Time for bold moves

How banks can achieve high performance by 2012 and beyond

Executive summary

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In the wake of one of the world's worst financial crises, the banking industry will be significantly reshaped. Substantial overcapacity makes consolidation inevitable. New operating models will require flexibility and resilience. Bank executives tell us that banks also must struggle with eroding customer trust, loyalty and advocacy.

Accenture interviewed more than 35 leaders from banks, private equity firms and other experts from outside the banking industry in developed and emerging markets. We also analyzed more than 150 banks around the world and validated our extensive results with clients.

What these leaders told us leads to an inescapable conclusion: now is the time for bold moves to pave the way for high performance in the face of profitability pressures.

A new landscape

Looking ahead to 2012, Accenture believes that the banking landscape will evolve in several noteworthy ways.

New business and operating models

Most successful banks in the developed world will gravitate to a retail/commercial banking business model, organized regionally or locally. This new model will rely on pulling customers in rather than pushing products out. It will be a simplified model, focusing more on an integrated multichannel distribution network than on branch locations.

Surviving multiregional universal banks will be global in nature but there will be fewer of them than today. A few players will be able to operate with truly simplified global operating models pursuing economies of scale, like HSBC or Santander. Other players will choose to simplify their businesses and become specialists on a global scale. Already Citi is re-emphasizing its capabilities in global corporate and transactional banking. UBS may focus on wealth management.

By far the most common business model by 2012 will be retail and commercial banks serving regions or local markets. Some big banks with strong regional franchises will divest loss-making divisions and become regional retail/commercial banks focused on their core markets and customer segments. We anticipate that many European players may eventually fall into this category.

Non-traditional competition

Community banks, credit unions and low-cost banks will gain market share in retail and commercial banking in the developed world. They can count on stronger relations with retail clients and a "fresher" image. However, they will not become the dominant force.

We expect new, nonbanking entrants—such as retailers, telecommunications operators and energy companies—to become powerful players in some markets. The United Kingdom's Tesco, one of the world's largest supermarket chains, is already quite active in banking. In the United States, Progress Energy offers 10-year financing to residential customers for energy efficiency improvements up to $20,000, according to its website.

In emerging markets, one of the most noteworthy examples is M-PESA, a mobile banking service in Kenya developed through a partnership between Vodafone Group and the Department of International Development. M-PESA allows money transfers and payments through mobile phones for subscribers who do not have bank accounts—typically urban migrants transferring money to their families in the countryside. Agents in wireless mobile phone stores, petrol stations and local retailers are the channel for cash deposits and withdrawals. We believe remote deposit capture methods like this will become increasingly common both within and outside the banking sector.

Stronger weight for emerging market players

We foresee that emerging markets, particularly in Asia, will be a hotbed of merger and acquisition (M&A) activities due to the sustained momentum of their capital flows and higher rate of capital formation. Because emerging-market banks in the BRIC countries (Brazil, Russia, India and China) have performed better during the crisis, they will become more important players in the future. In the next three years, however, we believe they will expand in higher-growth domestic and regional emerging markets and will not target markets in Europe and North America.

