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How to win the mid-market

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Mid-market corporates in Europe are set to become a source of increased focus for multinational and domestic banks alike. The experience of US banks points strongly to a set of critical factors required to successfully compete for the segment.

In Europe, the provision of treasury management services has traditionally been focused on large corporate firms and financial institutions - customer segments with the volumes and complex, multinational needs to command the attention of the large multinational banks who dominate this sector. Meanwhile, domestic-only banks have been content to serve mid-market firms (broadly €10m - €300m in annual sales, though definitions vary considerably) who have quite different needs from large corporates.

Recent trends in Europe are leading to an increased interest from banks of all sizes in the mid-market segment. A sustained period of economic stability and benign economic trends have encouraged the growth of mid-market firms (by 13% per annum in recent years according to the European Commission[1]). As their businesses grow, mid-market firms are also seeking the more advanced services typically associated with large corporates, such as multi-bank cash pooling.

Moreover, the mid-market can be very profitable for banks. Profit margins are typically higher for mid-market firms as they cannot secure significant volume discounts and are somewhat less price-sensitive. In the US, we observe margins for mid-market firms to be 30-40% versus 20-30% for large corporates. In fact, our research in the US showed that the mid market segment was often the largest contributor to overall profitability to a typical bank. For one US bank client, the mid-market comprised 15-20% of treasury management relationships, but contributed 50-60% of total profits.

Large multinational banks are considering, if not already entering, the mid-market segment. The large corporate segment in which they play is concentrated, mature and competitive, and large banks see it as a natural move to extend their services, appropriately tailored, into the mid-market. ABN Amro is one example, leveraging its successful experience in the US (where it acquired LaSalle bank, long considered one of the best players in the US mid-market). Domestic-only banks who are dependent on their mainly small-to-mid-market clients will need to up their game to defend market share.

The development of the Single Euro Payment Area (SEPA) is likely to accentuate banks' growing interest in treasury management services for the mid-market. The big players will need more volumes to offset the expected higher operating costs of a SEPA environment, and will consider growth opportunities in the mid-market to do so. Other domestic-only banks will need to re-think how they can offer treasury management services profitably under greater margin pressure.

The US Experience: Banks Converging on the Mid-market

If this sounds familiar, it is probably because you heard a similar story about the US. The US banking sector was, similar to Europe today, geographically fragmented, but along state lines rather than national lines. Local regulations and state control of banking licenses were high entry barriers, leading to many small single-state banks (the state of Illinois had over a thousand). Deregulation over decades led to the creation of large state-wide banks, with consolidation accelerating after 1994 with the passing of the Riegle-Neal Interstate Banking and Branching Efficiency Act, which effectively permitted banks to enter and compete in any state.

Large and small US banks converged on the mid-market and learnt that treasury management services were an important component of the overall offering to win and retain market share. Tellingly, banks did not compete merely through cutting prices on existing services but innovated their products, service delivery, channels and organisations to differentiate themselves and maintain margins. In the past five years, clear mid-market winners have emerged, including LaSalle (ABN Amro), Wells Fargo and Bank of America.

While there are clearly notable differences between the US and Europe (e.g., the still important, albeit declining, role of the cheque in the US as a corporate payments instrument) - and notwithstanding the diversity of the European context - we nonetheless believe it is worthwhile for European banks to understand what has set the successful US banks apart. There are relevant similarities between the US and Europe which make lessons transferable. In both, mid-market firms are largely dependent on their banks for credit and therefore often put up with very basic treasury management services, and often a low quality of service in implementation and customer support. Core product sets are similar (e.g. ACH-type payments, sweeping, information reporting). The Internet (which became the key delivery channel for treasury management services to US mid-market firms) is widely adopted among mid-market firms in Europe (80% have broadband access and 78% use the Internet for banking services[2]).

