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Get global. Get specialized. Or get out.

Unexpected lessons in
global financial markets

Financial Markets



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Unexpected lessons in global financial markets

By Suzanne Dence, Wendy Feller and Daniel W. Latimore

Financial markets firms have historically avoided the commoditization trap by innovating to create new products and services. The bulk of their impressive growth has typically come from mature markets. Yet today, growth opportunities in those geographies are evaporating, and meaningful future expansion will come from new markets. Indeed, the worldwide industry opportunity is expected to double by 2015. But which firms will seize these emerging profit pools? We believe it will be those that specialize in the areas their clients value while optimizing their global reach...and do both in ways that aren't expected.

Introduction

Despite the turn-of-the-century downturn, financial markets firms have enjoyed double-digit revenue growth in excess of 11 percent over the past decade. However, firms serving the world's largest markets – such as the United States, the United Kingdom and Japan – are now watching opportunity fade.¹ Even with a steady stream of innovative products and services, they will find it increasingly difficult to grow revenue in these satiated veteran markets where rivals are competing for a shrinking pool of opportunity. Firms need to look elsewhere. But where?

As we considered how best to answer that global question, we decided that customary forecasting techniques based on past performance would be too shortsighted and simplistic to assess the impact of globaliza-

tion on the financial markets. We needed a better model – one that projected with higher precision, examined a longer time horizon, and was based on factors that demonstrated the greatest influence over financial markets growth. In collaboration with the Economist Intelligence Unit, we developed such a model and have used it to trace the effect of globalization across 35 of the world's largest economies. We also surveyed 848 financial markets executives from around the globe and 107 of their corporate clients.

Our analysis resulted in some unexpected lessons for the financial markets industry:

- *The worldwide opportunity is large – but it won't necessarily be found in the same old places.* Worldwide investable assets are expected to double by 2015 to almost

US\$300 trillion. By 2025, the opportunity quintuples to nearly US\$700 trillion. However, 60 percent of this future growth is coming from nontraditional places that we're calling prospect markets – this contribution is more than twice that of veteran markets.² While veteran markets will remain large, these newer markets could soon have asset bases that rival those of their long-standing peers.

- *Firms are not prepared to capture this emerging opportunity.* Many financial markets firms are not in a position to capitalize on this more geographically dispersed industry opportunity. More than 93 percent of the executives interviewed acknowledge that their firms are not operating in a globally integrated fashion. And when asked to assess their proficiency with globally oriented organizational and operational practices, two-thirds of the respondents rated the performance of their firms as poor to moderate.
- *The business model executives generally believe is best may actually be the wrong bet.* Among industry executives, the general gut reaction was that large diversified universal banks are the firms best positioned to compete globally. However, when reflecting more deeply about the capabilities required, executives actually rated specialists higher than universals on some critically important global capabilities. This

self-contradiction reinforces the point that being the best in every niche of the industry is increasingly difficult and costly.

- *The people side of financial markets firms may be getting short shrift.* It might sound heretical – given the high salaries and enviable perks they offer – but many financial markets firms may be neglecting the people-related implications of running a global business. Executives pointed out a number of barriers to becoming globally integrated, and most are related to culture and associated intangible assets.

Collectively, these lessons suggest that financial markets firms may literally be moving into unfamiliar territory. Globalization is changing the nature of the financial markets industry. To lead the worldwide playing field, we believe firms should differentiate by focusing on those particular areas of the business that matter most to their clients. Equally important, firms need to systematically shift away from rigid, multinational organizational structures toward more fluid, globally integrated enterprises that enable them to capture opportunities whenever and wherever they emerge. In short, firms must get global and get specialized – or get out.

Get global. Get specialized. Or get out.

Unexpected lessons in global financial markets

The pace of globalization – or the lack thereof – is dictated by a confluence of sophistication factors.

How globalization is playing out in the financial markets

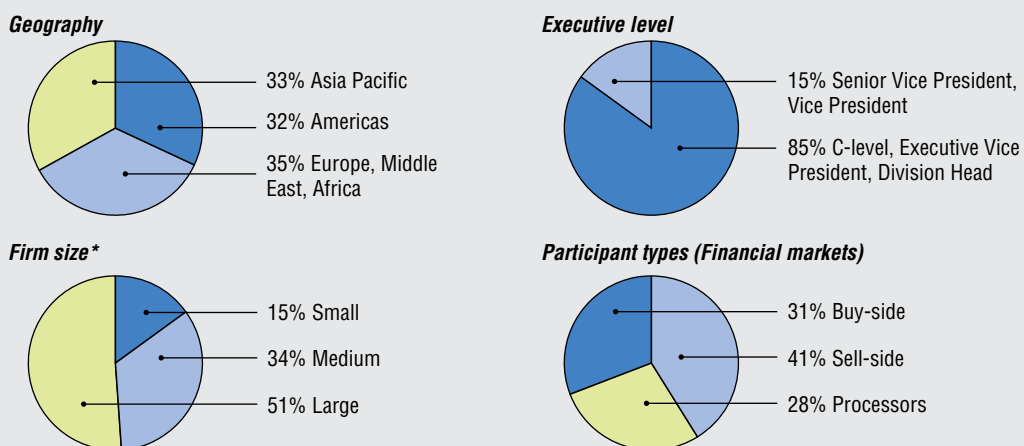
A number of market sophistication factors are dictating the pace of globalization in the financial markets industry. For the purposes of our analysis, we categorized these factors into two groups: the *socio-political* environment within a given country (such as government stability, regulatory environment and legal system) and the *ability to connect* with the rest of the world (transportation infrastructure, use of global standards, technology adoption and so forth).

Generally, improvements in these areas lead to increased market sophistication, which, in turn, tends to accelerate globalization. Conversely, a lack of sophistication can be a stumbling block that hinders or halts further globalization. For example, India's infrastructure is underdeveloped: it has only 17 major airports, compared to 189 in the United States and 56 in China.³ Its electricity generation is substantially lower as well; it produces just one-quarter of the kilowatt hours that China does.⁴ But perhaps more important, on the socio-political side, India has had one of the

Research methodology

As part of our research, we surveyed 955 business leaders – including 848 financial markets executives and, importantly, 107 corporate clients (see Figure 1). To advance the ongoing debate on the impact of globalization, the IBM Institute for Business Value worked with the Economist Intelligence Unit to develop a macroeconomic model that would not only forecast future worldwide investable assets, but also seek to answer the difficult question of how these assets will shift between veteran and prospect markets through 2025. Unlike most forecasting models, our analysis ties financial asset and investment flow growth to nominal gross domestic product (GDP) and factors of relative sophistication across 35 countries. The relative size of an economy should not be the sole determinant of financial assets in aggregate; thus, it was important for us to consider the regulatory environment and other factors of market sophistication. For additional information on our Financial Markets Globalization 2025 model, please send an e-mail to iibv@us.ibm.com.

