Inspiring Innovation: The Transaction Banking Perspective

In this month’s Executive Interview we are delighted to welcome back Michael Spiegel, who looks at some of the changes that are taking place in the transaction banking space, and the threats and opportunities that these present.

As 2015 comes to a close, what characteristics of the transaction banking market would you highlight that are setting the agenda for the coming year?

Both the bank and our customers are living through interesting times in transaction banking, from both a cash management and trade finance perspective. In trade finance, margins are being compressed as a result of low commodity prices and high levels of market liquidity. From a cash management perspective, interest rates remain at historically low levels and in some markets at a negative rate, while market harmonisation through SEPA and growing competition from both traditional and non-traditional players is also resulting in narrowing margins. Some bankers and commentators expect more “normal” conditions to return when interest rates rise, but we would seem to be at or near an inflection point in the development of cash management and trade finance.

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Firstly, complexity. Corporate treasury is becoming more complex as a result of wider geographic coverage, the emerging need for more efficient data management and analytics, and higher volumes, particularly in payments and collections. These in turn are resulting in the need for more sophisticated liquidity management solutions and broader, more integrated risk management. The use of the term ‘solutions’ rather than ‘products’ is deliberate. Complex and diverse treasury needs demand not products that solve isolated problems or address individual requirements, but solutions that span the working capital value chain from short-term lending through to FX, trade finance, cash management etc.

The second development in the evolution of transaction banking is the impact of new market entrants, particularly financial technology providers. Innovations in the way that people and businesses pay and receive funds and access services are having a profound effect on business models and expectations amongst service users.

To what extent do these financial technology providers pose a threat to traditional banking services?

The transaction banking industry is being transformed, and banks need to ensure that they are drivers rather than passengers in this transformation. The most significant changes have taken place in the retail space so far, with traditional business models for accessing services and making or receiving payments being overturned. New solutions focus on consumer-led self-service and convenience, leading to the growth of aggregators, mobile commerce, and mobile payment solutions. As banks, we should be under no illusion that some of these newer market entrants, which include both smaller start-up businesses and large, established enterprises, could replace some of the services traditionally served by us. But this phenomenon is not restricted to the retail space: in the wholesale market too, ‘disruptive’ players and business models will also have an impact on the way that corporates and institutions do business, and therefore the needs that they will have from their banks. It’s an interesting environment for banks: fintechs can be our competitors, customers and partners at the same time.

In some cases, banks consider this ‘disruption’ to be a threat, and undoubtedly it poses challenges, but equally, it is an opportunity to harness innovative technologies and partner with leading enterprises to benefit our customers.

How could this work in practice?

In many cases, we have known and worked with these financial technology companies for some time: indeed, for many years in some cases. For example, we already act as a cash management and settlement provider to payment solutions providers, including embedding foreign exchange into payments and collections through our FX4Cash product. This provides users with the ability to streamline processes, avoids the need to maintain accounts for each currency and eliminates FX risk.

Banks – including Deutsche Bank – are now faced with a choice. Either we simply become a provider of basic infrastructure; or alternatively we transform our role to become an innovation enabler. Banks play a unique role in enabling companies to do business, acting as a trusted interface between borrowers and lenders, and transforming risk. This role will be as important in a new world as it was in the old. Banks such as Deutsche Bank also provide an unrivalled network, experience with regulators globally and a deep appreciation of the liquidity, risk and transactional needs, challenges and aspirations of the corporate community. What they lack, however, is the ability and in some cases vision to deliver innovation at the same speed as financial technology providers. That’s where we want to partner with non bank providers, as we already do in the area of supply chain finance.

As a result of their trusted relationships, expertise, high volume platforms and rigorous security, banks are uniquely placed to build an innovation ecosystem that connects bank(s), financial technology providers and customers, leveraging the strengths of each party to deliver benefit to the whole. The fourth ‘pillar’ of this
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How do regulators and clearing houses fit into this ecosystem?

