

LEVELING THE
PLAYING FIELD:
HOW SMALLER
BANKS ARE GIVING
THEIR LARGER
COUNTERPARTS A
RUN FOR
THEIR MONEY

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INTRODUCTION

The banking marketplace in the U.S. is drastically over-crowded. With close to 9,000 banks you might even say it's saturated. However, much of the business in the corporate sector is concentrated with a few key players. Today almost 50% of cash management revenues are generated by the country's five largest banks: Citigroup, Bank of America, JPMorgan Chase, Wells Fargo and Wachovia. By leveraging strong brands, customer footprints and extensive product portfolios, these banks have consistently won the business of large multinational companies as well as small businesses. However, things are beginning to change. This paper examines the changes that are now occurring in the market, and how banks of all sizes can best compete under these evolving conditions.

Many factors are contributing to the dramatic transformations occurring in bank to corporate relationships. Corporate customers have ratcheted up expectations of their financial institutions when it comes to improved service offerings that will make their day-to-day banking functions easier, less costly and less time-consuming.

Today's corporate banking customers are looking to their banks to provide more sophisticated benefits such as the ability to view account information online, streamlined payment services and a consistent and consolidated interface for viewing data, regardless of where they are viewing this information from in the world. Banks are reacting to these demands by turning increasingly to technology vendors that can help them bring services to market quickly and effectively. In the report, "IT Spending in Financial Services: A Global Perspective," Celent predicts spending on external software will rise to US \$8.9 billion by 2009.

As corporate customers develop more complex business demands, banks need to consider how they can most efficiently expand the scope of their product and service offerings, in order to retain current customers and win new business.

WHAT DO CORPORATIONS WANT FROM THEIR BANKS?

Fewer, Deeper Relationships - Corporate customers are looking to reduce the number of financial institutions with whom they bank. With a single bank to rely on for all of their needs, corporations can simplify their banking relationships and streamline accounting processes. For banks that are able to offer a competitive array of products and services, this is good news. Generally speaking, those customers bring in more business, are more profitable and more loyal. Aite Group estimates that cash management customers currently use an average of three to four products, an amount which is forecasted to reach five to six by 2009.

Payment Processing - Following on the heels of the rising adoption of online bill payment in the consumer banking world, outsourced payment processing has become a must-have for corporate customers as well. Corporations are increasingly turning to their banks to offload the tedious and time-consuming activities associated with payments – whether paper-based checks or electronic. Payment processing is a key area where banks can provide a high-value offering and differentiate their service. While the largest cash management banks offer payment processing services, this is not necessarily a standard offering for the rest of the banking community. However, this is one area where banks can provide differentiated service in a white-labeled manner, specifically in the areas of profitability and cost efficiency.

Single View of Cash and Risk - Corporate customers are looking for a consolidated, holistic, real-time view of cash. They no longer want to have to deal with multiple systems in order to access their various accounts, but instead they want a single, centralized platform. This requires tighter integration of product offerings and more sophistication on the back end.

Corporate customers are looking for a consolidated, holistic, real-time view of cash.

Banks offering the highest level of automation possible to corporate clients are ultimately the most desirable because they are assisting these companies in attaining STP through simplifying and consolidating critical functions, such as trade and cash management, as well as check-printing into one solution, thereby providing corporations with a single source for all of their banking needs.

