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Talent in wholesale banking: Building a sustainable competitive advantage

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The heart of wholesale banking, and the prime differentiator among firms, is talent. A small subset of talent creates the majority of value in the industry, making it critical to identify, attract, develop, and retain the right people. This task has become more challenging, however, as financial services has lost some of its allure as a destination for many top new graduates.

Here is the challenge: Banks must envision the future value chain for products, customers, and technologies in their sector, and then pinpoint what talent they will need to bring this value chain to life. They must assess what sorts of talent their business lines need; recruit and identify the individuals best suited for those roles; align talent to the value those functions produce for the organization, and maximize their productivity; and broaden their organizations' reach to create more diverse and inclusive teams of talent.

Best-practice talent management can deliver highly cost-effective incremental value. At capital markets firms, for instance, full electronification combined with the astute talent management required to attract and retain the talent that remains could shrink the front office by 20 to 30 percent in the long term, while increasing the productivity, value, and rewards to the remaining team. For the largest capital markets and investment banking firms, this combination of a smaller, more highly rewarded team could cut compensation costs by about 10 to 20 percent, realizing savings of $300 million to $600 million annually off of the average $9 billion in CMIB costs (3 to 7 percent).

Some banks are already reaping the benefits of investment in these kinds of improvements: In corporate banking, new skills and technology have produced significant revenue gains from a smaller staff of relationship managers (RMs), and shown gains in productivity on the order of 20 percent.

The impact of banking's electronic transformation on talent

Automation and analytics are transforming the basic processes and economics of commercial and investment banking.

In capital markets, electronic venues will continue to supersede voice trading, shifting the source of value from traditional traders to trading platforms and, importantly, to the engineers who develop them.

Trading operations will continue to evolve from the factory floors of the past, with large, expensive teams of traders and salespeople showing little differentiation in performance, to select technologyfocused staff. At Goldman Sachs, for instance, revenues from electronic trading in its FICC unit in the fourth quarter 2018 rose by 40 percent over the previous year despite an overall decline in FICC revenues. Automation is well underway, and will continue to reduce staffing needs for trading desks.

Off the trading floor, the automation and modernization of traditionally labor-intensive functions such as basic equity and FICC research, as well as pre- and post-trade analysis and processing, will deliver significant cost savings.

In corporate banking, predictive analytics can anticipate customers' credit needs, converting RMs' traditional brute-force selling efforts into more targeted and timely offerings. And as customers increasingly rely on digital channels for day-to-day business, RMs will be freed from many administrative tasks and gain as much as 30 percent in time to develop client relationships.

Traditional approaches to networking and business development need to be updated to leverage the latest technology and analytics, raising the success rates and productivity of RMs, and with them returns on firms' assets. The shift creates greater opportunity for each RM by enabling more targeted and strategic conversations, but also raises the bar to assemble the skills to leverage these new technologies.

Technology is central to the task, but as mentioned earlier, value in banking is centered around talent—as well as the firm's balance sheet. Our experience has shown that the top 10 percent of a capital markets bank's team creates as much as 50 percent of value, and that in corporate banking, RM production is similarly concentrated.

McKinsey Global Institute research shows that current technologies could automate the work of more than 40 percent of positions across financial institutions. The reinvention of banks' organizational mechanics is inevitable. Staffs will be smaller and more productive, and possess different talents and personal profiles.

To emerge with greater productivity, banks of all types will have to adapt their talent to the new structure, in their attitudes toward recruiting, training, succession management, and the work environment.

The gaps in banking talent

And yet, while many banks have come to realize the importance of these shifts in technology and environment to their talent management across all business segments, few have made the needed changes. Digital talent that is well-versed in capital markets and commercial banking has always been scarce—and even greater challenge in the current competitive labor market.

Complicating the challenge, finance is no longer the preferred career destination for much of the talent banks so crucially need. Among tech-skilled candidates, large tech companies and startups are typically viewed as offering engineers more interesting and innovative problems to solve, as well as more collaborative cultures, than the command-and-control financial world. Moreover, potential tech recruits perceive a limited career path at financial institutions.

In recruiting more generally, the damage to the industry's reputation from the financial crisis has dissuaded many students from pursuing financial careers.

Last, having stripped so many people from the cost base over the past several years, as well as reduced investment in training, many banks lack a strong internal bench of talent to develop. Thus, their organizational pyramids have become misaligned, and show gaps at critical levels.

Talent management in three directions

To succeed in the technology evolution in banking, banks will need to retrain, restaff and reorganize. They need to start by determining what skills they need, then identify individuals with those skills, and finally develop succession programs to ensure they have the right talent in the future.

Banks have many talent levers at their disposal, in three categories:

— Identifying talent, and aligning talent to value

— Improving the productivity of talent

— Building more diverse, inclusive and agile talent teams.