Key Characteristics of Mid-market Firms

The winning US banks really understand the product, service and relationship needs of mid-market firms - and tailor their approach and offerings to the segment accordingly. Some of the key needs that they have addressed are described below.

Many mid-market firms value cash management services more than credit

Our primary research in the US market shows that more than one-third of mid-market firms consider cash management services at least as important as credit, and one-in-four even choose their primary bank based on its treasury management services. However, it is still common practice for many banks to 'lead with credit' by default when selling to the mid-market. This is in spite of the fact that a mid-market firm has very different credit versus cash management needs depending on its business maturity and the nature of its business activities (e.g. cash intensity, investment needs, number and depth of supplier relationships). A one-size-fits-all approach should not be adopted when developing the appropriate product offer for mid-market firms.

Mid-market firms look for a few, strong bank relationships

US mid-market firms value a bank's long-term commitment more highly than large corporates as they cannot command the same attention or volume discounts as their larger peers. In return, mid-market customers are willing to shift their other product relationships to the primary bank, and will buy new products from the bank even if they are not as competitively priced. US mid-market firms have fewer bank relationships than large corporates, typically two to three, compared with between six and nine bank relationships per firm respectively. In a survey of US firms' buying behaviour, 77% of mid-market firms bought new services from existing banks while only 19% switched providers of cash management services because of lower prices[3].

Developing strong relationships and the ability to exploit them requires investment, which many banks are not willing to make for smaller customers. These banks are less effective at tracking product penetration and cross-selling, leading to lost revenue opportunities. For one such US bank client, we found that only 50% of its mid-market customers used its cash management services (which were not markedly inferior to those of its competitors) versus the industry average of 70%, missing out on a 10-20% revenue uplift per customer.

Core services must be well-integrated, accessible and easy to use

Mid-market firms typically have small, multi-functional treasury/finance teams and relatively simple treasury management needs. Many want products that can free up their time to concentrate on the actual work of running the business. However, the treasury management operations of most banks are set up to provide advanced customised solutions for large corporates who have more sophisticated needs, large teams of treasury specialists and complex bespoke systems. Many banks often inadequately serve mid-market firms with platforms meant for their retail customers.

Mid-market treasurers/CFOs want services that can help them in two main ways. The first is to get better visibility of their accounts and transactions and the second is to automate repetitive tasks, saving time as well as reducing user error.

Treasurer/CFO comments such as the following are common:

"I need to be able to see what is happening and what has happened in all of the accounts."
"I want all the information available online through a single sign-on." "To initiate draws or pay downs, I currently have to pick up the phone... I wish this could happen automatically"
"It would be great if the system was smart enough to check my data input... or auto-fill my company's information

Comparison of mid-market versus large corporate needs

	Mid-Market	Large Corporate
Customer Profile	• Small multi-skilled teams • Willing to adapt to best practices • Prefer simple integrated solution • Relationship manager (RM) often initiates sale	• Large teams, treasury and IT specialists • Do not want their operations disrupted • Prefer sophisticated integrated solution • RM and product specialist sell together
Customer Service Needs	• Quick, hassle-free on-boarding • Seamless service across channels: self-service VRU, CSRs, Internet • Immediate support from a CSR as fall-back to online service • Proactive follow-up on enquiries	• Substantial implementation time expected • High level of support due to size and complexity of products and relationship • Dedicated customer service team, product experts • Expects to do simple self-service tasks to improve efficiency
Electronic Channels	• Low cost-to-serve Internet is becoming *primary* electronic transaction channel	• Mainly specialised and often proprietary networks (EDI, SWIFTNet, etc.)
Parity Competitor Offerings	• Single view of accounts • Electronic and paper payments, lockbox • Single sign-on, self-administration of entitlements • Simple sweep services • Loan Reporting, Pay-Offs/Draw Downs • F/X and fixed-income trading; short-term investment options	• Advanced reporting, integrated into in-house ERP and financial systems • Multi-bank global cash management (netting, sweeping, cross-currency pooling) • High degree of "straight through processing" • Multi-bank platforms for F/X and fixed-income trading • Multi-bank loan collaboration tools

Source: Diamond research.