Domestic consolidation in developed markets

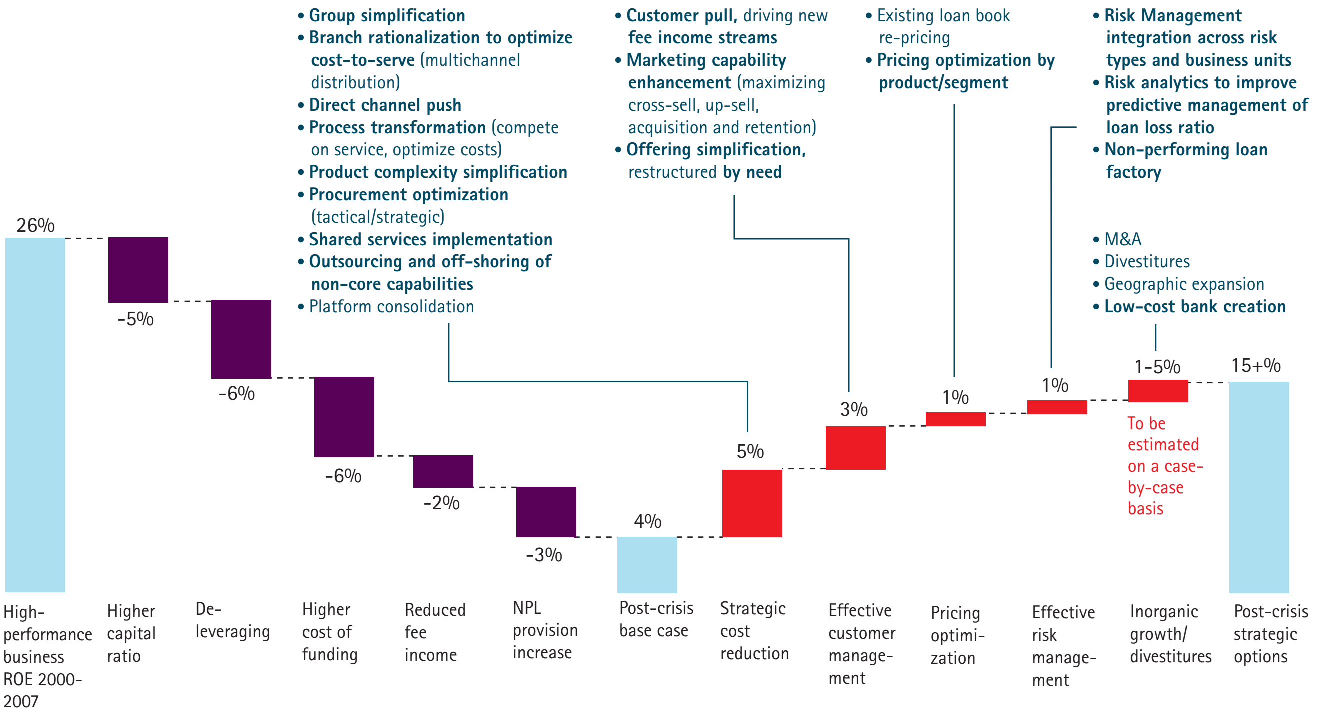
In the developed world, government action to stabilize the financial system has reduced the number of large bank failures that drove a flurry of activity in the last quarter of 2008. While we do not expect to see many large and cross-border acquisitions, domestic consolidation will be a feature of some overbanked markets. The long-predicted consolidation of the German Landesbanken sector or the Spanish savings bank and mutual sector may reshape these markets. In the United States, continued failure of some small and medium-sized banks will drive a series of consolidations, including acquisitions by nontraditional players, such as private equity.

Higher return on equity—but not like the glory days

The new regulatory landscape and renewed appreciation of risk will cause an end to the thin-capital, high-leverage model and off-balance sheet earnings that drove high return on equity (ROE) before the crisis. We believe that high-performance businesses in the banking industry will be able to achieve ROE of 15 percent by 2012—a considerable improvement over the current 4 to 5 percent common today but a far cry from the 26 percent average for high performers between 2000 and 2007. We also believe that costs should be at least 20 percent lower than 2008 levels. We estimate that at least 30 percent of the cost base by 2012 will be variable as successful banks use alliances, shared services and sourcing models more effectively.

Figure 1. Bank profitability can be rebuilt through a set of focused business model and operating model actions to achieve mid-teen ROE by 2012.

ROE evolution (retail/commercial bank, developed markets)



Source: Accenture research; in bold, levers used to quantify impact on ROE

As Figure 1 shows on the previous page, Accenture believes that profitability will be rebuilt through a set of focused business model and operating model actions.

Accenture also believes that financial key performance indicators for successful banks also will look different by 2012, as Figure 2 shows.