Identifying talent

Banks tend to fill leadership positions with their biggest individual producers. But big producers do not necessarily make the best managers. In addition, the current generation of top producers may not possess the digital skills and experience needed to identify and act on future value creation opportunities. Banks need a more expansive approach to hiring that recognizes the importance of digital skills.

Banks should also reconsider the practice of drawing senior producers from their industry competitors with lucrative pay packages. While proven production certainly has value, past successes may not be as relevant or lasting in a digital environment.

In recruiting, financial firms also tend to “hire in their own image”—for example, favoring candidates from a small circle of select business schools. Our research has shown that graduates from a range of universities can perform as well as, and sometimes better than, those hired only from the elite schools, depending on the specific needs and requirements of function. These graduates also frequently stay at their firms longer, reducing the burden of having to replace talent in the future.

To measure the value of casting the recruiting net more widely, one capital markets firm tested over 100 hypotheses linking employees’ value to the firm to their individual talent criteria, such as education, professional experience, and non-career interests and skills. After identifying 15 metrics which proved to be highly correlated with success on the job, the firm ramped up its recruiting at state and non-Ivy League universities, and emphasized recruiting candidates with STEM degrees.

The same firm conducted in-depth interviews of its employees to determine what factors had initially attracted them, as well as those that induced them to stay on. Based on the resulting insights, the firm formulated an “employee value proposition” for use in its recruiting and development.

Conventional thinking on aligning talent to value holds that a business unit’s front office creates the most value. In a digital environment, however, a firm’s essential trading algorithms and platforms—and the software engineers that design them—may dominate the value equation and generate even more than its RMs, sales people, and traders.

A talent-to-value approach assesses the value creation and protection potential of key technologies and positions, and then identifies the roles that enable the creation of that value. Further, it looks at the skills required to capture value, and examines the fit of the incumbent team to those responsibilities. The last steps lead to a plan for managing talent succession with the existing team, and for building and refreshing the skills of the team.

To illustrate, one corporate bank found that only one-third of a particular unit’s value was derived from traditional front-office roles, while the rest was linked to “enabling” roles—such as those who lead the digitization of client journeys to improve customer experience and increase revenue, and the procurement staff that capture value by optimizing relationships with the bank’s myriad suppliers.

Banks that confine their value analyses to the top tiers of their organization can overlook 90 percent of critical roles. After a rigorous analysis, firms may find that in a digital world just 10 percent of their managers create 50 percent or more of the value, and yet none of them sit with the senior team. On the other hand, as many as 20 percent of firms’ managers may create little value.

Accordingly, firms must rigorously analyze value across the firm, both for business units as a whole and for their individual employees. To define value analysis at the individual level, firms can develop a detailed understanding of each role, to distinguish the value expected from being present on a team—the “beta” of value from the average seat on the desk—from the incremental value attributable to unique talent—the “alpha” of the individual producer.

Taking a more expansive view of talent to value can produce impressive results: Organizations that frequently reallocate high performers to their most critical strategic priorities are 2.2 times more likely to outperform their competitors on total returns to shareholders.

Improving productivity

Talent is both the scarcest resource and the greatest differentiator for banks, so they need to protect that resource and enhance productivity. We see three key ways to do so: through technology that leads to smarter decisions and more intelligent client coverage; through active coaching; and through training to supplement the skill base. Consumer banks have historically offered strong coaching and training programs for talent development, but such efforts tend to lag for most capital markets firms and commercial banks.

— *Decision technology:* Capital markets firms closely track talent performance indicators that emphasize outputs such as P&Ls and sales credits. They often fall short, however, in quantifying inputs which can heavily influence overall results—such as collaboration between groups to foster cross-selling—based on firm priorities and culture.

Within ten years, digital technologies will be able to relieve corporate banking RMs of many non-client-facing tasks, giving them more time to devote to production. To maximize the opportunity to relieve their front-office staff of manual tasks, banks should invest in advanced analytics systems, such as for client relationship management, which can automatically suggest the "next product to buy" for their clients, for automation of credit decisions, and for automatic distribution of market color and axes in capital markets.

— *Coaching:* In day-to-day management, banks should implement real-time, fact-based coaching and feedback with team members, guided by clearly defined matrixes of expected capabilities for development. Managers in commercial and investment banking are at a particular disadvantage in coaching, as many have been promoted on their production prowess rather managerial mettle, and lack a coaching awareness.

At McKinsey's 2018 Capital Markets Roundtable, only 5 percent of capital markets leaders said that coaching and capability building was their top talent management priority. To maximize productivity, capital markets banks must invest in concrete training that incorporates situations that confront managers and their reports.

Banks should also deeply assess the strengths of their top performers, and use the resulting insights to develop management training. Individuals can learn where they lead or lag peers and learn practices to enhance their capabilities. Through such programs, companies across industries achieve repeatable gains in revenues of from 5 to 20 percent, driven my more effective management (e.g., for target setting and sales force management).

