overall relationship with the institution, which may extend beyond the business account to such areas as personal banking and wealth management, and to identify opportunities to increase its share of wallet. Some of the more advanced analytic techniques include propensity modeling, which helps predict future customer needs by leveraging data from all contact channels (e.g., web, mobile, call center and social media). As shown in Chart 8, we’ve identified a number of attributes that would enable a bank to use data and portfolio analytics to their fullest potential.

A new approach to segmentation will also deliver a better understanding of a customer’s value to the bank. Historically, costs have been spread evenly across the total customer base despite a disparity in the revenues those customers provide. Our analysis has shown that approximately 35% of customers generate a net loss for the bank (Chart 9); 50% of all credit balances are associated with only 1% of customers, and 80%-90% of all income is drawn from just 20% of the total customer...
base (Chart 10). This highlights the importance of reexamining segmentation strategies and developing a much more targeted approach to serving customers.

2. Revamp service models

A new segmentation strategy will provide a better understanding of different customer tranches and will enable the bank to develop the most appropriate service model for each one. Our experience suggests the following models to consider:

- Retail plus – Branch, digital and self-service only
- SME core – Digital/self-service with relationship manager pool
- SME premium – Digital/self-service with named relationship manager

Each service model will use multiple channels to connect customers with the bank’s full range of products and services. The models that include a relationship manager will enable customers to use the managers as needed without having to rely on them for everything. A more strategic and structured use of relationship managers will also support retention of these valuable resources, giving them more time to focus on higher-value activities and providing them with a better defined role and career. For all models, even those that include relationship managers, suitable accountability around decisions will be vital.

Despite our selection of only three models, it is important to note that there must be flexibility in how a bank classifies customers, services them and transitions them through the different service models. Communication with the customer on future business growth plans, as well as on service requirements and expectations, is paramount. Banks must also ensure this information is passed on to internal discussions among service teams, to align customers to the correct service model and to improve the bank’s profitability.

Retail plus – Branch, digital and self-service only

The retail-plus model, which includes branch, digital and self-service channels but excludes access to a relationship manager, will be aimed at the lower-value segment(s) as derived from the

<table>
<thead>
<tr>
<th>Chart 8. Beyond a revenue-only approach to segmentation</th>
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<tbody>
<tr>
<td><strong>Value delivered to bank and cross-sell potential</strong></td>
</tr>
<tr>
<td>- Examines current profitability of SME to the bank</td>
</tr>
<tr>
<td>- Examines what bank can realistically cross-sell in future based on SME’s needs and current providers used</td>
</tr>
<tr>
<td>- Ranges from propensity modeling to more sophisticated prediction models</td>
</tr>
<tr>
<td><strong>Annual revenue and demographics</strong></td>
</tr>
<tr>
<td>- Subdivides SMEs by geography, industry and revenue</td>
</tr>
<tr>
<td>- Serves as common basis for segmenting markets</td>
</tr>
<tr>
<td><strong>Market penetration, growth potential and competitive intensity</strong></td>
</tr>
<tr>
<td>- Examines the competitiveness of market (1-3 players vs. 100+)</td>
</tr>
<tr>
<td>- Identifies where SME has penetration and where it is vulnerable</td>
</tr>
<tr>
<td>- Examines the future production and profitability of SME</td>
</tr>
<tr>
<td>- Distinguishes maturity of business</td>
</tr>
<tr>
<td><strong>Industry and sub-industry sector needs</strong></td>
</tr>
<tr>
<td>- Subdivides SME’s market into trade or sectorial segments</td>
</tr>
<tr>
<td>- Provides granularity into the unique industry and sub-industry that SME is in</td>
</tr>
<tr>
<td>- Allows banks to thoroughly understand the trends/needs of that unique sector and SME</td>
</tr>
<tr>
<td><strong>Customer treatment, attitudes, behaviors and profitability</strong></td>
</tr>
<tr>
<td>- Analyzes how SME treats its customers and how loyal/satisfied the customer base is</td>
</tr>
<tr>
<td>- Determines the SME’s customer-tenure bands</td>
</tr>
<tr>
<td>- Provides insight into the profitability levels of various customers and how that relates to satisfaction and tenure</td>
</tr>
<tr>
<td><strong>Current and future risk appetite</strong></td>
</tr>
<tr>
<td>- Analyzes SME based on its total risk exposure</td>
</tr>
<tr>
<td>- Primary focus is on credit risk of SME but potentially extends to other categories</td>
</tr>
<tr>
<td>- Incorporates an SME’s current and future risk strategies</td>
</tr>
<tr>
<td><strong>Scope of business</strong></td>
</tr>
<tr>
<td>- Assesses the current and future scale of SME and whether it is a purely local business model or one that encapsulates both local and international focus</td>
</tr>
<tr>
<td>- Provides insight into SME’s product needs and how these needs can be leveraged for differentiation</td>
</tr>
</tbody>
</table>

