SMALL BUSINESS BANKING AND THE CRISIS: **MANAGING DEVELOPMENT AND RISK**

World Retail Banking Report Special Edition

2010

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Contents

Preface

Capgemini, UniCredit, and Efma (European financial marketing association) are pleased to present this seventh edition of the *World Retail Banking Report*. Because the financial and economic crisis has had a tremendous impact on bank operating models and their ability to handle liquidity, manage risk and compliance, and generate revenue, we have focused this year on evaluating the effect of the global financial crisis and how to deal with it. We especially highlight trends in the small business market, which is a very important strategic market for retail banks.

This year's study, therefore, investigates the challenge small business banking faces to master risk while accelerating business development, which was brought to the fore by the crisis. As detailed in the Methodology, our analysis is based on 58 in-depth interviews with senior executives from leading banks in 21 countries: Austria, Belgium, China, Croatia, Czech Republic, France, Germany, Hong Kong, India, Ireland, Italy, the Netherlands, Poland, Romania, Russia, Slovakia, Sweden, Turkey, United Arab Emirates, United Kingdom, and United States.

Our report provides bankers with an overview of the challenging but critical small business market, proposes a winning model to overcome today's risk management and development challenges, highlights the major benefits of this model, and suggests practical next steps to reach and implement it successfully.

It is with great pleasure that we publish this 2010 edition of the *World Retail Banking Report*. We trust its findings will help answer key questions and stimulate debate. Most of all, we want to provide useful information that helps retail bankers deal more effectively with the difficult operational and strategic issues they will face in the post-crisis period.

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Principal Findings

Small Business Banking and the Crisis: Managing Development and Risk

The global financial and economic crisis—with the increasing cost of risk, the drop in demand, and the rising pressure on banks to support the economy—has highlighted the major challenge that small business bankers face: how can they both accelerate business development and manage risk?

To cope with this challenge, successful retail banks will develop along two key dimensions to reach what we call the "winning bank" model (see matrix below):

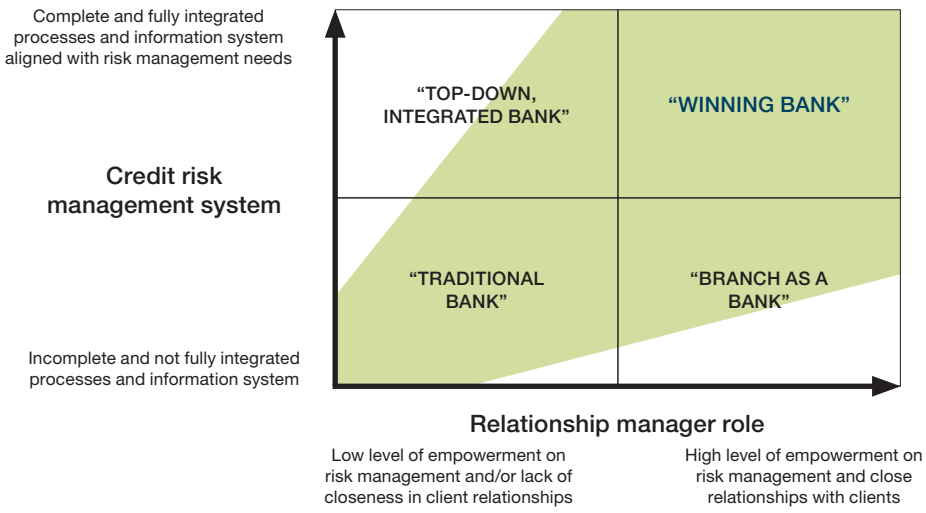
- Move the role of their relationship managers (RMs) towards closer relationships with their clients, a deep understanding of each client's needs and expectations, and increased empowerment on risk management issues, fully in line with policies and practices defined by the risk management department.
- Implement an efficient and complete credit risk management system—characterised by an appropriate governance scheme, fully integrated processes, and a complete and efficient supporting information system—that meets the highly specific and complex risk management needs of the small business market.

This model will enable banks to outperform their competitors on both development and risk management, by:

- Accelerating development through increased client satisfaction and the bank's ability to cross-sell successfully, thereby supporting revenue generation under the increased cost-of-risk pressure.
- Mastering risk, based on wider usage and sophistication of rating-based scoring tools, strengthened proactive management of performing credit portfolios, and an improved credit collection process with "soft collection".

To reach and implement the winning bank model, successful banks will design an appropriate transformation strategy (see matrix):

- Transformation paths depend on a bank's starting point on both axes, on its original market positioning (retail versus corporate), and on its culture and organisation.
- These transformation paths will be a combination of technical, organisational, and HR measures implemented through quick wins, incremental steps, or longer term actions.
- To succeed in this transformation, banks will have to set up robust change-management approaches to achieve alignment with the bank's overall strategy, support from senior management, and buy-in from employees.



Introduction

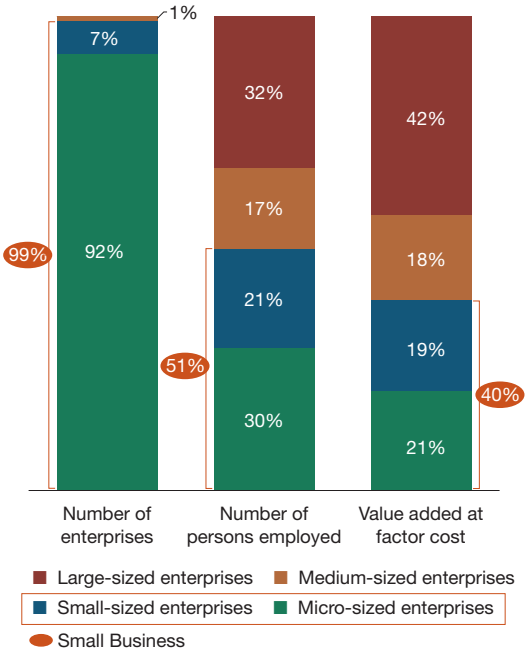
The financial and economic crisis has brought to the fore small business banking's key challenge:

How can banks master the cost of risk and also accelerate development?

FINANCING THE SMALL BUSINESS MARKET IS A KEY FACTOR IN THE WORLD'S EMPLOYMENT AND ECONOMY

Small businesses play a major role in the world economy. In Europe, Japan, and the USA, 99% of the enterprises belong to the small business market and are responsible for 51% of the employment in the private and non-financial economy (see Methodology for how we define the small business market). Small business employment is more than 50% in the EU27 and approximately 40% in the USA (see Figure 1).

Figure 1 **Contribution, by size category, in terms of number of enterprises, employees, and value added**



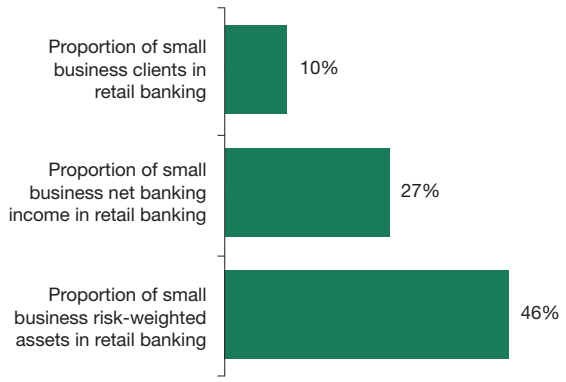
Source: EIM/European Commission, *Annual Report on EU Small and Medium Enterprises* (first section), January 2009.

This is a high-growth market. In Europe between 2002 and 2007, the number of small and medium enterprises grew by 11%, and their number of employees went up by 9% (versus 4% and 3% for the larger enterprises). The line-of-business diversification of small businesses helps mitigate the impacts of macroeconomic downturns at the national or global level. That is why, when added to the fact that small businesses employ such a large portion of a nation's people, governments often rely on small businesses to boost economic recovery in times of crisis.

THE SMALL BUSINESS MARKET IS A VERY ATTRACTIVE AND STRATEGIC MARKET FOR RETAIL BANKS

According to our interviews, while representing less than 10% of the retail banking client portfolio, the small business market accounts for almost a third of retail banks' net banking income (NBI) (see Figure 2).

Figure 2 **Weight of the small business market in retail banking**

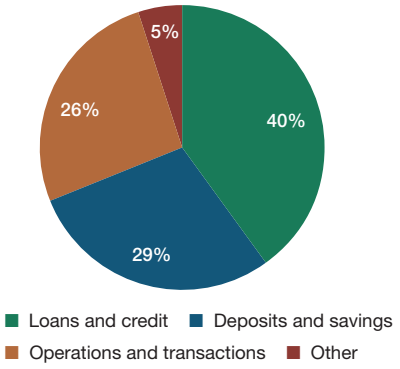


Source: Capgemini analysis from bank interviews, 2010.

Small businesses rely mainly on banks for their financing needs, because they have very limited access to equity. Credit and loans, therefore, are at the heart of small businesses' relationships with their banks, and represent 40% of the total retail banking NBI in this market (see Figure 3).

Small business clients also represent a high development potential for banks. One of the primary challenges is to become the client's main banker and capture as much of the flows, credit, and savings as possible through cross-selling and up-selling. But part of the challenge also lies on the private side, as bankers try to cross-sell products to the entrepreneur and secure client loyalty.

Figure 3 Small business net banking income product structure



Source: Capgemini analysis from bank interviews, 2010.

THE SMALL BUSINESS MARKET IS A HARD NUT TO CRACK BECAUSE IT IS RISKY AND COMPLEX

The small business market is risky. Small businesses are more vulnerable than larger enterprises (low capitalisation and no credit ratings, for instance) and have high bankruptcy rates. As Figure 2 showed, although small business represents 27% of retail NBI, it accounts for 46% of total retail risk-weighted assets.

Yet small business is a complex market to deal with. Spread across retailers, artisans, farmers, associations, liberal professions, and small enterprises, it features behaviours and needs from both the mass and corporate markets. To handle this market, successful bankers will develop a mixed approach between standardisation and customisation in their offers.

THE ECONOMIC AND FINANCIAL CRISIS HIGHLIGHTED RETAIL BANKS' CHALLENGE OF MANAGING RISK WHILE ACCELERATING DEVELOPMENT

The global financial and economic crisis strongly affected small businesses. They endured severe cuts in turnover and profit, and an increase in the number of defaults, insolvencies, and bankruptcies. Considering the high importance of small businesses in national economies, most governments and other public sectors have implemented measures to help them face the crisis, including supporting sales, cash flow, and working capital; enhancing access to finance; supporting investment; strengthening capital; and the like.

With small business clients going through hard times, bankers face two difficult threats: (1) a rise in the cost of risk; and (2) a drop in demand. According to the banks we surveyed, cost of risk is the first threat caused by the crisis (51% of respondents), followed by the drop in demand (31%), well ahead of pressure on prices (10%) and better-armed competitors (8%) (see Figure 4).

The tremendous increase in the cost of risk has forced banks to strengthen their risk management. In particular, one of the challenges banks now face is to continue assessing correctly the new credit applications for underwriting. The traditional way of assessing creditworthiness is questioned in times of crisis, because the analysis of most borrowers' financial statements or liquidity behaviours has deteriorated. Faced with this reality, banks have to define a cost-effective way to develop predictive or business planning analyses adapted specifically to the small business market.

