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# GLOBALIZATION OF FINANCIAL MARKETS - IBM

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IBM Global Business Services

*IBM Institute for Business Value*

# Get global. Get specialized. Or get out.

## Unexpected lessons in global financial markets

A future agenda study

# Agenda

- **Summary**

Results

Appendix

Summary

# We surveyed over 950 executives and conducted secondary research to determine how firms must respond to forces of globalization

- **Where will capital pools emerge?**
- **What will clients pay a premium for?**
- **How will the bases for competition evolve?**
- **Which organizational models will firms need to adopt to succeed?**

IBM Institute for Business Value
Economist Intelligence Unit

## Scope

- Our analysis focused on selected financial markets industry participants[1]:
  - Buy side
  - Sell side
  - Processors
  - Others: Corporations, individual investors, academics, plan sponsors, industry associations, regulatory bodies, IBM Research

## Approach

- We surveyed 955 business leaders from 361 firms[2]:
  - Qualitative interviews of 209 executives
  - Survey of 746 executives, in partnership with the Economist Intelligence Unit
  - 32% Americas, 35% EMEA[3] and 33% Asia
- We conducted secondary research and developed quantitative models

Note: [1]Please see appendix for detailed segmentation; Buy side includes institutional and retail asset management inclusive of private banking and the individual investor, Sell side includes investment banking and sales and trading, Processors include exchanges, ATSs, clearing and custody; [2]Firms include financial services firms and non-financial services firms; 85% of business leaders are C-level, EVP or divisional head with the remainder Director, SVP or VP level; [3]EMEA is Europe, Middle East, Africa

# Financial markets depth will double by year 2015 as capital pools disperse; firms will learn to compete in a more globally networked economy

## Summary of Findings

- Capital will disperse to newly created marketplaces; firms are unprepared
- Market sophistication is *the* double edged sword
- Firms will target opportunities along the global efficient frontier
- Introverted organizations will be crushed
- Winners will specialize and globally integrate

***Firms must recognize the importance of culture in designing tomorrow's global enterprise.***

# Agenda

Summary

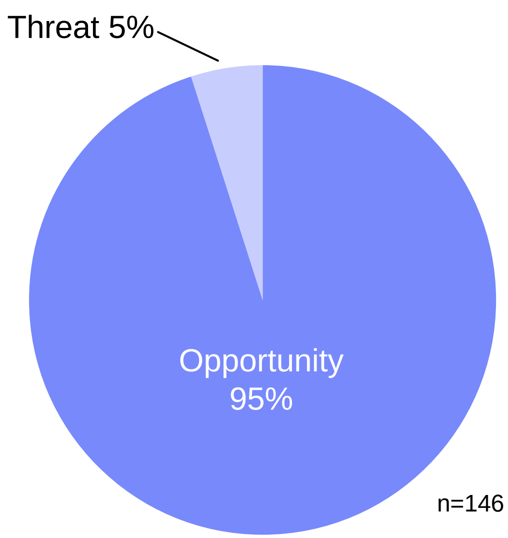
**Results**

Appendix

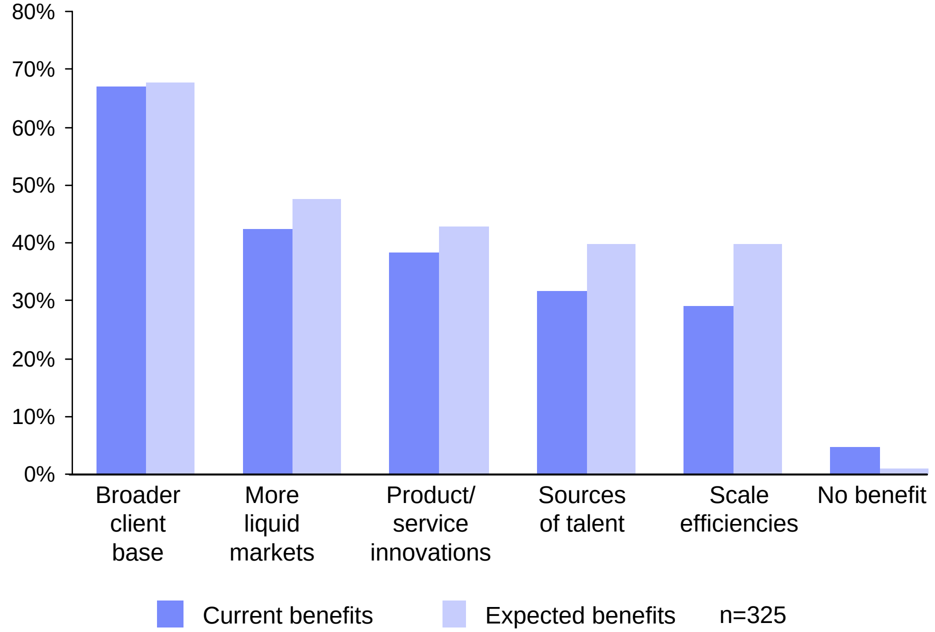
Results

# Most executives view globalization as an opportunity; client reach is cited as the largest benefit

## Globalization as an Opportunity or Threat
*(Percentage of Survey Respondents[1])*




## Benefits of Becoming a Truly Global Organization
*(Percentage of Survey Respondents[2])*



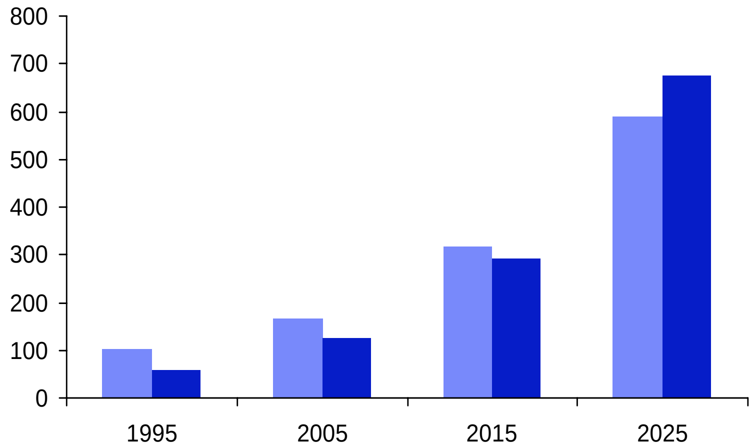

***86% of executives believe that in five years' time, forces of globalization will be a more important factor in their firm strategy.***

Note: [1]Executives asked: Does your firm pursue a global business strategy? [2]What benefit does your firm derive from being a global financial services provider? In five year's time?
Source: IBM / EIU Survey; IBM Institute for Business Value analysis

Results

# Executive instinct is accurate; financial markets will increase in worldwide economic importance

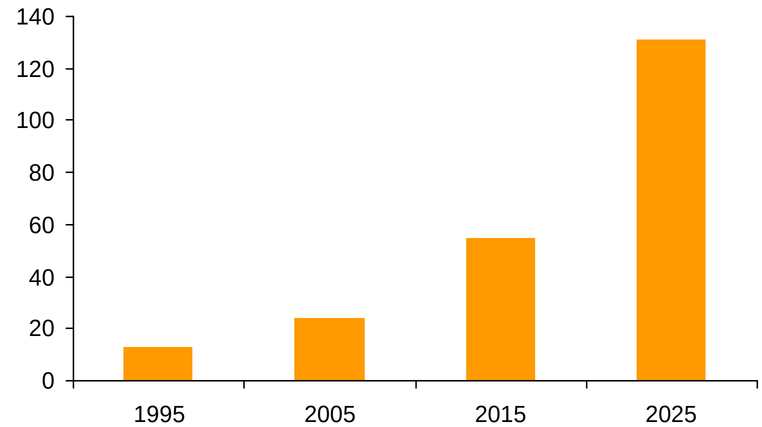
## Financial System Depth, 1995-2025
*(Investable Assets, $ Trillions)*




| | 1995 | 2005 | 2015 | 2025 |
|---|---|---|---|---|
| Securities % of GDP | 219% | 305% | 393% | 523% |
| Securities CAGR | N/A | 8% | 9% | 9% |
| Deposits CAGR | N/A | 5% | 7% | 6% |

Currency / Deposits Size    Securities[1] Size

## Financial System Flows, 1995-2025
*(Inward Stock Flows, $ Trillions)*




| | 1995 | 2005 | 2015 | 2025 |
|---|---|---|---|---|
| Flows[2] % of GDP | 48% | 59% | 74% | 102% |
| Flows CAGR | N/A% | 6% | 9% | 9% |

***Worldwide nominal GDP growth is projected to be 5% annually through year 2025.***

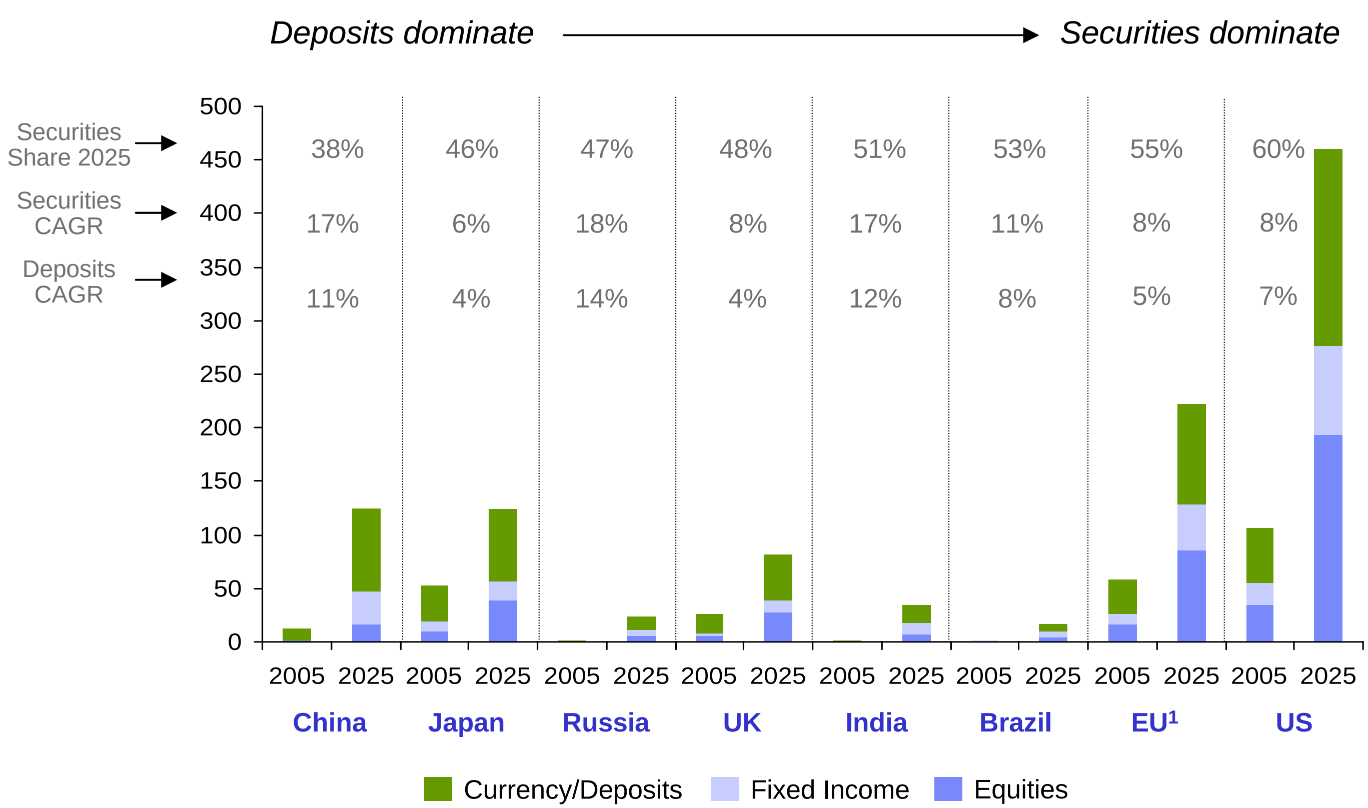
Note: [1]Securities includes equity and fixed income securities; [2]Flow CAGR is estimated from 1995-2005 and includes equity and fixed income securities, GDP is nominal GDP
Source: IBM / EIU Macro Model, 2007; IBM Institute for Business Value analysis