Mid-market firms need responsive service and regard it as a key indicator of bank commitment

Compared with large corporates, mid-market firms can be more acutely affected by single instances of poor service delivery. A few delayed collections can significantly impact their cash flow, while invoices that do not get paid on time may affect delivery of critical supplies. Mid-market firms have fewer resources to resolve issues like fixing broken payments, and are more reliant on their banks for support.

However, in the US some banks did not put in place enough well-trained customer service staff or processes to support mid-market firms. A common mistake was to focus too heavily on self-help features to keep costs down. While mid-market firms have proven willing to use online sources first, they expect to be able to fall back on prompt offline help. One treasurer told us, quite typically, that "when I need offline help, I need it now and want someone to answer the phone". Banks who did not address this were perceived by mid-market firms as not committed to them as customers, and were more likely to switch banks. A survey of US mid-market firms revealed that they perceived responsiveness to resolving problems as more important than even credit availability from a bank.

How to Succeed in the US Mid-market

So how did successful US banks address these needs? Improving revenue and retention with superior products and service delivery was key but not enough - banks had to significantly adjust back-office and IT operations to keep costs down to serve a larger number of smaller customers. Four key success factors that are common to many if not all of the successful banks are described below.

1. Monitor and drive sales performance based on relationships, not merely products

For banks to better understand and segment the mid-market customer base, they need to focus on customer relationships instead of products. In banks that performed well in the US mid-market, managers were rewarded based on relationship profitability and share of balances, rather than sales volume or profitability. This required training relationship managers to identify the cash management and credit needs of their customers (e.g. by examining net cash positions and purchase-to-pay cycles) and raise their knowledge of cash management services (many tended to have a credit-only background). American National (later part of Bank One) was the first to refocus its mid-market team in these ways, and was quickly followed by others like LaSalle when it proved a success.

2. Offer a well-integrated portfolio of core services online

Banks that did well in the US mid-market also offered a well-integrated set of core treasury management services accessed via a Web-based front-end. Offerings supported consolidated viewing of accounts (e.g. single sign-on for all products), updated frequently (same-day postings) and enabled customers to self-administer (e.g. security and authorisation levels). There were also simple features that really stood out by helping customers save time and eliminate manual paper processes (e.g. alerts when payments were received, auto-fill for electronic forms).

In the US, well-designed and marketed online service offerings proved highly successful. Wells Fargo, for example, converted 30% of its mid-market customer base to its new online service in 18 months while reducing attrition. Further benefits accrue in terms of the reduced costs to centrally introduce ongoing changes in a web-based delivery environment (e.g., to accommodate Patriot Act requirements).

An online service has become a competitive prerequisite - all major banks offer one and 70+% of mid-market firms use them. As the core online offer began to commoditise, leading banks continued to add new services to grow revenue and increase 'stickiness' (e.g. foreign exchange and investment management, electronic bill presentment and invoicing).

In Europe, where there is a greater diversity of business rules which need to be accommodated, banks can consider partnering with a software vendor to offer a combined package of treasury management software and services. Vendors such as SAP, Oracle and Sage sell ERP and finance software that firms use and have to integrate with a bank's systems. Vendors can offer a bank an additional distribution channel and sector-specific solutions, while banks can offer the follow-on processing and customer support services.

Customers would benefit from a comprehensive solution that is quick to deploy, has fewer teething issues arising from incompatibility between their software and the bank's systems, and potentially better end-to-end straight through processing.

3. Upgrade service delivery while maintaining cost efficiency

In the US, banks quickly found that a complicated and time-consuming on-boarding process was a major source of customer dissatisfaction and cost. Streamlining the process helped the customer get started quickly and reduced the number of support calls arising from teething issues (simple account-opening is typically an over-night process now). Wells Fargo pioneered the practice of sending multi-functional integration teams to customer premises to integrate their services with more complex customer legacy systems.

