

Retail Banking 2020

Evolution or Revolution?



Powerful forces are reshaping the banking industry. Customer expectations, technological capabilities, regulatory requirements, demographics and economics are together creating an imperative to change. Banks need to get ahead of these challenges and retool to win in the next era. Banks must not only execute on today's imperatives, but also radically innovate and transform themselves for the future.



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Foreword

We believe that retail banking will look very different in 2020 than it does today.

Many have predicted the fall of the traditional bank, as disruptive new entrants win share by offering a better customer experience through new products and channels. Yet, despite the emergence of new competitors and models, we believe the traditional bank has a bright future – the fundamental concept of a trusted institution acting as a store of value, a source of finance and as a facilitator of transactions is not about to change. However, much of the landscape will change significantly in response to the evolving forces of customer expectations, regulatory requirements, technology, demographics, new competitors and shifting economics.

Banks need to choose what posture to adopt against this change – whether to be a shaper of the future, a fast follower, or to manage defensively, putting off change. Staying the same is not an option. We believe that the winners in 2020 will not only execute

relentlessly against today's imperatives, but will also innovate and transform themselves to prepare for the future. This future will require institutions to be agile and open, ready to explore different options in an uncertain world.

So is this change a revolution, or an evolution? In truth, it is both. All the signposts for change are here. Many players are innovating and experimenting with new products, delivery channels and analytics. The industry has historically changed slowly – evolutionary change. And the changes we envision are less about imagining some unknown future, and more about implementing and integrating all the things we know today (see the sidebar on the next page). Yet the pace of change is increasing rapidly – banks that fail to shift gear risk being left behind. And if any institution could truly master all the priorities we set out in Section 3, it would be revolutionary indeed.

To produce this paper, we integrated insights from PwC teams worldwide. We surveyed 560 client executives from leading financial institutions across 17 markets regarding the challenges and opportunities of this evolving marketplace and their plans to respond. We developed a point of view regarding how mega-trends will impact the future of banking, using PwC's proprietary Project Blue framework. And we developed six priorities for retail banks today to help ensure their future success.

We look forward to engaging in a provocative dialogue with you and your colleagues, going forward. We would be pleased to share additional points of view, information and insights, as appropriate. Feel free to reach out to one of us or your existing PwC contacts to start the dialogue.



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Retail Banking 2020 – Evolution or revolution? Will you be ready to serve this customer?

Anna, 56, boards a high-speed train for her commute to one of the world's emerging megacities. She settles in and blinks twice, activating the display in her glasses. She is authenticated by retina scan, and reviews her messages.

A message from her financial adviser notes they sold her holdings from a recent IPO and transferred the proceeds into a new African high-tech fund. She made this decision after consulting with her financial adviser and reviewing recommendations from several independent investor analytics engines she reached through her bank's wealth management platform.

She then watches a message from the bank's leading education expert, suggesting it is time to set up a university savings account for her 13-year-old son. The adviser asks whether Anna expects her son to attend the new flagship online university, or a much more expensive residential programme overseas. She quickly outlines the estimated costs and benefits of each, taking into account Anna's age and planned retirement at 70. She recommends the flagship, and suggests supplementing her son's education with less expensive summer programmes in Mumbai, San Francisco and Beijing. Anna agrees, and the adviser seamlessly sets up the savings account and the auto-deposit.

At lunch, Anna browses the local electronics display, where the latest holovision catches her eye. A quick scan from her glasses returns customer recommendations, coupons and financing offers from multiple providers including her own bank (which itself has instantly reviewed the returns from the scan to ensure their offering is competitive). She makes her choice and completes the purchase, using a new peer-to-peer lender that offers a more competitive rate, due to a lower cost structure, thanks to a lack of legacy infrastructure and a less stringent regulatory regime.

The next day, Anna accepts an invitation for a video conversation with her bank business adviser. The bank had been monitoring the favourable social media coverage Anna has been receiving and concluded that her business might need additional services. The business adviser has already arranged for a commercial estate agent and loan officer to join them, and they discuss Anna's questions and offer advice on a range of small business topics. She shares that she is thinking of expanding her business into additional locations, and they explain the difference between the bank's products and the government small business facility, which offers less service, but a lower rate of interest and longer repayment periods. Also, Anna is passionate about environmental protection. The bank recognises this, and through its own programmes and partnerships, is able to present an offer where Anna's use of the bank's products results in direct donations to Anna's favourite charity. She accepts – happy she has found a bank that really seems to understand her.



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70% of global bank executives believe it is very important to consider how macro trends will impact the banking industry in 2020

Executive summary Powerful forces are shaping the industry

Powerful forces are transforming the retail banking industry. Growth remains elusive, costs are proving hard to contain and ROEs remain stubbornly low. Regulation is impacting business models and economics. Technology is rapidly morphing from an expensive challenge into a potent enabler of both customer experience and effective operations. Non-traditional players are challenging the established order, leading with customer-centric innovation. New service providers are emerging. Customers are demanding ever higher levels of service and value. Trust is at an all-time low.

Fewer than 20% of executives feel well-prepared for the future

Against this background, 70% of global banking executives believe it is very important to form a view of the banking market in 2020 – to understand how these global trends are impacting the banking system in order to develop a winning strategy.

Executives are divided as to who will be the primary beneficiaries of these trends. Just over half (54%) believe that large banks will be the winners in 2020. The other half (46%) see smaller banks capturing share through increasing differentiation. Executives are also divided as to the threat posed by non-traditional new players: 55% believe they pose a threat to traditional banks, while 31% believe they present innovative partnership opportunities.

Executives also differ in their views by geography. For example, fewer US executives think it important to form a view of the industry in 2020 (61%) than executives in the emerging markets (79%). And many more US executives view non-traditional new market entrants as a threat (71%), than executives in Asia (42%), where more view them as an opportunity (44%) for partnering and prospering together. This divide between developed and emerging market thinking is a theme throughout the survey.

In Section 2 we address these questions and concerns, and consider how global macro-trends will impact the retail banking industry.

55% of bank executives view non-traditional players as a threat to traditional banks

Figure 1: Importance of considering the banking market in 2020

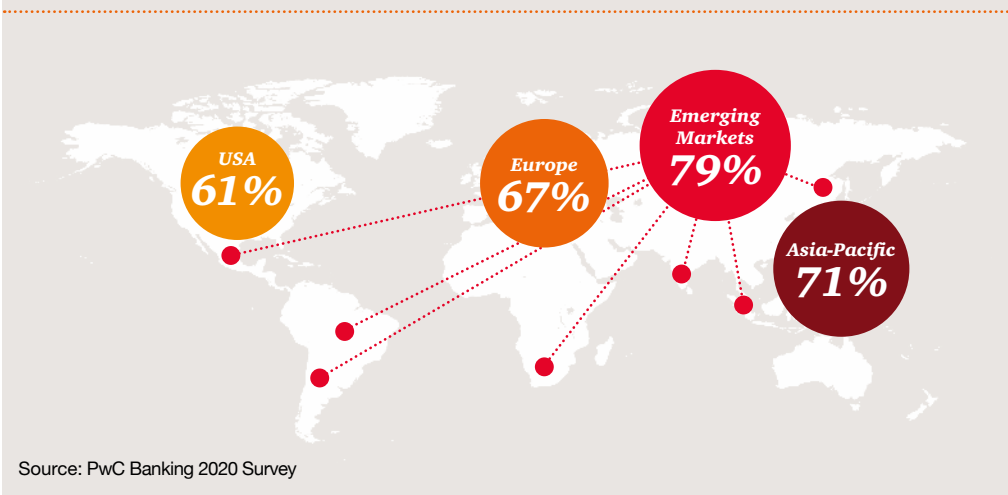
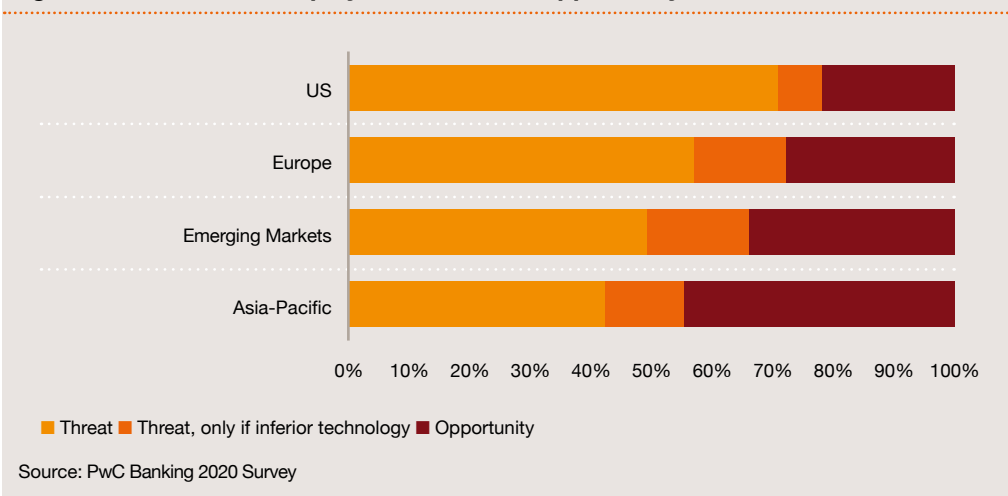


Figure 2: Non-traditional players – Threat or opportunity?



Today's challenges

Unsurprisingly, nearly all bankers surveyed view attracting new customers as one of their top challenges over the next two years – banks are hungry for growth, and finding new customers is the first response of a good product banker. However, banks also recognise the need to deepen their customer relationships and focus more on specific customer outcomes. Hence, enhancing customer service is the number one investment priority for banks, globally.

The impact of complying with growing and changing regulation remains a top challenge – indeed the number one challenge for US and European banks. Unsurprisingly, this is a top investment priority for banks in these regions. Bankers also tell us informally that they are still struggling to get ahead of this challenge and develop a proactive stance with their regulators – to stop seeing regulation as a burden and start weaving regulatory compliance into the fabric of their operations.

In the more rapidly developing Asian and emerging markets, where big, established banks have less dominance, bankers report that attracting talent and retaining existing customers in face of fierce competition and new market entrants are also top challenges. R&D, innovation and new product development are the top investment priorities in these regions.

Bankers tell us they are working harder than ever before to address these challenges, and are consistently being asked to do ‘more with less’, given the continued cost pressure facing the industry. ‘Execution, execution, execution’ is the mantra, particularly for banks in the US and Europe.

Priorities for 2020

However, the pace of change is increasing and banks need to do even more to ensure they are well-positioned to succeed in the future. Through our proprietary research and insights from client engagements, we have identified six priorities for success in 2020. They are:

- 1 Developing a customer-centric business model
- 2 Optimising distribution
- 3 Simplifying business and operating models
- 4 Obtaining an information advantage
- 5 Enabling innovation, and the capabilities required to foster it
- 6 Proactively managing risk, regulators and capital

Despite broad agreement that they are all very or somewhat important, fewer than 20% of executives feel that they are very

Figure 3: Top 3 challenges



Source: PwC Banking 2020 Survey

Figure 4: Top 3 investment priorities



Source: PwC Banking 2020 Survey

prepared against these priorities, and only a similar percentage report that they are making significant investments in these areas.

Banks universally agree that they are hindered from addressing these priorities by financial, talent, technology and organisational constraints. Banks need to take aggressive action to ease these constraints, and manage themselves in a more agile manner to enable innovation and transformation, while preserving their optionality to capitalise on market opportunities and address unexpected challenges.