Appendix

# Additional growth will be driven by a shift from deposits to securities as economies mature

## Financial System Evolution, 2005-2025

*(Investable Assets $ Trillions, Share and CAGR percentages)*



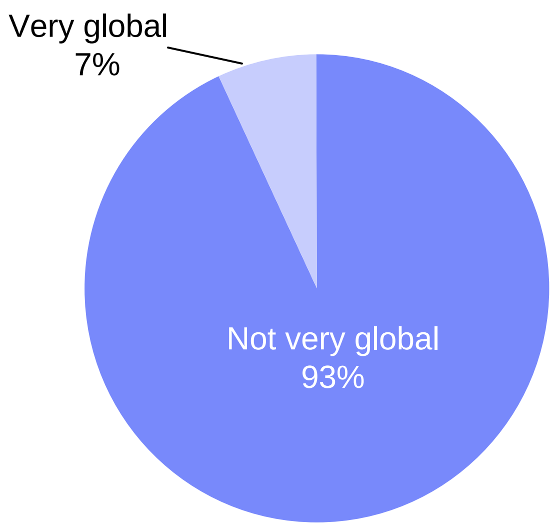

Note: [1]EU does not include the UK

Source: IBM / EIU Macro Model, 2007; IBM Institute for Business Value analysis

Results

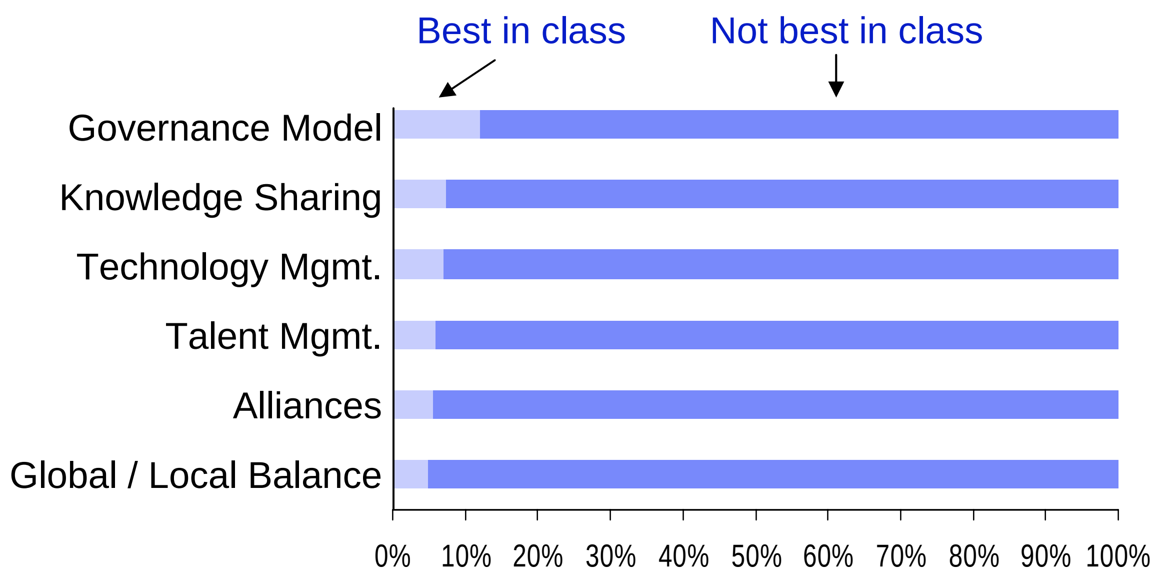
# Unfortunately, many executives are anxious about their organization's ability to respond

## How Global are Firms?
*(Percentage of Survey Respondents)*




n=146

## How Proficient are Firms at Selected Activities?
*(Percentage of Survey Respondents[1])*




n=637

*"We are just followers – we continue to follow the herd without thinking; it's amazing we can make any money at all." – CFO, Universal Bank, London*

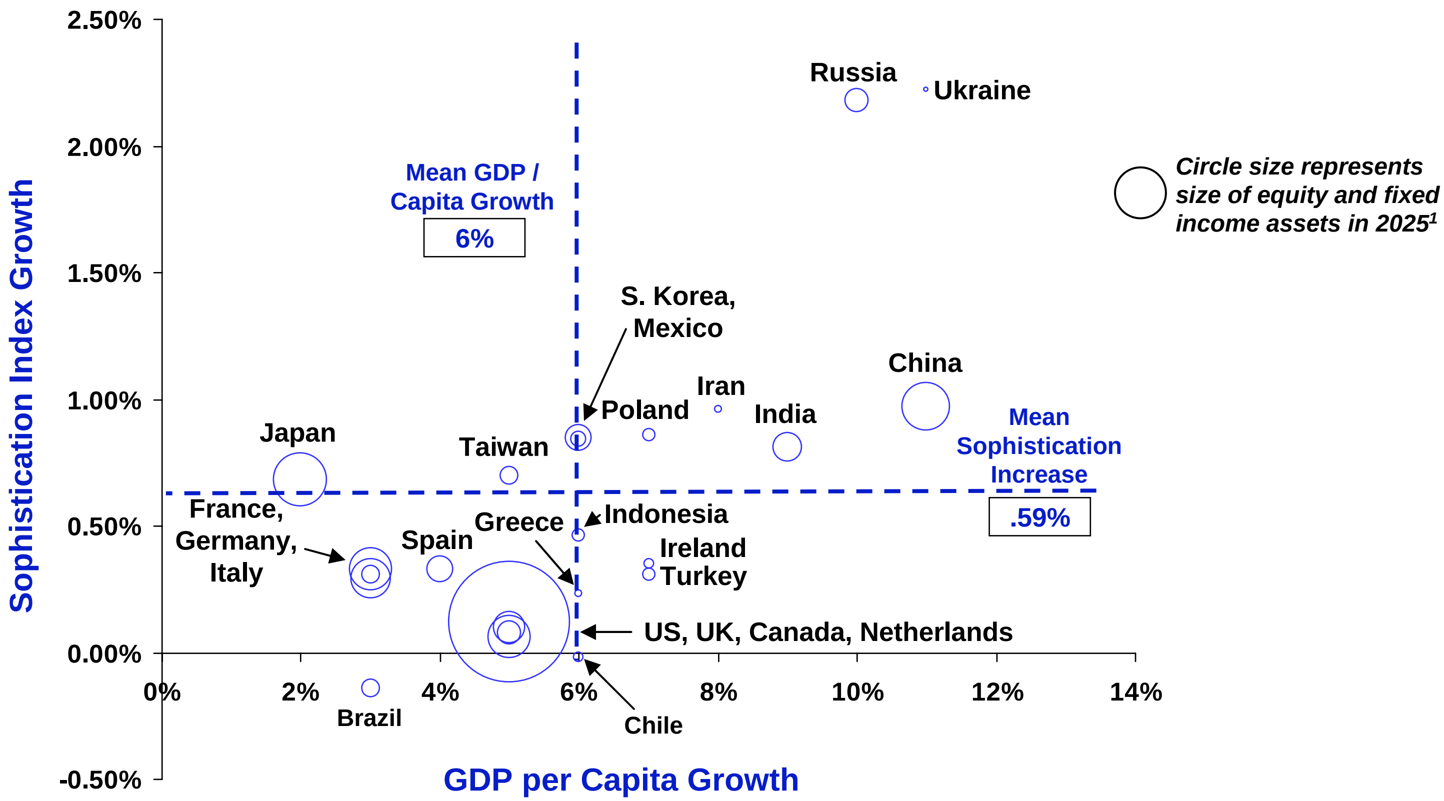
Note: [1]Executives asked: Please rate level of importance of global capabilities to firm's current strategy and level of proficiency for each from 1 to 5; 1=best in class / 5 = poor
Source: IBM / EIU Survey, 2007; Primary interviews; IBM Institute for Business Value analysis

Results

# As financial capital disburses, the opportunity will extend beyond BRIC

## Geographic Financial Capital Dispersion, 1995-2025

*(Growth in GDP per Capita vs. Growth in Sophistication)*



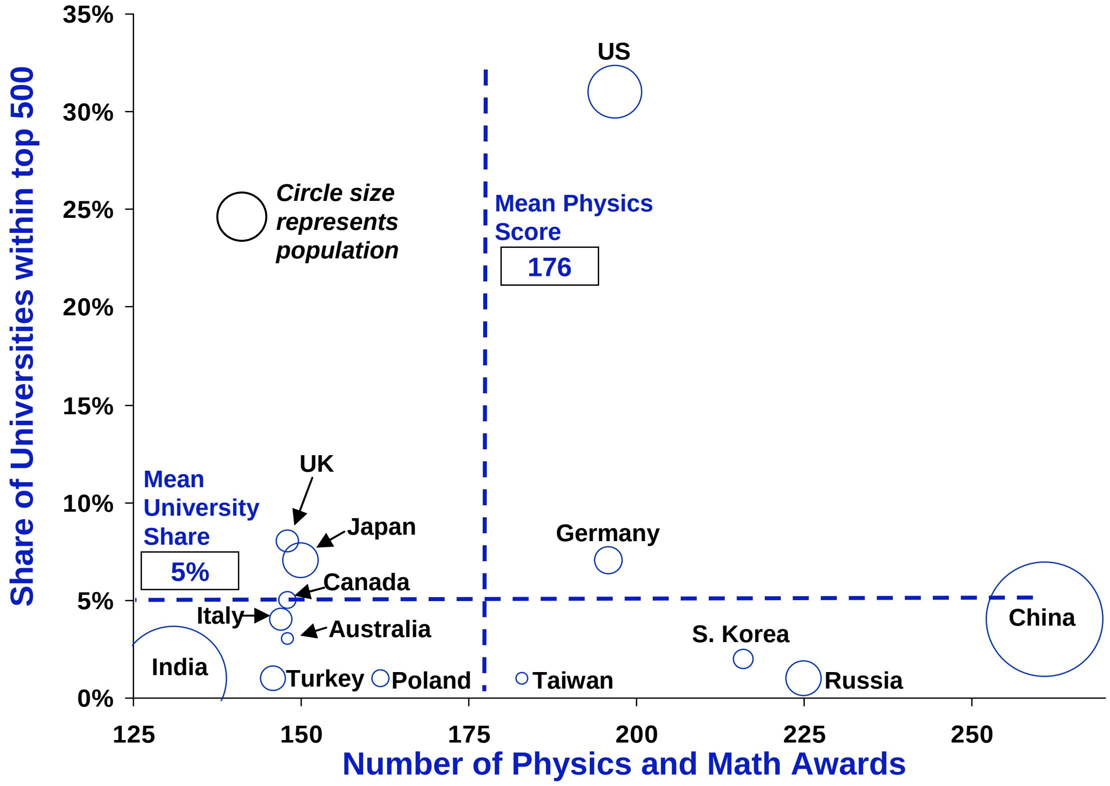

Note: [1]Countries selected based on largest 15 economies by asset size in 2025
Source: IBM / EIU Macro Model, 2007; IBM Institute for Business Value analysis