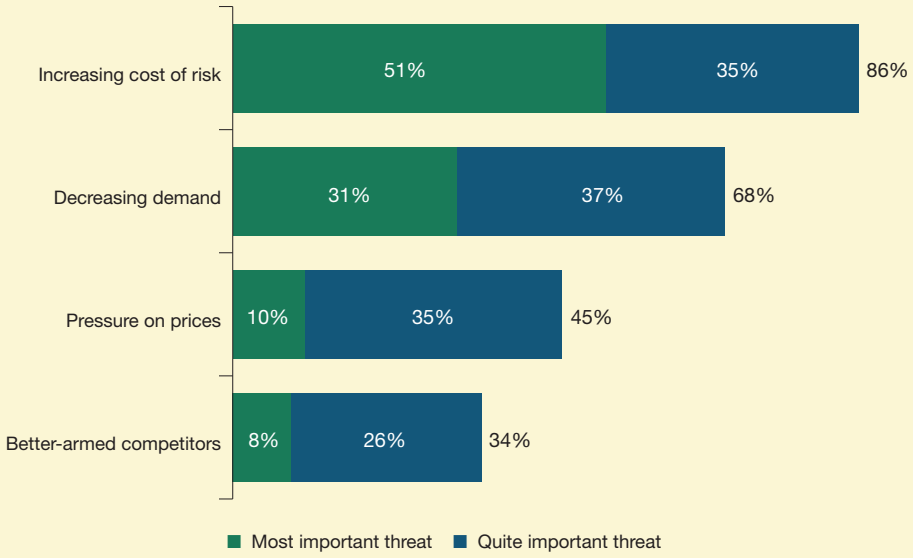
The drop in demand is mainly for credit, resulting from investment freezes and, to a lesser extent, from the use of such alternative financing as associative networks and public funds.

The global financial crisis has led to higher costs of financing. As a result, for the first time since 2005, European bankers expected a decline in their revenues from the small business market in 2009 (see Figure 5).

As a first reaction to the financial crisis, many banks were forced to slow down their credit activity in response to a peak in the cost of risk. This was only temporary, however, as the double pressure of governments' commands and banks' own growth needs made development a top priority.

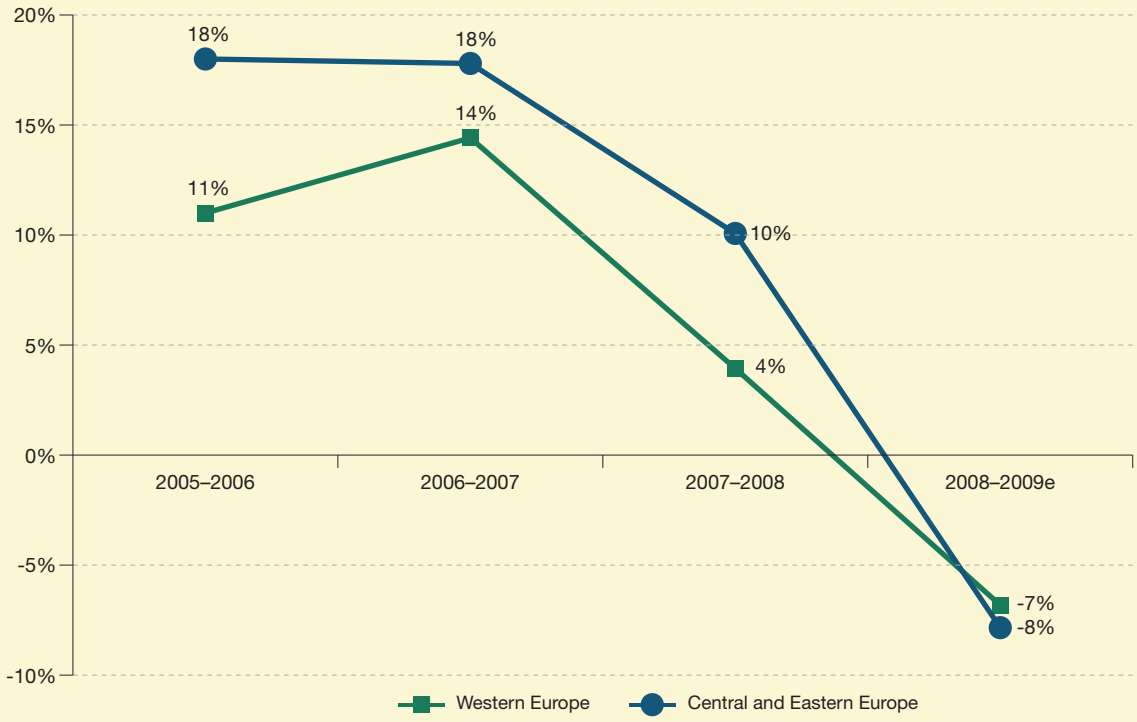
Banks have always faced the challenge of managing risk while accelerating development. In this time of crisis, however, the challenge has dramatically increased.

Figure 4 Main threats caused by the crisis, according to bankers (% of banks interviewed)



Source: Capgemini analysis from bank interviews, 2010.

Figure 5 Five-year revenue growth for European small business banking



Source: Efma/Finalta study, "Direct Channels for Small Business Banking", January 2010.

Chapter 1

The Winning Bank Model in the Small Business Market

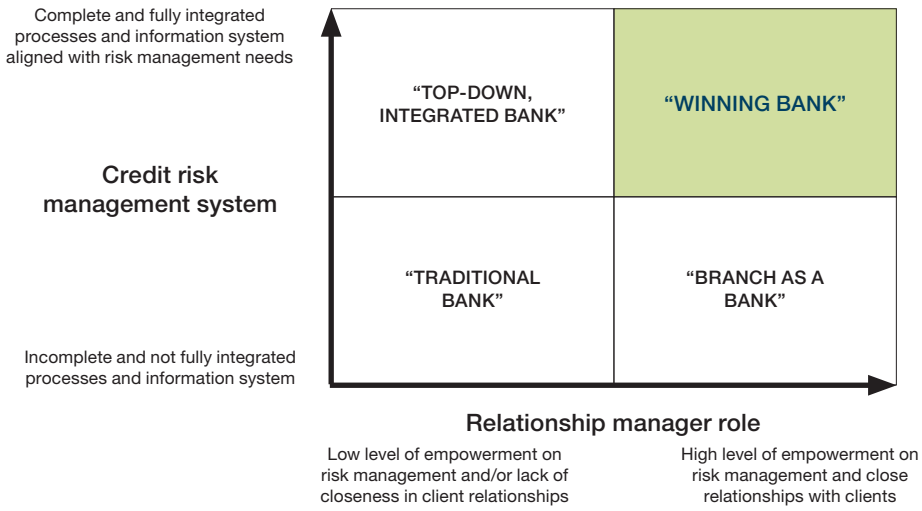
Based on our own experience and on the bank interviews we conducted for this report, we are convinced that to perform well in risk management and develop the small business market, and eventually become what we call here a "winning bank", successful retail banks will improve the role of their relationship managers (RMs) and beef up their credit risk management systems (see Figure 6).

This winning bank model has three primary characteristics:

- RMs with client relationships based on a deep understanding of each client's line of business, needs, and expectations, as well as substantial relationship strength.
- RMs empowered to act on risk management issues, in terms of both underwriting and active credit portfolio management, fully aligned with risk management department policies and supported by appropriate systems and organisation.
- To ensure the efficiency of these first two characteristics, banks also need to implement an effective and complete credit risk management system that meets the highly specific and complex risk management needs of the small business market. This system relies on fully integrated processes and an efficient supporting information system.

This first chapter of the report will describe these three characteristics. Chapter 2 will highlight the benefits of the winning bank model. In Chapter 3, we will specify the possible paths to reach and implement this winning model.

Figure 6 Four models for retail banks operating in the small business market



Source: Capgemini analysis, 2010.

RMs NEED TO DEVELOP CLOSE CLIENT RELATIONSHIPS

By close client relationships we mean proximity, availability, and stability of the relationship, along with genuine concern for the success of the customer's business. Moreover, deep knowledge and understanding of each client's line of business, needs, and expectations—and of the entrepreneurship issues behind them—are key success factors in the small business market (unlike corporate banking, where knowledge of the client's industry is much more relevant).

Among all distribution channels, RMs are—and will remain—the linchpin of client relationships. For the surveyed banks, 93% of their small-sized clients will be assigned to an RM portfolio in the near future, versus 89% today. Several banks that have developed call centres too far, disrupting the relationship between clients and RMs, are now coming back to a more RM-centric, multi-channel scheme, giving priority to face-to-face interactions. (For micro-sized clients, however—given their simpler needs—RMs can also interact by telephone or through other direct channels.)

This is one good reason why banks have to review and strengthen the role and profile of their RMs. To enable such RM positioning, lengthening the RM's job duration is a key success factor. Ideally, RMs should stay four or five years in their job. Today, based on what we observed in the market, RMs average three years.

Banks need to give their RMs the time they need to build very strong relationships. As a consequence, banks can limit the number of clients an RM manages, or limit their assignment in terms of expertise with products and services so that RMs do not have to sell all products and services in the small business range.

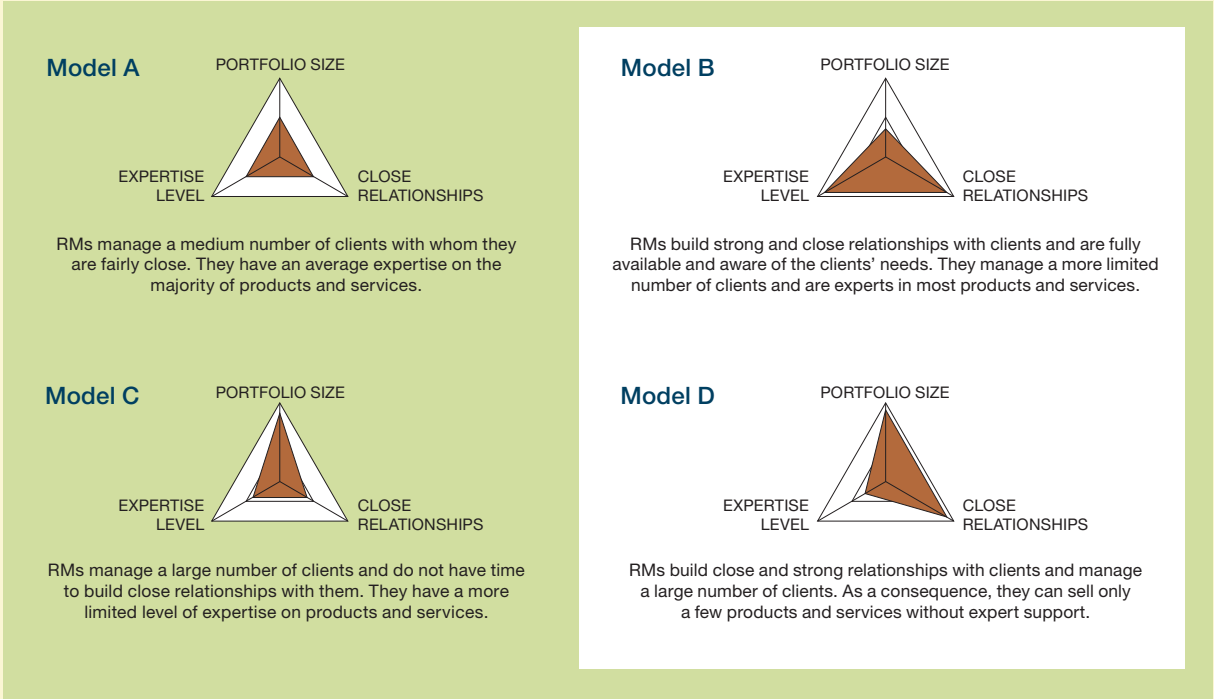
As shown in Figure 7, we identified four RM relational models that trade off differently between the three critical factors in solid relationship management: portfolio size, expertise level, and close relationships. Two of them—B and D—favour close client relationships.

Model B enables the RM to build strong client relationships, because the RM is fully available and deeply aware of each client's business needs. These RMs are experts on most of the products and services small businesses need. Their client portfolios, however, must be limited.

In model D, RMs also develop very close relationships with their clients while managing a larger number of clients than in model B. As a consequence, however, they are in a position to sell a smaller number of products and services unless they get help from product experts offering technical sales support.