FIGURE 1.
Demographic breakdown of participants.



Note: *Size is defined as size of revenues: small is < US\$500 million; medium is US\$500 million to US\$5 billion; large is > US\$5 billion.
Source: IBM Institute for Business Value/EIU 2007 financial markets executive survey.

highest ratios of public debt to GDP. In 2005, it was 80 percent – a full 10 points above the second highest ratio of 69 percent for Turkey and well above the 46-percent median ratio across 14 prospect markets.⁵ This substantial debt burden may limit the amount India can invest in future infrastructure, education and healthcare improvements.

However, sophistication can also be taken to the extreme. And inordinate complexity can actually reverse the flow of globalization. The U.S. regulatory environment is a prime example. To avoid the cost of complying with its extensive, rule-based regulations, many organizations are choosing to do business in other markets. According to one industry executive, its “poisonous” regulation has caused a temporary loss of economic value.

“Although many executives see it as a sizable opportunity, most banks remain bearish on China. It’s like the wild, wild west, with poor transparency and business practices – it needs adult supervision”

– C-level executive, Asset management firm, Japan

Collectively, these sophistication factors impact the overall magnitude of financial product consumption and creation within a particular nation. By *financial product consumption* we mean wealth and the associated appetite or demand for financial market products. *Financial product creation*, on the other

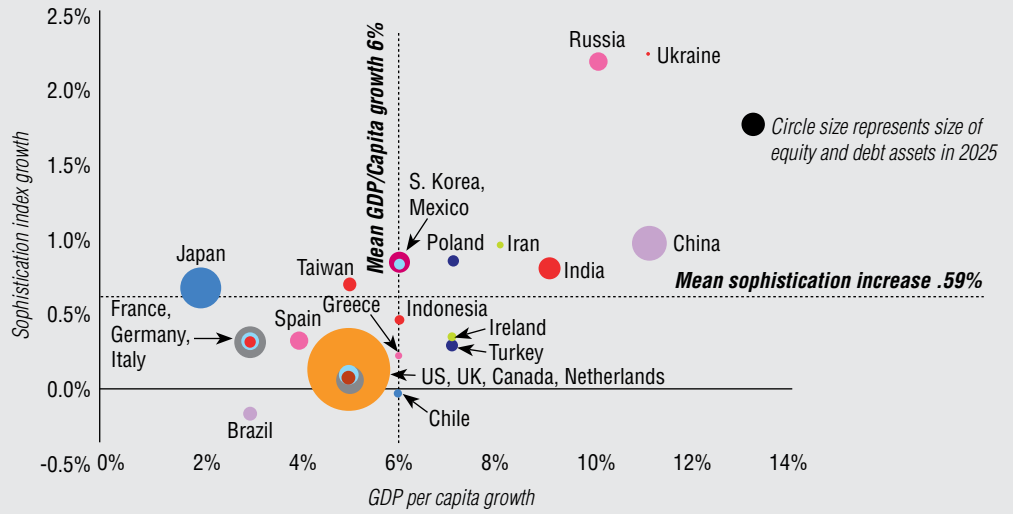
hand, is the supply side – the talent and infrastructure capabilities necessary to create and sustain a financial market.

For financial markets firms, moneymaking opportunities are found where both financial product consumption (demand) and creation (supply) exist at sufficient levels. But the greatest profit potential – the so-called sweet spot – occurs at the cusp of what we call *capital convergence*, the window of time when product consumption and creation in a particular geography *first reach* the necessary levels to support a viable financial market. To tap into these profit pools while they are at the most lucrative point, firms must time their entry into each market appropriately.

As financial product consumption and creation converge at a varying pace around the world, the locations of prime profit-making opportunities are changing. Our research also indicates opportunity is *inverting* – away from veteran markets and toward prospect markets. Though the investable assets of traditional markets – the United States in particular – remain significant, by 2025, veteran markets will be rivaled by other markets with faster growing economies and increasingly sophisticated financial product appetites (see Figure 2). In addition to the well-known BRIC markets, the next frontier is likely to include countries such as Poland, South Korea, Mexico, Indonesia and Turkey, where lower anticipated country risk is complemented by accelerated growth in GDP per capita and heightened sophistication of the financial sector.⁶

To make the most of global opportunities, firms must time market entry to coincide with capital convergence.

FIGURE 2. Growth in sophistication and GDP are leading indicators for financial asset growth.



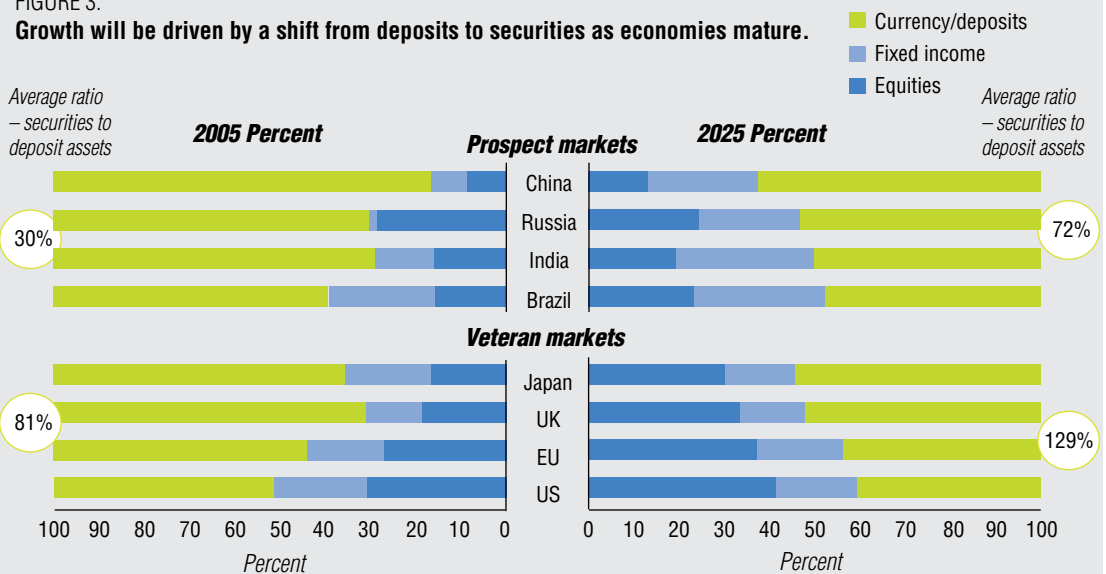
Source: IBM Institute for Business Value/EIU 2007 macroeconomic financial markets globalization model.