Results

# Leading organizations will recognize the importance of human capital dispersion across geographies

## Example Talent Pools, 2006

*(Physics and Math Awards vs. Share of Universities)*

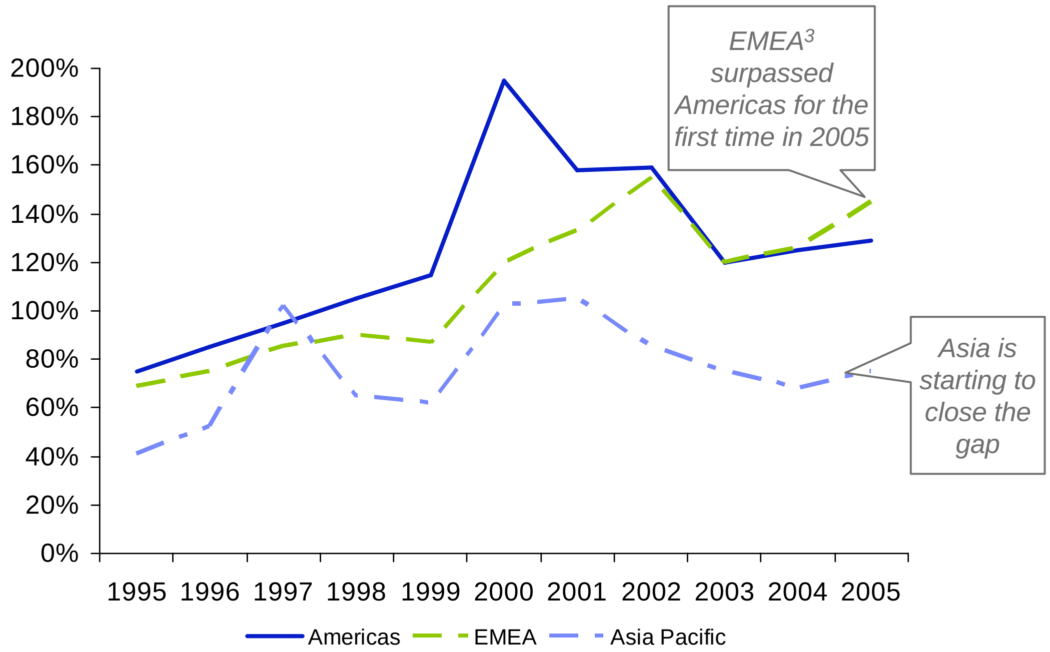


Results

# Market infrastructure may also disperse as market centers consolidate and mature

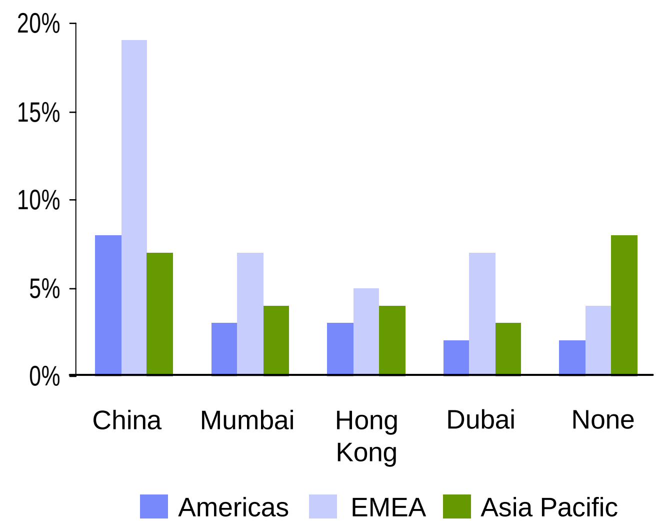
## Turnover Velocity, 1995-2005

*(Trading Volume to Market Capitalization[1])*




## Perceived Market Center Dominance, 2025

*(Percentage of Survey Respondents[2])*




***Deal value of Shenzhen, Shanghai, and Hong Kong, amounted to $53 bn. in 2006 which surpassed UK at $48 bn. and the US at $46 bn.***

Note: [1]Turnover velocity is calculated as the month's share turnover x 12 / month-end market capitalization; [2]Executives asked: Which market centers, if any, will be as dominant or more dominant than New York, London and Tokyo by year 2025; [3]EMEA is Europe, Middle East, Africa

Source: World Federation of Exchanges, Focus April 2007; BIS; IBM Institute for Business Value analysis

# Winners will specialize and build highly adaptable globally integrated enterprises, leaving the herd behind

## Recommendations

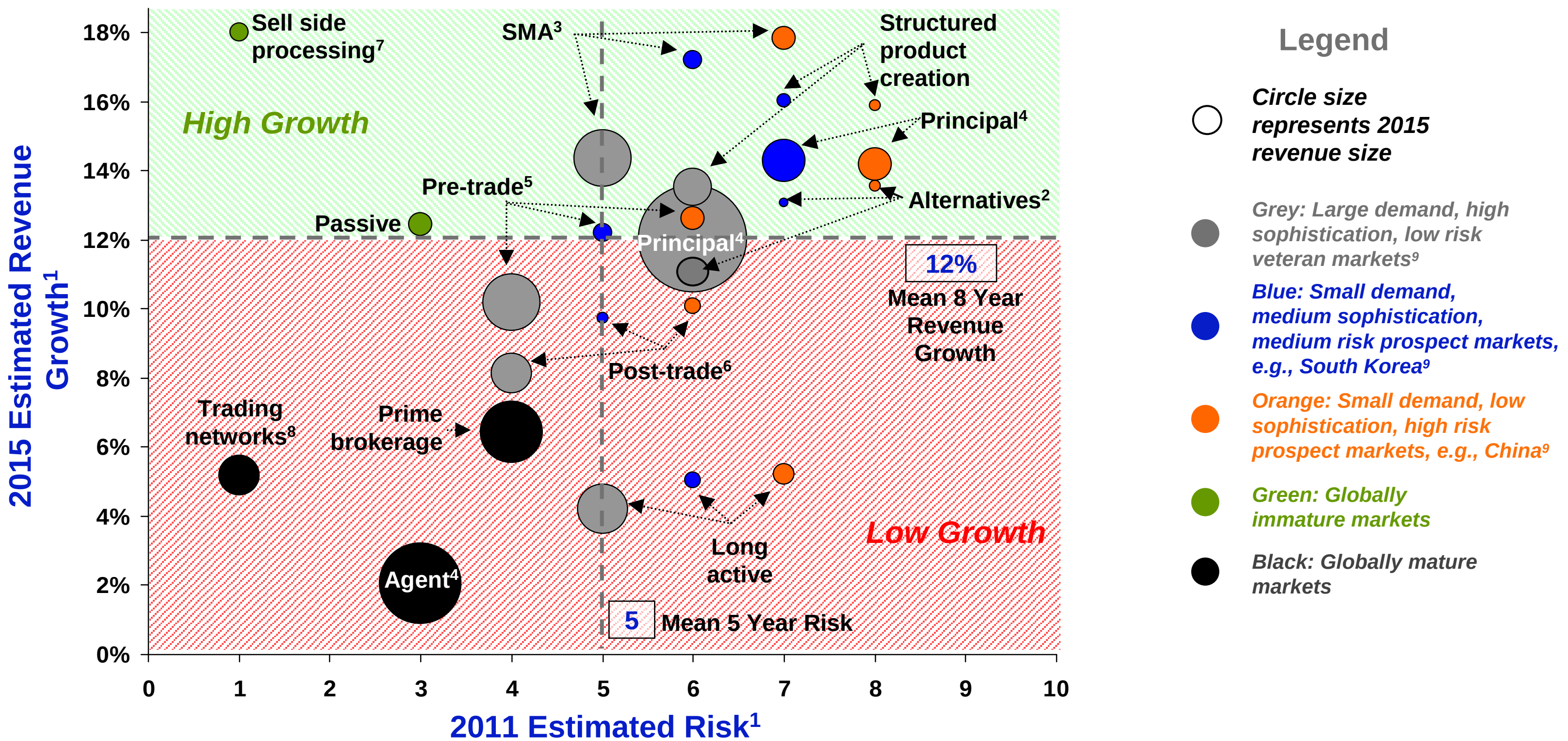
- Align portfolio with emerging revenue pools
- Eradicate client disconnects
- Reconsider role in industry
- Stop squandering scale
- Win minds

***Culture is cited as the number one enabler to succeed in a more global economy.***

Results

# Ultimately, firms must decide which revenue pools to target based on their risk appetite

## Risk vs. Revenue Projections



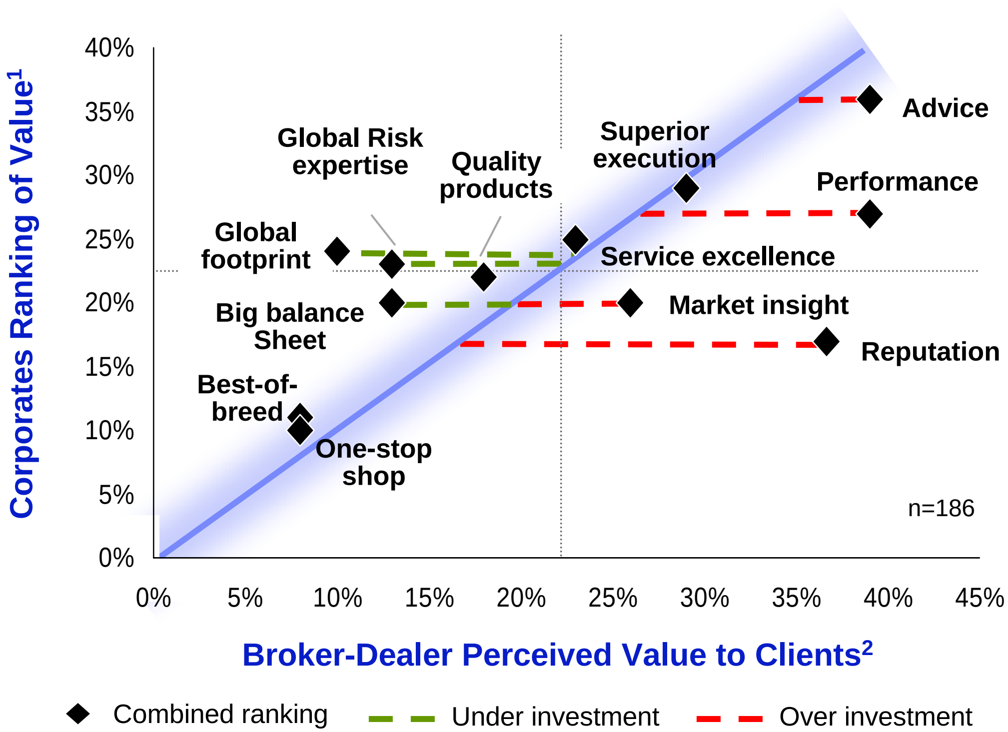

Note:[1]Risk is measured on a scale of 1-5 where 1=low and 5=high, normalized product risk based on volatility of ROE for product category, country risk is five year/medium term risk, revenue growth is compounded annual growth rates, global is indicative of activities that have limited margin and revenue growth differences across regions; [2]Alternatives includes hedge funds and private equity; [3]SMA is separately managed accounts; [4]Principal includes client principal trading and proprietary trading, Agent is client trading; [5]Pre-trade is middle office sourcing, securities lending, performance analytics, risk and compliance services; [6]Post-trade is custody and fund accounting; [7]Sell side processing includes any organization that generates revenue from processing instruments on behalf of broker-dealer organizations; [8]Trading networks include any organization that generates revenues from transaction or listing fees, e.g., exchanges; [9] Veteran includes US, Japan, France, UK, Germany, Blue prospect includes S. Korea, Spain, Poland, Ireland, Greece, Mexico, Chile, Orange prospect includes China, Russia, Ukraine, Iran, India, Turkey
Source: IBV profit map model; IBM Institute for Business Value analysis

Results

# Aligning around these opportunities will require a solid understanding of the capabilities clients will pay for

## Corporates vs. Broker Dealer Disconnects

*(Percentage of Survey Respondents)*




## Interpreting the Disconnects

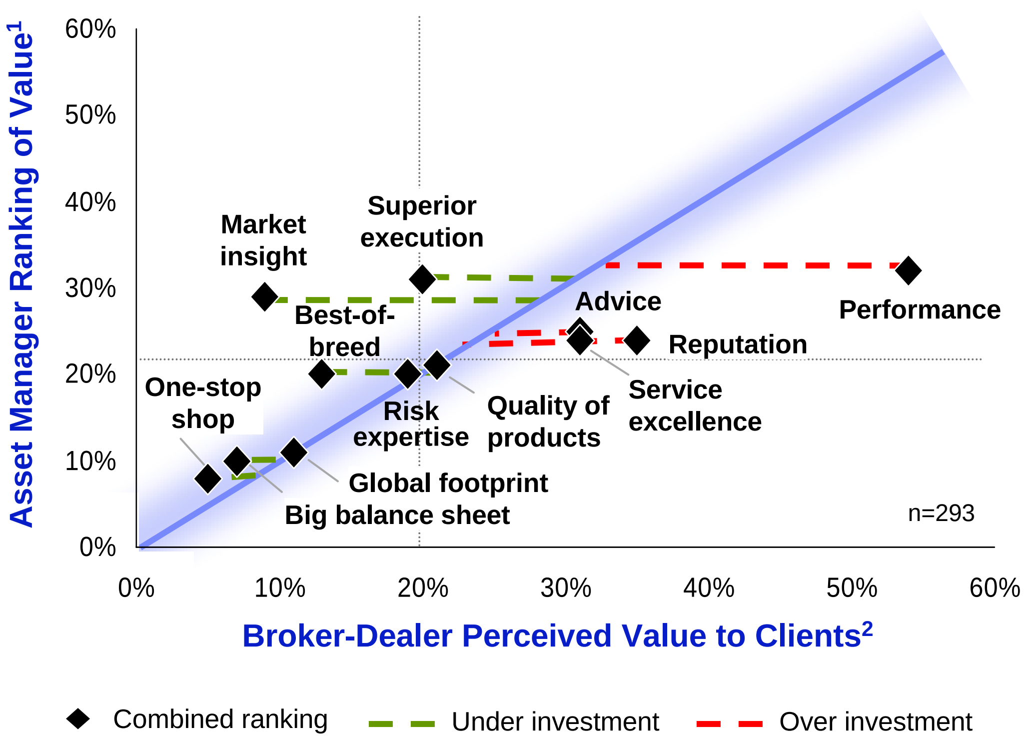
- Respondents agree, advice, superior execution and service excellence will be key in a more global marketplace
- Broker dealers are viewed as under investing in global footprint, risk expertise, and balance sheet renting
- Investment in performance, reputation and market insight appear to yield marginal returns, once a certain threshold is reached
- Specialization and quality of individual products will be valued over one-stop shop and best-of-breed business models