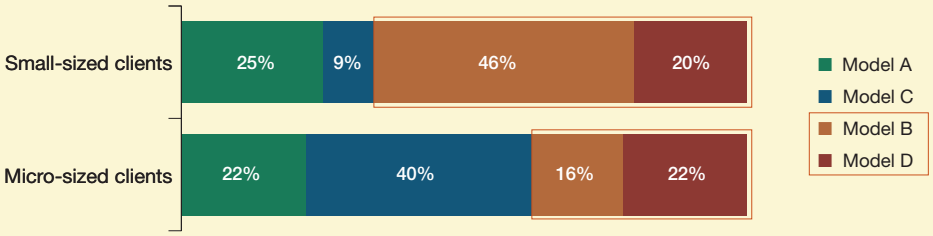
These two models are used most by banks in the small business market, especially for small-sized clients who require more RM time to build close client relationships. For these clients, 66% of surveyed banks are already operating one of these two models or will implement one of them in the near future (versus 38% for micro-sized clients) (see Figure 8).

Figure 7 Four relationship manager models, with two models favouring close client relationships



Source: Capgemini analysis, 2010.

Figure 8 Percentage of surveyed banks using model A, B, C, or D



Source: Capgemini analysis from bank interviews, 2010.

Accordingly, most banks interviewed intend to reduce the size of their RMs' client portfolio, as shown in Figure 9, which is consistent with model B.

Especially for banks implementing model D, technical sales support resources (such as product experts) can be set up for the most complex and sophisticated products and services, such as electronic payments, trade finance, internationalisation, and private banking. These product experts are used more and more by retail banks, and of banks we surveyed, 55% said they were already using them "today", and 12% said they would set them up "in the near future".

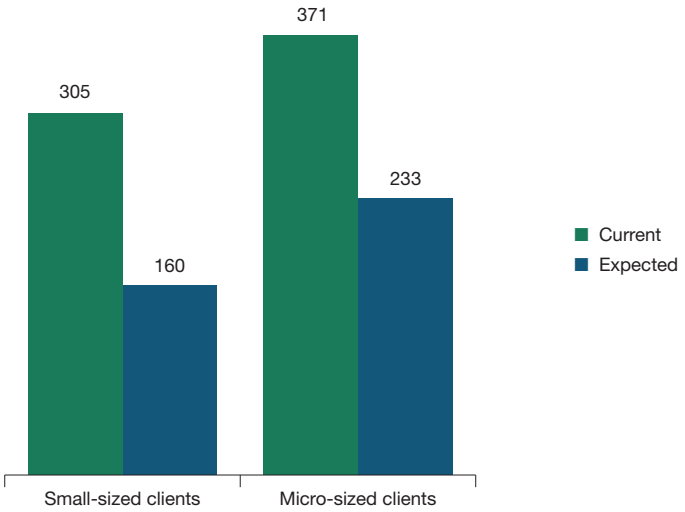
Beyond the implementation of these two models—with the reduction of client portfolio size or the creation of technical sales experts—banks need to enhance supporting measures designed to free up time for RMs, such as:

- Reinforcing and professionalising middle-office positions (such as sales assistants) to support RMs, primarily by lightening RMs' workload on administrative and non-commercial tasks.
- Simplifying the range of products and services they offer to small business clients, along with simplifying the process that helps RMs access and choose the right products. Of the banks we surveyed, 40% intend to simplify their product range, while 20% intend to make it more sophisticated (40% will leave the situation as is). As an illustration of a reduced product range, a large European bank that formerly proposed 250 products for savings and deposits is working to reduce it to 15 key products.
- Continuing to improve sales and after-sales process efficiency.

Banks will continue to encourage RMs to intensify their relationships with clients, and adopt closer management of the client portfolio, by increasing the number of client meetings (taking care to improve meeting quality to avoid being perceived as intrusive), and by integrating this dimension into their objectives system.

Finally, banks can help their RMs develop their skills and understanding of client needs by regularly updating and enriching an intranet dedicated to the small business market. The aim will be to capitalise on the knowledge that banks are continuously developing about such important topics as markets, business lines and professions, products, credit policies, processes and tools, and the like.

Figure 9 Client portfolio size per relationship manager (average number of clients)



Source: Capgemini analysis from bank interviews, 2010.

RMs NEED A HIGH LEVEL OF EMPOWERMENT ON RISK MANAGEMENT

Two opposite risk-empowerment profiles can be defined: *RM as a sales manager* and *RM as a small banker*. High-performing banks will select the second profile.

The first profile, *RM as a sales manager*, emphasises the "four-eye" principle: most of the credit decisions, especially underwriting or loan rescheduling, must be double-checked by a risk analyst, or at least a regional or national sales manager. The level of empowerment RMs have in this commonly found scenario is rather limited, and these RMs are focused on sales and customer service.

The second profile, and the one that leads to the winning bank model, is the *RM as a small banker*. It gives RMs substantial responsibility and empowerment on risk management, as well as for credit underwriting, behavioural monitoring,[1] and loan rescheduling. In this scenario, the RM is regarded as the person playing the key role to make the right decision on credit underwriting or even rescheduling, because he or she is responsible for the day-to-day client relationship and has the best knowledge of the client's needs and economic situation. In times of crisis, this point is all the more important because it becomes crucial to predict whether a client's difficulties are temporary or structural.

Depending on the profile adopted, successful banks will implement appropriate measures, tools, and processes aimed at ensuring performance, controlling the resulting risk, and supporting RMs.

In the profile *RM as a sales manager*, above all, a bank needs to invest in process efficiency, especially aimed at avoiding time-to-decision delays, since more people are involved in the decision at different levels and places in the company. Moreover, in this profile, efficient client data management (credit relationship management tools, data knowledge management processes, and so on) is necessary to ensure the availability of accurate information, both qualitative and quantitative, at any time and at any level of the bank (local, regional, national; sales and risk organisations). Strong RM training on decision processes (credit scoring interpretation, decision scheme, level of authorisation, scaling process) and data management processes are also mandatory for this profile.

In the profile *RM as a small banker*, banks need to: (1) strengthen the RMs' risk management skills; (2) free up time for RMs, continuously improve the credit process, and provide dedicated coaching resources to help them manage sales and credit decisions; (3) establish measures aimed at controlling the resulting risk of such a profile; and (4) create durable client relationships.

First, to ensure relevant and accurate decisions, excellent RM training on risk management is required in this profile, including credit scoring interpretation, risk assessment, behavioural monitoring, and loan rescheduling.

Second and above all, because it is difficult for RMs to deal with sales and credit risk issues at the same time, a bank will have to free up RM time by reinforcing support from middle-office resources, which will relieve the RM of administrative credit tasks, and also improve credit process efficiency. (Banks might also extend an automated decision process to a wider micro-loan scope.) In addition, RMs will need to be supported and coached by dedicated resources on all these issues (we develop this good practice further in the next chapter).

Third, appropriate reporting, or more thorough management by objectives (MBO) systems, are also necessary to highlight the cost-of-risk factor at the RM level. These systems allow banks to assess RMs' risk management performance so they can appropriately structure the RMs' level of empowerment, their incentives, their training, and even their career evolution. Such measures act as a barrier against potentially bad assessments or, even more critical, connivance with clients.

[1] "Behavioural monitoring" entails the RM reviewing (usually monthly) his or her credit portfolio, client by client, to catch early-warning signals of deterioration and decide what actions are needed for that particular client.

Finally, reduced sales force turnover to maintain durable client relationships is also a key success factor. It will strengthen RMs' client knowledge for relevant credit decisions, and ensure accurate cost-of-risk reporting at the portfolio level. The *RM as a small banker* profile might help a bank lengthen the RM job duration, as well, because it gives every RM the power to better help their clients in their businesses, making the RM job more attractive.

Figure 10 summarises the key measures that ensure each model will be effective and support the RM, and Sidebar 1 is a short case study of a large European bank using the *RM as a small banker* profile.

TOP BANKS WILL HAVE AN EFFICIENT AND COMPLETE CREDIT RISK MANAGEMENT SYSTEM

The winning bank model also relies on a bank's ability to implement a complete risk management system closely fitting the highly specific and complex needs of managing small business credit risk. By risk management system, we mean three major elements: (1) governance; (2) macro-processes; and (3) a supporting information system.

First, it is crucial to set up a clear and efficient governance scheme aimed at ensuring the right decisions are made on policies, processes, and tools by involving the appropriate level of management, depending on the financial stakes. Efficient governance relies on several key success factors:

- Setting up an appropriate committee scheme, differentiating committees focusing on operations from committees dealing with credit policy issues.
- Developing scenario analyses for the main risk parameters, to accurately plan, budget, and forecast loan-loss provisions, new non-performing loans, and expected losses.
- Developing specific risk strategies and policies in terms of risk appetite for each type of client, product, risk class, industry, geography, and distribution channel.
- Monitoring the credit portfolio, producing a set of reports (*tableau de board*), analyses, studies, surveys, simulations, and detailed forecasts, to measure credit risk, identify any anomalies or built-in problems to be communicated to the appropriate levels of management, and propose corrective actions aimed at constantly improving overall credit quality.[2]
- Arranging a constructive and regular dialogue between the sales and risk organisations.

Second, the credit risk management system relies on several key macro-processes in risk operations (underwriting, behavioural monitoring, and credit collection) and in risk management (such as risk strategies, portfolio monitoring, credit policies, credit models, credit data management, regulatory and compliance, audit and control). They must be constantly improved by the risk management department. (In Chapter 2, we will develop the three main best practices at stake following the crisis: wider usage and sophistication of rating-based scoring tools, strengthened proactive management of performing credit portfolios, and an improved credit collection process with "soft collection".)

Figure 10 Appropriate measures for the two risk-empowerment relationship manager profiles

	Process efficiency	IT supporting tools	Coaching, management by objectives	RM training	RM stability in the job
RM as a sales manager	Underwriting and rescheduling decision process, client data management process, etc	CRM tools, scoring tools, early-warning indicators, etc	MBO focusing mainly on client contacts and sales	Decision process, scoring interpretation, understanding risk by line of business or market, etc	Durable client relationships with low RM turnover, etc
RM as a small banker	Underwriting and rescheduling decision process, client data management process, etc	CRM tools, scoring tools, early-warning indicators, etc	Reporting of cost of risk at RM level, with integration of this dimension in MBO	Scoring interpretation, understanding risk by line of business or market, behavioural monitoring and rescheduling, etc	Durable client relationships with low RM turnover, etc

Strong need Significant need

Source: Capgemini analysis, 2010.

[2] "Portfolio monitoring" is performed centrally by risk management analysts.

Sidebar 1

Illustration of a large European bank operating with the *RM as a small banker* profile for risk management

This cooperative bank is one of the leaders in the small business market, with a 24% penetration rate. The bank delegates risk management decisions to the relationship managers, both for underwriting and for rescheduling, to ensure fast and accurate decisions.

NEW LOAN UNDERWRITING:

- Most of the decisions (85%) are made at the local level by RMs (or branch managers).
- The other decisions (15%) are commonly made at the regional level by sales and risk departments.
- The bank does not use scoring tools, and the only decisions that are made automatically (15% of the new loans) correspond to pre-approved loans (RMs may contact some clients to offer a pre-defined credit line).

EXISTING LOAN MANAGEMENT AND RESCHEDULING:

- RMs are fully involved in their loan portfolio monitoring. They are directly responsible for managing (including restructuring) the 15% of the riskiest performing loans.
- Collection is managed by a regional (or interregional) dedicated entity attached to the risk department.