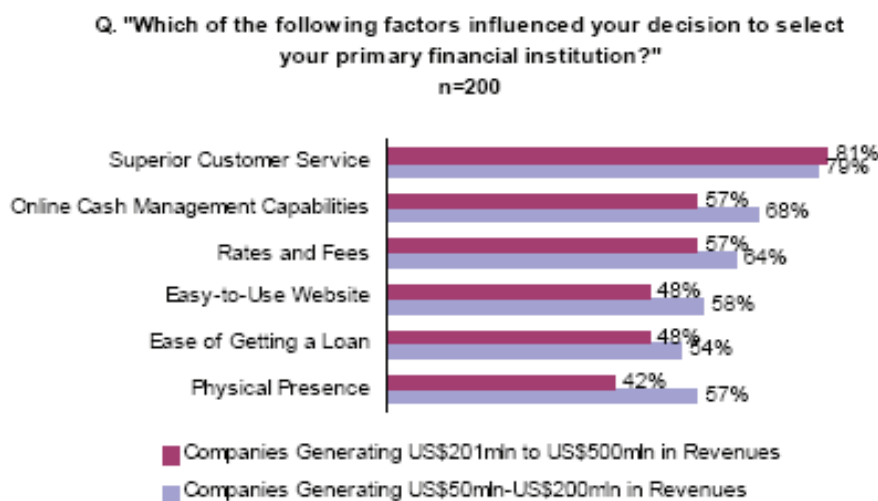
International Support - According to a survey by Aite, no longer are only the largest corporations doing business overseas and requiring global banking products, but mid-sized organizations are as well. Of banks surveyed, 40% stated that their middle-market customers are “very likely” to “extremely likely” to use global products and international capabilities. Whether leveraging correspondent banking, taking advantage of the ability to print and mail paper checks in another country, executing international wires, or other aspects of global trade, the provision of international capabilities is a distinctive growth area.

One Stop Shopping – Many customers are looking to outsource non-strategic aspects of their operations. Banks that can offer integrated solutions are competitively positioned to win business by being able to meet this demand. Outsourcing payment processing can help to significantly reduce time and costs expended on manual processes, such as data-checking and even stuffing envelopes with printed account information.

WHY DO CORPORATE CUSTOMERS CHOOSE ONE BANK OVER ANOTHER?

The U.S. in particular is a region that is heavily over-banked, and competition for customers is fierce. Given the demands of corporate customers referenced above, how can banks most effectively distinguish themselves in a crowded market?

Customer service is a definite consideration when organizations start shopping for a new banking partner. Results from Aite Group's February 2007 Middle Market Survey concluded that about 80% of mid to large corporations considered superior customer service a key differentiator when selecting a bank. While this is not the only factor, it's important to recognize how highly it is valued in the equation.



Source: Aite Group's February 2007 Middle Market Survey

In fact, today it is estimated that almost 60% of banks use technology primarily as a way to meet customer demands, as opposed to a way to improve customer service, which they view as the most important attribute for winning new business.

Robust online cash management capabilities are a vital consideration for corporations when choosing a bank, as transparency into account details and real-time cash visibility helps organizations to more effectively free up cash that may have been set aside for covering payments with clearing dates that were uncertain to the customer. With real-time visibility, customers are able to easily and accurately decipher when payments have been settled and therefore can allocate cash accordingly.

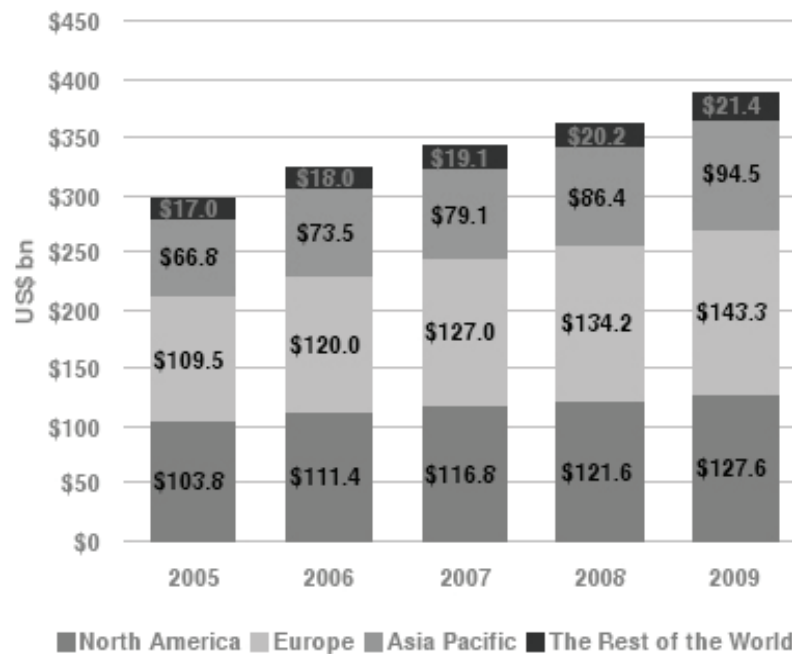
The ability to offer competitively priced services also factors importantly in the decision. The above-mentioned Aite survey also concluded that approximately 60% of mid to large corporations considered rates and fees to be a critical factor in