Note: [1]Executives asked: What will your firm pay its financial service providers a premium for; [2]Executives asked: What will your clients pay financial markets providers a premium for
Source: IBM / EIU Survey, 2007; IBM Institute for Business Value analysis

Appendix

# However, most firms struggle to understand what clients will value most in a more globally networked economy

## Asset Manager vs. Broker Dealer Disconnects
*(Percentage of Survey Respondents)*




## Interpreting the Disconnects

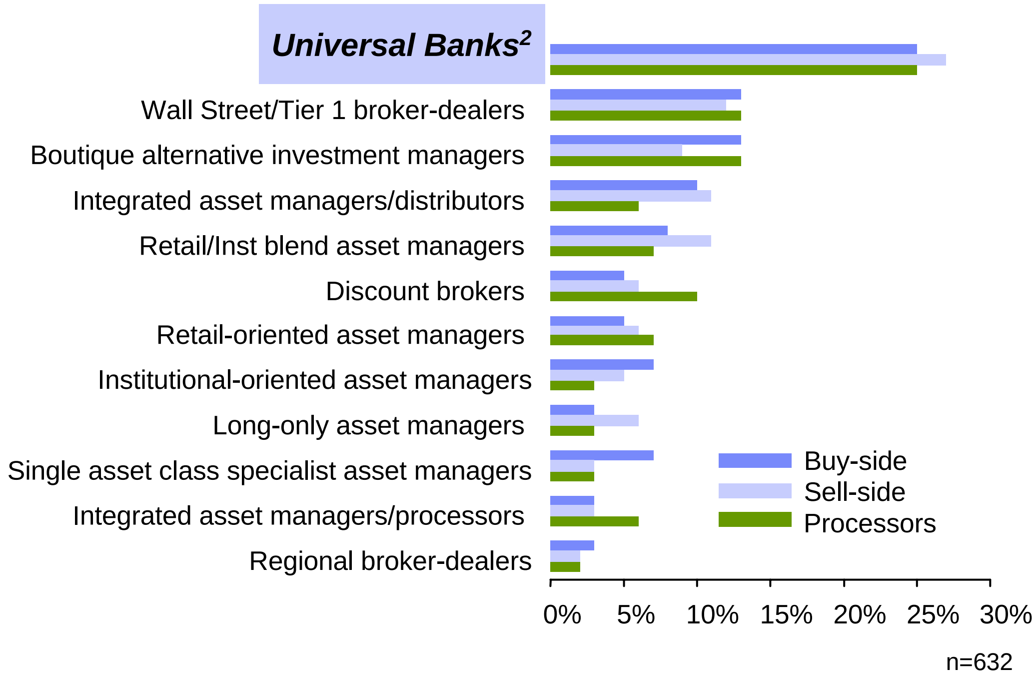
- Asset managers are emphasizing the importance of superior execution and the fact that they will pay for this the future
- Client respondents continue to point out the need for superior market insight and ideas
- Despite the fact that asset managers state they are going increasingly global, they rank global footprint in the bottom half of factors
- Clients view the one-stop shop as the least important factor

Note: [1]Executives asked: What will your firm pay its financial service providers a premium for; [2]Executives asked: What will your clients pay financial markets providers a premium for
Source: IBM / EIU Survey, 2007; IBM Institute for Business Value analysis

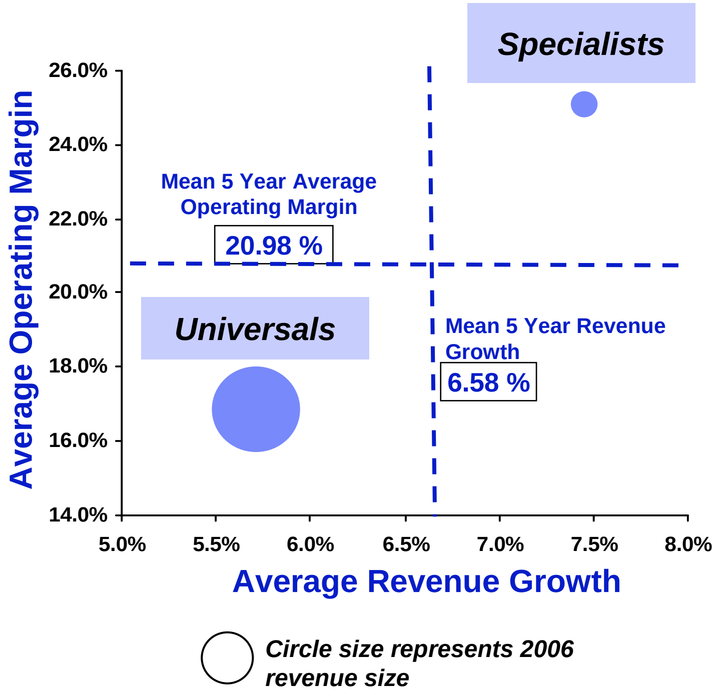
Results

# Executives believe that more globally diversified universals will be positioned to win; historic performance reveals the opposite

## Firms Most Likely to Succeed, 2006
*(Percentage of Survey Respondents[1])*



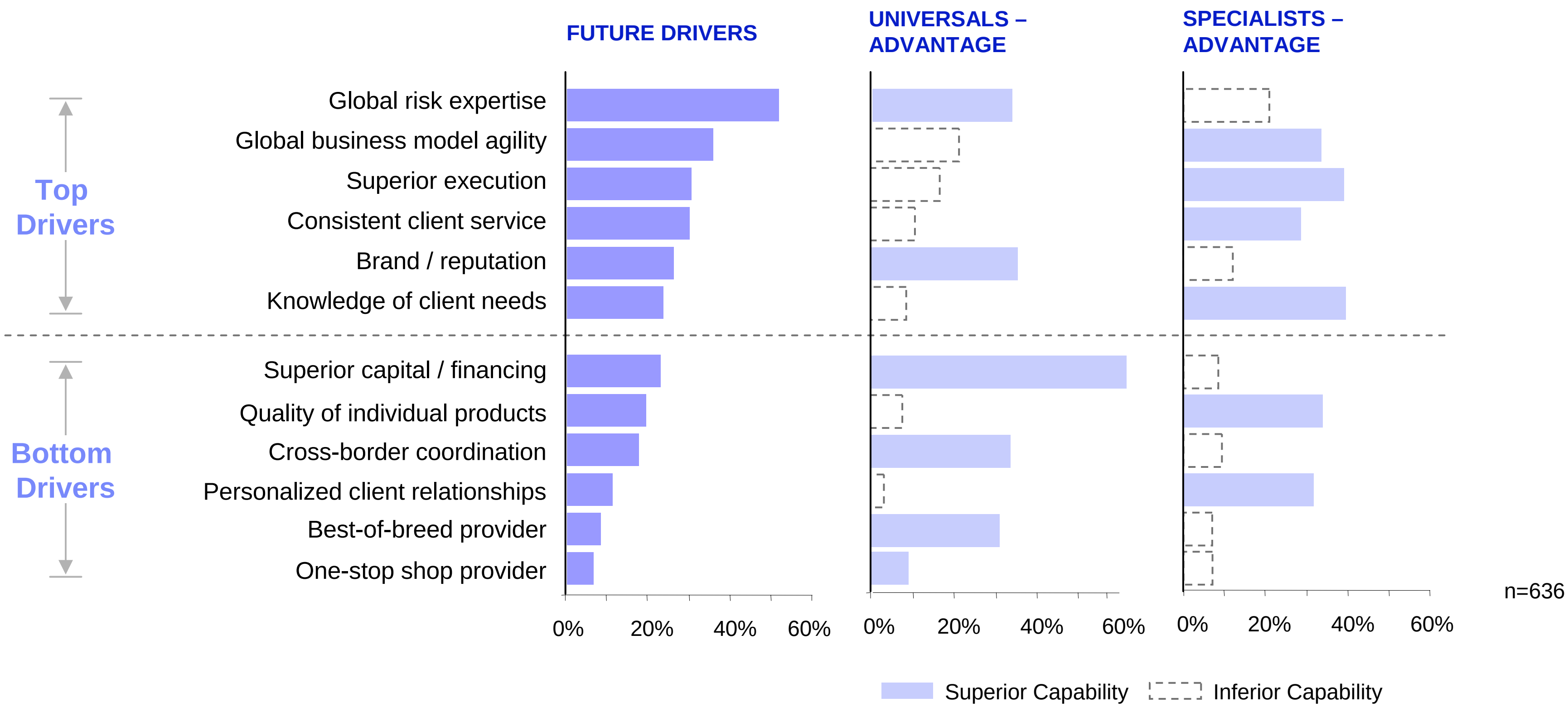

## Performance, 1996-2005
*(Historical Profit Margin and Revenue Growth)*




Note: [1]Executive asked: What firm types do you think will deliver the greatest value (shareholder/owner returns) in a more global financial market: [2]Universal is organization that generates between 25-65% of profits from retail banking, insurance, private banking or any combination thereof and between 25-65% of profits from wholesale businesses
Source: IBV / Economist Intelligence Unit Survey; Thomson One Banker; Annual reports; IBM Institute for Business Value analysis

# Universals may be playing the wrong game

## Future Drivers Of Shareholder Value Creation
*(Percentage of Survey Respondents[1])*

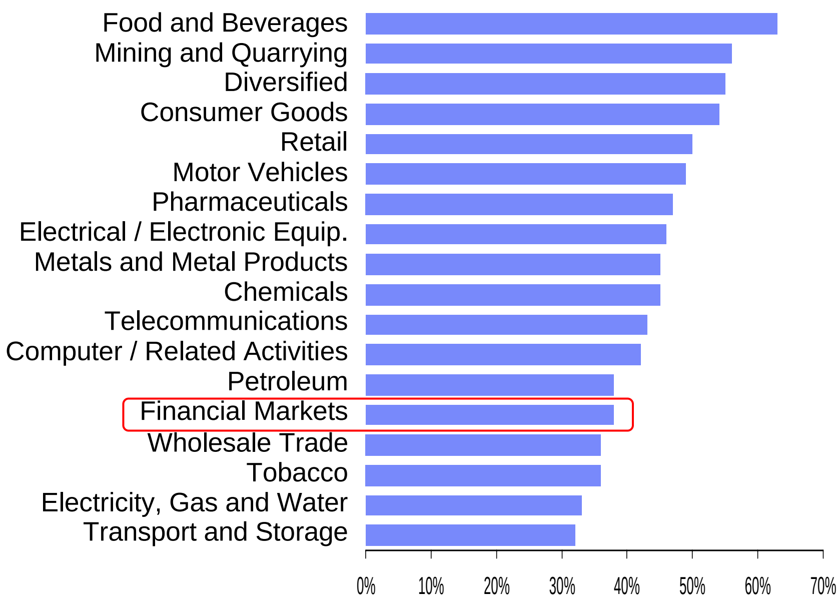



[1]Question asked: Which attributes do you think will be most critical to creating shareholder value in a more global financial market? Which type of firm will have an advantage
Source: IBM / EIU Survey; IBM Institute for Business Value analysis