New segmentation strategy
35% of customers generate a net loss for the bank.

Banks overspend on low-value customers, which can result in cost/income ratios larger than 1.

Source: EY analysis
new segmentation model. This model will aim to reduce reliance on branch personnel and relationship managers for day-to-day interactions and to make greater use of emerging digital technology to shift these activities to self-service and lower-cost channels. These could include self-service kiosks, call centers, online chat rooms, video conferencing and access to “how-to” videos for frequently asked questions.

However, if face-to-face interaction is needed for product inquiries, service, or more complex transactions, these customers will have access to branch personnel, including the branch manager. Within this model, it is important to provide a simple, seamless and connected experience as customers move across channels, so that they can easily begin a transaction in one channel and continue it in another. This model will be a 24/7 support channel, with the exclusion of the branch component, and will greatly reduce the cost to serve such customers, many of whom currently strain expensive front-office resources.

### SME core – Digital/self-service with relationship manager pool

This service model will be dedicated to the middle tranche of customers, who are more profitable than the lower-value customers, and whose needs are more sophisticated. Customers in this tranche tend to utilize many of the bank’s products or have large cross-sell potential. Many have begun to require more advanced products (e.g., trade finance, foreign exchange, derivatives and so forth) and have a strong growth trajectory. This customer subset will have all of the 24/7 digital and self-service channels available to use for more routine and less complex transactions, but it will also have access to a pool of relationship managers.

Based on our experience, we recommend a “one to many RM” approach, using junior relationship managers, each responsible for 200-1,000 accounts, or roughly 50%-75% of the total client base. The relationship manager pool would ideally be available 24/7 (based on a bank’s resources) and would be knowledgeable about the products and services the customer currently utilizes. With larger portfolios, relationship managers will need a sophisticated CRM tool that features strong analytical capabilities to help aid sales activity. Additionally, this pool of relationship managers will be aligned with a credit manager and a risk officer, who will provide the practical training and experience that the junior resources will need to learn to properly sell and assess the credit risk.

By implementing this approach, the bank institutes the concept of a deal team, which will allow the most junior resources to handle non-advisory products and administrative tasks and to learn from more senior managers. We envision that junior relationship managers will be in this role for a few years and then be promoted as they gain experience.

### SME premium – Digital/self-service with named relationship manager

For all high-value customers, the digital and self-service channels will be paired with a named relationship manager. Despite the growing acceptance and use of digital platforms, most banks acknowledge that the upper end of the SME segment is relationship-driven, with competitive advantage based primarily on the quality of that relationship and a customer-centric approach. Customers want a banker who can advise them or act as a sounding board on major strategic decisions and not have just a “transactional relationship.” This service model allows the customer to have a dedicated representative who has intimate knowledge of the account, the industry and the key stakeholders.
3. Implement transformational change initiatives across the front office and support functions

Banks can make further progress through additional streamlining and automating of processes, particularly when using new technology. Existing front-office service models tend to employ a lot of hand-offs from the front office to support functions, which can lead to considerable overlap and duplication between roles. Moreover, a lack of standardization means banks have less efficient and consistent processes in their global operations. Process breaks, bad data and poor automation can cause lengthy cycle times, errors and rework, all of which have a negative impact on customers and increase the risk of attrition. A more integrated framework at the process level can help alleviate many of these headaches.