Financial product consumption shifts

Over the next two decades, we anticipate pronounced changes in worldwide financial product consumption. Securities-based investable assets are forecasted to grow significantly. By 2020, the worldwide wealth tied to securities will likely surpass currency and deposits.

Though deposits currently dominate the investment profile in many parts of the world, by 2025, the securities-to-deposits ratio in prospect markets will be much closer to the typical veteran market profile, as shown in Figure 3.

FIGURE 3. Growth will be driven by a shift from deposits to securities as economies mature.



Note: European Union values do not include the United Kingdom since it is shown separately.
Source: IBM Institute for Business Value/EIU 2007 macroeconomic financial markets globalization model.

Despite the global push toward higher securities penetration, national culture still influences the pace of adoption. For example, even in 2025, Japan – the world's second-largest economy – still trails Russia, India and Brazil in terms of securities penetration. Its cultural bias toward savings outweighs the global economic pressure to participate in riskier types of investments.

Inward stock flows – foreign investment in local markets – are often considered a proxy for a country's financial interaction with the rest of the world. Globally, these flows are increasing as a percentage of worldwide GDP, with a 9 percent CAGR 2005 to 2015, as compared to a worldwide GDP growth rate of just 5 percent. Cross-border financial activity is currently increasing fastest in Russia, China and India.

“Capital flows to where opportunities are – it is as simple as that. Capital and money don't recognize boundaries.”

– Senior executive, Government Regulatory Agency, Middle East

As flows increase, so does the global connectiveness of the financial markets. Consequently, financial markets firms become more susceptible to crises in other markets, even if they are not operating there. This kind of ripple is fresh in most executives' memories. When the Shanghai Composite Index lost 9 percent on February 27, 2007, it shook markets around the world.⁷ Not surprisingly, contagion risk was the second most prevalent risk concern among our survey sample.

Signs of the coming inversion in financial capital

As financial product consumption morphs worldwide, we can already see clear indications that the bulk of new opportunities will be found outside traditional veteran markets:

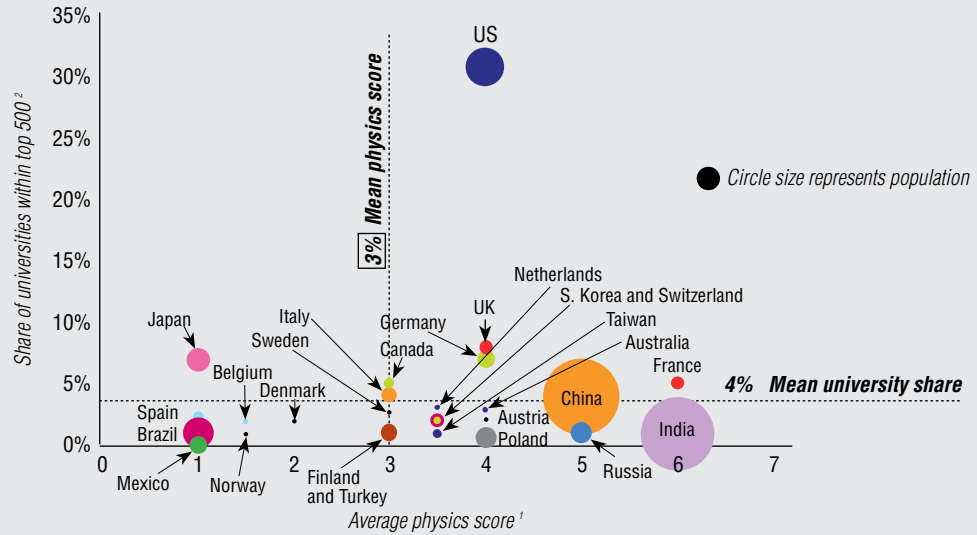
- According to our macroeconomic model, between 2005 and 2025, 60 percent of worldwide investable asset growth is expected to come from prospect markets.
- India now has the most billionaires among Asian nations, relegating Japan to second place.⁸
- China currently contributes more than one-quarter of the world's GDP – and we expect its contribution to rise another 30 percent by 2025.
- Inversion is not just favoring the BRIC countries; the United Arab Emirates economy experienced a 21-percent annual growth rate between 2002 and 2005, as compared to China's 18-percent CAGR.

Financial product creation shifts

Global financial product creation capabilities are maturing as well. For example, the worldwide financial markets talent pool – which we have defined as professionals in the fields of business, economics, physics, mathematics, computer science, engineering and liberal arts – continues to expand. In 2005, it consisted of 95 million professionals. By 2015, it is expected to total more than 176 million.⁹

Figure 4 shows the current distribution of financial markets talent. Physics scores were used as a proxy for the typical applied mathematics skill set required in the increasingly complex financial markets industry. As the Figure shows, the United States has the largest share of top universities by far, although other nations such as India, France, China and Russia have higher average physics scores.

FIGURE 4.
Distribution of talent pools as of 2006.



Note: ¹Physics is selected to represent science as it is the most historical field in science. Average physics score is a measure of high school students' performance, compiled in overall score on International Physics Olympiad (IPhO); ²Higher education status in each country is measured by the number of top 500 universities within each country, refer to <http://ed.sjtu.edu.cn/rank/2005/ARWU2005Methodology.htm> for methodology; Source: Schleicher, Andreas. "The economics of knowledge: Why education is key for Europe's success." Lisbon Council Policy Brief. 2006; International Physics Olympiads Statistics, 2006; "The World Fact Book 2006," Central Intelligence Agency, 2006; National Science Foundation Statistics, 2006; IBM Institute for Business Value analysis.