Results

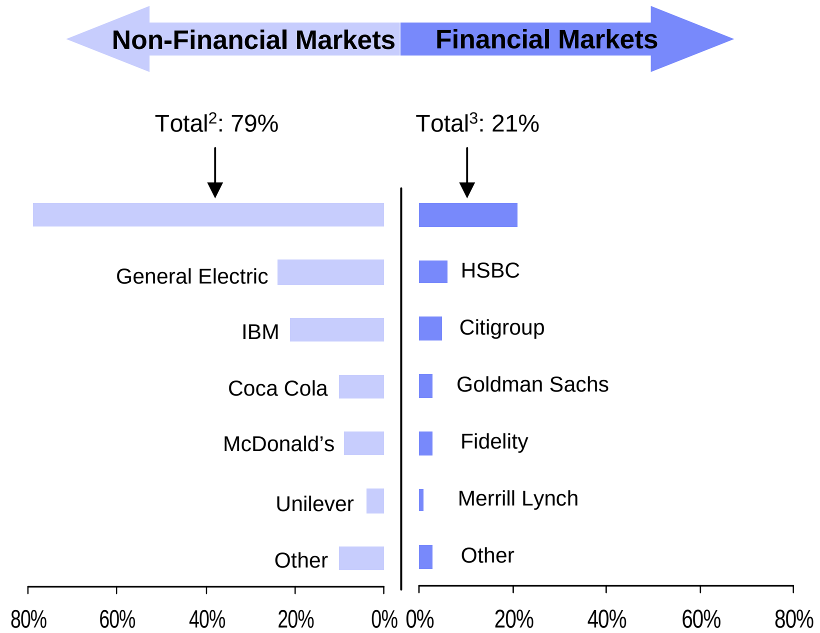
# Few financial markets firms operate globally

## Transnational Index By Industry, 2005
*(Weighted Ratio of Foreign to Total Firm Sales, and Assets by Industry)*




n=130

## Which Firms are Truly Global?
*(Percentage of Survey Respondents[1])*




n=190

Note: [1]Executives asked: In your opinion, which firms are truly global?; [2] Total represents number of respondents that answered 'no financial markets firms are global'; [3] Total represents number of respondents that articulated financial markets firms as being truly global
Source: World Investment Report 2006(UNCTAD)/ Company Annual Reports/Thomson One Banker and other SEC filings

# Redefining the organizations along three operating pillars will be critical

## The Globally Integrated Enterprise

### *Global Asset Leverage*

*Leverages the power of* ***global best-of-breed assets*** *across value chains, industries, geographies*

*From local & custom labor-based services to global intellectual property & asset-based services*

### *Dynamic Capability Assembly*

*Taps into a universe of* ***modular capabilities*** *to rapidly assemble and deliver tailored solutions and flawless execution to clients*

*From functional and proprietary to dynamic, modular capabilities, that balance global efficiencies with localized touch*

### *Open Collaboration*

*Manages and secures value via structured* ***collaboration*** *within an open ecosystem of partners*

*From simple value chain management to specialization within an open network of alliances, shared risk and control, and joint innovation*

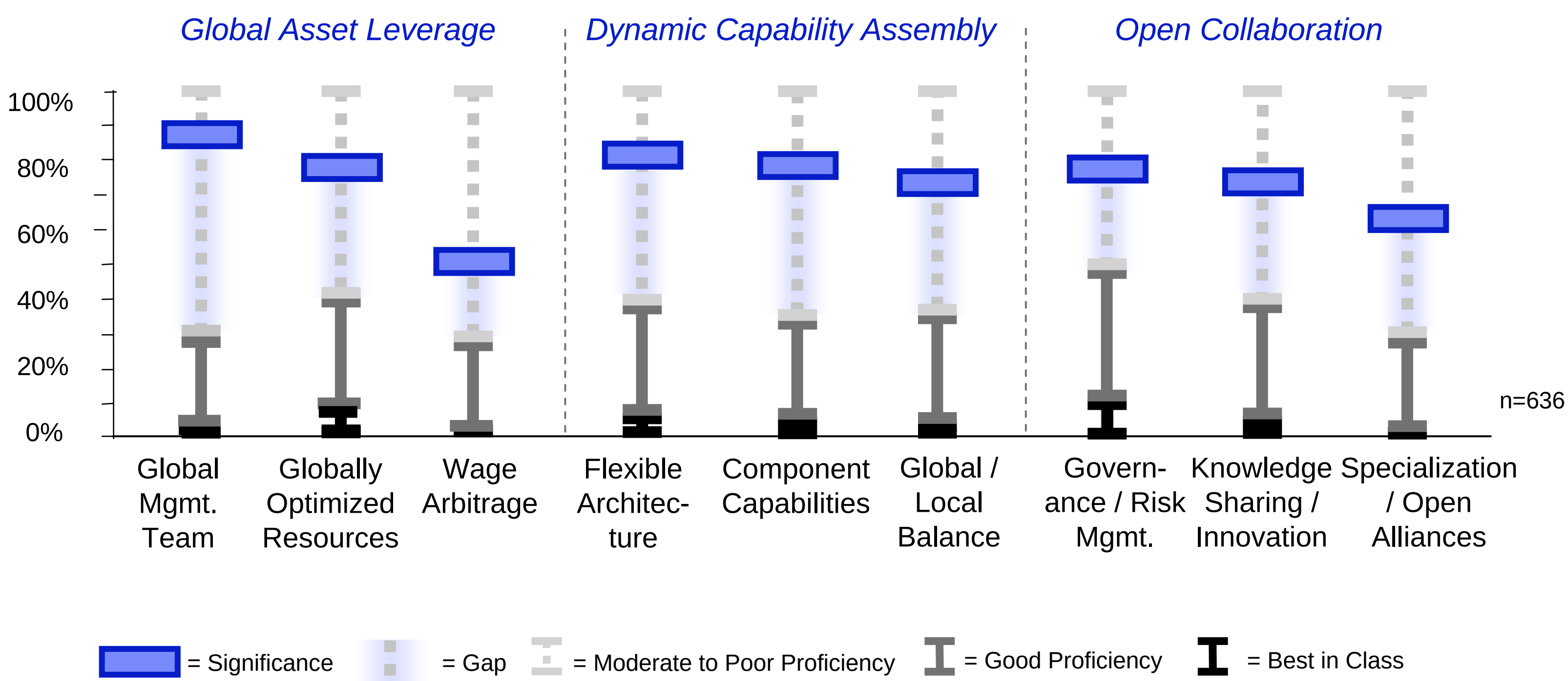
***"The new operating models are based on integration, cooperation and an exchange of resources – and above all are focused on the requirements of the global client."***
***- CEO, Large universal bank, Zurich***

Results

# Two-thirds of executives agree, their ability to manage the core assets of a globally integrated enterprise is limited

## Significance vs. Proficiency of Global Operating Capabilities

*(Percentage of Survey Respondents[1])*




[1]Note: Executives asked to rate level of importance of global capabilities to firm's current strategy and level of proficiency for each from 1 to 5; 1=best in class / 5 = poor

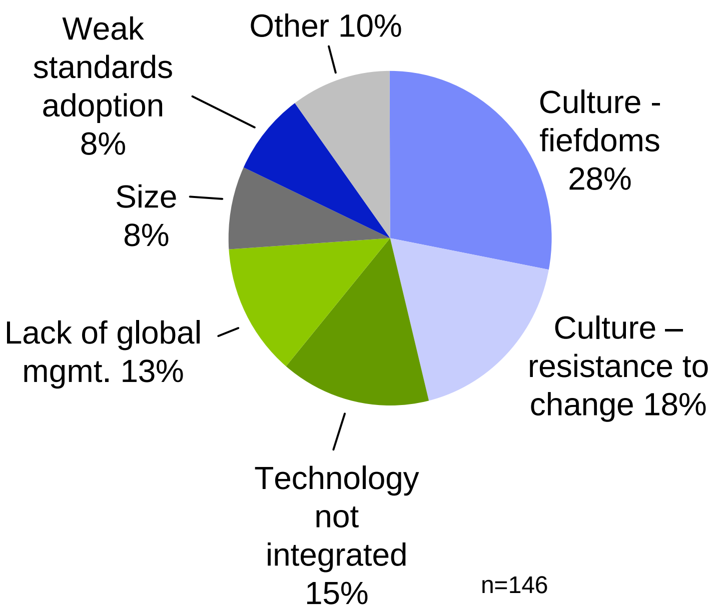
Source: Executive Surveys; Primary interviews; IBM Institute for Business Value analysis

Results

# Managing culture will be a key enabler to becoming globally integrated and enabling successful global delivery models

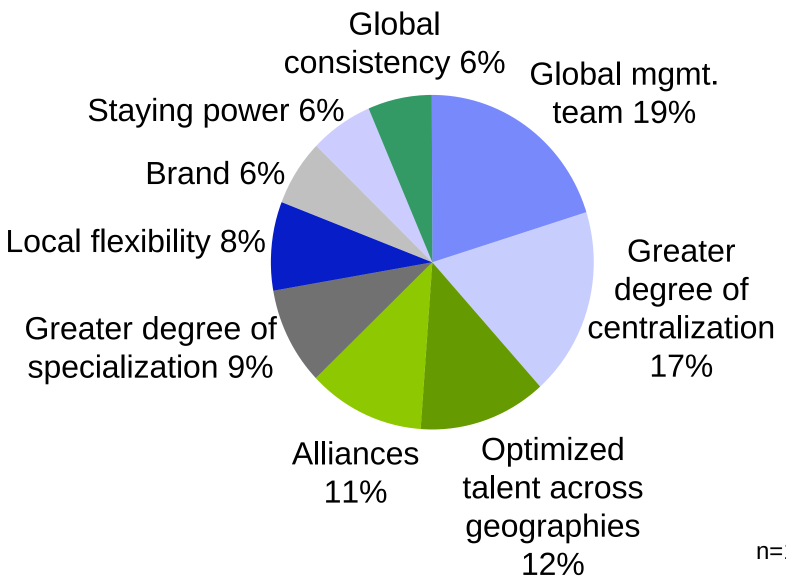
### Barriers to Becoming a Global Integrated Organization

*(Percentage of Survey Respondents[1])*




### Attributes Of The Globally Integrated Enterprise Requiring A Cultural Mindshift

*(Percentage of Survey Respondents[2])*




Note: [1]Executives asked: What are the largest barriers preventing globalization; [2]Executives asked: What are the winning attributes of a globally designed organization
Source, Primary Interviews, IBM Institute for Business Value analysis

# Firms must determine how prepared they are to take advantage of global opportunities and compete against new global players

## Key Considerations

- To what degree are you able to quantify the opportunity of going global? Opportunity cost of not going global?
- How will you specialize around what clients will pay for, given your capabilities?
- How will you learn to harness the power of global assets, greater agility and more open alliances to profit from globalization?
- How will you overcome the cultural barriers that often prevent firms from specializing and becoming more globally integrated?

## Agenda

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Appendix

# Dramatic change fueled by globalization will require a significant mindset shift

## Definition of Globalization and Example Industry Statistics

**Globalization is defined at the macro level as the extent of investment, trade and manufacturing moving beyond domestic borders, and at the micro level as the ability to strategically and swiftly capture value regardless of geographic and organizational boundaries**

***Butterfly effect is no longer centered on the US markets considering the February 27th worldwide downturn triggered by China***

***In 2006, China and London surpassed New York in IPO listings for the first time in history[1]***

***Asia's share of world GDP is restoring: share was 59% in 1880, 20% in 1950, 27% in 2007, 34% in 2025***

***Rolls-Royce Beijing had the highest sales in the world for the first time in 2006***

***In 2006, the number of individuals in the Middle East with more than $1 million in financial assets climbed 10% to 300,000. This is expected to rise to 1.8 million by 2010***

***India has the highest number of billionaires in Asia, elbowing Japan into the second spot, according to Forbes' 2007 rankings***