the selection process. Other top areas of concern for corporate customers include: a user-friendly Web site that is easy to navigate and displays an intuitive design, easy attainment of loans, particularly in the face of the credit crunch, and physical presence of a financial institution, including how well the brand or name is known throughout the industry.

HOW CAN BANKS RESPOND?

In the face of increased competition, banks of all sizes are recognizing the opportunities for fee-based revenues and cross-selling that exist in business banking products and services. Beyond the basic practice of lending and deposits, many banks today are expanding their offerings to include a broader array of fee-based services, such as asset management, wealth management, mortgage loan services, credit card services, trust services, brokerage services, financial planning services and corporate and investment banking services— to name a few. In fact, in the report, “IT Spending in Financial Services: A Global Perspective,” Celent predicted that global spending on IT products and services will grow to US \$386.7 billion by 2009, an increase of 6.3% from 2007.

Total Global IT Spending Snapshot



Source: Celent

Offering a more comprehensive suite of products and services to corporate customers increases 'stickiness' and makes it much harder for those customers to switch to the bank down the street who may be attempting to woo the customer away with a below-market loan rate, for example.

Increasingly, technology is playing a major role in not only leveling the playing field, but also in enabling banks of all sizes to effectively compete. Aite Group estimates that U.S. banks are now allocating 25% to 35% of their IT budgets to business initiatives. Tier 2 and 3 banks are motivated in large part by the threat of losing clients to larger banks that are ostensibly better equipped to offer these enhanced services. While the top five US cash management banks generate more than 50% of the total cash management industry revenues today, that market share is susceptible to erosion as small to mid-size banks refocus their energies on delivering a broader spectrum of service offerings to their customers.

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According to the Aite Group, more banks are in fact shifting away from in-house application development. With the exception of the top 10 banks, most of the 100 largest U.S. banks use vendor-built solutions, according to Aite. Often, outsourcing this function to technology providers is more affordable and efficient, enabling the bank to focus resources more effectively on what it does best. Increasingly banks in the U.S. are also taking a closer look at the ASP/hosted/on-demand model of service delivery, which allows greater speed to market and the potential to be more cost-effective.

For tier 2 and 3 financial institutions that do not have the available capital or the core competence to invest in developing and maintaining technology to support new banking services, outsourcing to technology providers can provide banks with the tools necessary in order to bring innovative payments products and services to market quickly and accurately.

Banks that work to develop new and innovative payments services to their clients are likely to gain the loyalty of current customers, as they are clearly conveying that their needs are valued. Corporate clients will be drawn to such a bank that puts the customer first through offering cutting-edge services, which will save them time and simplify processes. This, in turn, will increase customer loyalty.

The same theory holds true for acquiring new business. Corporations will consider establishing a relationship with a bank that offers competitive services, such as online banking or electronic account statement retrieval, over one that does not have any of the latest banking advancements in place.

Additionally, banks that provide flexible services capable of covering a wide range of a company's needs will likely boast a better customer retention rate, as it will be complicated and expensive for an organization to simply disconnect all of its ties to the bank and start from square one with a new financial institution.