**Opportunity is inverting
away from veteran
markets and toward
prospect markets.**

We expect this distribution to shift somewhat as prospect markets gain the means to invest more heavily in educational facilities.

For a robust financial market, economies must also have the vital information and communications technology infrastructure. According to annual e-readiness rankings of the world's 35 largest economies, global e-readiness grew at a 7-percent CAGR from 2001 to 2006, which is faster than worldwide GDP.¹⁰ On a scale of one to five, worldwide e-readiness was judged to be 3.27, largely led by developed markets. At the top of the scale were Switzerland (4.9), the United Kingdom (4.8) and the United States (4.6). India fell in the middle of the pack at 3.1. And China (2.6), Ukraine (2.6), Russia (2.4) and Iran (1.7) ranked lowest.

Economies must also have a sizable liquidity pool to support continued future growth of the capital markets. Based on our analysis of velocity, the ratio of trading volume to market capitalization over the past ten years, it is clear that liquidity is increasing globally. In 1995, the ratio for Europe, the Middle East and Africa was under 70 percent; but by 2005, it had more than doubled to 145 percent. Asia's ratio grew from 41 percent in 1995 to 75 percent in 2005. And even with a much higher overall volume of trading, the Americas' ratio increased from 75 percent in 1995 to nearly 130 percent as of 2005. This level of growth presents an opportunity for broker dealers in particular, as they realize higher revenues based on velocity increases across the geographies.

Inversion is underway in financial product creation capabilities as well

- Between 1950 and 2007, developed nations' share of the worldwide population shrank from 33 percent to 20 percent.¹¹
- The veteran market contribution to the financial markets qualified talent pool is expected to increase by 22 percent between 2005 and 2025, while the prospect market contribution triples over that same time period. By 2017, we anticipate that prospect markets will be providing over half the industry's talent.¹²
- For every one veteran market university graduate, the prospect markets produce five.¹³
- In 2006, China surpassed London and New York in initial public offering (IPO) listings for the first time.¹⁴
- The 2006 deal value of China's three largest exchanges – Shenzhen, Shanghai and Hong Kong – totaled US\$53 billion, surpassing London at US\$48 billion and the combined US\$46 billion produced by the New York Stock Exchange and NASDAQ.¹⁵

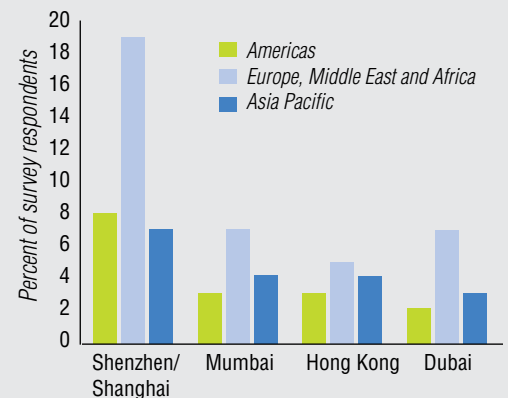
Three concurrent globalization phenomena

Three concurrent globalization phenomena are contributing to the inversion of opportunity: the flight of capital away from veteran markets, the potential leapfrog effect, and ongoing asset absorption by prospect markets. The second two shifts will admittedly take longer to come to fruition, but each of these phenomena is evident already.

- *Flight of capital* – As taxation, litigiousness and regulation become increasingly onerous in veteran markets, clients are actively considering other financial market centers with more attractive regulatory and legal frameworks. For example, in the past five years alone (2001 to 2006), the number

- Some survey respondents – particularly Europeans – already believe market centers such as Shenzhen, Shanghai, Mumbai, Hong Kong and Dubai could become as dominant as New York, London and Tokyo in less than twenty years (see Figure 5).

FIGURE 5.
Which market centers, if any, will be as dominant or more dominant than New York, London and Tokyo by year 2025?



Source: IBM Institute for Business Value/EIU 2007 financial markets executive survey.

of IPOs in the United States fell by one-third.¹⁶ Though some might argue this is a temporary situation that can be rectified, the proverbial dam has broken: Clients have been test-driving other markets, and the switching costs that historically kept them close to home have largely been overcome.

“There is a great dichotomy – companies and the industry are integrated and work on a global scale, but regulators are constrained by boundaries. Without harmonized regulation, you’ll simply get regulatory arbitrage.”

– Senior executive, Government Regulatory Agency, Middle East

Among the executives we interviewed, 86 percent believe being global is strategically important. Yet, few could name a truly global financial markets firm.

- *Leapfrog effect* – With fast-growing talent pools, more-liberal regulatory environments and increasing investments in technology, prospect markets will have the ability to compete with – or perhaps even leapfrog – traditional veteran market leaders. For example, in terms of percentage of population that has a university degree, South Korea now ranks third in the world – behind only Norway and the United States.¹⁷ This trend makes globalization matter to national firms that have no intention of pursuing foreign revenue opportunities; teaming with prospect market firms might be one of the best ways to gain access to leading practices and industry innovation.
- *Asset absorption* – With their expanding wealth, investors from prospect markets are on a spending-spree, buying up critical assets in veteran markets – ports, manufacturing facilities and more. These investments are making their way into the financial markets as well. In May 2007, the Chinese government, for example, announced plans to invest US\$3 billion of its foreign-exchange reserves in an American private-equity firm.¹⁸ With China's US\$1.2 trillion in investable assets, people are wondering where it will invest next...and how its financial clout will affect the global financial markets.

Importance of being global

So what do all these changes mean? Simply put, it is imperative for financial markets firms to become more global – at least in mindset if not also in footprint.

The majority of financial markets executives we interviewed agree with this in principle. Eighty-six percent believe globalization will be an important factor in their firms' strategies within five years' time.

“We will become more global because it is very difficult to generate alpha in developed markets – we must find alpha in emerging markets.”

– Division Head, Capital Markets Firm, New York

It's also important to their clients. More than 93 percent of corporate clients are convinced of globalization's strategic importance. Although their companies' foreign revenues and global presence are significant already, the corporate executives we interviewed anticipate further global expansion within five years.