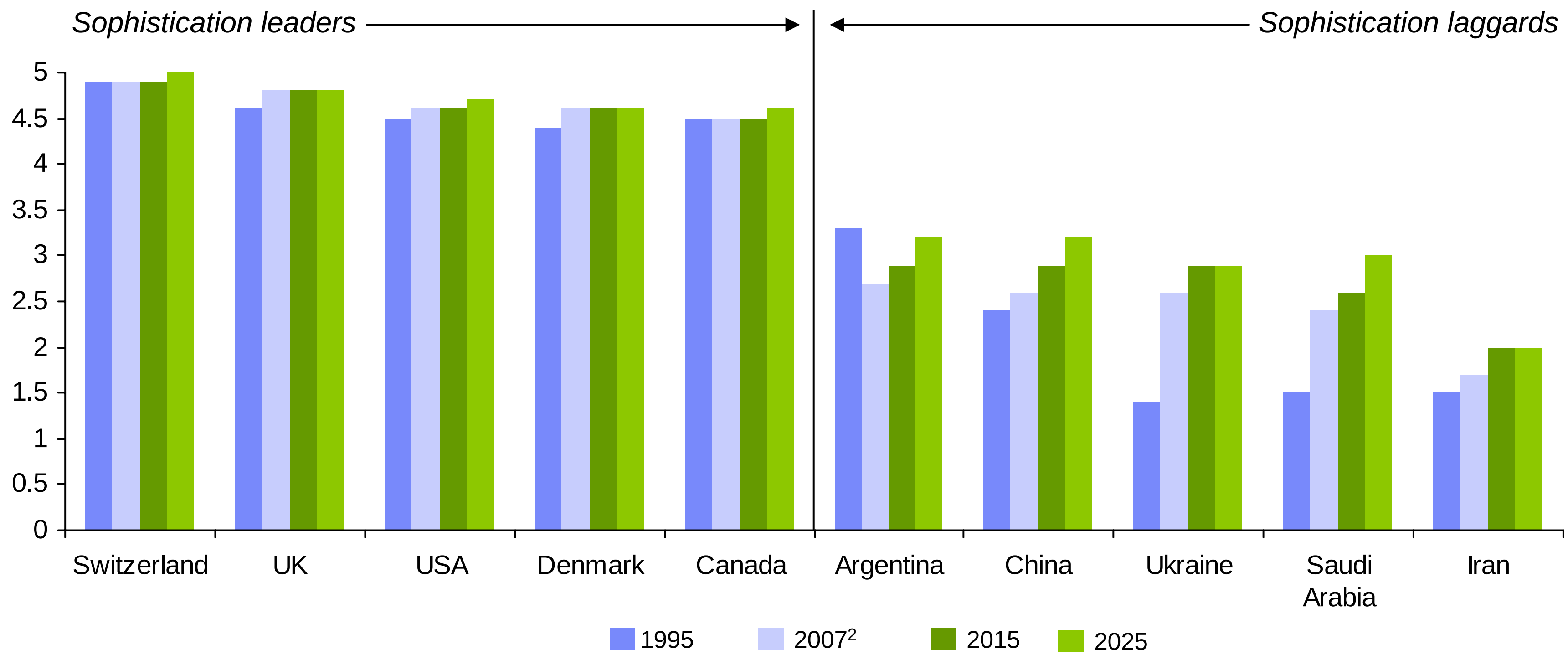
Note: [1]Deal value of China's three largest exchanges: Shenzhen, Shanghai, and Hong Kong, amounted to $53 billion in 2006. This surpassed UK at $48.3 billion and the $45.8 billion produced by the combined NYSE and Nasdaq; Asia share is measured in nominal GDP, data is from HSBC report and EIU Macro Model; Competition – this is nominal GDP annual compounded growth rates. Source: Deal value from Big Board, WSJ Online December 2006; billionaires from http://www.financialexpress.com/fe_full_story.php?content_id=157340; Rolls-Royce is from Rich Chinese Fancey Luxury Cars, WSJ Online, April 2007; Middle East millionaires from "All that glisters…." *The* Economist. December 16, 2006. IBM / EIU Macro Model, 2007; IBM Institute for Business Value analysis

Appendix

# The pace of globalization will be influenced by levels of country sophistication

## Sophistication Factors of Financial Sector, 1995, 2007, 2015, 2025

*(Sophistication[1] Index Rankings)*




Note: [1]Sophistication is measured on a scale of 1-5 where 5=most and 1=least, sophistication factors include interest rate spread, market distortions, open-ness to foreign investment, open-ness to product creation, use of indirect instruments, access to financing, monetary stability, regulation quality, liberalization, market capitalization, refer to appendix for methodology; [2]Rankings based on highest and lowest countries as of 2007
Source: IBM / EIU Macro Model, 2007; IBM Institute for Business Value analysis

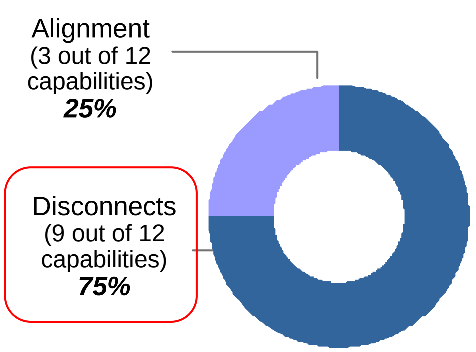
Appendix

# Introverted organizations will be harder pressed to profit from capital shifts

## The Need to Be Extroverted

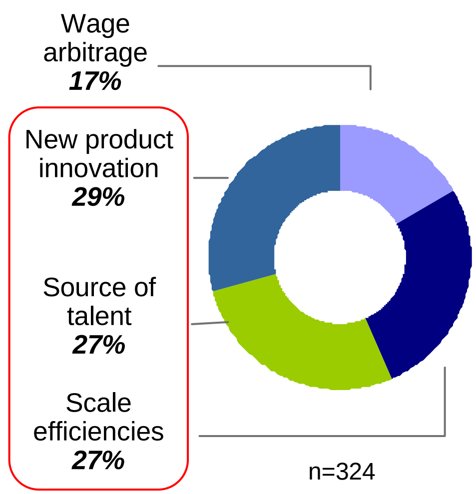
*(Percentage of Survey Respondents)*

### Firms Lack Understanding of What Clients Value Most[1]



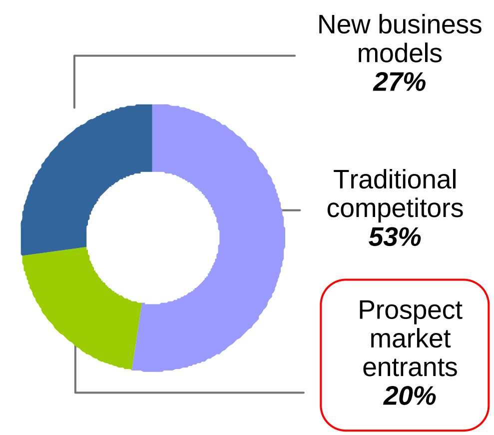

n=479

### Benefits of Partnering Extend Beyond Pure Wage Arbitrage[2]




n=324

### Changing Nature of Competition Demands Global Market Focus[3]




n=629

***We are the most introverted industry in order to keep information proprietary." – Senior Strategist, Investment Bank, London***

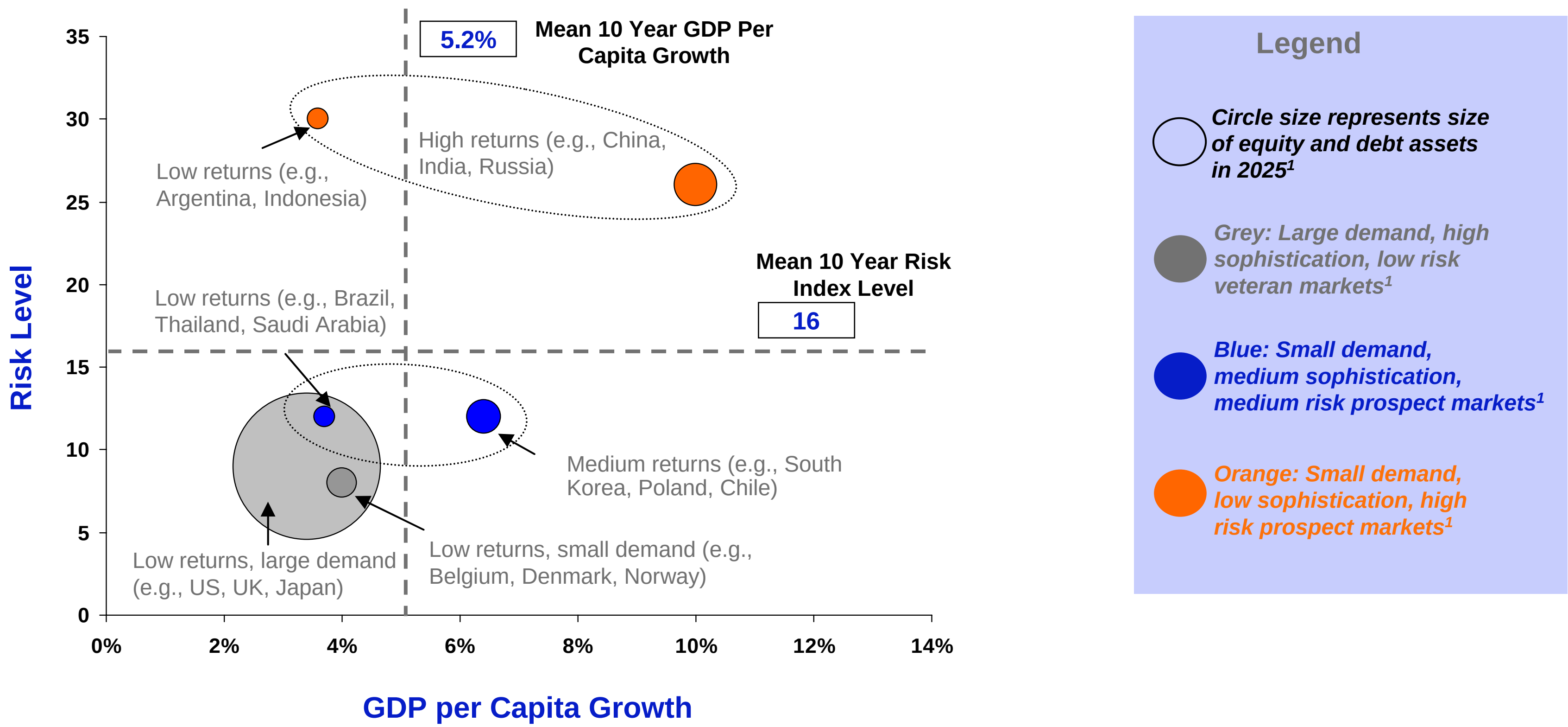
Note: [1]Executives asked: What will your firm (does your client) pay a premium for in a more global financial market; [2]Executive asked: What benefits do you expect your firm to derive from specializing and building global alliances; [3]Executive asked: Which type of organizations do you think will present the largest threat to your firm's business model in the future

Source: IBM / EIU Survey, 2007; IBM Institute for Business Value analysis

# Not all markets are created equal

## Projected Risk and GDP Per Capita Return, 1995-2015




Note: [1]Veteran includes US, Japan, France, UK, Germany, Blue prospect includes S. Korea, Spain, Poland, Ireland, Greece, Mexico, Chile, Orange prospect includes China, Russia, Ukraine, Iran, India, Turkey

Source: IBV profit map model; IBM Institute for Business Value analysis

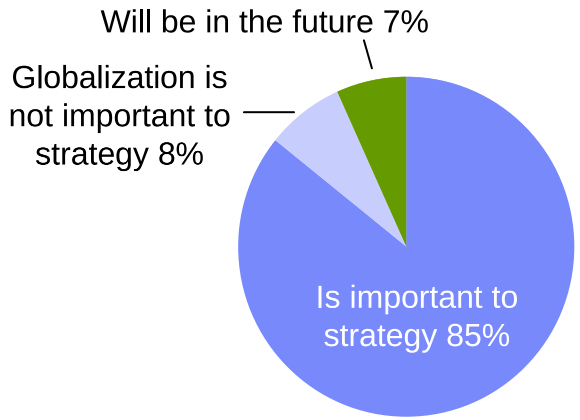
Results

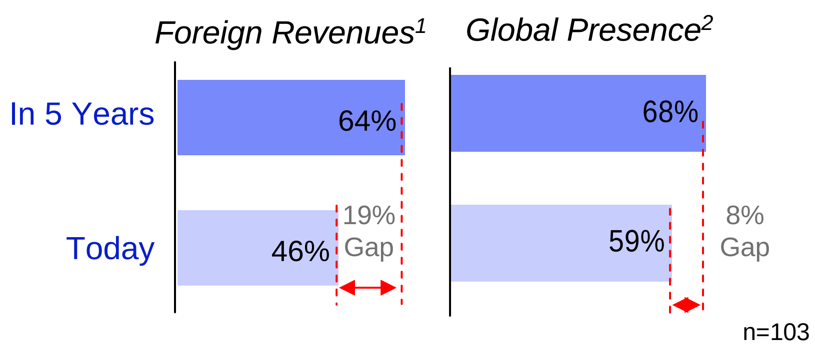
# This will become increasingly critical as clients extend their focus beyond domestic borders