To succeed in this rapidly changing landscape, banks need to have a clear sense of the posture they wish to adopt – whether to shape the industry, rapidly follow the leaders, or manage defensively, putting off change. And they need to have a clear strategy to deal with these challenges and address these priorities, including considering partnerships with third parties and applying lessons from other industries. Of course, the level of focus on each of them depends both on a bank’s starting point, and its unique strengths and challenges. However, each priority is important, and success will come from a balanced execution across them – and a balance of tactical initiatives and longer term programmes, all coming together as an integrated whole.

We discuss this further in Section 3.

90% of executives believe that each of these priorities is important; only 20% of executives feel very prepared to address them

2

Impact of global macro-trends on retail banking

To help frame the discussion of what banks should do (see Section 3, 'Six Priorities for 2020'), we first consider the macro-trends that are shaping the global financial landscape, building upon PwC's substantial research effort in this area, Project Blue. We framed this research around the following seven trends: global instability, demographic change, technological change, social and behavioural change, the rise and interconnectivity of the emerging markets, the rise of state-directed capitalism and the war for natural resources.*

* For further information on Project Blue, please visit www.pwc.com/projectblue





Figure 5: Project Blue – Framework and impact on banking landscape

Project Blue Framework	Adapt	Global Instability		
		Regulatory environment	Fiscal pressures	
		Political and social unrest		
Project Blue Framework	Plan	Demographic change	<ul style="list-style-type: none"> • Population growth discrepancies • Ageing populations 	<ul style="list-style-type: none"> • Changing family structures • Belief structures
		Technological change	<ul style="list-style-type: none"> • Disruptive technologies impacting FS • Digital and mobile 	<ul style="list-style-type: none"> • Technological and scientific R&D and innovation
		Social and behavioural change	<ul style="list-style-type: none"> • Urbanisation • Global affluence • Talent 	<ul style="list-style-type: none"> • Changing customer behaviours – social media • Attitudes to FIs
		Rise and interconnectivity of the emerging markets (SAAAME)	<ul style="list-style-type: none"> • Economic strength • Trade • FDI 	<ul style="list-style-type: none"> • Capital balances • Resource allocation • Population
		Rise of state-directed capitalism	<ul style="list-style-type: none"> • State intervention • Country/city economic strategies 	<ul style="list-style-type: none"> • Investment strategies • SWFs/development banks
		War for natural resources	<ul style="list-style-type: none"> • Oil, gas and fossil fuels • Food and water • Key commodities 	<ul style="list-style-type: none"> • Ecosystems • Climate change and sustainability

Source: PwC Project Blue

Of course, each of the macro-trends has a different impact on the retail banking industry, as well as on each specific institution. In this section we consider, in depth, the following four mega-trends we consider to have the greatest impact, although our thinking is informed by them all:

- Rise of state-directed capitalism – regulation reshaping the industry and dictating business models.
- Technology will change everything – becoming a potent enabler of increased service and reduced cost; innovation is imperative.
- Demographics – changing priorities and opportunities for growth.
- Social and behavioural change – rising customer expectations and the need to regain public trust.

We also consider potential disruptors to those trends, and their implications.



Rise of state-directed capitalism – regulation reshaping the industry and dictating business models.

Nation-states are seeking to better control their financial systems and the institutions within their borders, as they learn that a global banking system becomes local in a crisis. Stability is paramount, and central banks are heavily involved in managing markets. Regulation is increasingly prescriptive and local in nature. At the same time, governments are seeking greater influence over the financial system to advance various policy objectives including the fight against terrorism, promoting lending to certain favoured sectors (e.g. students, housing, small businesses, national champions), financial inclusion and supporting the housing markets. These trends, in our view, have a number of years to play out and impact the nature of the industry in 2020. Specifically, we predict that:

- **The playing field shifts from global to local. National and regional institutions will dominate.** Developed-world banks, especially in the EU, have been in retreat to their home markets since the crisis, and we expect this to continue. Historical perceived advantages of global banks, such as economies of scale (oft sought, yet rarely captured), will become outweighed by local regulatory constraints. Local lending activities will need to be matched more closely with in-country deposits. Global banks will be forced to compete on a local basis – they will focus and double-down on fewer markets where they can gain scale, and they will exit markets where they are subscale.
- **More local markets will close to outsiders.** Traditionally restricted markets such as China, India and Korea will be joined by others that limit market share for foreign institutions through local regulation and subtle preferences favouring domestic institutions. This, in turn, will limit the ability of emerging market financial institutions to penetrate markets outside of their home countries. The exception to this will be that regional and bilateral trade pacts concluded over the next five years will drive select opportunities for certain institutions where financial services are included in the scope of the agreements.
- **Regulated banking assets will be significantly smaller than today** (adjusted for inflation and GDP), due to the regulatory attempt to significantly reduce ‘sovereign risk’ through stronger capital requirements. The shadow banking industry – absent changes to the rules – will continue to grow to fill as much of the gap as it can, perhaps merely pushing future problems outside of the regulated industry. The pressure on the regulated industry will be particularly intense in those markets with growing appetites for credit.
- **Banking sector size will be more closely correlated to GDP than today.** By 2020, smaller countries with large institutions will have shrunk their banking sectors, relative to GDP, through a combination of asset reduction efforts, business sales and subsidiarisation. At the same time, there will be significant growth of domestic banks, particularly in emerging economies.
- **Leading institutions will practise proactive regulatory management.** Thirteen years after the financial crisis, the relationship between banks and their regulators will have reached a new equilibrium as banks more fully integrate the policy objectives of governments and their regulators into their day-to-day business.



Technology will change everything – becoming a potent enabler of increased service and reduced cost; innovation is imperative

In the last few years technology has rapidly evolved – big data, cloud computing, smartphones and high bandwidth are all now commonplace – and we've reached a tipping point. Analogies with other industries (e.g. music and video distribution, print media) suggest that 'digital' will drive huge shifts in industry value – compressing revenues, enabling new attackers, redefining service and crippling the laggards.

We are in the middle of a multiwave trend where digital is first focused on optimising current products and services. The second wave, where enhanced data capture and analysis drives more targeted customer offerings and improved services is underway. Mobile banking will increasingly disrupt distribution models (e.g. instant videoconferences with product experts) and the payments industry (e.g. P2P mobile payments). Advances in security and verification will enable all aspects of sales, service and delivery to be conducted online. Technology is making it easier for customers to switch banks, making relationships much less sticky. This will drive the third wave, where banks and their partners develop sophisticated profiles on each of their customers.

The pace of innovation will continue to increase, and leading banks will need to enable or leverage this innovation. All of this will accelerate the evolution of leading banks into customer-centric information and risk-

management businesses. In 2020, we predict the following:

- **Every bank will be a direct bank; branch banking will be undergoing a significant transformation.** As technology enables every aspect of banking to go online, and as cash usage falls away, traditional branches are no longer necessary. Given their high-fixed cost, branches will need to become dramatically more productive, or significantly less costly. Banks have already reduced staff levels, closed the most uneconomic branches and started experimenting with new branch concepts. We expect these trends to accelerate, as customer expectations and behaviours evolve. Branches will remain, but take many forms, from flagship information, advisory and engagement hubs (offering education, financial advice, full-service capabilities and community offerings) to smart kiosks (offering service, sales, cash and video contact with a range of specialists). Leaders will rapidly improve their footprints, reducing branch size and costs, introducing new models and migrating transactions to low-touch digital channels. Digital capabilities will improve, so that branch service officers and bank customers use the same platforms, with the same look and feel. The human touch will always be available, just much more through digital channels. Banks that are behind this trend

will start to struggle, due to structurally uncompetitive economics. In heavily banked markets such as the US, we expect at least 20% fewer branches by 2020, and that this trend will continue to accelerate. Emerging markets will continue to develop their physical footprints, using a growing range of points of presence.

- **Competitive reach is no longer determined by branch networks, rather by banking licences, technology and advertising budgets.** When every aspect of banking can be done online, a bank's target market and competitive arena is no longer defined by its physical footprint, but by its technology, regulatory boundaries and marketing budget. New entrants will no longer have their pace of expansion constrained by the availability of acquisition targets and/or prime retail locations. In developed markets such as the US, for example, top regional banks could become viable national players and ambitious foreign entrants with resources but without footprint could finally compete on a larger field. New entrants could grow rapidly, potentially creating dozens of new competitors and refragmenting the landscape. Further, we will see ever-more competition from non-bank players. Branding and marketing will be more important than ever before.

Technology will change everything – becoming a potent enabler of increased service and reduced cost; innovation is imperative

- **Surviving banks will be low-cost producers, with nearly every product profitable on a stand-alone basis.** Conventional wisdom suggests banks that engage certain customer segments holistically with targeted offerings, advice and solutions will maintain high margins. We agree. There is a premium customer segment that will find this holistic approach very valuable. However, new entrants will be offering similar high-value services, unencumbered by the massive legacy cost bases of traditional banks. So, even those banks targeting the highest-value customer segments will need to restructure their cost base, while at the same time investing in areas such as customer analytics and compliance data. And needless to say, those banks targeting mass-market customers with simple products will also be dependent on their ability to compete on cost. As the pain of switching providers continues to decrease, customers will become even more mobile – intensifying competition across all segments. Every traditional bank needs to become the lowest cost producer, and (nearly) every product needs to have acceptable returns. Moreover, the lowest cost in 2020 will be up to 50% lower on a per transaction basis than today, as banks redesign their processes and systems for the digital age, structurally changing their cost base and instituting more aggressive ongoing cost management processes.
- **The smart device will grow in importance, and take its place alongside cards as the primary medium for consumer payment.** The customer will be able to select between account providers (e.g. credit providers, deposit accounts) or locally stored value. Acceptance will be universal (with common cross-network payment protocols) and value-transfer instant. Multi-currency capabilities will become normal. Customers will be able to make contact payments or send funds to any other unique identifier (e.g. email address, phone number, bank account, credit card number, etc.). Transfers of locally stored value may be both traceable or untraceable, depending on service provider, as a result, removing removing the last powerful incentives to use cash – privacy, tax avoidance, lack of access to banking services. Cards will remain popular, as they are quick, effective, allow easy compartmentalisation of spend and don't run out of power.
- **Biometrics (e.g. fingerprints, voice recognition) will become commonplace in transaction authorisation, but will remain tied to a replaceable physical device (e.g. smartphone).** Biometrics are unique and unchanging, yet can be captured and replicated, so two-factor authentication (e.g. my fingerprint and my phone) will always be required.
- **Industry utilities will arise in nearly every area of infrastructure** (similar to the US 'bank in a box' vendors such as Fiserv), as cost pressures and technological advances force banks to focus on customer service and risk management, rather than the development of undifferentiated and expensive processing and payments infrastructures. A number of large banks with processing scale and efficiency will commercialise all or part of their operations and technology departments and offer services to other banks. Groups of banks might partner to achieve scale and find best practices, combining their infrastructure into joint ventures. Existing technology service providers will significantly expand the services they offer. Likely examples of processes provided by utilities include customer authentication, fraud checking, payments' processing, basic account infrastructure and KYC processing.

- **Most cross-border knowledge transfer of capital, best practices and innovations will take place through new market entrants, third-party partnerships and intermediaries, rather than through cross-border banking institutions.** We see a significant rise in cross-border banking partnerships and the increasing development of cross-border service providers and advisers to fill the intellectual property gap caused by the shrinking of cross-border banking. This movement is a direct response to the localisation of the global banking system, and the constraints on deploying capital across different jurisdictions. More specifically, we predict a growing mismatch of excess deposits in the developed world and banks unable to satisfy consumer credit demands in the developing world.





