IBM Global Business Services

IBM Institute for Business Value

Financial Markets and Banking

Toward transparency and sustainability

Building a new financial order

How will financial markets firms make money in the future? The current financial crisis has exposed the problems with creating and exploiting "pockets of opacity" across the system. If the industry is to deliver sustainable returns, it will have to embrace change. It will need to begin by working with regulators to build a financial system that is stable while still allowing for healthy innovation. Individual firms will also have to specialize and learn to fulfill their brand promises.

The global financial markets industry has been experiencing significant turbulence over the past 18 months. The current crisis is transforming the competitive landscape, how the industry operates and the way in which its clients behave. Given these changes, many senior executives are wondering how their firms will make profits in the future. This is the question the IBM Institute for Business Value set out to answer in its latest study of the sector.

We conducted a survey of more than 2,700 financial services industry participants to determine four things: Which forces are disrupting the industry? What will clients be willing to pay for? How will the basis for competition change? And what steps should financial markets firms take to prosper over the next three years? In short, where's the money? We supplemented our findings with in-depth interviews with 185 executives and government officials, extensive secondary research and quantitative modeling.

IBM's analysis shows that much of the wealth the industry has generated during the past decade has come from exploiting "pockets of opacity" – i.e., creating, buying and selling complex products, often via lightly regulated entities. However, this does not produce sustainable value. Using sophisticated financial instruments and structures can indeed generate very large profits, but it also results in more extreme risk assumption and mitigation cycles and makes the markets much more volatile.

If financial markets firms are to thrive in the future, we believe that they will have to adopt a different approach. They will need to:

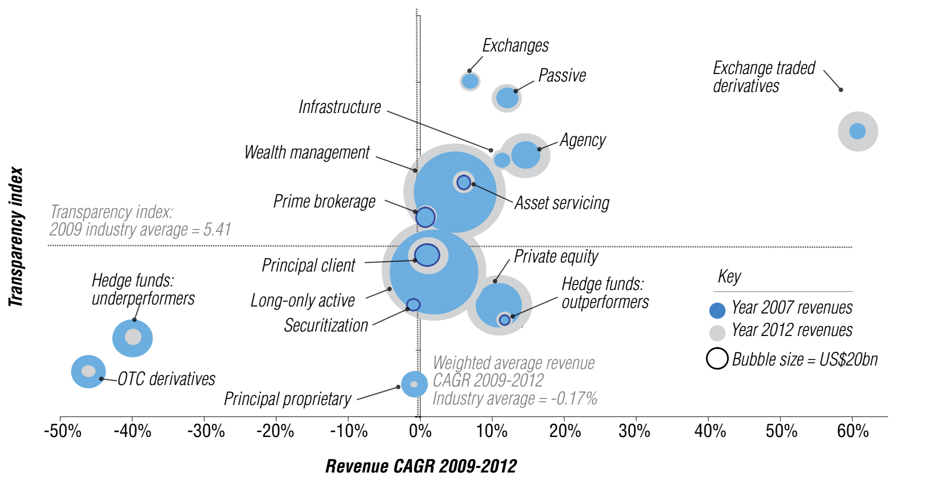
Work with regulators to develop a stable financial system that still allows for healthy innovation. That system must reflect the increasingly sophisticated environment in which the industry operates, but it should not be so rigid that it stifles all creativity. In other words, it must be a system that can simultaneously manage the tensions between intense supervision and unbridled opportunism, and between stagnation and boom-bust growth, to deliver sustainable returns.

Deliver what they promise. Most financial services firms have brands that implicitly promise to provide agility and stability, and to focus on the interests of their clients. In practice, however, the opposite is often true. In order to redress these deficiencies, such firms will need to focus on becoming more efficient, managing and pricing risk more effectively and moving closer to their clients.

More specifically, they will have to realize economies of scale, integrate their IT more closely with their business strategies and outsource a higher proportion of their back-office activities. They will also have to rebalance their portfolios; develop "fine grain" pricing models that take account of different interest rates, fee structures and abilities to pay; and concentrate on understanding how their clients behave, segmenting them and tailoring the services they offer accordingly.

Solve their identity crisis. Lastly, financial firms will have to change their business models to accommodate the trend toward greater specialization and the shift in the industry's revenue pools, as demand for products that help to create more transparency grows at the expense of demand for products that are opaque. Tomorrow's winners will be those companies that specialize, not those that try to do everything, and three specific areas of specialization are likely to emerge. Most firms will concentrate on becoming "beta transactors." A smaller number of firms will concentrate on providing advice, and a handful of "alpha seekers" will focus on generating high returns from high-risk investments.

Estimated global revenues for selected activities, 2007 and 2012.



Source: IBM Institute for Business Value financial model.
Note: The transparency index is as of 2009 and is a 1-10 ranking, where 1= highly opaque and 10= highly transparent. The index is based on quantitative and qualitative factors for each activity, categorized by extent of 1) complexity of product offered, 2) shareholder and investor communications and 3) operational transparency. Wealth management revenues duplicate underlying asset classes of long-only active asset management, passive asset management, hedge funds and private equity. Infrastructure is sell-side processing and clearing.

How can IBM help?

With a wide range of services and technologies, we're a flexible partner ready to help you:

- Develop new intelligence to drive client-centricity, while improving data quality
- Simplify and streamline to become more agile, while reducing costs
- Achieve smarter integrated risk management, optimizing financial and operational risk
- Adopt best-in-class infrastructure to provide security, scalability and flexibility.

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