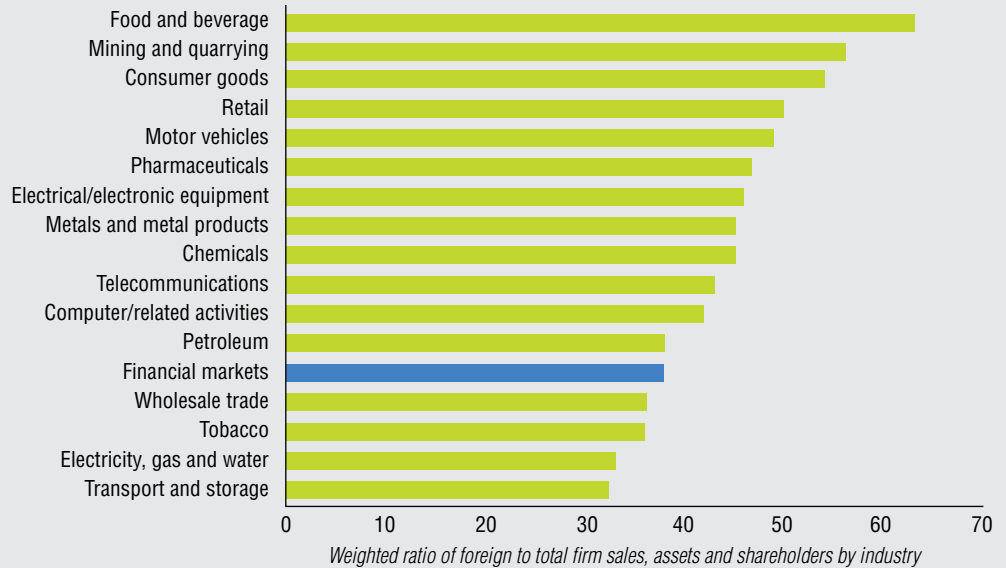
But aspirations aside, financial markets firms are not yet very global. Even when comparing some of the most rudimentary indicators of global operations – foreign assets, sales and shareholders – the financial markets industry ranks far behind other industries (see Figure 6). It's probably no coincidence that the industries at the top of this list are more product-based, while service-oriented industries fall much lower in the ranking. Purveyors of products have substantially different business models than those of more relationship-based enterprises. Still, this seems to indicate that financial markets firms can learn valuable globalization lessons from product manufacturers.

“We are the greatest navel contemplators of all time, because we have made money hand over fist. We are also the most introverted industry, keeping information proprietary.”

– Senior Strategist, Investment Bank, London

FIGURE 6.

Based on proportion of foreign sales, assets and shareholders, financial markets firms are less global than many industries.



Source: "The World's Top 100 Non-Financial TNCs, Ranked by Foreign Assets, 2004." United Nations Conference on Trade and Development. October 16, 2006; Thomson ONE Banker data; Company annual reports and other SEC filings; IBM Institute for Business Value analysis.

Clearly, the financial markets have some unique regulatory limitations that constrain globally integrated operation to some extent. However, the chief reason for the industry's limited global presence may simply be that they have had plenty of profitable opportunities at home. But those easy days are gone. Innovation, if confined to veteran markets, is not going to be enough to maintain the margins many financial markets firms have come to expect.

The story gets bleaker when we move beyond firms' basic global presence and consider how well they manage global integration across their organizations. Ninety-three percent of

our survey respondents told us their firms are not operating in a global fashion. In fact, when asked to name specific firms they believed to be truly global, only 20 percent of respondents named a financial markets firm; nearly 80 percent answered that *no financial markets firms are really global*.

Practically speaking, executives expressed serious doubts about whether their firms have the ability to operate as globally integrated enterprises. On average, across the nine most critical capabilities of global enterprises, 67 percent of surveyed executives rated the performance of their firms as poor to moderate (see Figure 7).

FIGURE 7.
Executives acknowledge their ability to operate as a globally integrated enterprise is limited.



Source: IBM Institute for Business Value/EIU 2007 financial markets executive survey.

Actions to consider

Our analysis suggests several key actions that can help financial markets firms break through the constraints of their current business designs and become more globally integrated:

- Align portfolio with emerging profit pools.
- Reconsider role in industry.
- Eradicate client disconnects.
- Recalibrate operating model.
- Win minds.

Align portfolio with emerging profit pools

As financial markets products become heavily adopted in multiple local markets and pricing discrepancies across borders disappear, those products become candidates for offering on a global scale. Indeed, products typically move along a maturity lifecycle: locally immature, locally mature, globally immature and finally globally mature.

However, there are a few products – such as advice – that will probably always be local because their delivery needs to happen in market, usually face to face. But over time, even those products tend to break out components that can be delivered globally. Continuing the advice example, this might be standardized advice incorporated directly into a product, such as a balanced mutual fund or an asset-liability matching product.

Given the gravitational pull of commoditization, immature products are usually the most profitable. This makes timing of market entry critical to the bottom line. Firms must monitor sophistication levels in local markets around the world in order to launch veteran products in local prospect markets *just as capital converges*, and take mature local products *global as soon as international sophistication levels allow*. Firms should also be prepared for the leapfrog effect: prospect markets may not stay interested in basic products for long, and companies must be prepared to quickly transition to more sophisticated products.

As a general starting point, we have plotted the outlook for some of the more promising opportunities based on our assessment of both financial product and market maturity (see Figure 8).

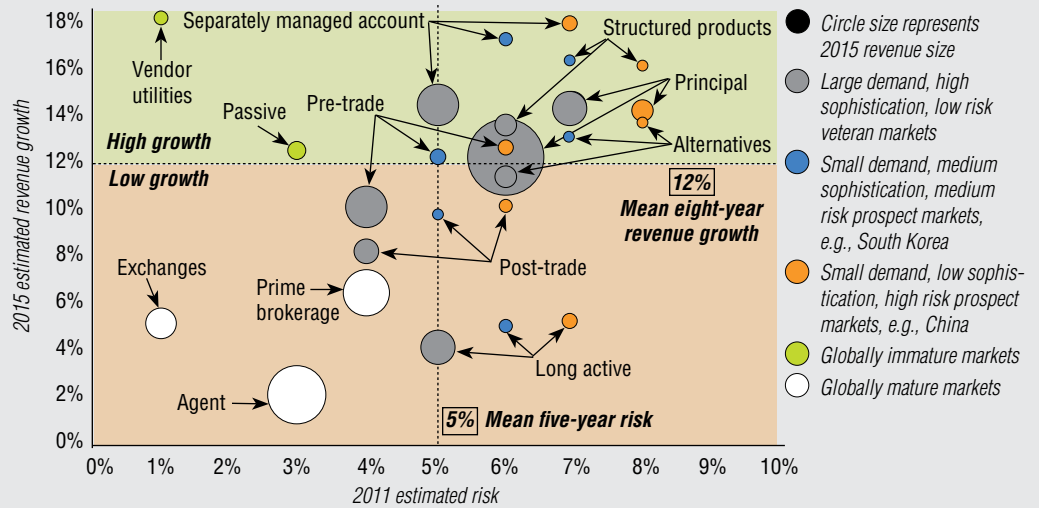
“The whole world is becoming an array of algorithms that search for pools of liquidity.”