Demographics – changing priorities and opportunities for growth

Demographic changes will provide opportunities for growth and will require innovation to develop new products and services.

Developed-market populations are ageing, driving focus towards savings and investment and away from credit and consumption. The developing world is more mixed. China has a similar demographic profile to much of the developed world, for example, which explains the reluctance of the Chinese state to create more of a credit-based ‘consumer culture’, despite internal and external pressures. Brazil, however, has a much younger population, and a rapidly growing appetite for consumer credit.

Individual life expectancy is rising, lengthening expected retirements. For example, a man born in the UK in 2020 is expected by the government to live for 92 years vs. 87 years for a man born in 1990; and the changes are far more dramatic in emerging markets.

Public and private pensions will be restructured, cutting benefits and indexing retirement ages to life expectancy.

The global middle class is projected to grow by 180% between 2010 and 2040, with Asia outpacing Europe by 2015. Over the next 30 years, some 1.8 billion people will move into cities, mostly in Africa and Asia, creating one of the most important new battlegrounds for financial services businesses.

By 2020, we expect:

- **Wealth management will move alongside deposit-taking as a baseline service for retail banking.** Banks without a strong wealth offering will lose share, as customers take increasing responsibility for their lifelong financial well-being and planning in both the developed and emerging worlds, and look for their bank to meet this need.
- **Fee-based revenues will increase as a percentage of total in developed markets and China,** as consumers use longer working lives to save more and take out less (pay down more) debt, and as banks favour growing business such as wealth management and retail brokerage. In developing markets with economic and social stability, we will continue to see rapid credit growth.
- **Cities will continue to grow in attractiveness** – as urban migration creates 1,000m new banked customers, as well as 800m new urban unbanked by 2040.
- **Banking the unbanked (urban and rural) will become a primary policy objective in both developed and emerging markets,** as governments seek to reap the economic benefits of broader access to financial services for their populace. This push will drive new products and business models, and will become the primary focus of governmental or state-sponsored institutions, particularly where the private sector is unable to fulfill the need.



Social and behavioural change – rising customer expectations and the need to regain public trust

Customer expectations are being shaped by their interactions outside of the banking industry – they increasingly want the type and quality of service they receive from industries that place significant focus on customer experience (e.g. the ease of use of Baidu, the seamless integration of Apple products across products and channels).

Customers are also increasingly connected to others across social, geographic and demographic boundaries. This ‘social world’ augments close friends and family as the primary source of information, opinion and recommendation. The smallest piece of noise can be amplified massively and instantly. Everything from reputation to purchasing decisions to sales channels is impacted.

Further, unprecedented numbers of women are heading households, controlling wealth and spending, and becoming the primary earners. In the US, for example, women control 50% of private wealth, head one-third of households, are the primary breadwinner in 40% of families and are increasingly more educated than men. Globally, women control 65% of consumer discretionary spending, and this is set to rise in the coming years.

Customer trust is at an all-time low, and they want their banks to be more socially responsible. They are also concerned about privacy and security, as more of their personal information and financial life migrates online.

By 2020 we expect:

- **Banks will organise themselves around customers instead of products or channels.** They will offer a seamless customer experience, integrating sales and service across all channels. They will develop the ability to view customers as a ‘segment of one’, recognising their uniqueness, and tailoring their offerings so that customers view banks as ‘meeting their needs’ not ‘pushing products’.
- **Banks (in most countries) will evolve their customer experience to be more female-friendly.** In one US survey, 73% of women said they were dissatisfied with the financial services industry. Complaints range from a lack of respect, to being given contradictory advice and worse terms than men. Winners tomorrow will address this through a combination of branding, product and service solutions. We expect many more bankers to be women in 2020, and many more banks to publicly state this as an ambition.
- **Social media will be the media.** Today, we view social media as co-existing alongside traditional media. By 2020, social media will be the primary medium to connect, engage, inform and understand your customers (from the mass ‘social mind’ to the minutiae of each and every individual), as well as the place where customers research and compare banks’ offerings. And, as today,

information and opinion (good or bad) can be amplified, creating new risks and opportunities. Mastery of social media will be a core competency.

- **Customer trust will be returning.** Some banks will benefit significantly from taking a leadership role in the public debate. The leading firms will have reclaimed at least some of the high ground they lost in the financial crisis and begin to reshape public opinion. They will inform and educate – from mass offerings on basic financial skills (imagine a bank-led MOOC on finance topics with high school accreditation) to financial history, culture and economics, reminding us of the fundamental benefits of banking to society. All major banks will incorporate consumer education as part of their sales process. For customers to trust their banks they need to feel that banks are acting in their best interests – common practices such as teaser deposit rates that reset after one year go against this, while the ability to design your own mortgage and control the flow and timing of paperwork is in line with this thinking. In any case, we see conduct risk moving from a largely Anglo-Saxon concern to a global requirement from an increasingly educated and empowered customer.

Social and behavioural change – rising customer expectations and the need to regain public trust

- **Cyber security is paramount to rebuilding this trust – winners will have invested significantly in this area.** Recent high-profile security breaches and media commentary surrounding cyber attacks have generated fear and uncertainty, further eroding stakeholder trust. There are now higher expectations about security of information and privacy among clients, employees, suppliers and regulators. Risks range from internal misuse of social media to organised cyber-crime (e.g. mass information theft, or denial-of-service attacks). In our recent 17th Annual Global CEO Survey, we found that 71% of banking and capital markets CEOs consider cyber insecurity as a threat to their business prospects, more than any other sector. Regulation on cyber security is increasing, and regulators are

intervening – witness Waking Shark II, the Bank of England-led cyber-attack wargame, simulating an attack on the UK financial system. But simply following regulatory rules won't allow the business to keep pace with the constantly growing and changing cyber threats. A proactive response is vital. Key priorities include identifying and focusing resources on the 'crown jewels' most in need of protection. By 2020, leading banks will have developed cyber-security strategies that are aligned with their business objectives, risk-management protocols and regulatory requirements. Many banks lack the resources to tackle these issues on their own, and will have partnered with third parties.

71% of Banking and Capital Markets CEOs see cyber insecurity as a threat to their business, more than any other sector. A proactive response is vital.

PwC 17th Annual Global CEO Survey, Feb 2014



Potential disrupters to this future

It is always easier to take the trends we see today and model their impact on the future. However, a number of ‘big things’ could happen between now and 2020, which could reverse or accelerate existing trends or even create new ones.

Shifting global resources

For example, what happens if the US becomes energy self-sufficient? Or, more radically, if technological developments in shale gas, solar and other clean energy means that nearly every country could be self-sufficient? What would that do for economic development and how would it change trade flows and economic activity? Does this stop or slow the relative rise of the East and decline of the West or does this allow China to grow without importing energy? What do oil-rich, but undiversified economies do when the world doesn’t buy their oil and gas? How would financial markets react and evolve? Would this simply accelerate the likely next battle for resources: water?

War or terrorism

Could a war or a terrorist strike with weapons of mass destruction cause the isolation of a significant country or region and create two or more blocs of financial systems in the world? Could a financial institution operate in both? Would they be allowed to by their home governments?

Healthcare and demographics

Do technological advances in health create quantum leaps in longevity that completely change the world demographic map? With the possibility of working and living productively for another 20 years (or longer), do countries with declining fertility rates have a distinct advantage? What if those advances dramatically cut the cost of care and, by extension, the current health bills and projected health benefit obligations that are constraining economic growth today? What would this mean for savings rates, demand for products and financial institutions themselves as they seek to manage their workforces?

Regulation

We said before that regulation is the most important factor shaping banks today. What if the regulatory burden on the financial sector becomes so great that it is impossible for the financial system to function efficiently and effectively? This, in turn, say, constrains the supply of credit and risk management tools to the real economy at levels that support economic growth in some countries and allow for the payment of sovereign debt. Do nation-states begin to pull out of international agreements such as Basel III and ‘go it alone’ for economic survival, so they can loosen the constraints and gain short-term economic advantage? Does this begin to unwind the improvements in global regulatory cooperation and consensus-building, post the financial crisis and further fracture the cross-border universal

bank model and accelerate the movement towards national vs. cross-border banks? Does it spur a new era of innovation in some countries and regions where alternative risk management and regulatory approaches allow for banks to safely increase lending and economic growth, or does this simply begin the process of creating the next financial crisis.

Financial crisis

What if the next financial crisis occurs between now and 2020? One can see a number of potential areas of risk: from the potential break-up of the Eurozone, the slowdown in emerging markets, and the sovereign debt crisis impacting most of the governments in the world. Even more than the last one, another financial crisis could be truly game-changing, not only for financial institutions around the world, but for the post-World War II geopolitical order that has underpinned the world for the last 70-plus years.

The bottom line is that the more agile and innovative institutions will be those best able to navigate any significant disruptors.



Evolution and disruption – an imperative for change

So let us take stock. ROEs, while improving, remain at or below the cost of capital in much of the world. Growth remains elusive. Regulatory reform, from liberalising rates in China, to capping card fees in the US, is impacting revenue streams. Efforts to cut costs have not been transformative and compliance costs have risen. Bankers admit that today's execution will not be sufficient (even as it is necessary), and that much more needs to be done.

The industry is at an inflexion point. Changing customer expectations require significant investment. Technology may render much traditional infrastructure obsolete while enabling superior service, growth and new competition. Bankers understand that the operational complexity of the past needs to be addressed to provide the efficient, effective platform for the future.

Banks need to get ahead of these challenges and retool to win in the next era of competition. This is imperative, and also a tremendous opportunity. Banks need to make hard choices about which customers to service, how to win and where not to play. They need to rebuild their organisations around the customer, simplify and structurally reduce cost. They need to learn to be agile, innovative and adaptable in order to execute effectively.

Much has been written about the current banking competitive landscape and the models that successful banks are following or should adopt in the future. For example, should one focus on wealthier sophisticated customers and offer a complete and high-margin complex product set? Or perhaps concentrate on delivering simple banking products at the lowest cost, leveraging direct distribution channels? Or seek the benefits of being the largest scale player?

In 2020, we expect to see new models and fiercely disruptive competitors. For example, what if a leading social network chose to set up a banking and payments business? Or if a leading search engine was to emerge as a global crowd-sourcing platform, raising funds and then voting on which competing enterprises should benefit?

We don't believe the future is clear enough to present a complete and detailed analysis of business models, market shares and margins of all players. In a way, that isn't the point – particularly given the high levels of uncertainty. Rather, we encourage banks to be thinking today about this disruptive future, and developing their own plans for success, plans that include developing agility and optionality – the characteristics that create value in times of uncertainty. These plans should address today's imperatives, contain a clear vision of the bank in the future and be adaptable enough to change as the world continues to evolve.

In short, banks need a clear strategic vision, and they need to do things differently.

In the next section we discuss how.

3

Six priorities for 2020

Each bank needs to develop a clear strategy to deal with this transforming landscape. They need to decide whether to lead, to follow fast, or to manage defensively, putting off change. They need to create agility and optionality, to adapt to rapid change and future uncertainty. Yet, whatever the chosen strategy, success will come from successfully executing the right balance across the following six priorities.