**Eradicate disconnects**

## Corporates Pursuing Global Strategy, Revenues and Footprint

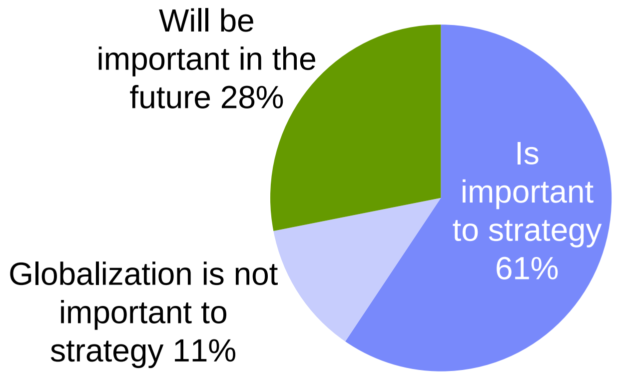
*(Percentage of Survey Respondents)*

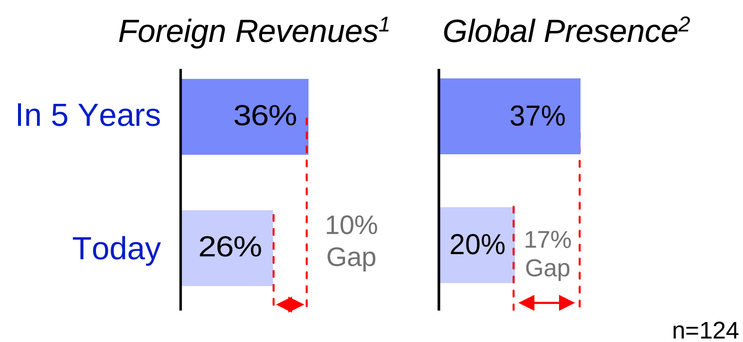



## Asset Managers Pursuing Global Strategy, Revenues and Footprint

*(Percentage of Survey Respondents)*



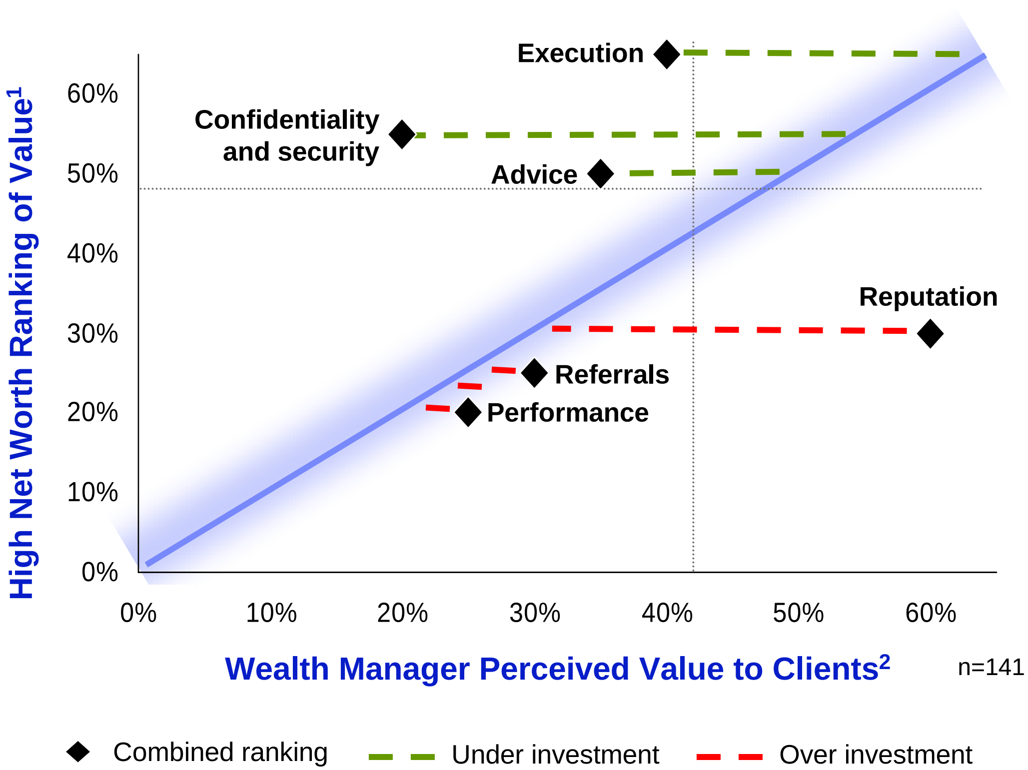




Note: [1]Foreign revenues is defined as revenues over 50% generated outside domestic market; [2]Global presence is defined as presence in more than 20 countries
Source: IBM / EIU Survey, 2007; IBM Institute for Business Value analysis

# However, most firms struggle to understand what clients will value most in a more globally networked economy

## High Net Worth vs. Wealth Manager Disconnects

*(Percentage of Survey Respondents)*




## Interpreting the Disconnects

- Clients are emphasizing the importance of superior execution and the fact that they will pay for this in the future
- Clients point out the need for confidentiality and security as well as high quality investment advice
- Clients select on the basis of quality of client service and delivery versus image, which the wealth managers view as paramount
- Clients view performance as the least important factor

Note: [1]Executives asked: What will your firm pay its financial service providers a premium for, HNW is defined as an investor with investable assets of more than $1 million; [2]Executives asked: What will your clients pay financial markets providers a premium for

Source: IBM European Wealth Management Report, 2005; IBM Institute for Business Value analysis

Appendix

# Firms will leverage key capabilities that accelerate cultural integration and drive enhanced value

## Top Drivers Of Shareholder Value Creation In a More Global Financial Market

*(Percentage of Survey Respondents, Rankings[1])*


## Value Creation Accelerators

***Superior Risk Management***
- Real-time global visibility of enterprise risk positions across all assets classes via executive dash board

***Deal Team Collaboration***
- Tools for virtual teaming among global teams – maximize knowledge and skills
- “Virtual deal-team”

***Superior Execution***
- Global “best price” execution platform that supports Regulation, e.g., NMS (U.S.), MiFiD (Europe)

***Service Excellence***
- Globally integrated client management with distinct service policies in each country, yet ability to provide a global view

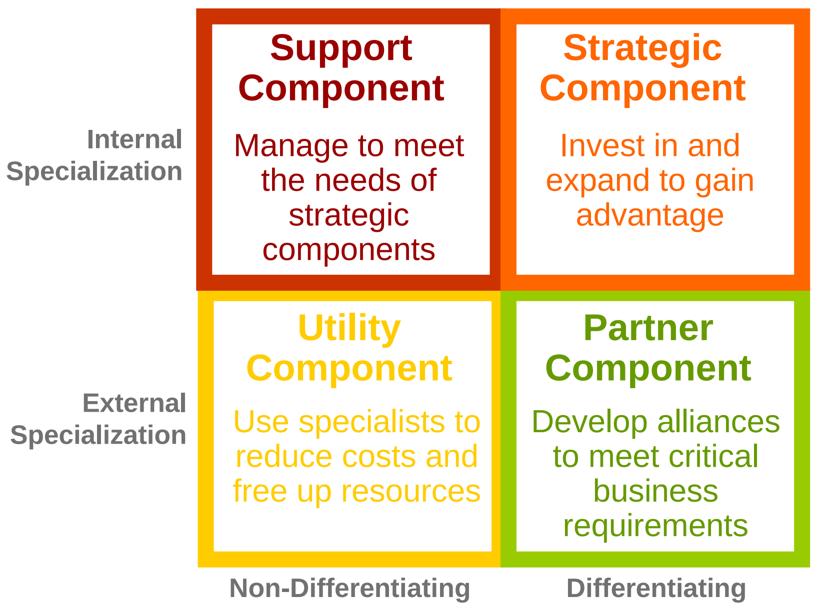
***Knowledge of the Client***
- Single view of client relationship globally across the service provider’s entire organization

Note: [1]Executives asked: Which attributes do you think will be most critical to creating shareholder value in a more global financial market? Which type of firm will have an advantage?
Source: IBM / EIU Survey; IBM Institute for Business Value analysis

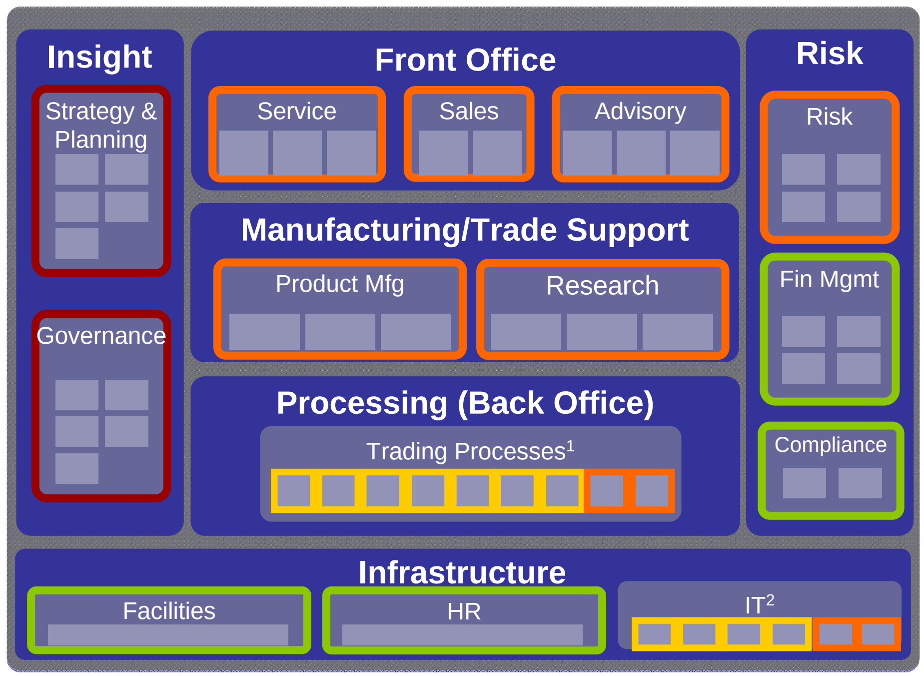
# Firms must learn to specialize

## Focus on core strengths and partner for everything else

### Business Component Decision Matrix




### Component Decisions Applied to FM Firm (Illustrative)




Note: [1]Trading processes in this scenario would be leveraging the utility for some but not all trading processes;[2]IT infrastructure in this scenario would be leveraging the utility for some but not all IT components

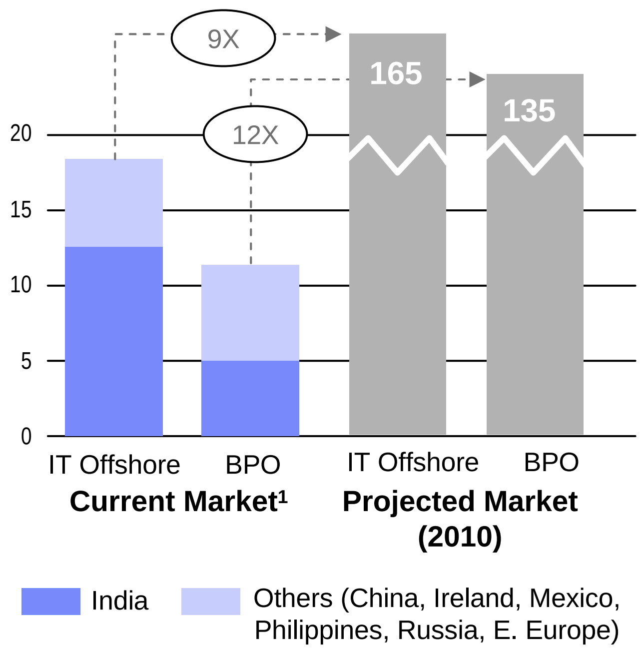
Source: IBM Institute for Business Value analysis

Results

# The quest to optimize global resources and achieve wage arbitrage will drive heated growth in offshoring, particularly, from key markets

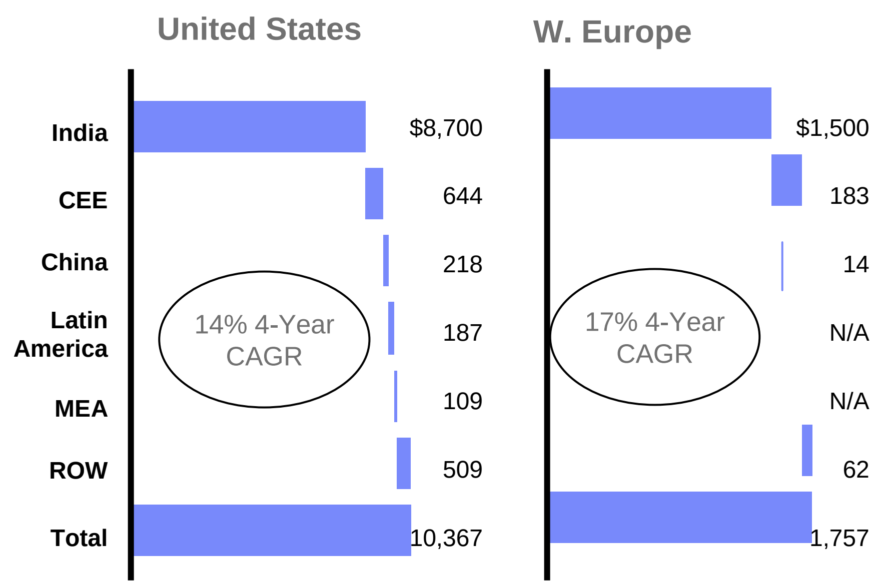
## Growth in Global Service Delivery Market