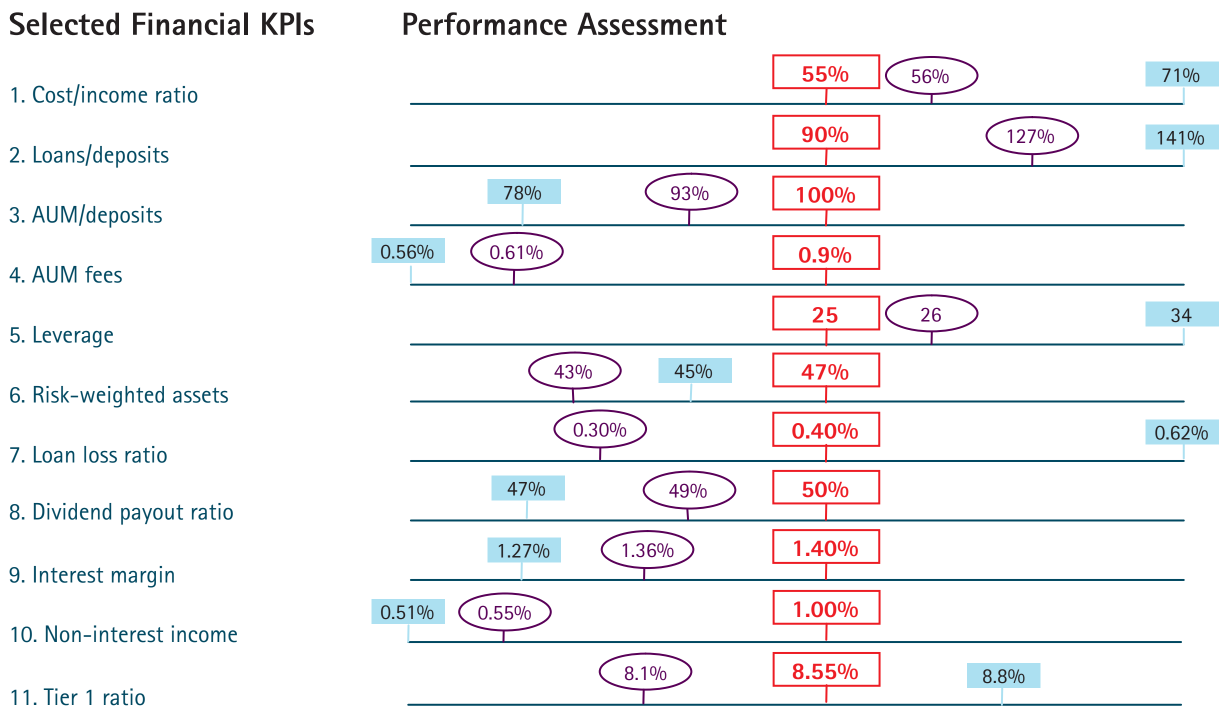
New revenue growth

Banks will embed new capabilities into their operating models—such as risk analytics, customer analytics, pricing optimization and industrialized management of nonperforming loans—so that marketing can be pursued much more effectively. These capabilities will drive high performance through new revenue growth from offerings based on customer needs, better pricing management and new customer propositions, like low-cost, aggressively priced banking.

CheBanca!, a high-tech, low-cost retail bank launched in 2008 by Italy's Mediobanca, is a good example of such an initiative in a developed market. Customers deal with the bank primarily through the Internet and contact centers, supported by small branches, to save time and still access a high-quality, professional service. Efficiency in the branch is supported with a lean infrastructure, including paperless processing and self-service.

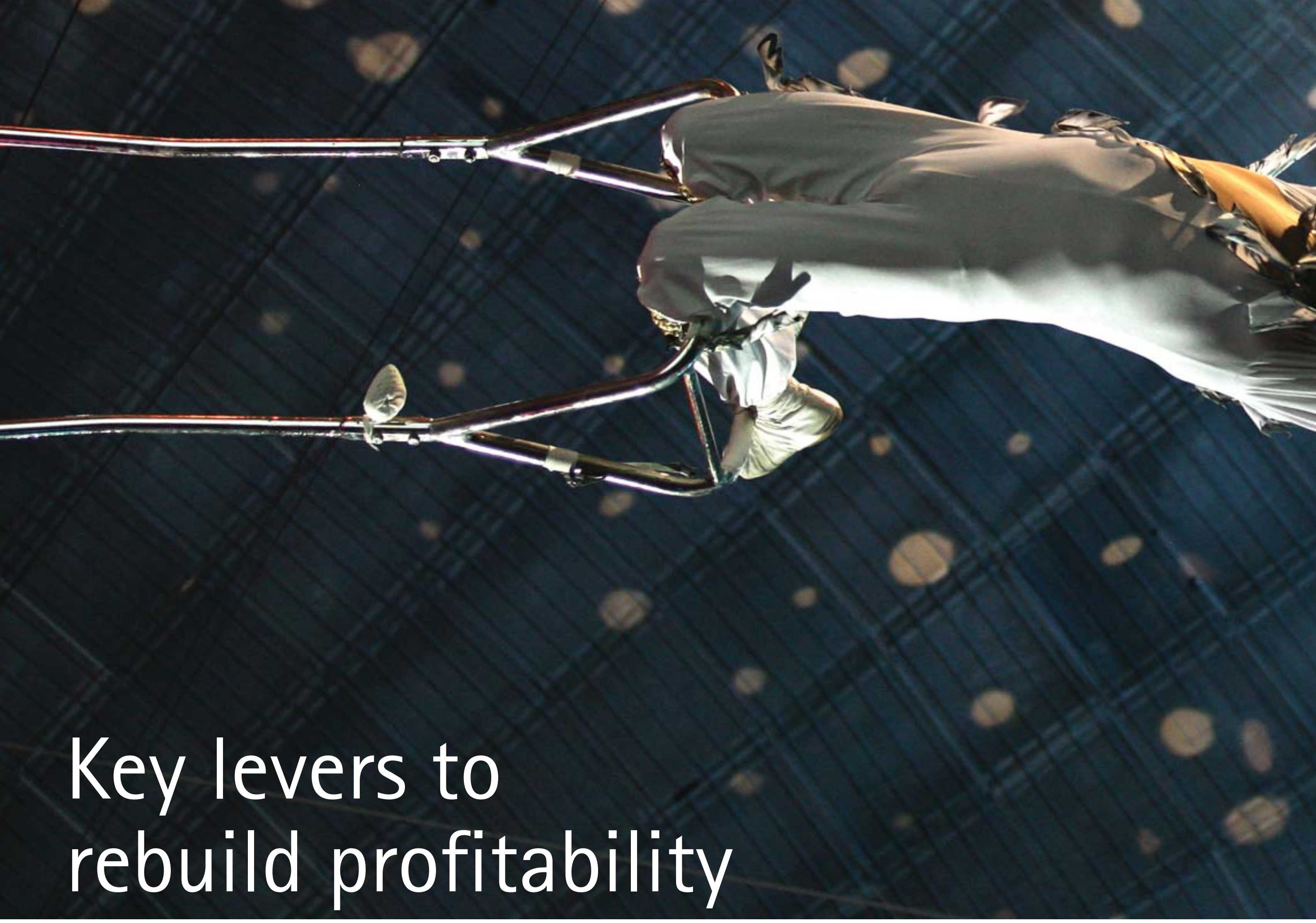
Our research indicates that new revenues also will be generated by products not usually offered by traditional banks before the crisis as well as by innovative new products. Differentiated offerings can command a premium if they focus on emerging areas of customer need, such as retirement and life, health and home insurance. Emerging community and social markets open doors for Islamic finance, microfinance and "green" products, such as mortgages, credit cards and loans focused on sustainability and targeted toward the unbanked, both in developed and in developing countries. Servicing these untapped client segments is now possible through mobile technology.