From our work with leading players worldwide, from our research into the macro-trends impacting banking and from our survey of global banking executives, we have identified the following six priorities for retail banks to win in 2020:

- 1 Developing a customer-centric business model.
- 2 Optimising distribution.
- 3 Simplifying business and operating models.
- 4 Obtaining an information advantage.
- 5 Enabling innovation, and the capabilities required to foster it.
- 6 Proactively managing risk, regulations and capital.

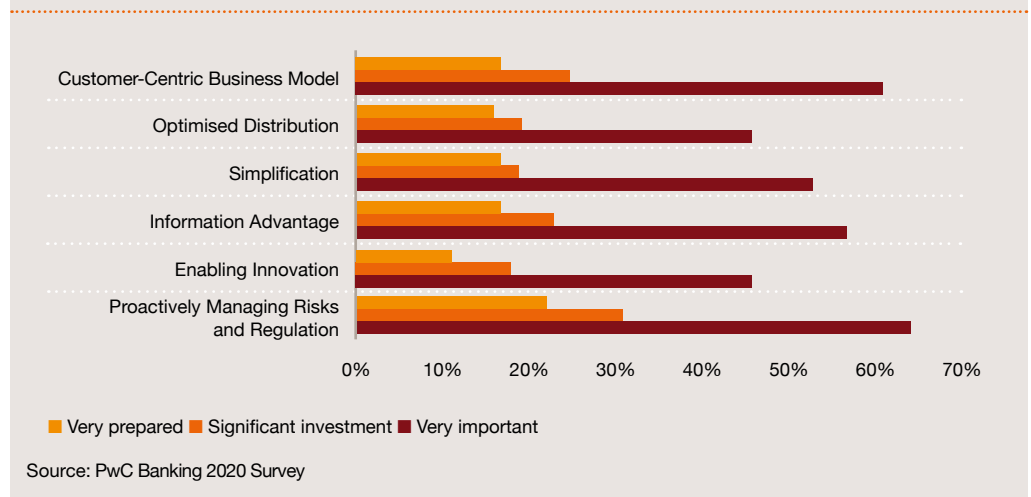
Every bank needs to develop a view of the future landscape, and the uncertainties surrounding it. Every bank needs a clear view of its own unique strengths and challenges. And every bank needs to develop its posture against this evolving and uncertain future. Every bank needs a clear strategy.

Yet, whatever the chosen strategy, it will involve executing a balance across these six priorities.

Banking executives agree that these priorities are very important, with each of them scoring between 4.3 and 4.5 (out of 5) in our survey. However, we found a striking gap between those ranking these priorities as ‘Very important’ (46%–64%) and those stating that they saw themselves as ‘Very prepared’ (11%–17%) and/or that they were making a ‘Significant investment’ (18%–25%) in these areas. Technological, organisational, talent and cost constraints were viewed as the greatest obstacles to success.

Below, we discuss each priority in turn. In this short paper we can barely scratch the surface of these complex issues. We welcome the opportunity to have a deeper conversation with you on these topics, as well as on crafting your overall strategic response.

Figure 6: Six Priorities: Significant gap between preparedness and importance



Designing your Fiercest Competitor. Mastering change by making it real.

It's hard to take big-picture trends and priorities, and translate them into tangible actions. It's even harder to be unreasonably aspirational, yet realistic in what can be achieved. Designing your fiercest competitor is a concrete way to tackle these abstract ideas – and identify how and where you need to change, to thrive in 2020.

PwC has worked with dozens of clients to re-imagine their companies in a practical, results-oriented way. In a way that leverages the ambitions and insights of your top team, and helps build real alignment as to the path forward. In a way that doesn't take six months and millions of dollars.

Imagine a series of facilitated workshops where your business and functional leaders are asked to think differently, to move beyond the incremental and imagine what could be. And then translate these insights into realistic actions. Actions that have been debated and agreed across business and functional silos. This is 'Designing your fiercest competitor'.

- **Catalyse provocative thinking.** We analyse industry trends and drivers, and assess their importance – to ensure a shared understanding of the industry landscape. We develop aggressive and disruptive scenarios – and then use them to provoke your leadership team into re-imagining the business.

- **Design your fiercest competitor(s).** We ensure participants take an end-to-end perspective, and define their fiercest competitor – a competitor with disruptive strengths that ruthlessly exploits your weaknesses. We design this competitor in a variety of different future scenarios. We define a fiercest strategy (value proposition, sources of sustained advantage, where to compete) and a fiercest operating model (organisation, processes, technologies, culture), so that you fully understand how these new players will win.
- **Make it real.** Finally, we translate the insights gained from designing the fiercest competitor into tangible actions for your own business. First, teams gain a heightened sense of priority – and decide to accelerate existing initiatives and abandon others, so as to focus scarce resources in the most critically competitive areas. Second, teams imagine new third-party partnerships. And finally, teams begin to develop ideas for disruptive business designs – ways to change their own strategy (where to compete) and operating model (how to compete) – to attack the market in similar ways to the fiercest competitor.

Our Fiercest Competitor Workshop is a powerful and practical tool to rapidly craft an integrated strategic response to these evolving forces

Part 1: Fiercest Strategy

Discuss industry perspectives, gain insights on market challenges and potential disruptions

Result: Quickly get past biases that may distort your market view and cause you to miss potential competitors

Part 2: Fiercest Business Model

Design the Fiercest Competitor and strategies for a new business model

Result: Rapidly assess impacts to your business model, and determine the best strategic path forward

Part 3: Closing The Gap

Make the organisation become the Fiercest Competitor

Learn to quickly work through business model challenges

Result: Avoid polarising viewpoints while quickly identifying and resolving the root causes of problem areas

Part 4: Prioritised Path Forward

Turn the discussion takeaways into action items
Gain expertise in roadmaps, mobilisation, and execution

Result: Work through challenges and prioritise the solutions as part of a long-term go-to-market strategy

Developing a customer-centric business model

Banks today have a simplistic understanding of their customers and a vastly complex product set. The winners of 2020 will turn this on its head. They will develop a much more complete understanding of their customers and dramatically simplify their product set, and so deliver a significantly enhanced customer experience with lower levels of operational risk. Begin with understanding customer needs, not with products and pricing.

Much has been written about the need to develop a more customer-centric business model. And many banks have been investing in improving the overall customer experience. But few (if any) have attempted the sort of wholesale transformation of their operating model which we believe necessary to win in 2020.

Our survey indicates a growing awareness, but a significant gap in preparedness. Sixty-one percent of bank executives say that a customer-centric business model is ‘very important’, and 75% of banks are making investments in this area (this pattern is consistent globally). Yet only 17% feel ‘very prepared’.

Banks today typically do not know their customer very well. Now, at the product level, many banks have invested significantly in customer analytics – plenty of credit card providers, for example, understand a customer’s value potential, can track spending patterns and make targeted offers. Yet, many still send customers multiple product offers in the hope that something will stick. And few can analyse a customer’s deposit account, see that his salary deposit has increased, and send a note congratulating the customer on his or her promotion together with an offer of a premium card and a higher credit limit.

Banks struggle to join the dots internally and prepare bank-wide views of a customer relationship, let alone integrate external sources of data. And, as such, risk and credit decisions are typically taken at the product level, not at the customer level.

Many banks carry vast product sets, with subtle differences, frequently not appreciated by customers. This comes with a consequent cost in operations, technology, service and, at times, risk and regulatory challenges. Systems are not modular in design, so that each variant adds to this complexity and cost. Legacy products, no longer offered for sale, are rarely discontinued. And every bank customer has experienced the thrill of being passed from call-centre operator to call-centre operator in the vain hope that one of the them can solve the problem, that is if they can figure out how to talk to a real person at all. No wonder customers are frustrated and regulators are concerned about fair customer treatment.

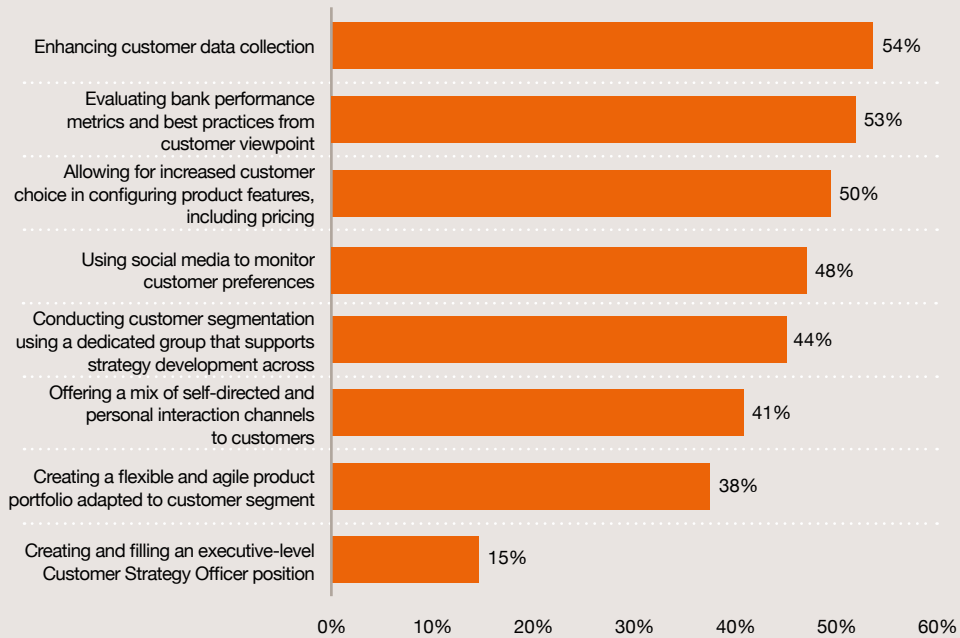
Yet, even as banks invest today to address these issues, the bar just keeps on rising. Customers are redefining their expectations, taking their cues from other industries that offer multichannel access, product simplicity, seamless integration and ‘segment-of-one’ targeting. They want convenience, personalisation, accessibility and ease of

use. They want to feel like their bank is anticipating their needs, not bombarding them with product offerings. They want transparency and no surprises in terms of fees. Today’s definition of first-class service, which most banks are a long way from delivering, is rapidly becoming a baseline expectation. And banks know that better customer experience leads to greater loyalty, advocacy and revenues.

The winners of 2020 will develop a much deeper, holistic understanding of their customers. They will need to acquire, integrate and analyse multiple sources of internal and external data. They will be able to understand their customers’ needs, and be present with a relevant solution at the time of need. They will simplify their product sets. And they will redesign their core processes from a customer point of view.

Further, they will (re)answer the most fundamental questions of who are their target customers, what is their value proposition to those customers and what competitive advantages will distinguish them in the marketplace. A bank does not need to be all things to all people to succeed.

Figure 7: Areas of significant effort over next 5 years



Source: PwC Banking 2020 Survey



Executing on today's imperatives.

Better customer service is rapidly becoming a baseline expectation, yet most banks are far from delivering it. Here's how to do better.



In our paper 'Experience Radar 2013 – Lessons from the U.S. Retail Banking Industry', we describe the actions banks should take to ensure a memorable customer experience. We see these lessons as broadly applicable across the globe.