— *Training:* Banks must develop a metrics-based approach to identify the attributes that generate productivity, then quantify and sharpen those skills. Leading banks are developing training and rotational programs tailored to building skills—in one case a week-long technology boot camp for all managers, in another a three-day executive training program to build collaboration.

Corporate banking RMs will need to handle a broader range of products, and in some cases assume a more strategic advisory role for clients, sometimes with CFOs and CEOs. They will need training in the products, of course, but might also require some psychology training to prepare them for the more empathetic role they may need to bring to these relationships.

Banks in regions with stringent labor regulations, such as continental Europe, face a particular talent management challenge. For example, labor regulations can constrain the size and timing of bonuses. Moreover, banks in southern Europe have little freedom in reducing staff, which means they need comprehensive in-house cross-training programs. In some cases, this can work to banks' advantage by diversifying and broadening the company's aggregate skill set—developing links between divisions, and contributing to the development of the next generation of leaders.

Last, meetings are an ongoing pain point for most institutions, and a drag on productivity. Banks can reduce the pain with a coherent set of meeting practices: for example, 45-minute time limits for standard meetings, mandatory advance agendas, discouraging attendance by multiple, similar senior managers (for example the CEO and COO of a business), and inviting only necessary attendees. (Our research has found that in many large meetings, decisions are made by a small group of senior leaders, while other's present do not participate.) And meetings need not be so frequent. Digital communications can readily supplant many face-to-face meetings, freeing the business to spend more time with clients.

Building more diverse, inclusive, and agile teams

Financial firms generally underperform in promoting women and people of color to senior positions, in spite of strong evidence in its favor: Across industries, firms in the top quartile for gender diversity are 27 percent more likely to create value, and those in the top quartile for diversity in both gender and ethnicity were 33 percent more likely to rank high in profitability.

Banks should expand their programs for diversity, and make those efforts known in recruiting programs. They should also act—leveraging data and analysis—to remove bias from promotions both in policies and practice.

Banks will also benefit from diversity through better integrating the talent in near-shore and off-shore centers which is frequently ignored and untapped. For example, banks can maximize the extensive quantitative talent in India by enabling the most talented individuals career paths that originate in back office operations and support functions in lower-cost locations, and progress to roles in global leadership. These locations can also serve as centers of excellence for bank automation and development of artificial intelligence.

Last, the foundation of agile banking operations is empowered, multifunctional teams. Increasing interactions among geographic business centers – head offices and technology and data hubs – will maximize the value of agile processes, but requires careful planning and more integration among units.

A new focus on bank talent

The continuing drumbeat of technological innovation is changing the banking industry in numerous ways—and the talent profile and talent-to-value equation are evolving as well. Following are some of the measures that top-performing banks are taking to meet the talent challenge:

— A bank's value is centered around its current and future talent. To capitalize on their investments in technology, banks need people with the right skills and capabilities. Bank staff need a thorough background in data and analysis, and banks need to provide tools to help them be more productive. Senior managers also need to fully understand technology, to effectively allocate capital and guide their businesses to successful growth.

— To improve their talent base, banks need to overcome their quality-of-work disadvantages in recruitment, and look beyond the few name-brand business schools for the next generation of talent.

— Banks can also enhance value creation by broadening their gender and ethnic diversity, and by tapping the potential in underutilized global operations, through unified recruiting and talent management strategies.

— Capital markets firms must be rigorous in identifying the factors that create value in their businesses—talent, versus capital, versus technology—and dedicate resources to those factors.

The value at stake is substantial. In capital markets, we expect continuing electronification to reduce the size of the front office by 20 to 30 percent over the medium to long term, while increasing the productivity and value generated by, and compensation to, the remaining core. For the average large global sales and trading bank, front-office compensation costs typically amount to 25 to 30 percent of overall costs (approximately 20 percent of revenues). Accounting for increased compensation to the remaining (more productive) front-office team, we expect total compensation to decrease 12 to 23 percent, or $300 million to $600 million annually, which is 3 to 7 percent of the current cost base for the average top 12 sales and trading firm. These savings can be directed to investment in new technology, and compound productivity growth.

For example, a select number of corporate banks, investment in skills and technology have led to strong revenue growth from a reduced number of RMs, and year-over-year gains in productivity on the order of 20 percent.

Questions for banking leaders

Debate on the following set of questions can help the leaders of capital markets firms frame their approach to one of the core challenges any bank faces today: how to refresh and reinvigorate the talent base.

1. What are the 50 highest-value seats in each business unit? Do we have a systematic assessment of the skill requirements for those seats, and do the people in those roles meet them?

2. Do we have a plan in place to fill any gaps in skills?

3. What are the expectations for average performance for each position—the "beta" or franchise value of the bank—and what additional contributions, or "alpha," are individual producers achieving?

4. What proportion of my time do I spend coaching and providing feedback to build the skills of my top team?

5. Do we have concrete targets and goals for diversity, and what action plans can enable us to reach them?

6. How do we encourage development and rotation of talent between our different locations and pull in the best talent from all regions?

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