In common with other areas of the bank, the business banking front office has its share of outdated systems and multiple legacy technology platforms. IT investment has been skewed toward maintaining these old systems (see

These individual relationship managers will be more senior and would likely have progressed from junior relationship manager roles. This development plan will allow more experienced relationship managers to be well-versed in the processes and services of the bank.

To ensure that clients in this tranche receive highly responsive service, the relationship managers will be responsible for only 75–200 accounts. By managing the client load in this way, the bank will enable these highly trained and effective sales people to build stronger relationships with the more profitable accounts and to enhance the bank’s share of wallet. These dedicated senior relationship managers will also be supported by senior credit and risk officers to aid them in developing and assessing more complex transactions.

Finally, it is imperative that banks’ processes, service models and targets all facilitate the progression of customers through the various business segments as it becomes appropriate (i.e., SME, mid-corporate and large corporate).

Chart 11. Breakdown of bank IT spend (in US$b)

Europe

<table>
<thead>
<tr>
<th>Year</th>
<th>Maintenance</th>
<th>New Investment</th>
</tr>
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<tbody>
<tr>
<td>2012</td>
<td>51.5</td>
<td>7.7</td>
</tr>
<tr>
<td>2013</td>
<td>52.1</td>
<td>8.2</td>
</tr>
<tr>
<td>2014</td>
<td>52.8</td>
<td>9.3</td>
</tr>
<tr>
<td>2015</td>
<td>53.4</td>
<td>10.9</td>
</tr>
<tr>
<td>2016</td>
<td>54.1</td>
<td>13.0</td>
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Asia Pacific

<table>
<thead>
<tr>
<th>Year</th>
<th>Maintenance</th>
<th>New Investment</th>
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</thead>
<tbody>
<tr>
<td>2012</td>
<td>41.5</td>
<td>17.8</td>
</tr>
<tr>
<td>2013</td>
<td>43.7</td>
<td>19.2</td>
</tr>
<tr>
<td>2014</td>
<td>46.9</td>
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</tr>
<tr>
<td>2015</td>
<td>49.7</td>
<td>20.5</td>
</tr>
<tr>
<td>2016</td>
<td>52.8</td>
<td>21.2</td>
</tr>
</tbody>
</table>

North America

<table>
<thead>
<tr>
<th>Year</th>
<th>Maintenance</th>
<th>New Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>41.5</td>
<td>13.2</td>
</tr>
<tr>
<td>2013</td>
<td>42.8</td>
<td>14.1</td>
</tr>
<tr>
<td>2014</td>
<td>43.7</td>
<td>15.7</td>
</tr>
<tr>
<td>2015</td>
<td>45.2</td>
<td>17.0</td>
</tr>
<tr>
<td>2016</td>
<td>46.4</td>
<td>18.4</td>
</tr>
</tbody>
</table>

Source: Celent, 2014
Redesigning the front office

Chart 11. In order to level the playing field with emerging competitors, banks will need to invest in reshaping their technology capabilities.

With any significant investment in IT, banks must ensure the project embeds the desired service changes and enables the bank to deliver faster and more intuitive solutions while strengthening controls and improving efficiency.

However, a key first step in reshaping the front-office model is conducting a thorough examination of the roles, personnel and processes presently in the front office. This phase ensures all current and future technology initiatives have quality information going in and quality data coming out.

Chart 12 isolates and outlines the benefits of seven key initiatives that banks should consider as they transform the front office and its interactions with other parts of the bank.

Banks should also examine opportunities to improve efficiency and customer satisfaction by streamlining activities around the completion of financial reviews, financial plans, business plans and Know Your Customer (KYC) forms.
Redesigning processes and incorporating these change initiatives will improve both internal and external work flows, but to ensure they are embedded effectively into the front office, banks will need to evolve the role of the relationship manager. The service models already outlined will help to provide a clearer career path and to retain key personnel (Chart 13). However, there is more to do to free up capacity and enhance the relationship managers’ capabilities.