- **Win the fee war.** Fees and rates dominate the banking experience – they are the number one driver of customer purchases, and two in five bad experiences touch on rates and fees. Frequent changes have frustrated customers. Mitigate this frustration with better communication and more customer-friendly fee strategies.
- **Fix the bad, fast.** Customers want to feel like their bank is working with them, not against them. Don't let customers walk away with a sour taste in their mouth. Two in five customers leave banks after a bad experience, and 45% of those will actively discourage others from using that bank. Turn issues into opportunities to build loyalty. Empathy and an apology go a long way towards satisfactory problem resolution. Identify these negative experiences and work to remove the causes.
- **Help your story get told.** Customers can become your best marketers. Look to your staff to make this happen. Fifty percent of recommendations are due to good experiences, not to rates or products. Identify key influencers among customers to serve as brand advocates – promoters account for 80–90% of positive word of mouth. Manage social media exposure – one in four customers share experiences this way.
- **Go digital.** Customers want to interact whenever, wherever. Give them the convenience they seek through digital tools. Sixty-one percent of customers want to research on their own, and 42% buy on their own without help from representatives or experts.
- **Balance automation with the human touch.** Sixty percent of great experiences are due to great staff. Twenty-five percent of customers rely on staff to do research, 46% to select products and 63% to resolve their problems. Create a multichannel strategy that balances cost and service. Encourage self-service for routine matters, and refocus branch and contact centre staff on higher value-added activities like relationship building and sales.

Optimising distribution

Historically, banks with the best branch footprint have dominated their markets, gaining outsized share. By 2020, all banks will be direct banks, and branch banking will be changing fast. Leaders will offer an anytime, anywhere service, fully utilising all banking channels in an integrated fashion. They will be re-imagining their physical footprints, introducing new branch formats, expanding physical points of presence through third-party partnerships, driving sales and cutting costs. As transactions and sales shift to digital channels, branches that cannot create incremental value will need to close, or be transformed.

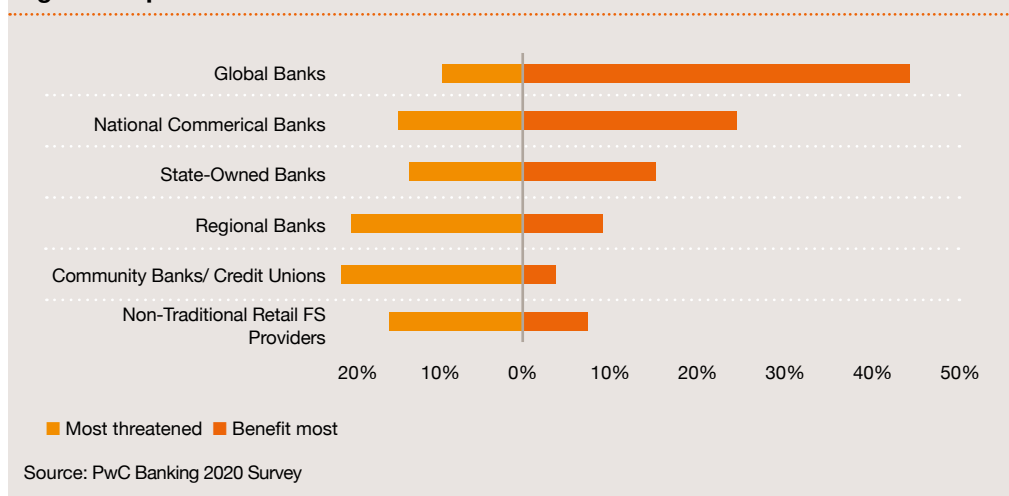
The coming revolution in branch banking and the need to optimise distribution networks is clearly top of mind for banking executives. Eighty-five percent of respondents see optimising distribution as important, 71% are making investments in optimising distribution (with an additional 22% expecting to do so in the near future). Globally, 82% of respondents feel that their organisation's distribution model needs to change (90% in emerging markets).

Fifty-nine percent of respondents expect the importance of branch banking to diminish significantly as customers migrate to digital channels, and 48% expect branch banking to change significantly by 2020. Yet, only 16% of respondents viewed themselves as 'very prepared' for this shift. Respondents globally view the largest banks as benefitting most from these changes, and smaller regional and community banks being the most threatened.

Banking was once all about real estate – banks were located in prime locations and built to project strength, stability and safety. ATMs, telephone banking and then the internet – all provided added convenience and expanded a bank's reach. But real estate still rules supreme, and many products still require customers to transact through a branch

We are now at a digital tipping point, with rapid technological advances enabling all

Figure 8: Optimised distribution



aspects of banking to be conducted online. And customers' expectations are evolving in tandem. They want to transact at their convenience, with information and advice at their fingertips. Even many of those who value the privacy and face-to-face interaction you find in a branch, will soon demand this from their office or home. They do not want to be forced to travel nor wait in line.

Further, branch network costs are very high, with few easy ways left to reduce them (for example in the US, banks have already

reduced staff – from 13 FTE per branch in 2004, to an average of less than 6 today). New, digitally focused, competitors are not so encumbered.

Quite simply, distribution is ripe for digital disruption. The transformation of the music, film and print publishing industries provide chilling analogies for those banks unable to get ahead of this trend.

Optimising distribution

The vast majority of banks aren't there yet. But the leaders understand these dynamics and are moving fast, experimenting with new concepts. By 2020, banks will manage distribution holistically. Products will not be built-into, or serviced through, the channel: rather, banks will develop shared platforms that distribute products across all channels. Future in-branch advisers will use the same technology and infrastructure available to bank customers. "Let me help you open an account sir? You want to do it yourself? Sure, just go online – you can borrow my tablet, or use one of the touchscreens. You have your own? Terrific, take a seat and let me get you a coffee." Every bank, whether in the developed or developing world, will be a direct bank.

Distribution is ripe for digital disruption. The transformation of the music, film, and print publishing industries provides chilling analogies for those banks unable to get ahead of these trends.

The value of a branch will need to be redefined. There will be different models, tailored to specific purposes – for example, flagship stores, community centres and expanded ATMs. 'Flagship' branches will offer information, education and advice to drive engagement, loyalty and sales. We would expect them to host events, such as a seminar on 'The challenges of growing a small business', with small business advisers and product specialists on hand for questions and drinks after. They will be in high-value high-traffic locations. 'Community' branches will be smaller in scope, focused on community outreach and engagement (e.g. offering financial education and wealth-management advice). 'Expanded ATMs' will be in-store or in other well-trafficked sites, and as valuable as marketing, sales, transaction and cash-handling points – perhaps even with dedicated staff. Partnerships with third parties will enable banks to further expand their reach with significantly lower real estate costs.

Advisers and product specialists will be present in all types of branch – in person, or by video from centralised advisory offices – expanding sales' reach. Tellers will need to evolve into financial advisers, fluent in all bank products – a massive transformation of skills. Banks will likely need to simplify their product sets – for the benefit of both employees and customers. Transaction processing will be almost entirely digital –

though many transactions will continue to be 'in store', just conducted through smart ATMs, tellerless kiosks and touchscreens.

In developed markets such as the US, leading banks in 2020 are likely to have a far greater number of physical points of presence and far fewer 'traditional' branches – perhaps as many as 20% fewer across the industry, with the trend accelerating through 2020 as leases roll off.

In developing markets, where branch networks are thinner, physical distribution will continue to evolve, and banks are more likely to partner with new entrants to create alternative distribution channels (for example, M-PESA in Kenya, handles deposits and payments using a network of agents and customers' cellphones and is used by two-thirds of the adult population).

These trends are inevitable, and banks today need to choose what path they want to follow. What is your future distribution vision? At what pace do you want to change? Do you push aggressively to precipitate this change and capture advantage, through digital optimisation, alliances, partnerships, spin-offs, closures – or manage defensively to postpone the inevitable.

Executing on today's imperatives.

High-cost branches cannot survive in their traditional form. Evolving the network today to align with changing consumer behaviours and economic realities can help banks position themselves for the future. Here's how.



In our paper, 'Rebooting the Branch: Reinventing branch banking in a multi-channel, global environment', we discuss the evolution of branch banking in detail.

Leading banks are moving away from 'managing branches' and instead are 'managing distribution' across all the bank's channels including evolving branch models to balance local-customer needs with the high cost of branch delivery. They are designing their branch strategies to deliver a differentiated experience, based on customer needs, the competitive landscape, brand promise and internal capabilities:

- **Begin by focusing on the customer experience**, answering the question: Who are we and what kind of bank do we want to be? Consider customers, competitors, brand and capabilities.
- **Choose an appropriate mix of branch models** to support the desired customer experience. We see various models being experimented with today – assisted self-service, in-store branches, full-service branches, community centres and flagship stores.

- **Design an optimised distribution network** that supports the needs of the local markets and scales to the density of market opportunity – meeting customer needs and minimising the cost of delivery.
- **Develop intuitive, experience-driven individual branch designs**, based upon a deep understanding of customer needs, behaviours and usage.
- **Redefine the operating model** including the organisational structure, branch processes and infrastructure – to support the branch model and network design.
- **Develop cross-channel enablers** to deliver a seamless and consistent customer experience – regardless of branch model mix.

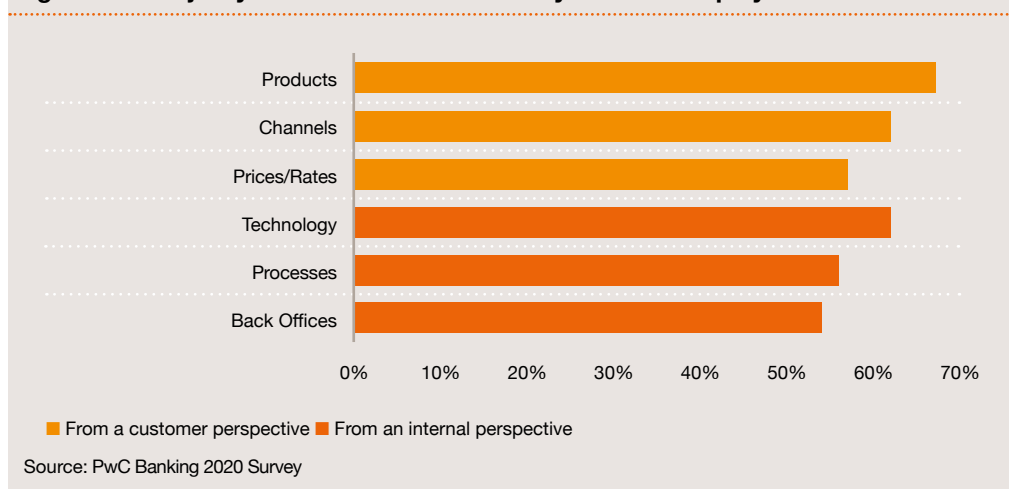
Simplifying the business and operating model

Banks have developed staggeringly complex and costly business and operating models. Now they must simplify. Rising customer expectations, increasingly active regulators and stagnant shareholder returns demand it. Efforts to date have not been enough. Start with the customer and work backwards – simplifying the experience requires that products, channels, organisation, operations, all simplify and change. This is a big deal – but getting it right can deliver an improved customer experience, structurally lower cost and reduced levels of operational risk.

Banks have developed staggeringly complex and costly operating models. Often, each product has separate operations, technology and risk management processes. And banks typically have a multitude of products, many not even offered to new customers, all of which require some kind of operational customisation to serve. In several cases we have found that only 5% of products deliver over 80% of revenues and an even larger percentage of profits. Further, many banks have been built over decades of acquisitions, and new product and channel development, typically with each development adding additional systems, processes and costs. Few have tackled the difficult and expensive work of integrating, optimising and simplifying their platforms.