– Portfolio Manager, Large Pension Fund, United States

Firms need to adjust their portfolios to take advantage of prospect market opportunities as those markets mature while watching for opportunities to take selected products global as demand expands and pricing discrepancies fade.

FIGURE 8.

Opportunities vary widely based on market sophistication, risk and growth potential.



Source: "Global Risk Service: Executive Overview." Global Insight. Fourth-Quarter 2006; IBM Institute for Business Value analysis.

Contrary to popular belief, specialization may trump scale in a more global financial markets industry.

Reconsider role in industry

The executives polled in our survey believe that diversified universal banks, those with a fairly even split between retail and wholesale revenue, are the type of firm most likely to succeed in the future global market.¹⁹ Across all categories of respondents, buy-side, sell-side and processors, executives ranked universal banks highest – naming them twice as often as the second-highest ranked type of firm (Wall Street/Tier-one broker-dealers). This perspective seems understandable given the global presence many universals already enjoy.

Interestingly though, when we probed further, beyond respondents' surface-level perceptions, we found a different story. We asked executives which type of firm (universal versus those with more specialized business models) had the greater advantage in each of the capability areas they designated as future

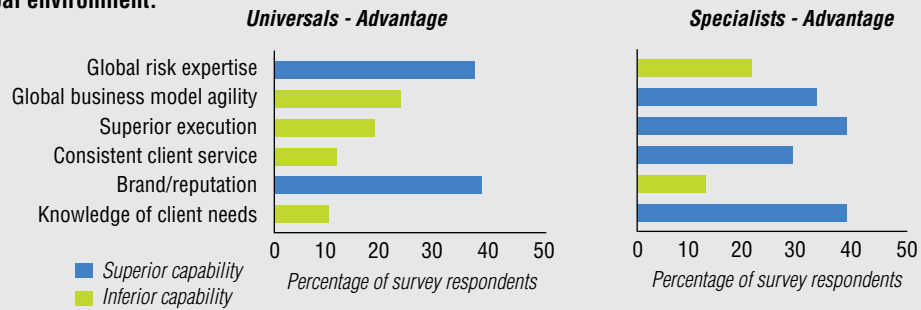
drivers of value. At this more granular level, specialists emerged on top (see Figure 9).

A financial comparison of the two groups backs up our respondents' more detailed assessment. Although the bulk of total revenue falls in the universal camp, over the past five years, specialists have demonstrated higher revenue growth and better margins. As a group, specialists are averaging 30 percent more revenue growth than universals. They also have average operating margins of 25 percent, while universals are averaging margins of 16 percent and are falling below the industry average of 17 percent.

This analysis calls into question the conventional assumption that a universal strategy is best. We believe financial markets firms of all stripes – particularly universal banks – should be looking for ways to focus and specialize in order to deliver differentiated value in the future.

FIGURE 9.

Executives believe specialists may have more of an advantage among the top drivers of value in a more global environment.



Question asked: Which attributes do you think will be most critical to creating shareholder value in a more global financial market and which type of firm will have an advantage?

Source: IBM Institute for Business Value/EIU 2007 financial markets executive survey.

“It is hard to be on top of your game in every niche and marketplace and to avoid descending into mediocrity. The question becomes to what degree are universals squandering scale? Or are they able to create such high levels of value that scale squander just does not matter?”

– Portfolio Manager, Large Pension Fund, United States

Eradicate client disconnects

To specialize effectively, firms must have a keen understanding of their clients’ needs and priorities – and adjust their focus accordingly. And in an increasingly global financial market environment, what clients need may not be the same as it was in the past.

Regardless of the type of client relationship – individual investors and their advisors, corporate clients and their investment banks, and asset managers and their broker-dealer and processor service providers – the majority of clients consider advice, performance, superior execution and service excellence as critically important. Even more interesting, clients ranked the ability to provide a “one-stop shop” and best-of-breed products at the bottom of their lists, calling into question many of today’s dominant business models. In fact, we found a fair amount of disparity between *what clients say* they will pay for as they become more global and *what service providers think* clients will value.

“Clients are globalizing their expectations – they expect the same quality of products and services from India as they receive in the U.S.”

– Head of Sales and Trading, Universal Bank, India

Specialization needs to be centered on what clients value most. Unfortunately, firms may have misguided ideas on what is most important to their clients.

We can see this disparity clearly in some examples from the broker-dealer segment of the industry (see Figure 10). Broker-dealers and their corporate clients are likeminded about the value of advice, superior execution and service excellence. However, it appears broker-dealers may be under-investing in global footprint, global risk expertise and balance sheet renting. With their increasingly global footprint, businesses want their financial services provider right there with them, handling their IPO in China and their next acquisition in Thailand. Similarly, asset management clients place a much higher value on market insight and superior execution than broker-dealers expect, underscoring the buy-side clients' need for customized ideas and cutting-edge trading capabilities.

Across our study, clients consistently rated some characteristics – such as reputation and performance – lower than service providers expected. However, these disconnects do not necessarily mean those characteristics are unimportant. (In fact, in the broker-dealer example, performance is actually the most

important attribute to asset management clients.) Instead, the disparity might mean that while firms must meet a certain bar, continued investment produces only marginal returns.

Firms must also reconcile investment across their entire portfolio of clients. As the broker-dealer example in Figure 10 demonstrates, investor needs vary widely by segment.