TO ENSURE RISK MANAGEMENT PERFORMANCE AND CONTROL, THE BANK HAS SET UP SUCH MEASURES AS:

- Maintaining stringent reporting of cost of risk at the RM portfolio level, integrated in the MBO system, to personalise the RM's incentive and level of authorisation for underwriting and rescheduling. Recurrent or high cost of risk may affect the RM's career evolution.
- Giving priority to sales force skills and client knowledge in underwriting (scoring system improvement and process efficiency are not priorities).
- For existing portfolio management, tracking early-warning indicators (EWIs), such as increasing past-due payments, decreasing transactions or operations, increasing utilisation of credit lines, etc.
- Inducing RMs to stay on the job at least five years; current average duration is four years, the range being three to eight.

Third, banks have to implement a complete and fully integrated credit risk management information system, attuned with business needs through the entire credit risk management value chain, as shown in Figure 11.

This system will leverage existing tools of other markets as well as applications specifically developed for the small business market. It will enable full integration—along all stages of the credit sales and risk-management value chain (from underwriting to behavioural monitoring and credit collection)—of all processes linked to client management, internal decision-making, prudential reporting feeds, and audit trail constraints.

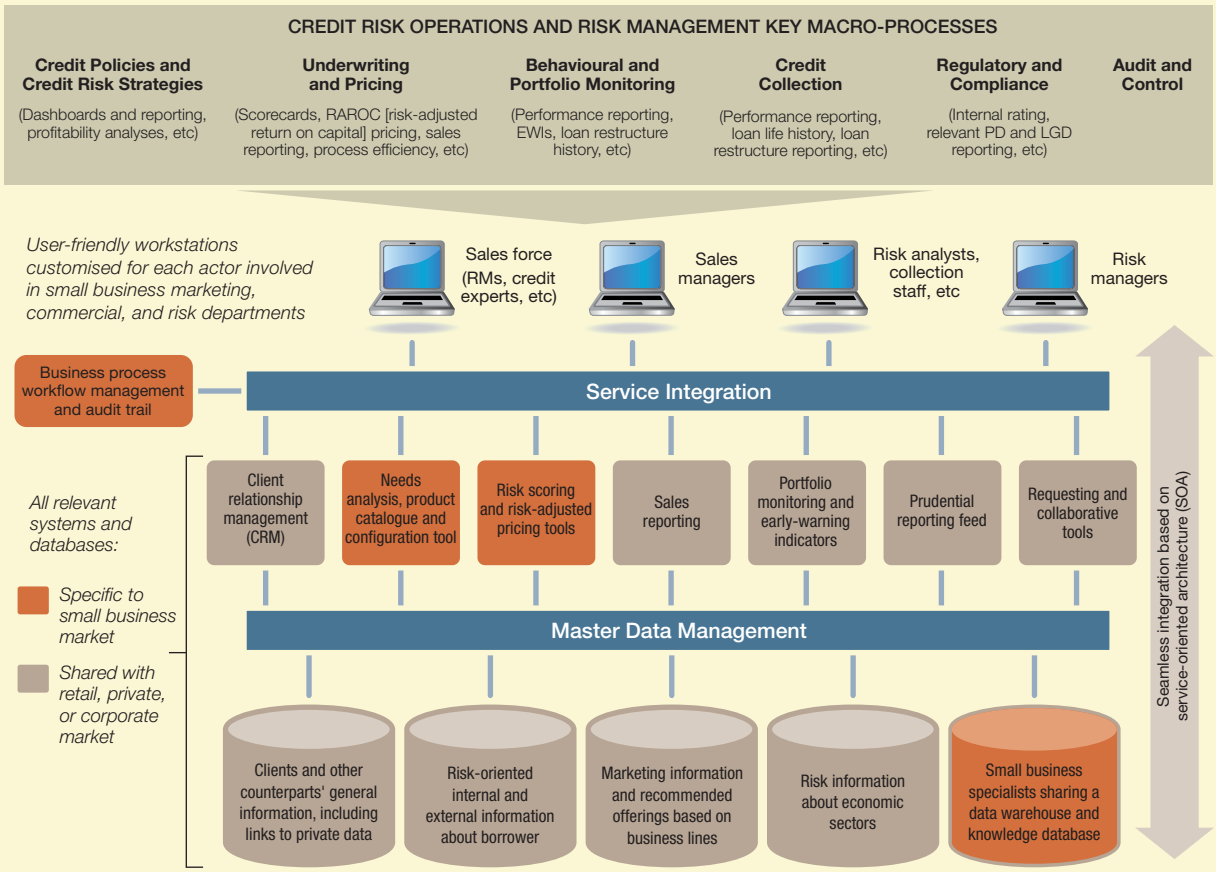
Such a system will help banks cope with the primary credit data management challenges they are facing in the small business market today (see challenges in Figure 12). It will ensure that several major considerations are covered:

- Relevancy and deepness of data gathered from internal and external sources (e.g. diversified data for scorecards: financial data, predictive data, qualitative information, and so on).
- Quality of data regularly validated and updated.
- Integration of data to avoid redundancy or the necessity to capture repeatedly the same data at different stages (e.g. the underwriting decision process, credit origination process, and regulatory compliance/Basel II process).
- Knowledge management over time to enable trend and historic analyses (e.g. follow-up of a loan from origination to servicing and recovery—especially efficient collection).
- Wide and appropriate diffusion to guarantee full data accessibility by credit information systems and specialists. This system also takes advantage of a service-oriented architecture (SOA) to perform the seamless integration of datamarts and applications specific to the small business market, as well as those shared with other markets. It provides final users (such as sales forces, sales managers, risk analysts, and risk managers) with a comprehensive portal on their workstations that allows access to all relevant tools and information with a user-friendly Web 2.0 interface.

Finally, by using collaborative tools, such as instant messaging, forums, wikis, and peer-to-peer solutions, banks will be able to spread across the community of their small business specialists the best practices developed in their network.

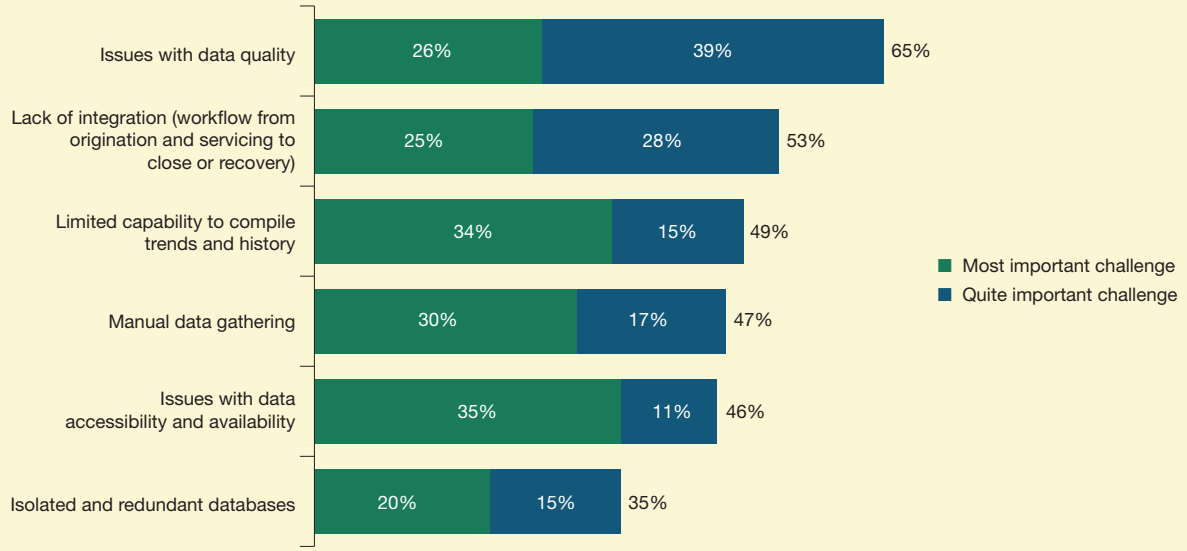
By combining RM closeness to customers, high RM empowerment on risk management, and an efficient and complete credit sales and risk-management system, successful banks will be able to master risk while maintaining high business development and outperform their competitors in the small business market. In the next chapter, we will develop the benefits that implementing the winning bank model can achieve.

Figure 11 Complete and fully integrated credit risk management information system for the small business market



Source: Capgemini analysis, 2010.

Figure 12 Credit data management challenges (% of banks interviewed)



Source: Capgemini analysis from bank interviews, 2010.

Chapter 2

Key Benefits of the Winning Bank Model

We identified three major benefits of the winning bank model:

1. It contributes to higher small business client satisfaction, especially since the crisis.
2. It better leverages a cross-selling strategy, which is at the heart of retail banks' development efforts in the small business market.
3. It enhances a bank's ability to develop and use risk management best practices.

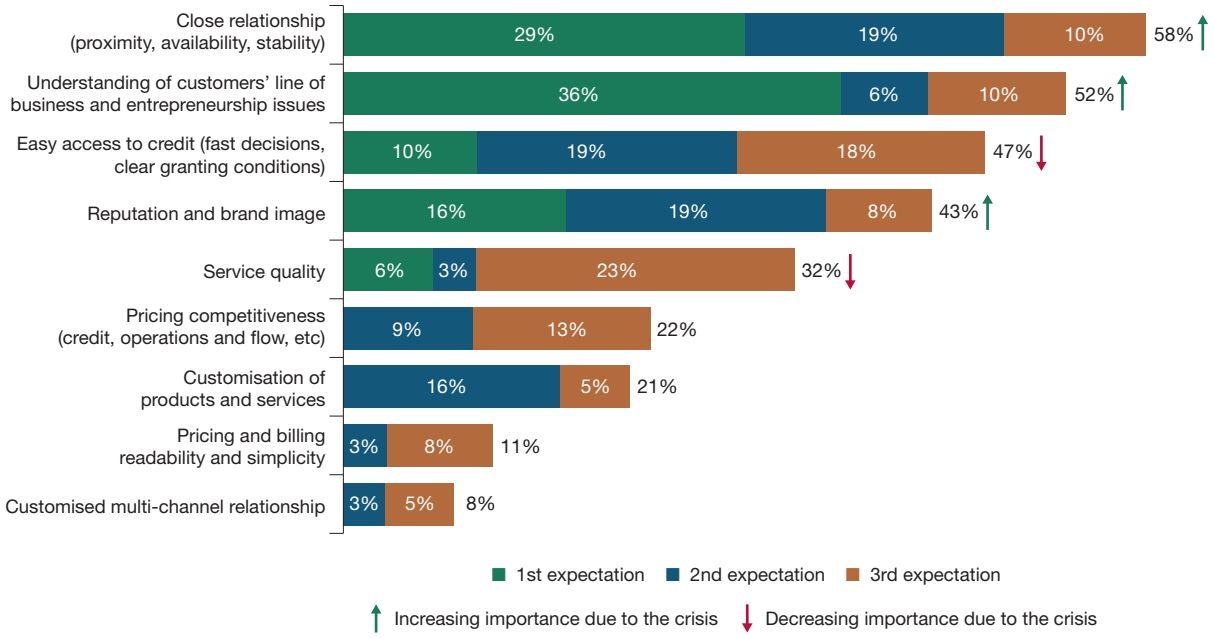
THE WINNING BANK MODEL BETTER SATISFIES SMALL BUSINESS CLIENTS, ESPECIALLY SINCE THE CRISIS

The global financial crisis has pushed closeness with customers (proximity, availability, stability of the relationship), along with an understanding of each client's line of business and entrepreneurship issues, to the top of the small business client's expectations list.

As shown in Figure 13, 58% and 52% of our surveyed banks put these expectations high on their list of most important expectations. Easy access to credit and brand image and reputation are also important expectations for small business clients.

A highly empowered RM profile, furthermore, will help satisfy clients, who usually prefer to deal directly with a decision-maker rather than a messenger and appreciate receiving a quick answer concerning their credit requests. Our winning bank model meets all of these expectations.