A majority of banking executives (53%) believe that simplification is very important, and 70% are making some level of investment in simplification. Yet, only 17% feel well-prepared. Taking a customer perspective, a majority of executives believe their banks must simplify products, channels and prices/rates. Taking an internal perspective, a majority of executives believe they must simplify their technology, their processes and their back offices. Bankers believe that simplification will lead to better service, lower costs and increased profitability.

Figure 9: A majority of executives believe they need to simplify



This complexity and redundancy drives poor customer experience, high cost, operational risk, employee frustration and regulator unease. And the traditional separation between customer-facing activities, and operations and technology means few business leaders are strong end-to-end managers who understand sales through delivery. Indeed, we frequently hear of business leaders complaining about their operations and technology cost allocations, instead of managing them.

Since the crisis, banks have been fighting hard to cut costs. Headcounts have been significantly reduced, belts tightened. Every bank has launched re-engineering efforts with some considerable successes. Yet, expense ratios remain stubbornly in line with pre-crisis levels as regulatory implementation costs continue to rise. And with higher capital charges, ROEs remain depressed. Customer demands and competitive intensity are both increasing. Banks need to do something different – more of the same is not enough.

Figure 10: Bankers believe simplification will...



A strategic redesign of bank business and operating models is needed – a major simplification and automation – to enhance customer experience, structurally reduce costs, reduce operational risk and prepare for the next era of banking.

Banks need to start with the customer and ensure they truly understand what customers want, and what they are unhappy with. They need to consider their business models in light of this – the package of products and services they offer. They need to consider their organisational capabilities and alignment, their operational

processes and their technology platforms. Redesigning the bank operating model requires a fundamental shift in how retail banks think about their operations – product simplification; integrated distribution; shared service infrastructure; risk management at a customer not product level; streamlined compliance processes.

Finally, banks need to arm their executives with information and tools to continuously manage costs, once the new models are put in place. Too often there is insufficient transparency around unit costs, cost drivers and what is best in class.

The most successful banks are learning from other industries. Many consumer products companies (Adidas, Apple) do not own the entire value chain. They focus on what makes them distinctive – product design, marketing, distribution – and contract out much of the rest to third-party specialists. Leading banks will know their customers intimately; they will design solutions to meet their needs, provide advice and capital, and manage risk. Much of today's infrastructure is not a source of competitive advantage. We expect the continued rise of industry-wide or multi-bank utilities – with more banks outsourcing processing activities. We expect leading banks with scale to insource effectively from others, or create independent utilities to do so. If customer and risk skills are the core of future banking, then the entire manufacturing process is a candidate for outsourcing.

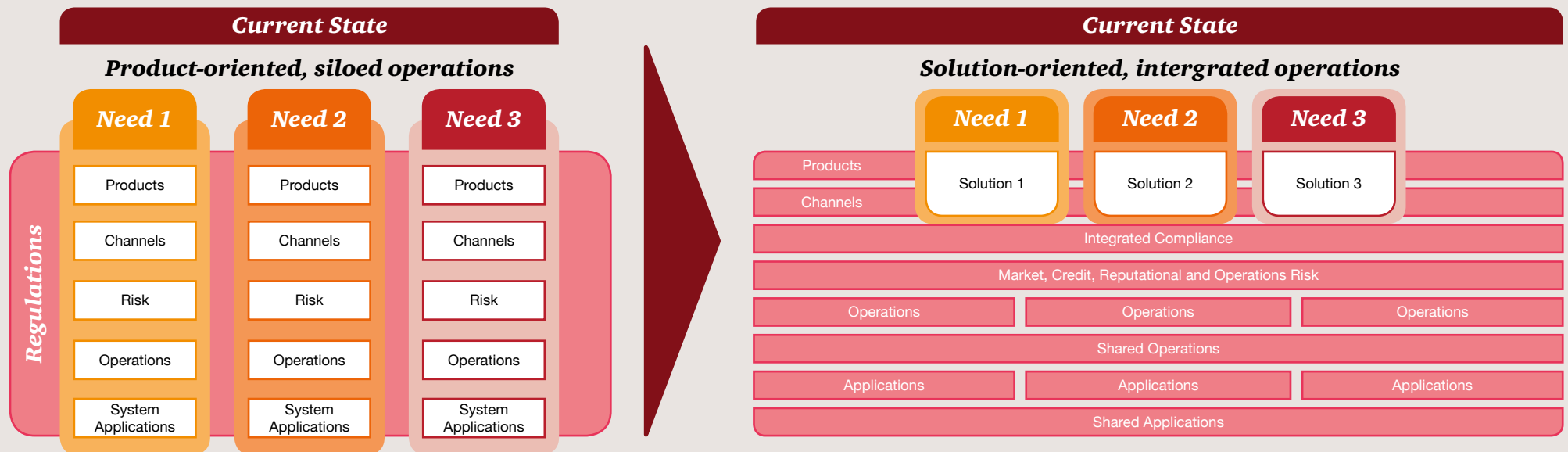
Financial institutions globally believe simplification will deliver a myriad of benefits.

Simplifying the business and operating model

Leading banks will make simplification a priority. They will strategically redesign their business model, end-to-end. They will develop multi-year change programmes. And they will ensure that they have the organisational capabilities necessary to achieve the change.

Banks that get this right will achieve dramatic results. In our experience, by taking such an end-to-end perspective, we have seen clients realise 50% performance enhancements on key customer metrics, together with 25%+ cost reductions and reduced levels of operational risk.

Figure 11: Banks that move towards solution-oriented integrated operations will be the winners in 2020



Source: PwC Banking 2020 Survey

Executing on today's imperatives.

Banks need to dramatically simplify their business and operating models to enhance customer service and structurally reduce cost. We leveraged our battle-tested Strategic Business Design approach to help one client achieve precisely that.

Our client, a global provider of financing solutions, was facing the familiar pressures of rising customer expectations, increased cost of capital, growing competition and ongoing pricing pressure. Like many players, they were highly siloed by functions, businesses and products. Turnaround times and error rates were higher than they desired, driving too many customer complaints. Their cost-to-serve was higher than the industry average. Processes were non-standard and involved multiple hand-offs. Employee satisfaction was low.

Over an 18-month period we helped them design and deploy an innovative new scalable and sustainable operating model, in this case without touching the underlying technology platform. It achieved results. They reclaimed 50% of sales team time to focus on revenue generation. They reduced cost-to-serve by 25%. Processing performance improved 45%. Turnaround times and error rates have reduced significantly. Processes were standardised, and handoffs reduced (from an average 20 to 3). Customers and employees are happier.

This tried and true approach yielded real, rapid benefits. And it realised sufficient savings to enable our client to then reinvest in transforming the underlying technology platforms – so enabling even greater savings.

The critical elements of our approach included:

- **Developed a detailed current state understanding.** Conducted voice-of-the-customer analysis to align customer needs, value proposition and service delivery. Leveraged lean to identify current state issues and opportunities. Analysed spans, layers, location and headcount to identify gaps and opportunities. Conducted competitor benchmarking to inform and underscore case for change. Conducted stakeholder readiness analysis – to inform change management strategy. Developed robust and realistic business case.
- **Designed and tested the revised operating model.** Leveraged lean to redesign and optimise processes, and develop a revised operating model. Streamlined processes, and functionally aligned the organisation. Conducted 'wargame' simulations to test the new processes and provide baselines and targets for the revised operating model.

- **Managed the deployment to success.** Developed critical programme management, change management and continuous improvement infrastructure. Created a detailed incentive structure to align the performance framework with strategy. Established performance management, monitoring and reporting – with KPIs and detailed information. Built organisational capabilities – trained over 50 client leaders on internal continuous improvement, to facilitate empowerment and build culture of improvement.

Obtaining an information advantage

Getting this right will be a game-changer. Fast movers will create competitive advantage in every area of the bank – customer experience, underwriting and pricing, operations, risk management and financial/cost management. Few banks will be able to master the skills to integrate, analyse and act upon the insights from the ever-increasing mass of data. Executives expect the largest banks to be the winners. We expect third-party providers to emerge to help the others.

Customers (and banks themselves) now generate exponentially more information than ever before. Leading players will harness both structured and unstructured information – from traditional sources (such as credit scores and customer surveys) and from non-traditional sources (such as social media, and cross-channel bank customer interaction data). They will ‘wire’ their own operations to build the information rigour more typical of the manufacturing industry. And they will collect and purchase other behavioural data (such as mobile location and purchase data) – particularly as

customers grow accustomed to forgo some degree of privacy for proven value.

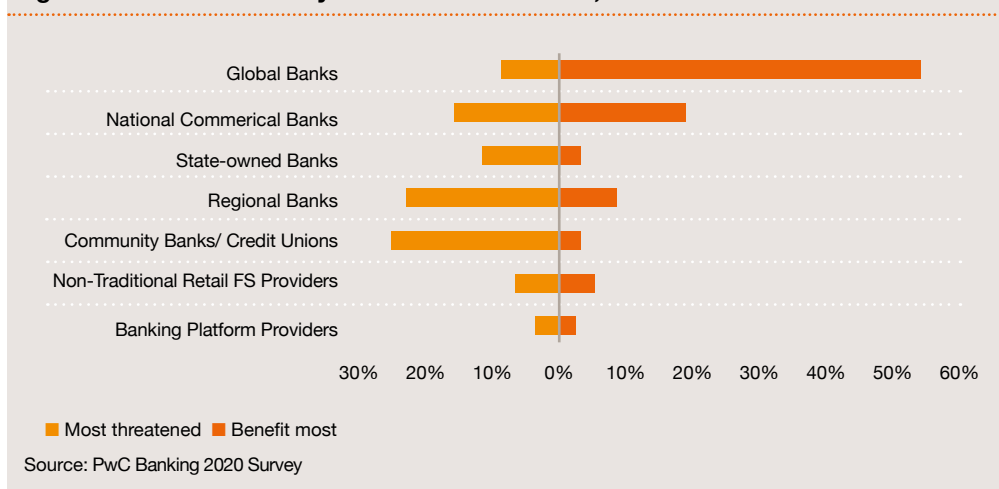
Leading players will develop advanced analytics capabilities to integrate this vast library of data, analyse it and create actionable insights. 57% of bank executives consider these capabilities to be very important (with 92% considering them very or somewhat important). Three-quarters of institutions are making investments. Yet, only 17% believe they are very well-prepared.

Banks will use these capabilities to create an enhanced and connected customer experience – to understand a customer’s need and be present at the time of need with a relevant offer. For example, spotting that a current bank customer is walking into a car showroom, and sending a message that the customer has been pre-authorised for financing (based upon analysis of existing accounts and spending behaviours).

Banks will enhance their credit, risk and pricing models (adding, for example, social media reputation scoring). For example, a bank may be able to detect the beginnings of trouble at a small business, well before receivables and turnover start to show signs of weakness, by identifying negative trends in social media – enabling a much higher quality of risk management and customer service.

Finally, banks will develop a much more sophisticated view of their cost structures and the key drivers of that structure. They will use analytics and benchmarks extensively to constantly measure performance with defined metrics and ‘best-in-class’ competitors.

Figure 12: Advanced analytics – Who will benefit, who will be most threatened





Bank executives (54%) expect only the largest global and national banks to master this capability – in line with their capacity to invest. We expect those players to gain significant competitive advantage, until these capabilities are available to all. Other banks will need to forge partnerships with third parties to match this advantage. We expect innovative service providers to emerge and assist smaller banks in competing with larger institutions. Among others, we expect today's technology services providers to develop these offerings – it will not be enough in the future to provide technology and processing platforms, without information and analytics. This will enable the rest of the banking industry to catch the leading players and reduce their early advantage.