*(USD $ Billions)*




## Example: IT Offshore Services Imported by the US and W. Europe

*(USD IT Imported Services Ranking, Millions)*




[1]Current Market: April 1st, 2004 to March 31st, 2005

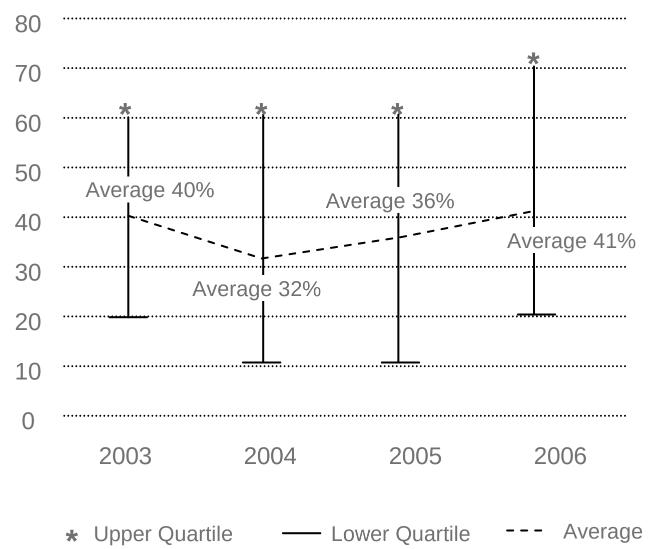
Source: NASSCOM; McKinsey; IDC, 2005

Results

# Firms are increasingly focused on skill arbitrage as a way to increase leverage of global assets…

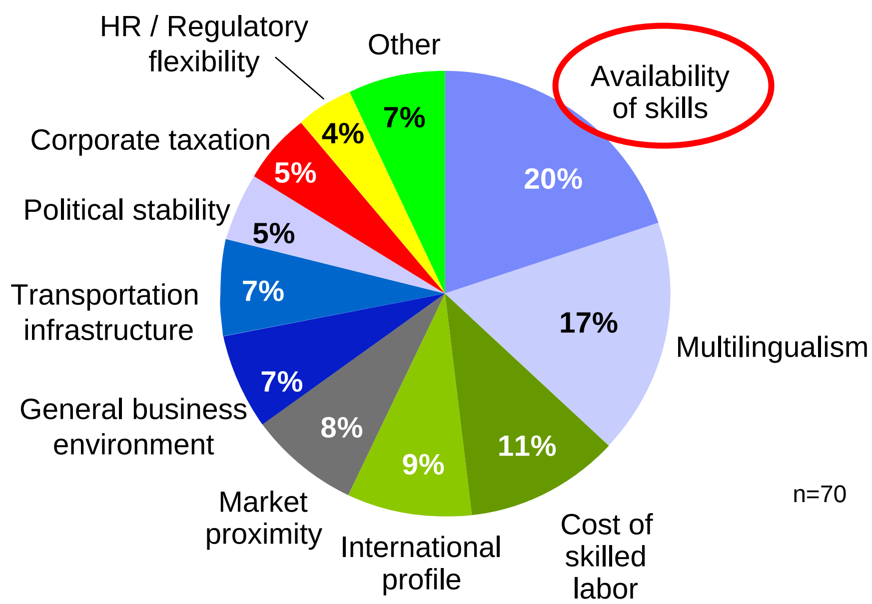
## Cost Savings Achieved by Offshoring in Financial Institutions

*(Percentage of cost savings[2])*




## Top Factors in Selecting an Offshore Location

*(Percentage of Financial Market Respondents[1])*



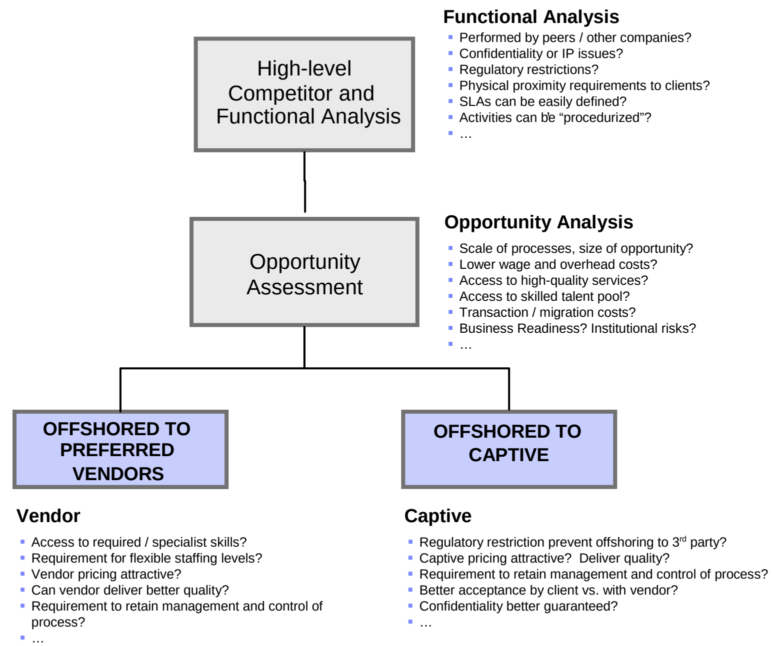

Note: [1]Executives asked: When evaluating a location, what factors do you place the greatest emphasis on?
Source: IBM BCS Plant Location International, Global Location Strategy Services; 19 Mar 03. [2] Deloitte Global Financial Services Offshoring Report, 2007

# …and are continuing to reassess the balance between captive vs. vendor services

## Financial Markets Offshoring Landscape In India

| | Captive | Vendor |
|---|---|---|
| Front Office | ▪ Trade Analytics<br>▪ Credit Risk Management<br>▪ Market Risk Management<br>▪ Mortgage Originations<br>▪ Mortgage Pool Analysis<br>▪ Equity Research<br>▪ Quantitative Research<br>▪ Macroeconomic Research | ▪ Financial Modeling / Quant Research<br>▪ Company / Equity Research<br>▪ Fixed Income Research<br>▪ Investment / Market Research<br>▪ Legal Services<br>▪ Credit Decision Support<br>▪ CRM Analytics |
| Operations & Infrastructure | ▪ Financial Accounting<br>▪ Cash Management<br>▪ Treasury Operations<br>▪ Reconciliations<br>▪ Securities Settlements<br>▪ Derivative Settlements<br>▪ Mainframe Support<br>▪ IT infrastructure<br>▪ Accounts payable | ▪ Billing and Accounting<br>▪ Treasury and Tax Mgmt.<br>▪ Data Analytics<br>▪ Financial Operations Risk Mgmt<br>▪ Price Benchmarking<br>▪ Credit / Rates Derivatives<br>▪ Reference Data Management |

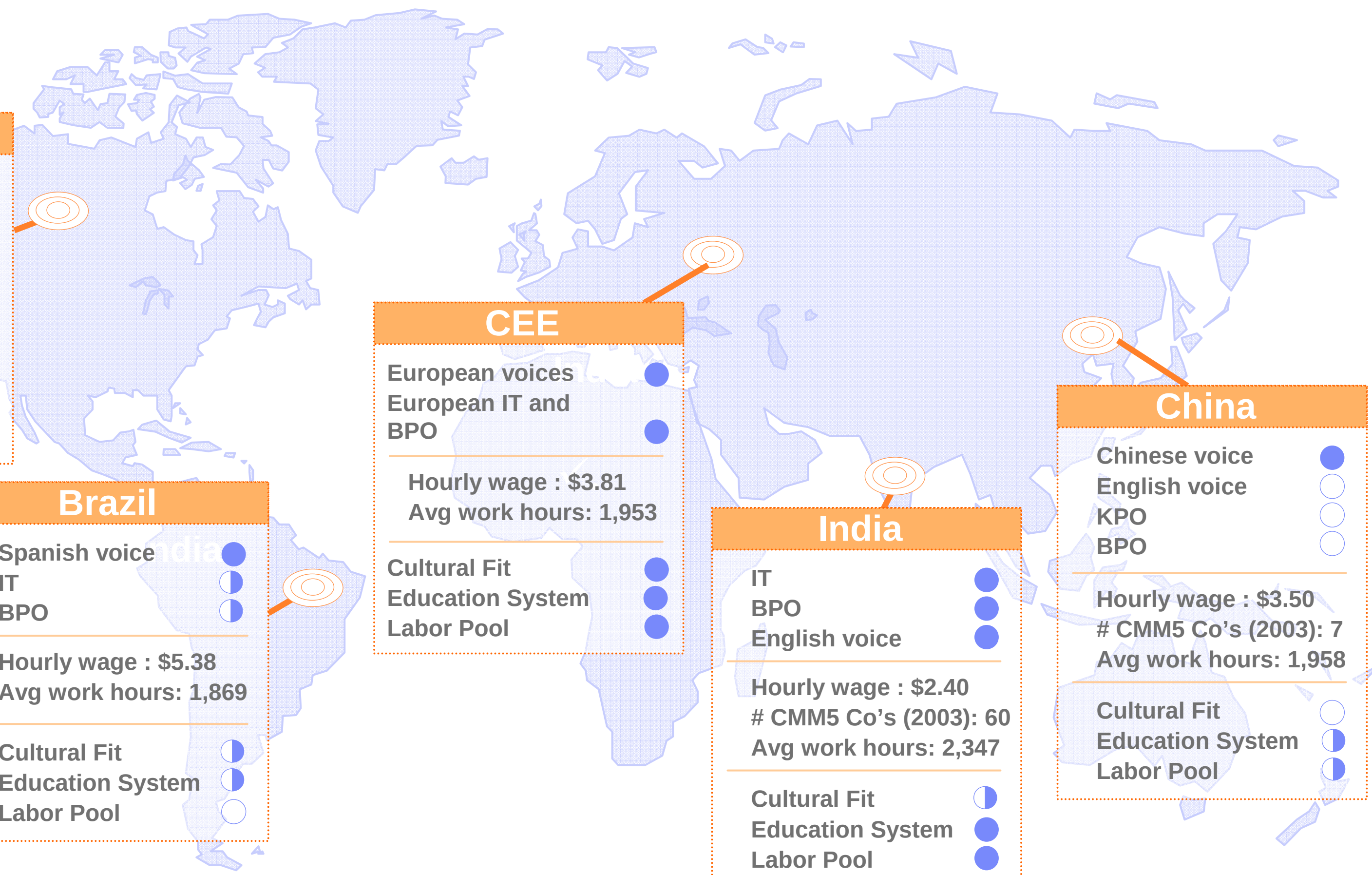
## Example Framework for Global Deployment Decisioning




Source: Deutsche Bank, Opera Solutions Analysis

# A number of factors will drive the decision to consider other markets

## Comparison of Offshore Locations



### Canada

English voice ●
IT ●
BPO ●

Hourly wage : 7X EMs
Avg work hours: 1,869

Cultural Fit ●
Education System ●
Labor Pool ●

### Brazil

Spanish voice ●
IT ◐
BPO ◐

Hourly wage : $5.38
Avg work hours: 1,869

Cultural Fit ◐
Education System ◐
Labor Pool ○

### CEE

European voices ●
European IT and BPO ●

Hourly wage : $3.81
Avg work hours: 1,953

Cultural Fit ●
Education System ●
Labor Pool ●

### India

IT ●
BPO ●
English voice ●

Hourly wage : $2.40
# CMM5 Co's (2003): 60
Avg work hours: 2,347

Cultural Fit ◐
Education System ●
Labor Pool ●

### China

Chinese voice ●
English voice ○
KPO ○
BPO ○

Hourly wage : $3.50
# CMM5 Co's (2003): 7
Avg work hours: 1,958

Cultural Fit ○
Education System ◐
Labor Pool ◐

## *IBM Institute for Business Value*

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***Identify and assess strategic alternatives***

***Quantify the expected return on key initiatives***

***Formulate roadmaps for moving forward***

***Determine the best metrics for measuring success.***

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