Figure 13 Key small business client expectations, and impact of the crisis, according to bankers (% of banks interviewed)



Source: Capgemini analysis from bank interviews, 2010.

THE WINNING BANK MODEL ENABLES A BANK TO LEVERAGE ITS CROSS-SELLING STRATEGY

Because it can make the most of a deep understanding of client needs, the winning bank model fully supports customer-centric development strategies currently favoured by retail banks, aiming at becoming the client's principal bank in a win-win relationship. Of the banks we interviewed, 73% viewed cross-selling or up-selling as a priority, both on professional and private offers, as shown in Figure 14.

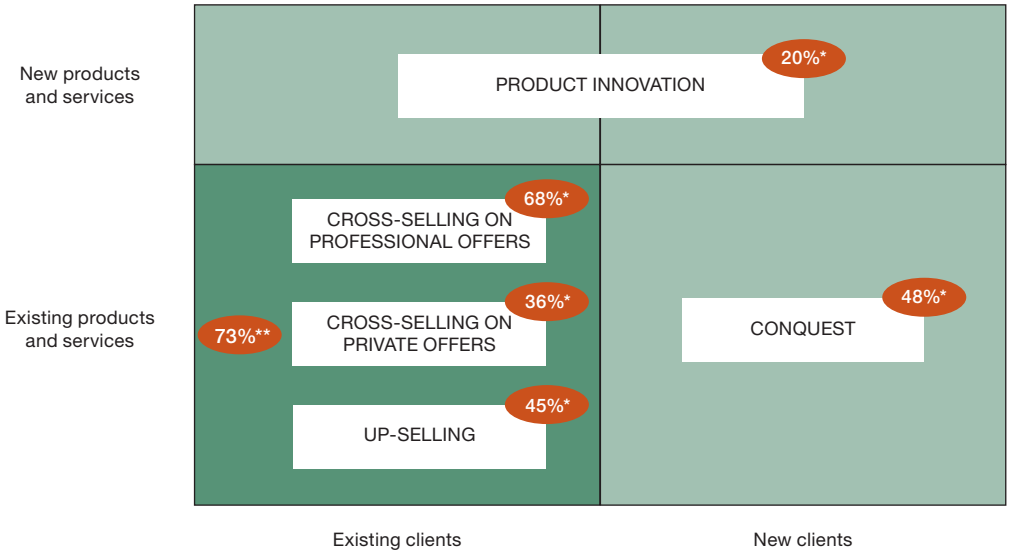
RMs are clearly at the forefront of cross-selling strategies. Among all marketing levers for cross-selling, sales action is the first to succeed in this strategy, well ahead of product improvement or pricing innovation, as shown in Figure 15.

As an illustration of good practice in sales action for credit, defining pre-approved credit lines for some clients can create demand. To develop sales in current account operations and transactions, many banks are proposing unbundled offers, or simplifying their billing policies through such innovations as fixed-price contracts, to satisfy clients' expectations for more simplicity, clarity, and transparency.

Another key success factor to help banks develop business and make the most of cross-selling is the use of relevant commercial/relational segmentation aimed at designing the best commercial organisation to serve various client categories (such as RM generalists or specialists, professional or private relationships, or a multi-channel model). Almost 80% of the banks we interviewed said they use commercial/relational segmentation. To do so effectively requires availability and relevancy of client data. Generally speaking, we found 40% of surveyed banks followed a segmentation sophistication trend (versus 20% of banks intending to simplify their segmentation and 40% expecting to keep it unchanged).

As illustrated in Sidebar 2, banks are using different types of commercial/relational segmentation, built on diverse criteria.

Figure 14 Development strategies favoured by banks (% of banks interviewed)



Source: Capgemini analysis from bank interviews, 2010.
* Percentage of banks that selected this strategy as a priority.
** 73% of banks surveyed have selected at least one of the three cross-selling or up-selling strategies.

Figure 15 Cross-selling marketing levers by category of product (% of banks interviewed)

	Sales action	Product improvement	Billing or pricing innovation	Price reduction
Short-term financing (working capital, factoring, etc)	75%	48%	20%	8%
Current account operations and transactions	78%	43%	23%	3%
Long-term financing and investment loans	80%	70%	15%	10%
Insurance products	67%	61%	17%	0%
Deposits and savings	68%	38%	16%	10%

More than 75% of respondents | 50–75% of respondents | 25–49% of respondents | Less than 25% of respondents

Source: Capgemini analysis, 2010.

Sidebar 2

Illustrations of commercial/relational segmentation

Objective: Commercial/relational segmentation aims at defining client clusters with homogeneous needs and expectations, allowing banks to design for each:

- An optimal commercial organisation (RM's role and client portfolio size)
- An appropriate relational model and policies (e.g. development objectives, and frequency of contact, types of contact, and channels of contact)

Criteria: Segmentation criteria differ greatly from bank to bank, and may include:

- Client's line of business (e.g. farmer, retailer, liberal professional, small enterprise, association) and market segment (e.g. health, building, financial, food, trade)
- Client's annual turnover
- Client's level of risk (e.g. credit rating)
- Enterprise life cycle (creation, development, transmission)
- Nature of the relationship (business or personal banking)
- Client's annual banking income or profitability (current and potential)
- Seniority of the relationship
- Complexity of the business cycle

ILLUSTRATION 1: SEGMENTATION AIMED AT DEFINING DIFFERENTIATED RELATIONAL AND COMMERCIAL POLICIES

Segmentation	Associated Commercial Policy	Sample Actions
High banking income and cash only or low credit risk	Maintain loyalty	Support client investments, create barriers preventing transfer of business to competitors, cross-sell value-added products and services
Low banking income and cash only or low credit risk	Raise profitability	Support client investments, review when possible pricing for selected products, increase cross-selling
High credit risk	Protect credit risk	Evaluate economic outlook, require more collateral, reduce exposure, review credit pricing
Very high credit risk or risk of payment default	Reduce exposure or exit	Impose stricter credit conditions and require more collateral, stop proactive commercial actions

ILLUSTRATION 2: SEGMENTATION AIMED AT DEFINING DIFFERENTIATED RELATIONAL/BUSINESS MODELS

Segmentation	Associated Relational/Business Model
High annual turnover and high total credit outstanding with all banks	▪ Face-to-face management ▪ One RM handles client's business and personal banking
Low annual turnover and high total credit outstanding with all banks	▪ Remote management: relationship almost entirely managed by phone and e-mail ▪ Two different RMs handle client's business and personal banking
Low total credit outstanding with all banks	▪ Remote management: relationship almost entirely managed by phone and e-mail ▪ One RM handles client's business and personal banking

ILLUSTRATION 3: SEGMENTATION BASED ON CLIENT'S LINE OF BUSINESS AND AIMED AT ORGANISING SALES FORCES

Segmentation	Associated Commercial Organisation		
Farmers	RM specialist*	or	RM generalist or branch manager (BM)
Liberal professionals	RM specialist*	or	
Other micro-sized enterprises	RM specialist*	or	
Small-sized enterprises	RM specialist*		

* For branches or business centres with large client portfolios.

Source: Capgemini analysis, 2010; bank interviews by Capgemini, 2009; bank presentation at Efma SME Business Banking Conference (Amsterdam, October 2009).

THE WINNING BANK MODEL ENHANCES A BANK'S ABILITY TO DEVELOP AND USE BEST PRACTICES IN RISK MANAGEMENT

We identified the following best practices to perform on risk management in the small business market:

- Wider usage and sophistication of rating-based credit scorecards to support underwriting and monitoring decisions.
- Enhanced proactive management of the performing credit portfolios.
- Improved collection policy, with development of soft collection (or "amicable" collection).

Thanks to its strengthened RM role, the winning bank model raises the quality of gathered data (producing more relevant credit scores and reporting) and improves the quality of solutions and negotiations with clients for proactive credit management and collection.

The effective credit risk management system of this model makes the most of credit scorecards' accuracy and relevance, improves the quality of early-warning indicators, and enables integrated loan follow-up for efficient collection, throughout the loan's life. The model also helps banks develop a set of analyses and reporting that supports credit policy governance.

Wider usage and sophistication of rating-based scorecards to support the underwriting decision

Having relevant scorecards is a key competitive advantage for underwriting, especially when it comes to mass-market credit. In the small business market, assembling sufficient statistics is all the more difficult because it is a fragmented market. This obviously provides a big advantage to leading banks.

Since the beginning of the crisis, most banks have increased their use of scoring tools; 69% of the banks we surveyed told us that underwriting decisions are now or soon will be supported by new scoring tools, versus 63% before the crisis (see Figure 16).

To increase the relevance of scoring tools, the best retail banks will continue to search for more accurate and diversified data. Almost half of the banks we surveyed believe that scoring improvement is among the most important factors to ensure underwriting effectiveness, and 53% of surveyed banks plan to strengthen the data underlying their clients' credit scores.

As shown in Figure 17, banks use three primary types of information about the borrower and the loan: (A) external financial information (mainly based on financial statements, rating when available, and, more rarely, business planning to integrate predictive analysis); (B) external qualitative information about the borrower (such as experience, competitive position, and the like); and (C) internal information about the borrower's relationship and behaviour with the bank (liquidity analysis, revenues and profitability, proportion of past-due payments or NPL history, utilisation of credit lines, and so on). This last criterion (C) is considered a good indicator by which to assess a client's situation, and 62% of the banks we surveyed see it as the most important source for scoring.

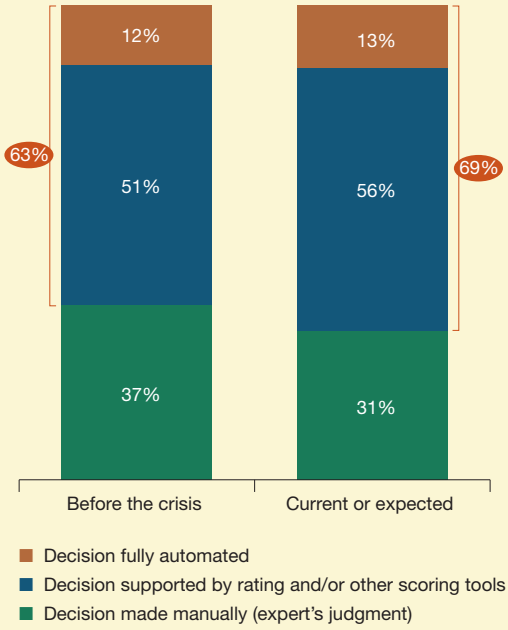
With the crisis, however, the backward-looking analysis of financial statements and the observation of clients' behaviour and liquidity profile are less relevant. In times of crisis, most small business clients' financial statements and liquidity ratios deteriorate. The problem for banks today is to decide whether or not these difficulties are only temporary. This is why banks will succeed only if they integrate more predictive considerations into their decision process, such as business planning approaches.

However, it is quite difficult, costly, and time-consuming to extend the use of business planning to a lot of clients. This is why it is important to rely on RMs' client knowledge and proximity to select clients requiring a thorough business planning assessment. Beyond that, banks should think about developing innovative tools, processes, and RM training to use in business planning approaches in a cost-effective way.