To master these capabilities, banks will need to learn how to create an open, agile and innovative organisation. They will need to attract and retain a new sort of talent (seen by executives as the biggest barrier to success). They will need to pay more attention to foundational data management and data governance.

Building these capabilities will create significant advantage in the near/medium term, and be critical to successful competition in 2020.

Executing on today's imperatives.

Understanding and Leveraging Social Data. Social phenomenon, along with other trends, has shifted the balance of power to consumers, accelerating the need for greater engagement. PwC's SocialMind can deliver actionable insights from social media.

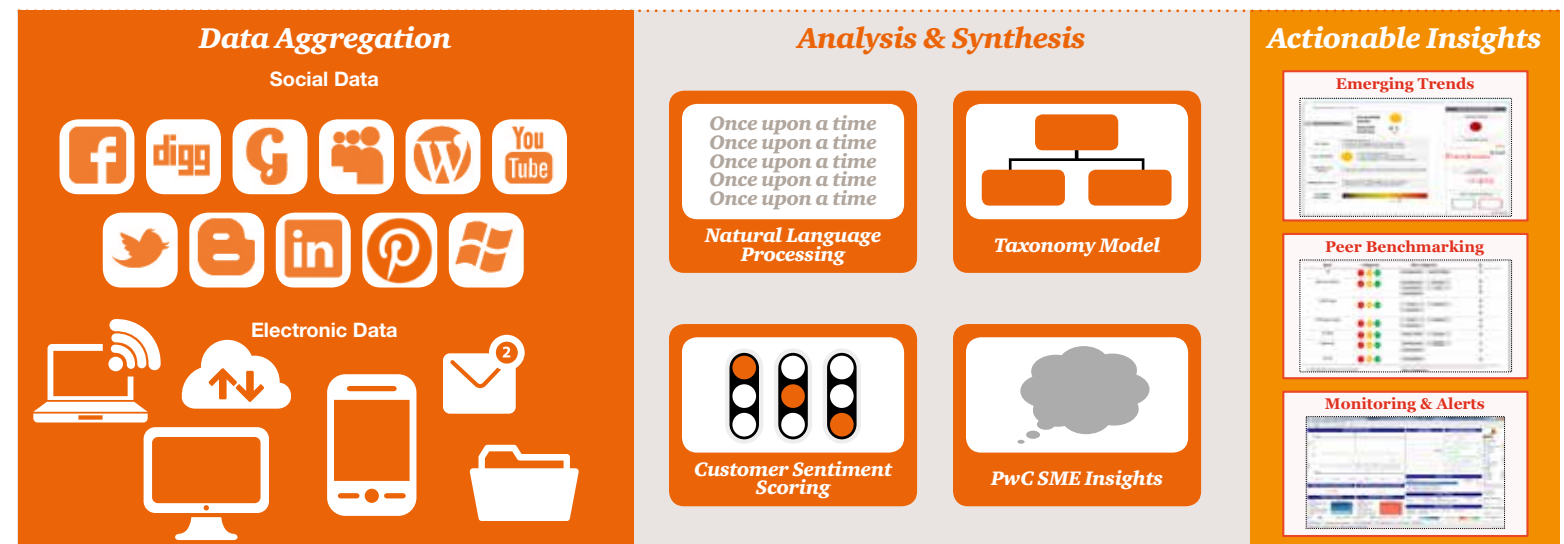
Social media has created both opportunities and risks. Opportunities include greater engagement and proactive risk management. For example, 90% of customers trust recommendations posted on social media websites, and 71% are more likely to make a purchase based upon social media referrals. Banks can gather customer feedback to generate leads, tailor products, improve customer experience and spot trends earlier. And leading indicators can enable banks to spot operational risk breaches, and proactively address reputation issues early. However, social media also brings greater risks – lower bargaining power and influence, and greater risk of brand damage. Customers are empowered to voice grievances widely, and have much greater transparency to features and price.

One client wanted to capture these opportunities and manage these risks – developing actionable insights and recommendations well beyond their existing capabilities. We helped them, leveraging our *SocialMind* toolkit. This combines best-in-class social, web and text listening, and analytics capabilities, leveraging both project-based analysis and ongoing tools.

Our client identified loan modification issues at competitors, enabling its own proactive operational management. They identified a fake bank website scam, and took steps to proactively manage complaints and their reputation. They identified customer complaints about loan transfers, and used these inputs to enhance their product. They set up the following new capabilities:

- **Peer benchmarking** – allowing volume and sentiment comparisons across a series of categories, and enabling focused issue identification.
- **Trend and control analysis** – allowing identification of anomalies and variances from the normal range of volume mentions and sentiment ratings, and enabling identification of root causes.
- **Early warning radar** – allowing identification of emerging issues and topics ranging from regulations to customer experience to operational risk, as measured by acceleration in volume or sentiment.

PwC's Integrated SocialMind Platform



Source: PwC

Enabling innovation, and the capabilities required to foster it

Innovation is the single most important factor driving sustainable top- and bottom-line growth in banking. But banks today are not known as places where innovation thrives, nor are they the favoured destination for top software engineers and other innovators. Banks need to organise and manage differently – protecting and enabling talent, becoming agile in their development processes and being open to partnerships with outside institutions. Developed market executives will need to take more of an innovative mindset.

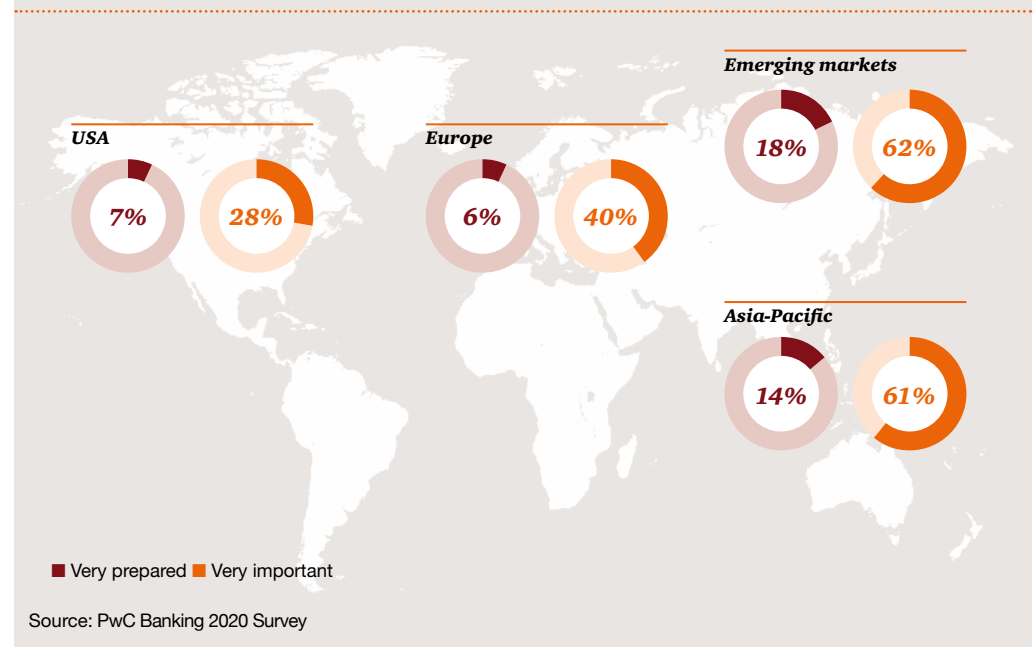
Innovation will be the single most important factor driving sustainable top- and bottom-line growth in banking over the next five years. Innovation is doing things differently. Not just new products or a new customer experience, but doing things differently across the entire business model including transforming the business model itself.

Innovation within the banking industry is considered to be somewhat or very important by 87% of respondents, yet in stark contrast, only 11% believe they are very prepared. And there are significant regional differences – over 60% of executives in Asia-Pacific and the emerging markets view open innovation as very important; however, only 40% of European executives and 28% of US executives agree. We believe developed world executives need to take more of an emerging markets view of the importance of innovation, particularly once the new regulatory framework stabilises.

Executives believe that the large global and national banks will benefit most and that smaller community banks and credit unions will be the most threatened.

Executives report that their main focus areas for innovation are customer interfaces and channels (57%), followed by customer need identification (53%), products (52%)

Figure 13: Open innovation – importance and preparedness



and core platforms (52%). In Asia-Pacific, there is much less focus on interfaces and channels (44%), likely reflecting the greater penetration of mobile banking, and much more focus on customer need identification (59%) – to help create that enhanced customer experience. The emerging markets

place more focus than other markets in every area (all above 64%), with the greatest focus being on innovating their core platforms (67%).

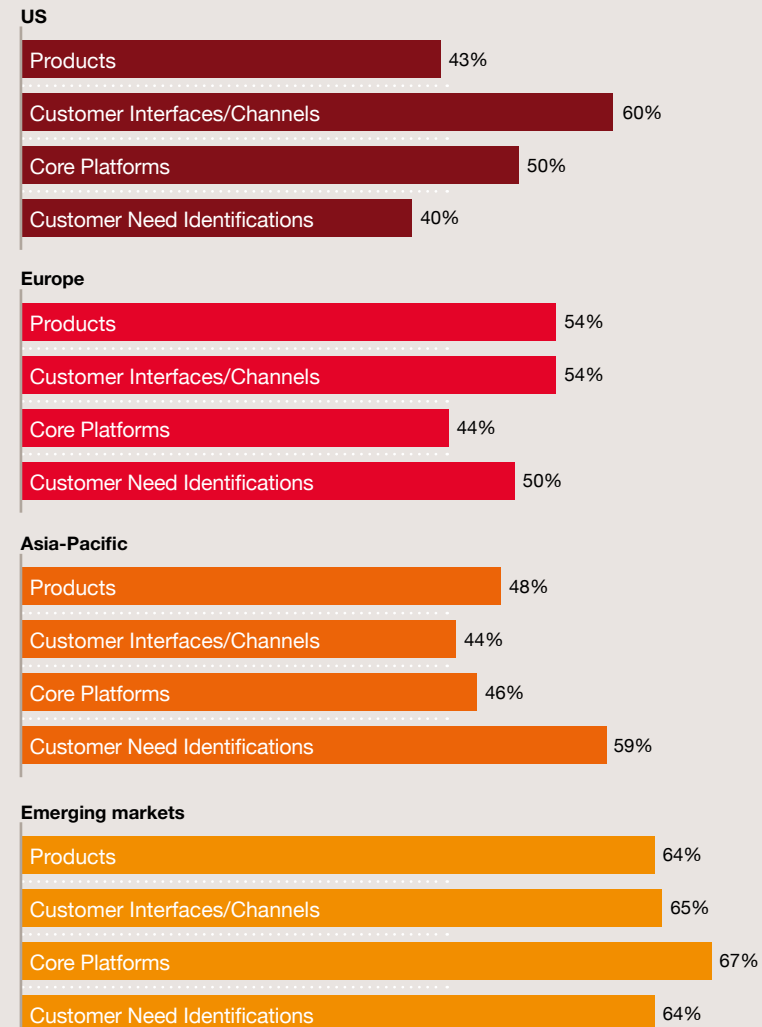
Enabling innovation, and the capabilities required to foster it

Banks are not today known as hotbeds of innovation. While the sector has had its fair share of innovation over the years, today, banks tend to be cautious, bureaucratic, and subject to multiple layers of process and stifling levels of oversight. Executives recognise they need to do things differently. Over 50% are planning to enhance their internal capabilities to foster innovation, and to create innovation management teams across business units. Perhaps most importantly, there is a recognition that partnerships and third-party relationships may be the best way for banks to reap the benefits of innovation.