Currently, relationship managers tend to be involved in most, if not all, client support activities, especially those related to credit. Our analysis has shown that approximately 20% of a relationship manager’s time is spent on non-customer-related activities and less than 50% is spent on sales or lead generation. Many of today’s relationship managers are “reactive product pushers” rather than “advisors and solution providers.” This is significant as relationship managers are, in effect, the banks’ sales force and fundamental to generating new business. Thus, redefining their roles is critical to increasing revenues.

Functional alignment of all non-customer-facing personnel is an integral step to freeing up relationship manager capacity. This can be accomplished by centralizing all operational support and management and, once achieved, will enable greater clarity of resource requirements and capacity management. To help track the improvements in efficiency and profitability gained from restructuring, we suggest all banks adopt a front-office scorecard.

Having defined new roles as part of the transformation, identifying skill gaps in the existing team and implementing a new training program are crucial next steps. This program should seek to enhance the relationship manager’s ability to handle all customer inquiries, with extensive training on credit, as well as insight into other products and services offered by the bank. While training and restructuring will help relationship managers become more effective advisors and sales professionals, a new compensation model will be required to reinforce these behaviors. It will also help the bank to ensure adoption of the “customer-first” attitude demanded by regulators in the wake of the global financial crisis.

Many relationship managers are now compensated on the basis of their total

<table>
<thead>
<tr>
<th>Chart 12. Seven key transformational change initiatives</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Straight-through processing</strong></td>
</tr>
<tr>
<td>• Aids all commercial lending activities</td>
</tr>
<tr>
<td>• Connects the various steps of a loan application into one synchronized system, alleviating hand-offs and errors, improving work flows and cycle time and enhancing automation</td>
</tr>
<tr>
<td><strong>CRM technology</strong></td>
</tr>
<tr>
<td>• Enables all customer-facing personnel to input key customer data and interactions with customer</td>
</tr>
<tr>
<td>• Utilized in prospecting activities</td>
</tr>
<tr>
<td>• Monitors customer service and sales activity</td>
</tr>
<tr>
<td><strong>Proactive and relevant covenant monitoring</strong></td>
</tr>
<tr>
<td>• Provides front-office personnel access to the various covenants in a formal debt agreement</td>
</tr>
<tr>
<td>• Identifies key contractual restrictions on borrowers and monitoring those constraints (e.g., early warnings and product suitability)</td>
</tr>
<tr>
<td><strong>Sales force automation</strong></td>
</tr>
<tr>
<td>• Helps manage the entire sales cycle from initial contact with the prospect or customer to final sale</td>
</tr>
<tr>
<td>• Aids sales force in streamlining repetitious activities conducted across the entire portfolio</td>
</tr>
<tr>
<td><strong>Target operating model architecture</strong></td>
</tr>
<tr>
<td>• Serves as overarching technology architecture that illustrates the business capabilities, channels and customers of the bank</td>
</tr>
<tr>
<td>• Identifies key processes, work flows and redundancies, which aids redesign across all functions of the bank (including outsourcing initiatives)</td>
</tr>
<tr>
<td><strong>Data governance</strong></td>
</tr>
<tr>
<td>• Helps understand and formulate storage of key data</td>
</tr>
<tr>
<td>• Sets rules, responsibilities and requirements for utilizing and storing bank data</td>
</tr>
<tr>
<td>• Eliminates data quality issues</td>
</tr>
<tr>
<td><strong>Business process automation</strong></td>
</tr>
<tr>
<td>• Provides software applications integrated throughout the organization, which ensures faster, more accurate and more consistent processes</td>
</tr>
<tr>
<td>• Aids in reducing costs by streamlining and automating processes that were previously completed by more costly resources</td>
</tr>
</tbody>
</table>
Redesigning the front office

Chart 13. The revised career path of a relationship manager

**Leadership pool**
- Focused on managing groups of RMs
- Responsible for managing operational performance of team
- Provides coaching and management to junior team members

**Experienced RM**
- Traditional RM role, focused on supporting clients in the SME segment
- Focused on 75-200 clients with dedicated support teams