Enhanced proactive management of performing credit portfolios

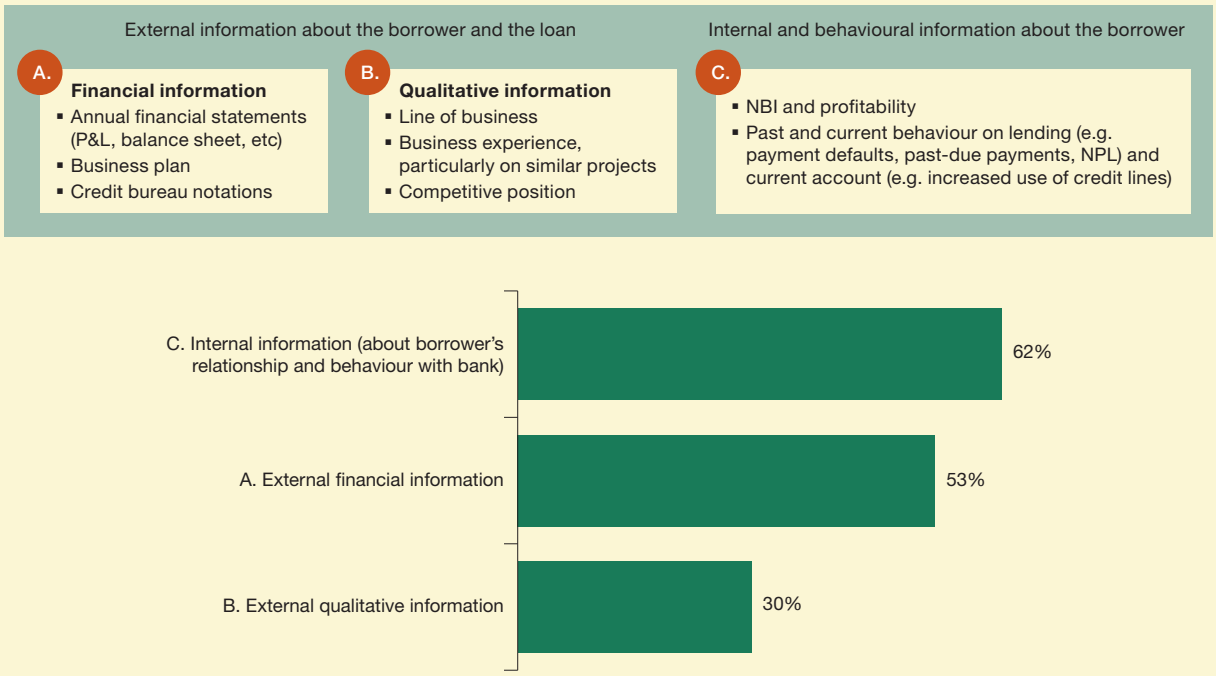
By proactive management, we mean quickly identifying loans showing the first signs of deterioration. Only in this way can a bank agree with a client on a solution and prevent these loans from becoming non-performing. Today, proactive management of a credit portfolio is becoming even more crucial, because the crisis has produced a large increase in both the cost of risk and the number of non-performing loans in the small business market.

Figure 16 Use of scoring tools in underwriting decision-making (average % of loans of banks interviewed)



Source: Capgemini analysis from bank interviews, 2010.

Figure 17 Most important criteria (among three types) used by surveyed banks to establish their borrowers' credit scores (% of banks interviewed)



Source: Capgemini analysis from bank interviews, 2010.

We believe all banks should proactively manage their portfolios, but 11% of the banks we surveyed still do not, as shown in Figure 18. We think banks should even extend the scope of proactively managed loans. On average, the banks we surveyed are planning to proactively manage 43% of their total performing credit portfolios in the near future.

Efficient proactive management relies on having more accurate early-warning indicators that help the bank quickly identify borrowers facing difficulties (note the nature of EWIs used by banks in Figure 19). Because of the crisis, 55% of surveyed banks plan to improve their EWIs.

The main challenge for banks is to identify whether the difficulties facing their clients are structural and long-term, or temporary. RMs are in the best position to assess their clients' difficulties. Top banks will involve their RMs to manage their portfolios proactively through situation analysis, solution design, and negotiation with the client.

To do so, it is essential that banks raise RMs' ability to proactively manage their portfolios. Here again, they need to increase the number of contacts with clients and keep close tabs on their clients' economic situations to detect quickly the first signs of difficulty. Most RMs must be trained on this issue and have a clear understanding of the potential solutions to suggest to clients, whether those solutions be payments postponement or even loan rescheduling (see used solutions in Figure 20).

To help them succeed with deteriorating loans, many banks have implemented dedicated resources—usually attached to a risk organisation—to monitor the existing portfolio and coach the RMs. Even further, 46% of interviewed banks are relying on proactive management indicators in the MBO and incentive systems to improve RM effectiveness.

Improved collection policy with soft collection (or amicable collection)

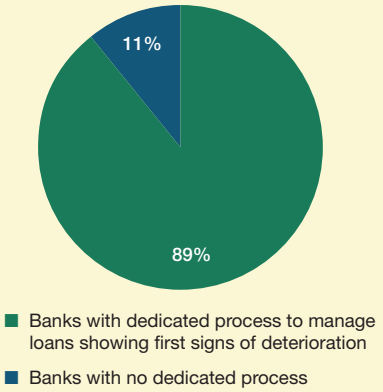
Despite banks' efforts to deal with deteriorating loans as early as possible through proactive management of a performing portfolio, the crisis has pushed more and more small business clients, even the most valuable of them, towards insolvency difficulties.

Traditional collection policies, usually focused on simply recovering money, have their limits and could break the client relationship. Soft collection is a consistent answer to one of the key success factors for small business banking—to care about the customer's business success—and also an answer to governments' pressure on banks to support the economy.

As a result, many banks have implemented soft collection processes, which aim at returning client relationships to "normal" without losing money while maintaining a trustful relationship. Since the crisis began, 43% of banks surveyed have softened their existing collection policies (see Figure 21).

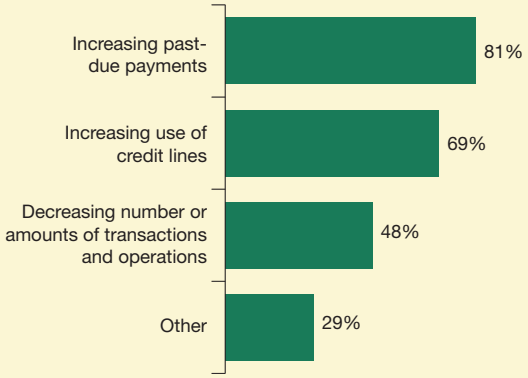
Generally speaking, a soft collection process can be applied to all clients as an intermediate stage between proactive management and collection. Yet 13% of banks surveyed use soft collection only for their most valuable clients.

Figure 18 Banks proactively managing their performing credit portfolios with small business, versus those that do not (% of banks interviewed)



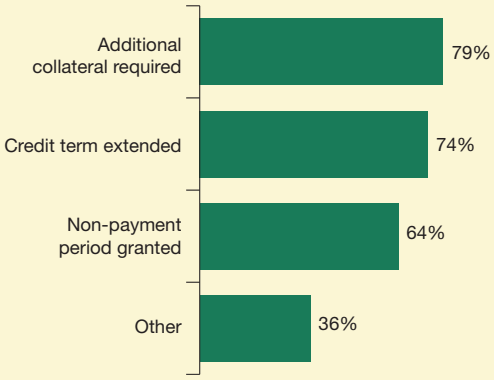
Source: Capgemini analysis from bank interviews, 2010.

Figure 19 Types of early-warning indicators (EWIs) banks use or soon will use (% of banks interviewed)



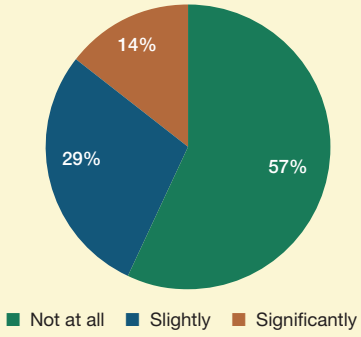
Source: Capgemini analysis from bank interviews, 2010.

Figure 20 Solutions to manage performing loans showing first signs of deterioration (% of banks interviewed)



Source: Capgemini analysis from bank interviews, 2010.

Figure 21 Extent of collection policy softening (% of banks interviewed)

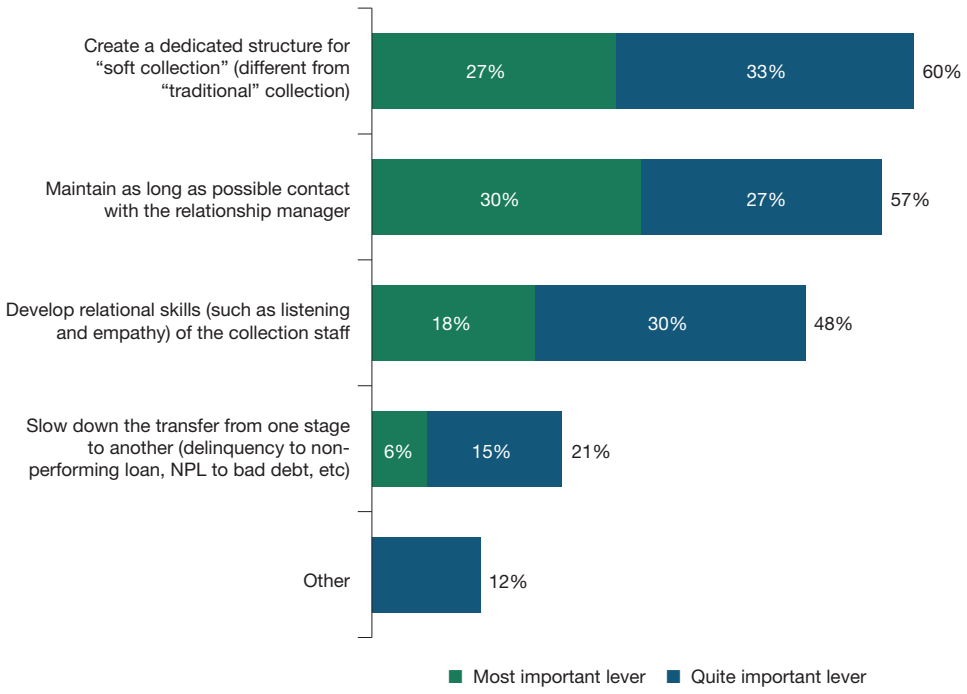


Source: Capgemini analysis from bank interviews, 2010.

According to our experience, having a dedicated organisation in charge of soft collection is most efficient, and 60% of banks surveyed also consider this as an important factor in soft collection effectiveness (see Figure 22). Having a dedicated organisation lightens RMs' workload, and it is done by dedicated staff with specific empathy and listening skills that are different from the skills required in the traditional collection process. That is why some banks choose former RMs to handle their soft collections. This dedicated organisation is most often attached either to the risk organisation (true for 56% of surveyed banks) or to the commercial organisation.

Even for a bank with an efficient and dedicated soft collection organisation, it is important to maintain, as long as possible, the RM's contact with the client before transfer to a collection unit (according to 57% of banks interviewed).

Figure 22 Key levers in soft collection (% of banks interviewed)



Source: Capgemini analysis from bank interviews, 2010.