Once on board, customer service support becomes the major cost driver. Some US banks achieved a balance of high-quality service and cost efficiency in a number of ways:

- Offer self-help features extensively online, backed up by a shared pool of customer service agents, to keep costs down while maintaining responsiveness (Key Bank, Merrill Lynch).

- Provide a single point of contact across the customer's life cycle and across products - typically a regional/national RM or RM Assistant (Northern Trust, JPMorgan Chase).

- Integrate customer service across channels, since mid-markets tend to use several channels.

- Put in place processes to ensure customer enquiries are followed up to ensure timely advice and resolution (e.g. hand-offs between staff on different shifts are typical weak points).

- For customers with more complex needs, an RM could transfer support to a product specialist to be more responsive, freeing up his time for other customers (Bank of America, PNC Bank).

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Key success factors in serving the US mid-market

	To focus on	Rationale
1. Relationship selling, not "product push"	• Don't just "lead with credit" – understand customers' cash management and credit needs • Customer profitability, share of balances, attrition • Incentives and training of sales teams	
2. Offer online portfolio of core services	• Well-integrated core services, not product depth • Quick access to information, ease of use • Add value-added services as core commoditises • Consider partnering with software vendors	• Small multi-skilled finance teams • Relatively simple treasury management needs • Internet is low cost-to-serve channel • Vendors can offer key component of the overall solution and additional routes to market
3. Upgrade service delivery	• Streamline on-boarding • Self-help upfront, back up with CSRs • Responsiveness and quick follow-up are key • Consider outsourcing if subscale	• Slow on-boarding impacts a bank's customer satisfaction as well as cost • Impact of bank's poor service can be significant to customers' profitability • Re-engineering in-house and gaining sufficient scale can be challenging
4. Re-design IT to support scale and new capabilities	• Integrate what exists, rather than build something new where possible • Focus on core services / infrastructure upfront • Plan for extending functionality later on	• Functionality for large corporates can be re-purposed for mid-markets • Core services commoditise quickly, expect to develop new services to maintain margins

Source: Diamond research.

4. Re-design technology architecture to support scale and new capabilities

It was not unusual for banks to have multiple legacy and newer systems supporting their treasury management services, developed over time in a stovepipe fashion, and with functionality designed to meet the needs of large corporates. Many were costly to operate as well as inflexible to support new services for the mid-market effectively. Some banks preferred to serve mid-market firms with retail banking systems, often falling short of customers' expectations but being well within the bank's ability to deliver.

Some US banks have bitten the bullet and consolidated their technology architectures. This involved migrating to a single enterprise application integration (EAI) layer for all products while preserving the multiple legacy systems underneath (e.g. LaSalle, PNC, Northern Trust). This enabled banks to give their products a standardised look and feel, reduce the costs associated with running more complex architectures and make it easier to add new applications later. It also required relatively modest upfront investment (compared to replacing whole systems) by re-using existing technology assets.

In addition, leading banks planned ahead to allow them to extend their functionality when required. Banks that bought new platforms ensured they included robust development environments, tools and vendor support. Others preferred to tweak their existing development capability by retraining teams that were accustomed to developing applications for large corporates (and keeping overall development costs down).

The European mid-market segment is set to become a source of increased focus for multi-national and domestic banks alike. This is good news for mid-market firms and - given the value opportunity - good news for the banks that can properly equip themselves to profitably serve them. The US experience, we believe, offers useful lessons - and points to four critical dimensions which banks would do well to incorporate in their strategies to pursue the segment.

Based on growth of firms with 50-249 employees and revenue of €10m - € 50m in the EU19 from 2003 to 2005. 'Observatory of European SMEs', European Commission, 2005.

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About Diamond

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