**Senior RM**
- Focused on the premier accounts with complex service and sales needs
- Higher targets to reflect seniority and potential of clients

**Junior RM/RM assistant**
- Learning role for RMs new to the business, mentored by more senior RMs
- Learns products, either supports larger accounts or focuses on low-value and less sophisticated clients
- Focused on 200-1,000 clients
Redesigning the front office

book of business, as well as various other individual benchmarks and goals. By rewarding total book size, banks tend to drive actions that focus solely on increasing top-line revenue instead of bank profitability. We propose that banks implement a more profit-sharing structure to eliminate this “my client” mentality, which at times can interfere with the service and product sophistication a bank offers.

Furthermore, banks should consider including portfolio health, credit risk, long-term viability of the relationship and conduct-based metrics in overall compensation calculations. By establishing a more holistic team approach, along with an emphasis on personal responsibility, front-office personnel will have incentives to adhere to correct selling, on-boarding and servicing practices. Additionally, they will be motivated to have a long-term view of the quality of the business they bring into the bank.

As banks look to reshape processes and compensation plans, they must be mindful of the evolving regulatory agenda. As new rules are finalized, banks and their customers will be affected. As with any change program in the current environment, banks will need to consider compliance with regulation and the impact on customers, as well as the impact on the bank itself.

4. Initiate customer communication and incentives program

In order to rebuild trust and develop cohesion as the front office is redesigned, customers must be an integral part of the change program. This breaks down into two steps.

The first step is communicating with customers to help them understand the rationale for the changes and to educate them on the benefits. Banks should implement an active contact strategy, informing clients of changes through a range of channels (e.g., emails, online tutorials, mailings and branch pamphlets).

The education process should also highlight the various channels that particular customers will have access to and then allow them to choose which ones best fit their needs. Allowing customer choice will help to alleviate any confusion and dissatisfaction.

The second step is incentives. The desired outcome is to have the customer choose the service model that is appropriate to its particular segment and the lowest cost to the bank. Proper incentives are crucial to ensuring customers choose correctly. A bank can achieve this in the lower two tranches of the revamped customer segmentation model by lowering costs for customers who choose the retail-plus approach. Another option is to use a variable-cost approach for customers who are uncertain about the level of front-office interaction they will need.

To rebuild trust and develop cohesion as the front office is redesigned, customers must be an integral part of the change program.
Conclusion: Why act now?

Initial improvements can raise relationship manager capacity by about 10%, with further process reengineering increasing capacity up to 25%.

Now is the time for banks to redesign their front-office service model for the SME segment. Not only are customers dissatisfied with the current model, but banks are under pressure to increase revenues and profitability. Often underserved, the SME segment provides a significant opportunity to improve profits and brand reputation. Banks should act now before new entrants with more proficient systems and services truly disrupt the market. To that point, we’re already working with banks around the world to develop strategies to address this competition. We see three core benefits to implementing the elements needed to redesign the front office.

First, banks can free up capacity and enhance the capability of the front office. Relationship managers should not continually be burdened by middle- and back-office activities. By allowing them time to sell and to build customer relationships, banks will be able to increase overall profitability. A renewed and best-in-class service model will drive differentiation in a very competitive marketplace while delivering improved ROI from capital-intensive resources (relationship managers). Based on our experience, initial improvements can raise relationship manager capacity by about 10%. By building on that foundation to deliver more extensive changes, such as process reengineering, leading banks have increased relationship manager capacity by 20%-25%.

Second, banks can drive down operational and credit administration costs, reduce loan- and product-processing times and improve decision-turnaround times. All of these improvements should generate additional new business, deepen key relationships through increased cross-selling, deliver higher margins and, ultimately, increase ROE.

Third, banks will enhance the customer experience. If they can strengthen the satisfaction of a client through improving error-resolution processes, credit turnarounds and digital functionality, banks will obtain greater customer advocacy and retention. Additionally, through improvements in internal processes, employees will have higher job satisfaction, which should lead to better retention rates and better trained resources.
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EYG no. EK0294
1404-1235278 NY
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