It is not only beneficial, but becoming increasingly vital for financial institutions to gain automation if they plan to sustain their growth in the face of increased competition. Outsourcing payments technology to a vendor is a far more affordable option that will equip any financial institution with the tools necessary to offer new services to clients quickly, without having to rely on IT in order to build an in-house solution from scratch. Banks that choose to improve their current systems and IT infrastructure will, in effect, also reduce costs associated with meeting market standards and handling increased transaction volumes.

HOW ARE LARGE, MEDIUM AND SMALL SIZED BANKS RESPONDING?

Large-Sized Banks: Large banks are the most powerful when it comes to acquiring and maintaining customers, as they possess the resources necessary to offer the most cutting-edge products and services to their customers. In most cases, these larger scale institutions utilize a tri-pronged approach to interacting with customers, through multiple channels including phone, online and in person, covering all communication bases.

Additionally, these dominant financial institutions are more likely to have the available capital to invest in improving technology and training with the goal of enhancing their overall services. Generally, this segment is also more financially equipped to implement solutions supported by outside vendors, or even to build customized internal solutions. A major downfall, however, of building highly tailored internal systems is that a bank may still have problems relating to connectivity or an incompatibility with various systems. For this reason alone it is perhaps more beneficial for a bank to consider partnering with a vendor whose expertise lies in this area.

Another characteristic of larger financial institutions is that they have a diverse customer base, which may range from small 'mom and pop' shops to multi-billion dollar organizations. These banks are challenged with serving the widest range of customer types, as they have the broadest array of services. Straight-through-processing is desired by almost all companies - large, medium and even small - and by utilizing the strong centralized services that a large bank is able to offer, a corporation can more easily work towards acquiring this processing goal.

Mid-Sized Banks: Medium-sized banks are in a challenging position. They are not equipped with the same high level of internal technology resources or brand awareness as larger

banks, yet they inevitably seek to compete with them for business.

However, these middle tier banks are increasingly finding ways to more effectively compete, offering products comparable to those of the larger players, which is leveling the playing field in many respects. Middle-tier banks are gaining ground by offering automated systems necessary to cater to the demands of larger companies, including online capabilities such as user customizable dashboards, multi-currency support and the ability to set-up alerts for notification of balances that have hit thresholds.

Small-Sized Banks: The niche of smaller-sized and community banks is the personal feel and strong customer service that clients are offered. For this reason, this particular category of banks is most attractive to consumers and smaller, locally run businesses. These banks typically can't meet the requirements of more complex large corporations, as they do not have a strong brand identity, nor do they possess the extent of banking services that a larger company may need.

However, that is changing as well. Hungry for more business, many smaller institutions are looking at developing more advanced capabilities that will appeal to a broader range of customer segments. Community banks will be able to increase their competitive position through leveraging new technology that will assist them in the development of better payments services. Many have already taken the first step through offering online banking, enabling customers to access up-to-date account information and transactional details. In order to keep up with the evolving atmosphere, these smaller banks must also look to implement additional capabilities, such as positive pay entitlements, automatic approvals, payroll, and foreign

SUMMARY

The majority of banks today are placing an enhanced focus on developing new product and service offerings such as online and outsourced payments services that will help to retain existing customers, as well as entice the business of new ones. While these banks are actively taking measures to improve the depth and scope of their payments service offerings, they still have a way to go. Fortunately, many technology vendors are delivering scalable, affordable solutions that can be easily implemented by banks of all sizes, allowing them to compete more effectively for business now and in the future. These solutions can work to introduce STP, as well as improve overall productivity and significantly lower operating costs.

Additionally, middle market companies prove to be a desirable market for all sized financial institutions, as large, mid- and small banks each have an equal shot in luring this customer demographic. These middle-sized organizations are increasingly engaging in business globally as well, which presents a need for technology that can introduce standardized processes and promote connectivity with systems around the globe.

In order to be successful in the area of payments services, it is imperative for banks of all sizes to strengthen their strategies. Technological providers such as SunGard are today offering the tools necessary for banks to efficiently diversify their payment product portfolios.

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