Figure 2. Key performance indicators by 2012 for successful banks show less leverage, more risk-weighted assets and higher non-interest income.



Source: Accenture analysis of 100 leading banks' accounts

Typical "Good Bank" (retail/commercial) in 2012
Average across 100 banks EOY 2008 (post-banking crisis)
Average across 100 leading banks EOY 2007 (pre-banking crisis)



Key levers to rebuild profitability

Based on our findings, Accenture advises banks to focus on five key levers to achieve high performance by rebuilding profitability and emerging with stronger economic, operating and business models by 2012.

Strategic cost reduction

By focusing on strategic—not tactical—cost reduction opportunities, banks can lower their fixed-cost base and gain a more variable cost structure. Core capabilities should be selected for the opportunity to create market differentiation. Noncore capabilities, like application management, should be outsourced where possible. They also can be managed in partnerships, such as joint ventures with utilities for payment processing. Back-office capabilities that apply across industries, like collections, delinquency management and after-sale service, can be managed with industry partners such as telcos.

Products should be rationalized to simplify sales, back-office and information technology (IT) processes. Branch networks can be reshaped to reflect a better mix of multichannel services and offerings. Direct channels can apply wherever appropriate to reduce the cost to serve. However, it will be important to work with branches to create a common experience across channels.

Processes should be simplified and reengineered, with more shared services, outsourcing and offshoring implemented for support services and IT. One example of a successful shared services center is BCB, a payment transaction services company founded in 2004 by Deutsche Postbank. BCB provides payment services to four of the five major German banks. It has gained a 20 percent market share in payment transaction processing and given banks the advantage of scale efficiencies they could not achieve on their own.

Cloud computing, which leverages the Internet to enhance speed and flexibility, enables banks to dramatically consolidate and rationalize IT costs. So does the creation of virtual, shared IT utilities, which are likely to proliferate among smaller banks.

Our respondents tell us that most tactical cost savings have been realized. Instead, they are looking to transform their cost base strategically, targeting an average 18 percent cost reduction by 2012. Achieving this kind of efficiency will be critical to build the required ROE for a bank on the path to high performance by 2012.

Robust customer management

Customer trust and bank reputation are the biggest challenges ahead for our survey respondents. Improving transparency, simplifying customer

offerings and improving the customer experience are at the top of their list of priorities. In light of these findings, we expect banks to maximize their focus on customers because of their growing dissatisfaction and propensity for churn. Customer protection laws also make it easier for customers to change banking partners.