To succeed as innovators, banks will need to organise and manage themselves differently.

Talent. Banks need a new type of talent and a new way of managing it. They need to attract people who think big and who challenge the status quo, people who are obsessed with the customer and not with the process. Banks need to enable them to succeed. These people need inspirational oversight and cultivation, not check-the-box management. They may need to be managed outside of the existing corporate structure – with different reporting lines, different measures of performance and even different office space – asking people like this to report to the typical bank IT project manager or embedding them one by one in the business is likely to lead to failure. Many banks have set up dedicated innovation labs outside of their head offices to accomplish just this.

Figure 14: Area for innovation



Source: PwC Banking 2020 Survey

Agile development. Banks need agile product and technology development skills – to bring new products and capabilities to market much quicker than today. This requires continual iteration, real-life pilot testing and rapid learning from customers. This does not require writing and rewriting business requirements documents, 12-month product release cycles, or technology organisations far removed from the customer.

Partnerships. Major innovations are taking place outside traditional banks. Banks might foster partnerships and create new ecosystems for innovation – ranging from technology start-ups to academic institutions, or even with non-bank players.

Senior sponsorship. Because of these challenges, the entire innovation effort will need very senior sponsorship. When people are asked to do things differently, they need to believe they will be rewarded, not penalised, for doing so. People look to the actions of senior leadership to set their priorities. The tone needs to come from the top.



The importance of innovation.

PwC's Global Innovation Survey: Breakthrough Innovation and Growth highlights the importance of innovation in driving growth and the challenges of achieving success.



PwC's Global Innovation Survey: Breakthrough Innovation and Growth

Only 10% of CEOs see their companies as innovation leaders

Innovation has become a major C-level concern. Ninety-seven percent of CEOs consider innovation as a key priority for top- and bottom-line growth, but only 10% of CEOs view their organisations as innovation leaders. Further, 64% of CEOs agree that neither innovation nor operational effectiveness are dominant – and are looking to succeed at both.

There are good reasons for this. Our results suggest that the most innovative companies are expecting to grow much more rapidly than the market – they are predicting 62% growth over the next 5 years vs. a market average of 35%, and only 21% from the least innovative companies. This is a big deal – for a \$10bn company this creates a \$2.7bn gap in 5 years.

Respondents do not only see innovation as a product-level concern. Rather, they see innovation throughout the entire business model as critical to drive performance – innovation in technology, the customer experience, in systems and processes, in services, in channels to market and in supply chains.

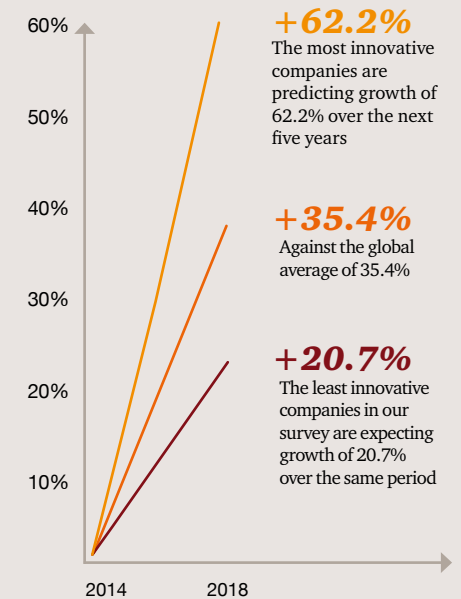
They recognise that innovation requires a new management discipline; that innovation activities need to be coordinated and managed for maximum efficiency, and not left to evolve by chance within individual business units.

They also highlight some of the challenges with driving successful innovation. The challenge of taking new innovative ideas to market in a rapid and scalable way, of finding the best talent to make innovation happen, of establishing a culture within which innovation can thrive and of finding the right external partners to help make it happen.

97% of CEOs see innovation as a key priority for growth

64% of CEOs see neither innovation nor operational effectiveness as being dominant – they are looking to succeed at both!

Figure 15: Innovation is a critical C-level topic



PwC's Global Innovation Survey: Breakthrough Innovation and Growth

Proactively managing risk, regulations and capital

The post-crisis flood of regulations signals a major mindset change for regulators. In the past, regulation was just one of many considerations. Capital was plentiful and not a significant business constraint. Conduct issues were thought to be few and far between. Today, not only are the rules much more complex, but regulators are more suspicious, and less flexible in their demands to improve compliance, reporting, and the underlying business processes and data. Leading banks are taking a different and more comprehensive approach to managing their regulatory obligations. This approach is pragmatic, proactive and increasingly integrated into 'business as usual'.

Executives in all regions, unsurprisingly given the last five years, consider this the biggest priority, with 64% stating this as very important. Again, however, very few (only 22%) consider themselves very prepared. The biggest obstacles to addressing these issues are the level of financial investments required and technology constraints.

Enhanced capital and risk management

Global regulation of capital, liquidity and related stress-test requirements, as well as enhanced prudential standards, will continue to evolve and eventually force globally active and/or systematically important banks to meet even higher stringent and binding standards.

These requirements are making a compelling case to seek alignment of risk appetite, capital planning and adequacy assessment, recovery and resolution planning, liquidity risk management, stress testing and overall enterprise risk management activities.

Moreover, this should ultimately lead to capital and liquidity optimisation, which would become a competitive advantage for banks competing in a highly capital-burdened environment.

Given the enormity, complexity, and inherent linkages and interdependencies of regulation and supervisory expectations in each of these respective areas, there are tremendous challenges as well as opportunities to address this in a manner that drives for long-term efficiencies and sustainability.

Banks that are taking a proactive approach to addressing these challenges in a systematic and disciplined manner will see tremendous benefit driving both operational efficiencies as well as bottom-dollar benefit.

Establishing a common thread of consistency to support a sound, robust and integrated enterprise risk framework will be key to meeting regulatory expectations from both micro- as well as macro-prudential perspectives.

These new capital requirements and restrictions will impact bank structures and business models in the following ways:

- Banks that manage their funding most effectively, leveraging securitisation structures such as covered bonds where possible, will have a competitive advantage over those whose strategies are primarily driven by their level of deposits.

- Multinational universal and commercial banks will need to ensure a balance of deposit-taking and lending in each country in which they operate, typically requiring new deposit-raising strategies. Moreover, these banks will have to rely on local sourcing of capital rather than relying on their foreign parents.
- Requirements for all forms of non-common equity ('gone concern') capital to now have equity conversion triggers in order to be counted as capital will further increase the cost of capital for banks. Additionally, the requirement of bail-in debt, a form of ('gone concern') capital, which is also required to convert to common equity at resolution, further underscores the unwillingness of regulators to ever having to use taxpayer money to bail out failed banks in the future.
- These capital requirements will ultimately lead to an environment of 'ring-fencing', where the ability for multinational banks to move or repatriate capital freely between different jurisdictions will be restricted.

Proactively managing risk, regulations and capital

- In their quest to chase yields in order to justify these incremental capital requirements, banks may seek riskier assets and strategies, especially in environments where banks lack pricing power to pass the capital costs on to the consumer, given they may be more of price-takers than market-makers.
- We expect to see an increased premium on wealth management and other lower capital-intensive businesses.
- Capital management will need to be considered as part of individual business, customer and pricing decisions. Capital-intensive products will need to be priced higher. This will add complexity to credit risk and pricing functions, which are already undergoing change to ensure customer-centric pricing and underwriting. We discuss this further in our paper 'Look Before You Leap'.

Beyond maintaining a strong, independent risk management function that is focused on the core financial risks that banks face, sufficient oversight of operational and reputational risk will be critical.

- Cyber security is now top of mind as new technologies like mobile expose customer data to greater risks.
- Vendor risk will need to be managed more closely. Banks have hundreds of partners, and are seen as responsible and accountable, end-to-end.
- Banks have become both information hubs and potential targets as governments

ensure the proper payment of taxes, compliance with KYC/AML laws, sanctions, FATCA, etc.

- Increased regulatory requirements such as stress testing and Basel III drive greater operational and reputational risk. Banks will need to be able to report detailed information on portfolio metrics and trends, and be able to rapidly model alternative scenarios.
- Risk management will expand and interact more closely with every area of the bank including marketing, product development, business analytics and compensation. This requires a more robust end-to-end view of the business, and an expanded skill set within the risk organisation.

Proactive regulatory management

As we discuss above in 'Rise of state-directed capitalism' and as we know from recent events (e.g. admissions of wrongdoing and record fines related to LIBOR, US mortgages, and others), governments and regulators are increasing levels of scrutiny and are increasingly penalty-minded.

Regulators do not want banks just to be correcting mistakes, nor to be ticking boxes. Rather, they want banks to embrace regulatory intent, and create sound, secure, unbiased businesses, where regulatory compliance and sound conduct is embedded in the processes and values of everyday operations.

Additionally, banks have built a labyrinth of compliance processes as regulations have changed – a new regulation, a new process bolted on. This creates high cost and poor customer experience.

Banks should embrace regulation, and embed it in their core business processes – it is not just the responsibility of the compliance group. They should bring analytical rigour, and need to tackle the existing high-cost complexity.

The challenge is that so many of these initiatives are being led by different groups across the businesses, and regulatory and risk functions, and so they lack effective coordination, leading to inconsistent understanding of regulatory implications, lack of clarity around firm-wide decision-making, and inefficiency and duplicative processes around the bank.

Underpinning truly proactive regulatory management is a strong global regulatory lead and team, overseeing and coordinating bank-wide activity. Done right, this provides clear accountability, consistent messaging, integration of regulatory strategy and change management, proactive communication internally and externally, and ensures regulatory considerations are consistently considered in other corporate initiatives and projects. This core team can ensure connectivity and oversight of business-level initiatives, corporate initiatives, as well as acting as the core office of regulatory affairs – proactively leading the bank's interactions with all regulatory bodies and stakeholders.

4

Conclusion

Much is changing in the banking landscape – with regulation, technology, demographics, changing customer expectations, greater competition and issues with banks' own legacy business and operating models. The challenges are clear, even if the ultimate endgame is not.

Banks need to get ahead of these challenges and retool to win in 2020. They need to make hard choices about which customers to serve, how to win and where not to play. They need to rebuild their organisations around the customer, simplify and structurally reduce cost. They need to learn to be agile, innovative and adaptable in order to execute effectively – and deal with uncertainty as the future unfolds. They need to do things differently.

Each bank's unique response will depend upon the bank's current position, aspirations for the future, desired customer focus, organisational capabilities, brand promise, regulatory situation and capital constraints. Banks should consider the posture they wish to adopt. Do they want to shape this future, rapidly follow, or manage defensively, putting off change? Staying the same is not an option.

Every bank needs to develop a strategy to tackle these challenges. One that transcends the status quo and considers all possibilities. One that can adapt to an uncertain future. And one that takes an end-to-end view – integrates the changes in markets, customers, risk, regulation, operations, technology – and the challenges of implementing real-world large-scale change.

We hope this perspective has been provocative and provides insight as you consider both your own strategy to thrive in 2020 and the tactical actions you need to take today.



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For more information on the Global Retail Banking 2020 Marketing programme, contact Lara De Vido at lara.de.vido@us.pwc.com

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