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Banking 2012

Preparing for a revolution

By Noel Gordon and Piercarlo Gera

In the post-crisis industry landscape, success in retail and commercial banking will be redefined by transparency, simplicity and renewed customer-centricity.

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Most commercial banks in developed markets will settle for lower risk and moderate growth in their quest to achieve high performance.

From 2000 to 2007, the developed economies' top-performing banks had an average return on equity of 26 percent. Today, many of these same banks are looking at returns of 4 percent to 5 percent—if they are still in business.

The post-crisis challenges these banks face are indeed enormous. They are operating under tighter supervision at a time when they are also trying to restore declining customer trust. The securitization surge that fueled revenues and propelled balance sheet expansion before the crisis has slowed to a trickle. And disruptive digital technologies are strengthening the competitiveness of new entrants.

Not all banks will succeed. However, having analyzed more than 150 institutions worldwide and having interviewed more than 30 of their leaders, as well as private equity experts and other industry watchers, Accenture believes that those banks that make bold decisions about their businesses and operating models in 2009 will rebuild their returns on equity to 15 percent or even higher within the next three years.¹

Shifting industry structure Among the survivors, different banks will pursue different strategies, depending on their markets. But all players will be much more focused. The handful of global banks likely to be flourishing in 2012 will owe much of their success to having significantly scaled back the complexity of their operations.

For these big global institutions, the challenge will be to become simpler and more specialized. If they have deep roots in specialized businesses, they may choose to concentrate on those franchises. This is already happening at Citibank, which is reemphasizing its traditional strength

in global corporate and transactional banking. Others may choose to refocus on wealth management and private banking.

By 2012, most banks will be retail and commercial banking institutions serving regional or local markets. Some big banks with strong regional franchises will divest loss-making divisions and instead focus on their core markets and customer segments. We anticipate that many European players may eventually fall into this category.

However, a few existing global banks—Barclays and BNP Paribas, for example—are taking advantage of the financial crisis to increase their overseas presence. Similarly, several Japanese financial services groups are selectively expanding internationally, among them Nomura Holdings, which has acquired defunct Lehman Brothers' European and Asian assets.

New economic model

Few of the bank executives we have interviewed are comfortable with the more intrusive regulation that will inevitably accompany greater government involvement in the industry. Yet most recognize the need for new and more effective internal approaches to managing risk.

Indeed, soundness and solvency, balanced with generating returns, are the banking industry's new imperatives. And we believe that most commercial banks in developed markets will settle for lower risk and moderate growth in their quest to achieve high performance by 2012.

A few banks—notably in Spain—were managing risk at the board level before the crisis. By 2012,

¹ This article is based on Accenture's Banking 2012 research project, which included extended interviews with executives from 35 financial organizations in Europe, the Americas and Asia Pacific.

Banking in a new world

By 2012, banks will have to manage profitability and growth under significantly tighter capital, risk, liquidity and balance sheet constraints.

Area	2008	2012
Capital	<ul style="list-style-type: none"> • Lower capital ratio • Low cost of equity • Securitized assets 	<ul style="list-style-type: none"> • Higher capital ratio • Higher cost of equity • On-balance sheet assets
Risk	<ul style="list-style-type: none"> • Low market / credit risk premiums • Basel II Accords, International Accounting Standards—pro-cyclical* • Innovation in risk derivatives 	<ul style="list-style-type: none"> • Higher risk premiums • Counter-cyclical provisions • Regulated risk derivatives
Assets	<ul style="list-style-type: none"> • High leverage / rapid expansion • Off balance sheet / innovation • Low yield / ROA 	<ul style="list-style-type: none"> • Lower leverage • Higher risk premiums / returns • Transparency
Liabilities	<ul style="list-style-type: none"> • Reliance on wholesale funding • Low cost of retail deposits 	<ul style="list-style-type: none"> • Focus on retail deposits • Wholesale funding costs rising
Liquidity	<ul style="list-style-type: none"> • High market liquidity • Low average cost of funds 	<ul style="list-style-type: none"> • Higher liquidity reserves • Counter-party risk focus
Return on equity	<ul style="list-style-type: none"> • Thin capital / high leverage • High performers (20–25%) 	<ul style="list-style-type: none"> • Higher capital / lower leverage • High performers (10–15%)
Growth model	<ul style="list-style-type: none"> • Leverage based 	<ul style="list-style-type: none"> • Reputation and capability based, core capabilities substantially strengthened

* Pro-cyclical: The regulatory system magnifies the impact of the business cycle by allowing capital requirements to fall in periods of economic growth and strong credit quality, and rise when credit quality deteriorates. Counter-cyclical: The regulatory system requires banks to hold capital or make additional provisions against default in good times to protect against losses in bad times.

Source: Accenture analysis

we believe all successful banks will view risk as an enterprise-wide business responsibility. Merging market and credit risk, for example, will make the whole business of risk management more portfolio-driven, and risk management will be integrated across product lines and business units.

We estimate that at least 30 percent of the banks' cost base will be variable by 2012, as successful banks use alliances, shared services and sourcing to manage noncore capabilities more competitively. For example, shared services arrangements with telecommunications companies and energy utilities could improve economies of scale (for both partners) and lower costs.

Many such alliances are already in place. BCB is a payment transaction services company—founded

in 2004 by Germany's Deutsche Postbank—that provides payment services for four of the country's five major banks; it now accounts for more than 20 percent of the German payment transaction processing market.