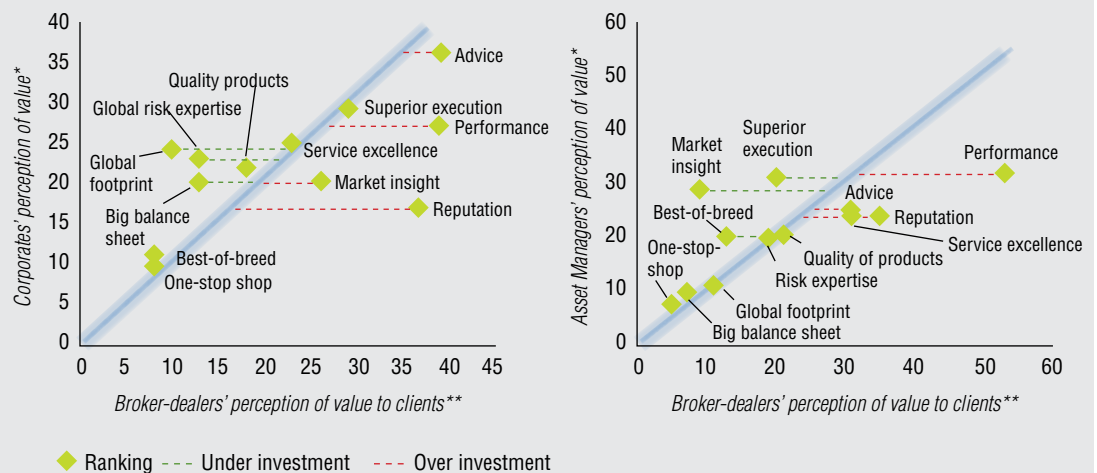
Recalibrate operating model

To be in a position to capture global opportunities, a firm's operating model must be built on three key tenets: global asset leverage, dynamic capability assembly and open collaboration.

To date, *global asset leverage* has mainly been driven by the need for cost reduction; but increasingly, firms will depend on geographically dispersed assets for revenue growth and innovation. The goal is to leverage best-of-breed assets (for example, talent, shared services, knowledge, sources of innovation and partners) across value chains, industries and geographies.

FIGURE 10.

The broker-dealer segment provides an example of the disconnect between what firms think their clients want and what clients actually value.



*Question asked: What will your firm pay its financial service providers a premium for?; **Question asked: What will your clients pay your firm a premium for?

Source: IBM Institute for Business Value/EIU 2007 financial markets executive survey; IBM Institute for Business Value analysis.

Globally integrated firms have the ability to utilize their best assets wherever needed, collaborate extensively to expand capabilities beyond their own organizations, assemble all those internal and external capabilities precisely when needed – and disband them just as easily when the need fades.

“I think the term globalization is trite – it may be better to consider just how local you are.”

– Chief Marketing Officer, Capital Markets Firm, New York

Although firms must learn to optimize the use of all assets, human capital is perhaps the most challenging to manage globally. Firms need to recruit and build a diverse talent pool and immerse employees in cultural training and, where possible, international assignments. HSBC, for example, proactively searches out candidates from around the world; this year's recruits include 50 different nationalities.²⁰ The company's extensive training programs often include a rotation outside the employee's home region.²¹ Firms must also create incentives that encourage employees to use diversity to their advantage. Intentional diversification may present a larger hurdle for firms in historically isolated markets; financial markets firms may actually be the change agents leading global integration for their nations.

Firms may face some thorny obstacles when attempting to leverage talent globally. Many organizations are currently constrained by what we call “illiquidity of talent.” Employees are wary of moving away from headquarters. They fear the old adage “out of sight is out of mind” will exclude them from important learning experiences or rob them of potential career opportunities. This apprehension is particularly acute in services industries, as opposed to product-oriented industries. To allay these fears, firms must be diligent about making remote employees feel included and

rewarding those who take “risky” roles in other geographies.

The second characteristic of firms' future operating models is *dynamic capability assembly* – the ability to bring together a variety of modular capabilities to deliver client value, and then disband once the need fades. The film industry models this kind of dynamism: producers, directors, funding entities, actors, film crews and so forth come together to develop a particular film and then all go in different directions for their next projects. For financial markets firms, dynamic capability assembly is by no means simple – the location of physical assets, technology infrastructure constraints and regulatory requirements present significant hurdles. However, it is critically important.

“Just the word ‘home office’ is an issue – You are not a global company if you have a ‘home office.’”

– C-level executive, Asset Management Firm, Japan

Why? The short answer is speed. After all, firms only have brief windows to capture global opportunities. Too often, firms centralize and pull decision making up to headquarters levels in an effort to gain cost efficiencies and speed, but then find themselves struggling to satisfy local market needs. Instead, we believe firms should standardize policies and processes and establish shared values; unifying in this way preserves both local flexibility and speed. Service-oriented architectures and realtime information management can also help firms gain the flexibility they need to assemble,

disassemble and reorganize capabilities as required in a rapidly changing global business environment.

“To seize on opportunities, our firm will be an organization made up of separate niche players, all part of our larger organization; this will give us the ability to create new businesses quickly to capture growth opportunities.”

– Chief Strategist, Asset Management Firm, India

The longer answer has to do with specialization and sustainability. In our survey, clients made it clear the one-stop-shop model is *passé*. But specialization carries inherent risks: what if you select the wrong focus? What if your specialization is obviated by industry advances? Some of the most profitable industry positions are also the most precarious. This means firms that specialize must have extremely flexible business processes, infrastructures and relationships that allow them to adapt quickly as the industry evolves.

Lastly, *open collaboration* is critical to the future operating model. For decades, financial markets firms have gone solo. They rely heavily on proprietary intellectual capital and home-grown IT solutions. A do-it-yourself attitude is part of their DNA. But today, easy profits have disappeared; market share is harder to capture; and financial markets firms are faced

with the need to collaborate more extensively. When addressing the global opportunity, for instance, local partners with in-market expertise can help firms enter new geographies more successfully. Clearly, collaboration introduces risk (e.g., intellectual property protection) and is subject to constraints (e.g., regulatory restrictions on sharing private information). However, these hurdles can be addressed. And we believe the alternative – going it alone – will not be viable much longer.

“We don’t think that being bigger is better – you don’t need to own retail distribution nor do you have to own a balance sheet – you can borrow both of these things from others.”