Already banks are learning from other industries, such as retail and telecommunications, to leverage customer data and analytics capabilities so they can deliver deeper customer insight and more targeted marketing. Importantly, banks can be better assured that they are offering what customers need while simplifying the current product complexity typical of today's large banks. A stronger customer focus also enhances cross-selling, up-selling, and customer acquisition and retention.

Successful banks will "pull" customers—rather than "push" products—thanks to their ability to offer easy access and simple, easy-to-understand, need-based products. A compelling social and environmental agenda also will attract customers.

In addition, technology will play a pivotal role in securing customer loyalty. Communicating with customers across multiple channels—via handheld devices and the self-service kiosks already available in some bank branches, for example—will improve both the customer experience and the efficiency of bank distribution networks. Indeed, banks will become more like retailers when it comes to marketing their products and services.

If banks manage customers more effectively, we estimate they can increase ROE by about 3 percent.

Pricing optimization

In combination with a renewed focus on customer management, banks should optimize pricing by product and segment. In fact, pricing will be the next battleground for winning customers and optimizing profitability, our respondents say. As cost-to-income ratios worsen, pricing is one of the biggest profit improvement levers. Market-specific pricing and personalized offers can attract the right customers at the right margins.

If banks optimize pricing, we estimate an impact of about 1 percent on ROE.

Banks also should pursue innovations in services to increase non-interest income (see Figure 2). Investment products need to be examined critically and reengineered to restore trust and confidence while being better attuned to shifting customer demand. These

actions will increase banks' ability to capture more general household and pension savings, increase fees for accounts under management and make pricing transparent.

Integrated risk management

Our survey respondents see the result of public sector intervention leading to increased transparency and stricter corporate governance and local regulatory compliance. To meet these challenges, risk-management practices and procedures need to be integrated across risk types and business units and deep within the organization's culture to safeguard the achievement of aggressive targets while protecting against downside risks and minimizing credit write-downs. In this regard, risk analytics can improve predictive management of the loan loss ratio, while a nonperforming loan "factory" can more efficiently assist with recovery and collections.

Inorganic growth and divestitures

Banks need to focus on the core market segments in which they can compete profitably and seek opportunities to consolidate those positions through inorganic growth. Otherwise, they should divest business units where they do not have scale or specialized capability and allocate the capital to areas of market leadership.

In developed markets, retail banks should consider developing or buying low-cost banks, which have siphoned off price-sensitive customers with a few highly targeted, need-based offerings. By embracing these new models, retail banks can better acquire and retain customers for whom pricing is a critical factor.

Beyond 2012

Beyond 2012 we expect a new wave of M&A, not only within countries but also cross border. Fast-growing Asian markets will be key targets for both emerging and developed market players, including private equity and sovereign wealth funds as well as banks. We also believe that banks on the path to becoming high-performance businesses will capture the benefits of digitalization, mass customization, social networking and mobility as they try to get closer to the everyday lives of their customers.

In addition, banks could aim to position themselves at the center of an alliance ecosystem of bank and nonbank players to create new profit pools and protect market share in the face of growing competition from nonbank entities, such as mobile telephone operators.

Achieving high performance

Achieving high performance by 2012 and beyond requires much more than just the aggressive cost cutting that many banks are doing to make up for large write-downs and reduced earnings. They need to focus on their core customer businesses rather than rely on leverage-based models and inflated off-balance sheet earnings. To be successful in the future, banks must start from a clear, distinctive positioning and implement sustainable change.

They should begin by launching a program of initiatives that generate value in the short term, targeting the 15 percent return on equity that we believe high-performance businesses in the banking industry should expect by 2012. They should define a scalable and flexible operating model that responds quickly to customer needs, market changes, product innovations and changes in the volume and mix of products, channels and transactions. They must invest in differentiating core capabilities and team with others or outsource noncore capabilities. They should align their management team to the new strategy and ensure that leaders can adapt quickly to change. Finally, banks need to create the ability to constantly monitor changes in markets, technologies and regulations to better anticipate the competition and effectively drive innovation in business and operating models.

Both by 2012 and beyond, the new banking virtues—marketing and customer management, strategic cost management, integrated risk management and technology-driven innovations—will be more important than ever to regain the high performance that banks seek.

About the authors

Noel Gordon, managing director of the Accenture Banking industry practice, has worked for and consulted with some of the world's largest and most diverse banks for more than 30 years. His experience includes organizational transformation, strategy, merger integration, back-office rationalization, and credit and risk reengineering. Gordon also has worked as a banker at JP Morgan Chase & Co. and NatWest Group, where he led a range of retail and corporate banking teams.

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