Sidebar 3

Illustration of a large European bank's credit risk management organisation at the local level

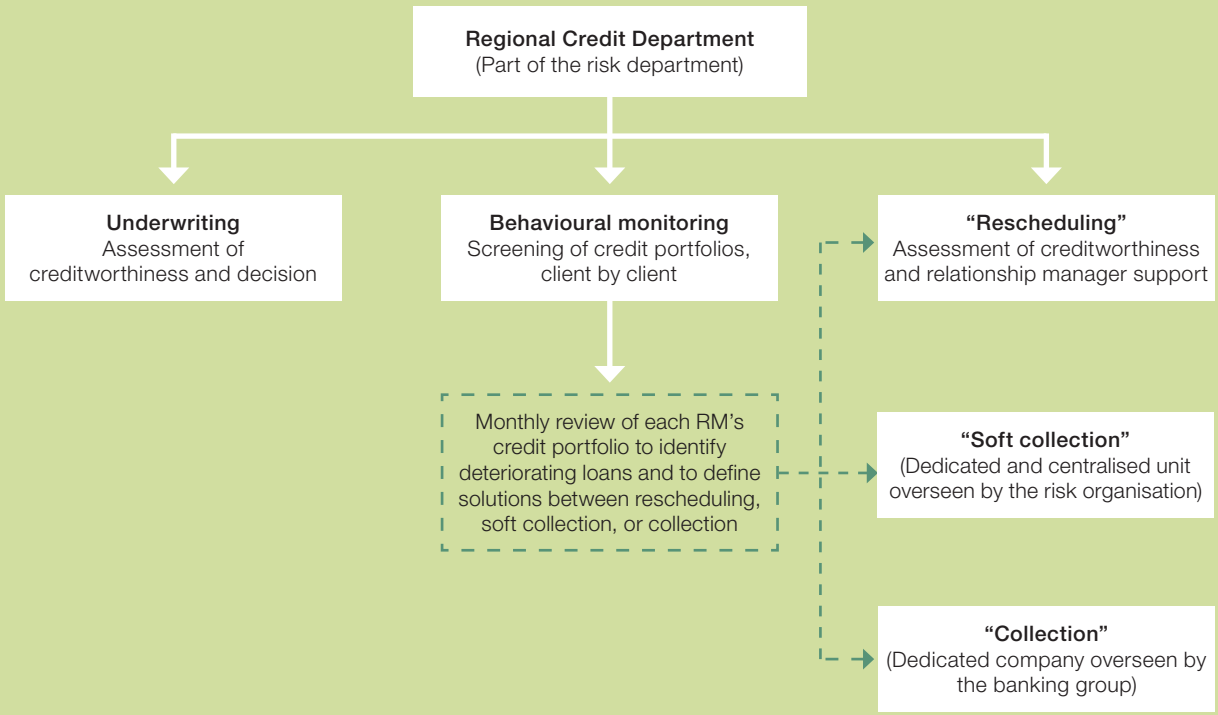
- In this large European bank, the credit department and RMs are jointly managing behavioural monitoring of credit portfolios. Every month, they review each RM's credit portfolio to identify the deteriorating loans to be:

  1. "Rescheduled" by the RM, supported by a "rescheduling" expert.

  2. Transferred to the soft collection unit.

  3. Transferred to the collection entity.

- Soft collection is managed by a dedicated and centralised unit overseen by the risk department; collection is managed by a dedicated company overseen by the banking group:



Source: Bank interview by Capgemini, 2009.

Chapter 3

Moving Forward: Transforming the Business to Reach the Winning Bank Model

The winning bank model will help successful banks outperform their competitors, both on development and on risk management.

Each bank needs a framing phase to define its starting point, the target, the associated transformation roadmap, and the resulting business case. The transformation path to reach and implement the winning bank model requires banks to move along the two axes, strengthening their RMs' role, and improving their credit risk management system.

TRANSFORMATION STRATEGIES ALONG THE RM ROLE AXIS

Banks can develop the RM role—close client relationships and high empowerment on risk management—through organisational or technical measures, mainly by incremental steps starting with some quick wins:

- Implement first level of RM empowerment on risk management (revised delegation scheme) supported by sales force training (quick win).
- Intensify client relationships and number of client contacts, especially by integrating contact objectives in RMs' MBO system (quick win).
- Simplify product and service range and linked processes.
- Reduce client portfolio size, especially for small-sized clients.
- Develop technical sales support (product experts).
- Professionalise middle-office resources to support RMs.
- Implement dedicated resources to support and coach RMs on proactive credit management or soft collection.

Most of all, to fully develop the RM role both in terms of client relationships and risk management, successful retail banks will have to address a crucial issue—the lengthening of the RM's job duration. It is a hard goal for retail banks to reach, taking into account employee expectations in terms of career evolution and the competitive pressures on the retail banking employment market. Over the past few years, in many countries, banks have extended their branch networks and continued searching for more branch managers, especially by recruiting from the ranks of small business RMs. It appears that the crisis has brought a certain amount of stability, with a longer stay in the RM job, but this is probably not a durable trend. To lengthen the RM job duration in a meaningful way, banks need to review their HR policies by identifying different career paths for small business RMs, and provide an attractive incentive scheme to retain RMs in their jobs.

The transformation along the RM axis depends on a bank's starting point. For instance, as shown in Figure 23, regarding the RM empowerment profile, 61% of surveyed banks currently use the *RM as a sales manager* profile, which is not the profile consistent with the winning bank model.

We can assume that developing the RM role will be easier for decentralised banks than for centralised banks. As shown in Figure 24, decentralised banks are often cooperative banks favouring local decision-making, with strongly empowered RMs, while centralised banks rely on their highly process-oriented organisations. *RM as a small banker* is the dominant profile for decentralised banks (76% adoption), but this profile is seldom adopted by centralised banks (only 21% adoption).

TRANSFORMATION STRATEGIES ALONG THE CREDIT RISK MANAGEMENT SYSTEM AXIS

Banks start from varied points in terms of credit system information maturity, efficiency, or sophistication. Depending on their original market position, banks have a more or less long way to reach a performing risk management system that is aligned with the specific needs of small business credit sales and risk management. Banks originally positioned in the private/mass market are much further from the targeted system than universal banks operating in the corporate market, which only need to adapt their corporate tools to serve the small business market.

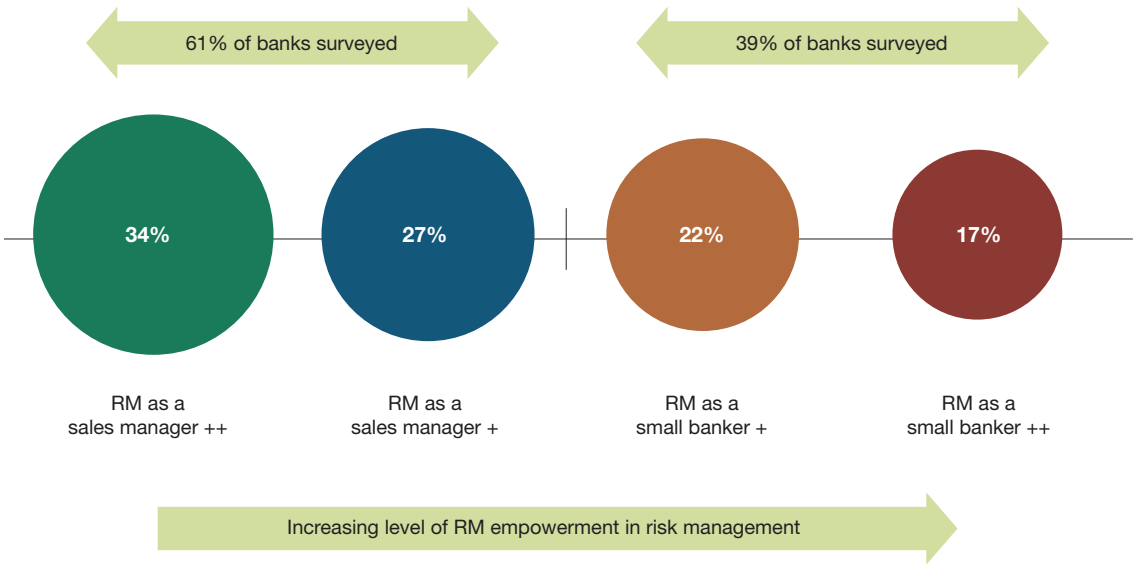
To reach and implement a complete, effective, and efficient credit risk management system, banks can move their efforts in three directions—depending on their starting point and their current weaknesses: improving governance, macro-processes, and information systems.

Regarding the information system, three types of actions can be initiated:

- Focus on the final users' workstations and portal by first working on the seamless integration of datamarts and applications.
- Improve data quality, relevance, and depth, to ensure (for instance) accuracy and relevance of client data, scorecards, early-warning indicators, and reporting.
- Create or increase the sophistication of tools and applications to serve the small business market (including risk-adjusted return on capital pricing tools, scoring tools, and early-warning indicators).

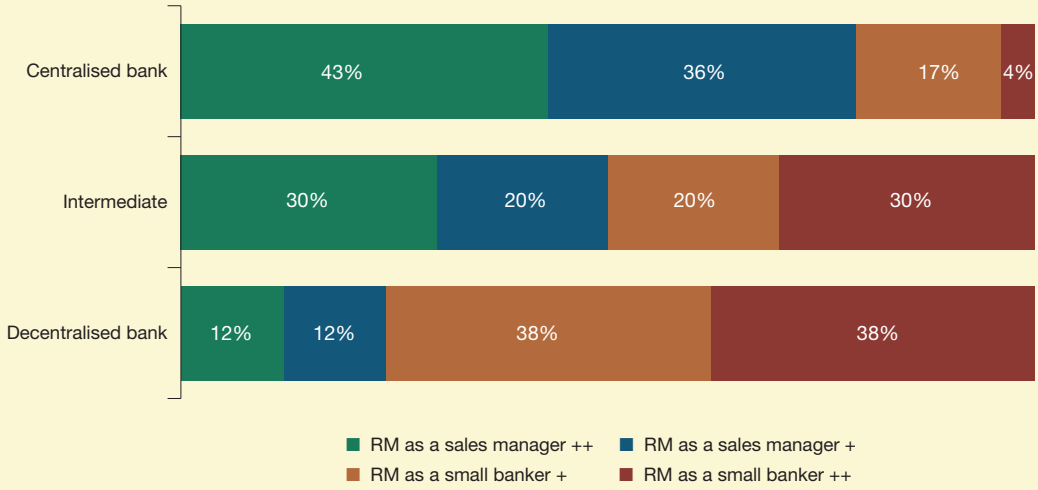
As Figure 25 illustrates, specific transformation strategies are needed that combine technical, organisational, and HR measures through quick wins, with incremental and longer term steps necessary along the way.

Figure 23 Bank positioning in terms of RM empowerment profile (% of banks interviewed)



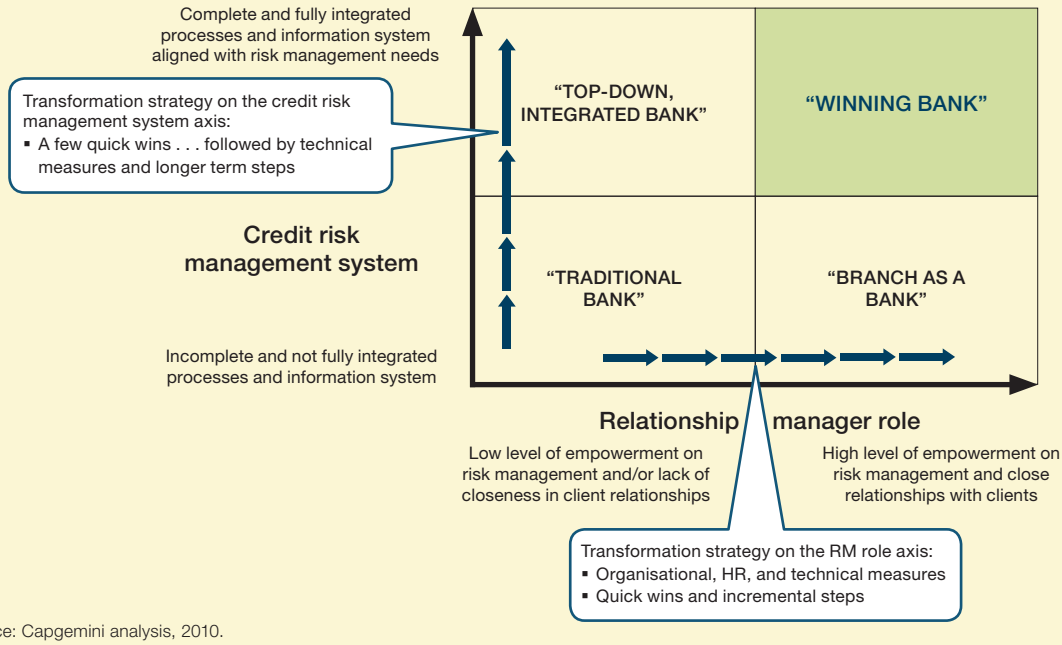
Source: Capgemini analysis from bank interviews, 2010.