– C-level executive, Investment Bank, London

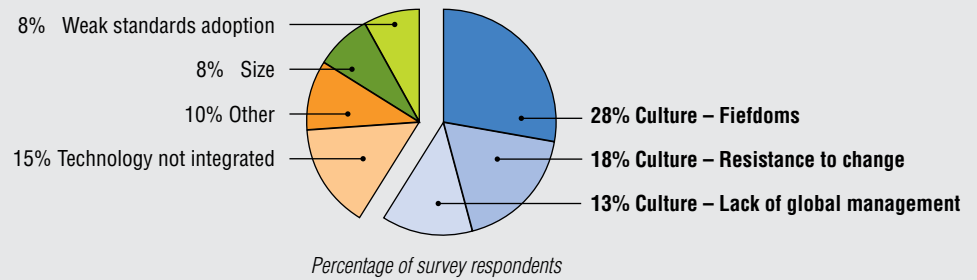
Win minds

There is a common thread that weaves through the suggested actions described thus far: *changing the corporate culture*. To manage the inherent tensions of going global, firms will have to adjust attitudes and management practices, employee biases and incentives. In short, leaders will have to win minds.

Determining risk versus return across geographies, balancing friend versus foe in industry relationships, centralizing versus decentralizing operations are all part of executing a global strategy. Executives acknowledge the challenge ahead: In the course of becoming a globally integrated enterprise, they told us cultural change is half the battle (see Figure 11).

Organizational culture can often make or break a global strategy. It demands executive-level attention.

FIGURE 11.
Many of today's organizations will be forced to overcome cultural barriers to achieve superior performance.



Question asked: *What is the largest barrier inhibiting your organization from profiting from globalization?*
 Source: IBM Institute of Business Value/EIU 2007 financial markets executive survey.

Cultural constraints like organizational fiefdoms, resistance to change and lack of global management can derail global integration, as can technology limitations.

Interestingly, executives ranked global management team as one of the most critical enablers of global integration. But as Figure 11 shows, they also cited *the lack of global management* as one of the biggest barriers. When senior management is trapped in ethnic-, gender- or geo-centric molds, the side effects can be significant: insufficient breadth of products and services, lack of global teaming and failure to attract necessary types of talent, just to name a few. Several financial markets firms are already taking initial steps to diversify their management structures. Credit Suisse, for instance, recently appointed the leader of its U.S. Investment Banking division as CEO.²² Outside of financial services, there are even more examples. Pepsi's new CEO Indra Nooyi is an Indian woman leading a quintessential American corporation.²³

For financial markets firms, going global is about much more than physical assets and

business processes. It has tremendous implications for the "softer side" of the business, those intangibles that are hard to quantify and assess – and even harder to change.

How globally integrated and specialized are you?

Though it seems like semantics, there really is a difference between being global and being globally integrated. The former refers to mere presence; the latter gets at the heart of how you operate as an enterprise. There is also a difference between organizations that "specialize" by focusing on their core competencies and those that specialize in areas clients value. The first firm has simply focused – the other has a true specialty recognized (and rewarded) by the marketplace.

Here are some questions to help you assess how prepared you are for a more global financial markets industry:

Aligning your portfolio to emerging profit pools

- How diversified is your current product portfolio? Is it too heavily weighted toward

mature veteran market offerings? Does it include an appropriate mix of global and local offerings? Which products could be rejuvenated in a different geography?

- Have you put concrete processes in place to weigh the benefits, costs and risks of pursuing opportunities outside your traditional markets, in India or South Korea for example?

Reconsidering your role in the industry

- What kind of approach are you using to select (and continuously revalidate) your areas of specialization? How does it incorporate what clients value most?
- Are you more focused on building scale or partnering?

Eradicating client disconnects

- Are you focused on the capabilities deemed by clients as most important, such as superior execution, market insight and advice?
- Where have you found discrepancies between what you are currently investing in and what clients are willing to pay for?

Recalibrating your operating model

- How global is your senior management team? Does it mirror the diversity of your target client set?
- How globally diverse, culturally aware and mobile is your talent pool? What percentage of your top performers has had the opportunity to work outside their home markets? What incentives do you have in place to encourage diversity?

- How confident are you that you are leveraging the best assets (talent, technology, innovation, partners, etc.) available globally?
- How quickly can you assemble a global team to address an international opportunity, such as a Shenzhen IPO for a Saudi Arabian client? Would they have enough decision-making flexibility to close the deal? How rapidly could you disband and refocus these individuals after the deal is done?
- How collaborative is your operating model?

Winning minds

- When it comes to global integration, what are your specific cultural strengths and weaknesses?
- How successful have you been at implementing enterprisewide cultural changes in the past?

In less than ten years, financial markets firms could be looking at twice the amount of investable assets available in the world today. The question is: will they be looking in the right places? And will they be capable of capturing these more globally dispersed opportunities? We believe the future leaders of the industry will be those firms that can successfully specialize around what clients value most and become fluid, adaptable, globally integrated enterprises.

About the authors

Suzanne Dence is responsible for research and thought leadership for the Financial Markets industry within the IBM Institute for Business Value. She has presented research at numerous conferences around the world, including the Economist Forum, China International Banking Convention and Seoul Financial Forum. She is also the author of several papers on the financial markets industry, the most recent being: “The trader is dead, long live the trader,” “Asset managers turn up the heat” and “Capturing the sell-side upside.” Her work has been cited by a broad range of media outlets, including CNBC, BBC, The Financial Times and The Economist. Prior to joining IBM, Suzanne worked in the custody and investment management divisions of multiple global financial institutions. Suzanne can be reached at sdence@us.ibm.com.

Wendy Feller leads the Financial Services Sector practice across the Financial Markets, Banking and Insurance industries for the IBM Institute for Business Value. She spearheads the team’s strategy-oriented research, exploring pressing issues facing today’s financial services organizations. Ms. Feller has over ten years of experience in the financial services industry, having previously worked as a strategy consultant advising many of today’s leading organizations. She has authored multiple studies and is a frequent speaker at conferences across the globe on topics such as the future of financial markets and globalization and specialization of the industry. Wendy can be reached at wefeller@us.ibm.com.

Daniel W. Latimore, CFA, is the Global Research Director of the IBM Institute for Business Value. With more than 20 years of financial services experience in the industry and as a consultant, Mr. Latimore now leads cross-industry business strategy thought leadership efforts for IBM. A frequent conference speaker and author, Mr. Latimore is currently focusing on topics such as collaboration, innovation and global integration. Dan can be reached at dwl@us.ibm.com.

Contributors

Ashish Bhiwandiwala, Global Business Services – Global Delivery, Financial Services Consultant

Vijaya Mani, Global Business Services – Global Delivery, Financial Services Consultant

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