The traditional remit of regulators and market infrastructure providers has been to create the right business conditions and infrastructure to facilitate transparency and integrity in their home market. However, this remit has not kept pace with the demands of globalisation, which has become an incontrovertible and irreversible feature of the way that people live and companies do business. As a result, lack of regulatory and infrastructure consistency across markets is becoming an increasingly complex challenge, not only for global banks such as Deutsche Bank, and the technology providers with an international reach, but also our customers.

Looking at our own industry, for example, banking regulations are generally welcome, as it is in everyone’s interest that the industry is sustainable and robust; increasingly, however, this complexity is resulting in regulations that have unintended consequences. With the global financial crisis far behind us, we need to take the opportunity to review critically the regulatory realities that now exist, and engage in a regular and objective dialogue across the industry to identify the unintended economic impact and how we can address these intelligently. Furthermore, the changes to the banking industry and the growing role of financial technology participants need to be taken into account when considering the scope, role and direction of future regulations. Competition is fair if we compete on the same grounds; the same rules need to apply to all, but this level playing field does not yet exist.

Is the growth of these financial technology companies driven by customer demand, or more a commercial push from these firms?

At the moment, growth is still supply rather than demand-led, but the opportunity is there, and demand will grow as solutions are proven and become established. Consumer expectations will also drive corporate expectations. For example, payments such as direct debits are becoming far easier for consumers, and businesses will increasingly have similar expectations. The issue is not the level of innovation that is available, but vendors’ ability to convert this into sustainable, robust and secure solutions. The potential impact of solution or vendor failure is high, so companies will invest in these initiatives and stake the reputation of their business only when they have a high level of certainty about them.

Once again, banks have a key role in providing this certainty and stability by incubating, financing, distributing and adding credibility to emerging financial technology solutions. We are establishing three innovation labs with large technology companies including Microsoft in Berlin, HCL in London and IBM in Silicon Valley to provide the inspiration, space, expertise and financing to foster new entrants and turn great new ideas into the solutions that will set the financial technology agenda in the years ahead.

What about innovation within Deutsche Bank?

That’s a crucial point. Banks continue to have a fundamental role to play in innovation to deliver the sophisticated solutions that customers need to connect and reinforce the financial value chain. Deutsche Bank already has an impressive track record in this respect, and we are investing €1bn in Deutsche Bank’s digital strategy and another €1bn in global transaction banking innovation over the next five years, including innovative electronic delivery of solutions and integration with areas such as FX to meet our customers’ demand for more complex, integrated, end-to-end solutions. Scalability, security and reliability remain key objectives in everything that we deliver in transaction banking, which few third parties would be in a position to replicate. One of the ways in which we do this is to wrap a configurable layer around our core platforms that allows us to create innovative solutions more quickly but without impacting on the core infrastructure.

Eighteen months ago, we launched an in-depth training programme across our different teams: product management; sales; coverage; risk management etc. to encourage people to think at a solution rather than a product level, increase financial literacy and develop a more detailed awareness of client needs and challenges. This programme, which is ongoing, is already resulting in a change of culture, awareness and behaviour, with implications across the wider corporate banking construct including global transaction banking, coverage and corporate finance. Our solutions are enveloping a wider range of products, so they meet customers’ needs more precisely. For example, Deutsche Bank was an early provider of international trade finance, and has built up an enviable reputation: now we have extended our position further with structured trade finance solutions for exporters and importers that combine transactional capability with FX and working capital financing.

Providing our clients with robust, sustainable, secure and innovative corporate banking solutions across our network, including our core regions of EMEA and Asia Pacific, together with our hubs in the United States and Latin America, is key to our value proposition. Global transaction banking plays a key part in this, by delivering the solutions and services that facilitate our clients’ business and support global liquidity. While the financial services industry is changing, and opportunities for innovation are materialising rapidly, our commitment to our customers, our network and our solutions remain the same. What will be exciting in the coming years is to find ways of demonstrating and delivering on this commitment in new and inspiring ways.