Figure 24 Bank positioning in terms of RM empowerment profile, depending on bank organisation (% of banks interviewed)



Source: Capgemini analysis from bank interviews, 2010.

Figure 25 Transformation strategies along the two axes



Source: Capgemini analysis, 2010.

RESULTING PATHS AND KEY SUCCESS FACTORS FOR TRANSFORMATION TOWARDS THE WINNING BANK MODEL

As Figure 26 illustrates, banks can take different paths to reach and implement the winning bank model. Banks that combine changes along the two axes are more likely to succeed, because transformation of the credit risk management system is also a way to accelerate the transformation of the RM role. These changes rely on the implementation of technical, organisational, and HR steps, both short-term and long-term.

As noted, it will be easier for decentralised banks to develop along the RM role axis, taking advantage of their existing ability to empower their RMs to build close relationships with clients.

Beyond the need to design an appropriate transformation path, the successful transformation towards the winning bank model also depends on a bank's ability to set up robust and relevant change management.

According to a survey completed by Capgemini Consulting and the Economist Intelligence Unit ("Trends in Business Transformation", 2007), interviewed executive managers reckoned that "support from senior management", "alignment with a bank's overall strategy", and "buy-in from employees" are the most important factors in a successful transformation. We therefore believe that retail banks that want to succeed in their transformation and be at the forefront of the small business market must take the four following change-management actions (see Figure 27):

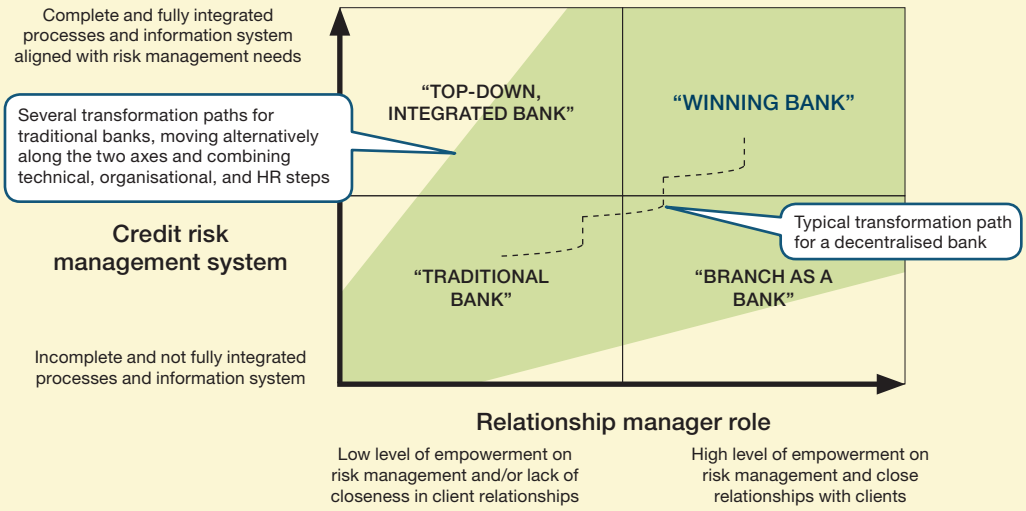
- Set a shared vision and ambition.
- Design the transformation strategy.
- Build the guiding coalition.
- Create the conditions for collective commitment.

MOVING FORWARD

The implementation of the winning bank model—along with all the supporting measures ensuring its efficiency—is the best way for retail banks to master risk while maintaining high business development, outperforming other banks in the small business market.

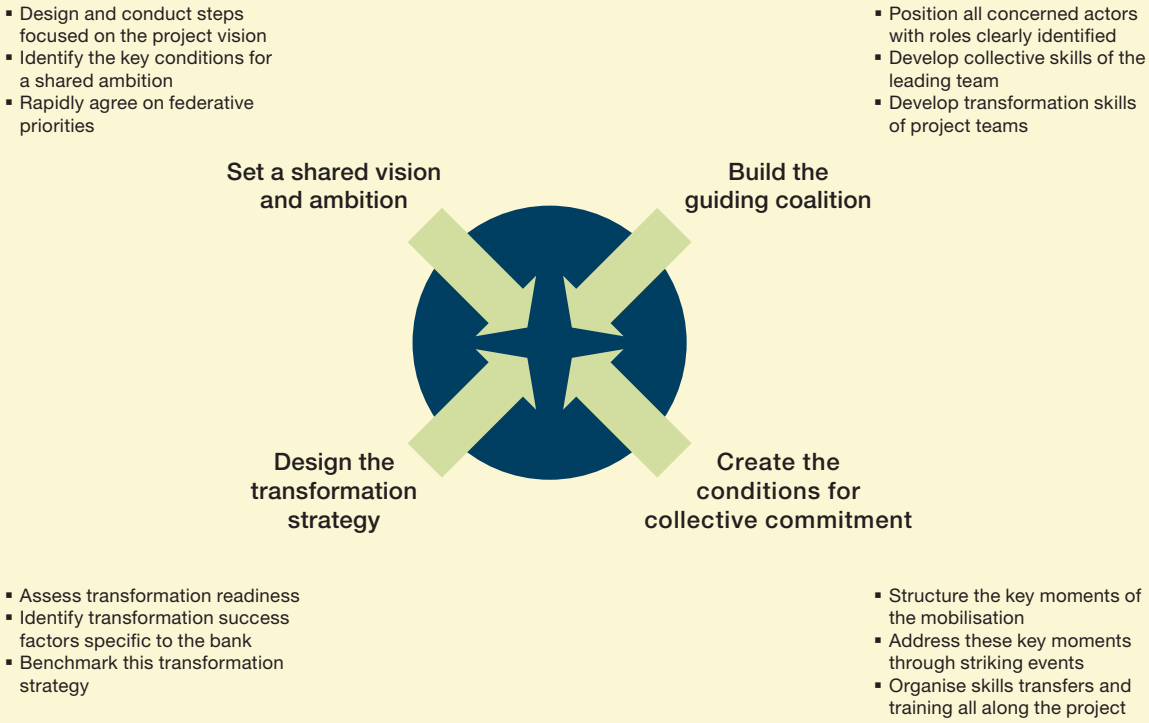
This 2010 edition of the *World Retail Banking Report* has attempted to shed light on the key issues retail bankers will have to consider as they seek to address the challenges brought to the fore by the global financial and economic crisis. Retail bankers face serious challenges ahead, and we hope the insights this report contains will prove to be valuable in supporting effective decision-making.

Figure 26 Banks' transformation paths to reach the winning bank model



Source: Capgemini analysis, 2010.

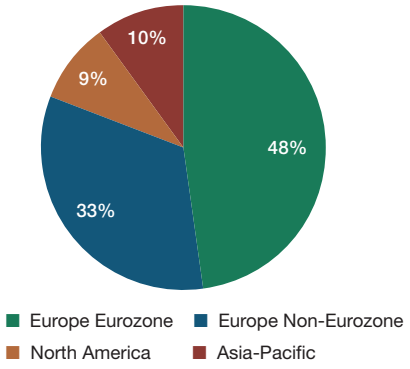
Figure 27 Key change-management actions for successful transformation



Source: Capgemini Consulting, Transformation University, 2010.

Methodology

Figure M1 Bank interviews, by geography



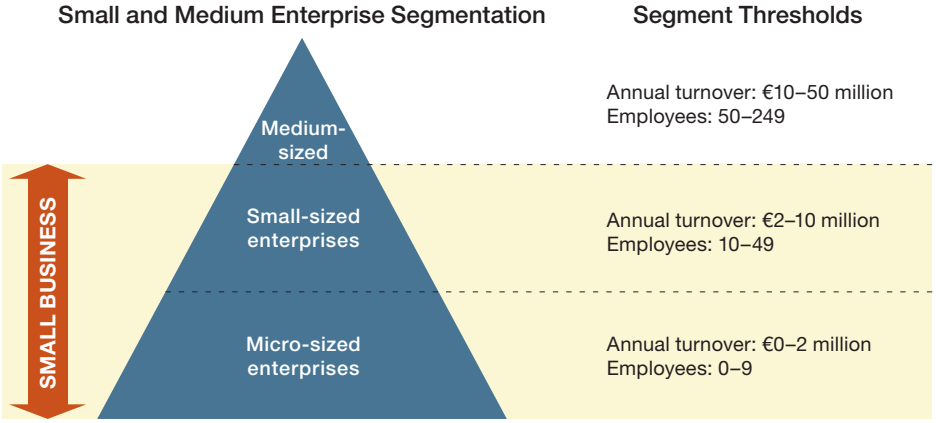
Source: Capgemini analysis, 2010.

We based our small business spotlight analysis on two investigations: a market survey and bank interviews. The bank questionnaires contained three sections—activity overview, development issues, and risk management issues—with qualitative and quantitative questions.

We conducted 58 interviews in large retail banks in 21 selected countries around the globe: Austria, Belgium, China, Croatia, Czech Republic, France, Germany, Hong Kong, India, Ireland, Italy, the Netherlands, Poland, Romania, Russia, Slovakia, Sweden, Turkey, United Arab Emirates, United Kingdom, and United States (see Figure M1 and bank list at the end of this report). Executives who participated were from both the risk management and marketing departments.

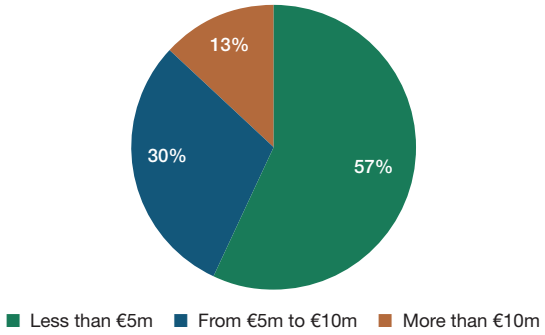
We began with the European Commission definition of small business, which encompasses small-sized and micro-sized enterprises (see Figure M2).

Figure M2 European Commission small and medium enterprise thresholds



Source: European Commission Recommendation 2003/361/EC.

Figure M3 Annual client turnover surveyed banks selected to define their small business market (% of banks interviewed)



Source: Capgemini analysis from bank interviews, 2010.

From a practical standpoint, however, banks use varied definitions for what constitutes a small business (see Figure M3). Of the banks surveyed, 57% expressed the upper limit of clients' annual turnover as €5 million, 30% used the €5–10 million bracket, while 13% used an upper limit that exceeded €10 million.

For most banks surveyed, the small business market is managed entirely by the retail bank; however, for a few banks, larger small business clients are managed by the corporate bank.

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The Group operates in the following countries: Austria, Azerbaijan, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, Germany, Hungary, Italy, Latvia, Lithuania, Kazakhstan, Kyrgyzstan, Poland, Romania, Russia, Serbia, Slovakia, Slovenia, Turkey and Ukraine.

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EUROPEAN FINANCIAL MARKETING ASSOCIATION

Efma promotes innovation in retail finance in Europe by fostering debate and discussion among the main players involved in change. Formed in 1971, Efma comprises 2,960 different brands in financial services worldwide today, including 80% of the largest European banking groups.

Through regular events, publications, and its comprehensive website, the association provides retail financial service professionals with answers to their questions about the main issues at stake in their business: multidistribution strategies, customer approach, CRM, product and service marketing and improving profitability.

Efma is above all a dynamic association, providing a great opportunity for discussion and exchanges without any commercial constraints. It provides its members with a wide range of exclusive services as well as discount rates on non-gratuitous activities. The loyalty of its members as well as their permanent financial support are the best proof of its efficiency.

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Barclays
BAWAG PSK
Caisse d'Epargne
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* Interviews in two or more countries per bank:

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