Technology will play an increasingly important role in the industry's transformation. So-called cloud computing, which leverages the Internet to enhance speed and flexibility, will enable banks to dramatically consolidate and rationalize IT costs—as will the creation of “virtual” shared IT utilities, which are likely to proliferate among smaller banks.

Indeed, Internet-oriented computing is a disruptive technology with the potential to redefine the future operating model for all banks. By

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CheBanca! and M-PESA: New business models for a new era

Low-cost, aggressively priced products and a keen local focus will be two of the hallmarks of successful banking in 2012 (see story). These traits already distinguish pioneering players starting to reshape the industry landscape in developed and emerging markets alike.

Last year, Italy's leading investment bank, Gruppo Mediobanca, launched CheBanca!, a new retail banking venture that offers customers attractively priced yet innovative products via the channel of their choice. In its first year, CheBanca! (which means "What a bank!") has proven so popular, especially among younger Italians, that it has opened 170,000 accounts, attracted €5.3 billion in deposits and is selling, on average, 2,000 products a day, including mortgages, savings accounts and a so-called portable account, which can be used as a current account, at an ATM or as a credit card.

The majority of those new accounts originated online, and the bank recently introduced a home banking option via the iPhone as an additional channel for the digitally savvy. Internet banking penetration in Italy is still only about half the European average, so CheBanca! is also expanding its branch network—it opened 50 branches in June 2009 and has plans to open 110 more by 2011.

While CheBanca!'s direct channel access has kept costs low, its simple, stylishly designed branches have offered a strong complementary service for customers. CheBanca!'s branch model is also designed to be highly efficient, emphasizing self-service and paperless options that allow for minimal staffing. Branch employees are trained to pull customers in rather than push products out. The branches also keep retail hours, which are more convenient than traditional banking hours. Customers can also access their accounts via self-service counters in shopping centers.

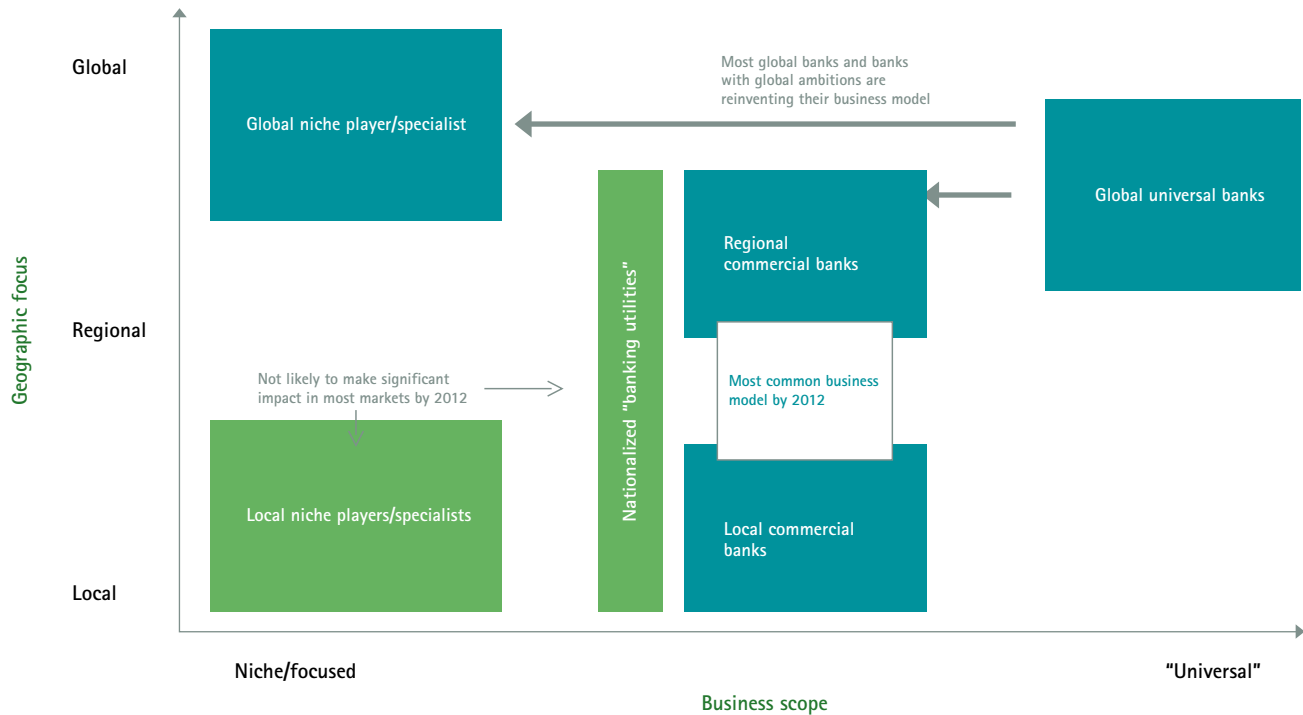
In many emerging markets, of course, banking facilities of any kind are in woefully short supply, particularly in remote rural areas where traditional banking services are too expensive to serve low-income customers. To help address this, a joint venture made up of Vodafone; Safaricom, Vodafone's Kenyan affiliate; the UK Department for International Development; the Nairobi-based Commercial Bank of Africa; and Faulu Kenya, a local microfinance organization, launched a service in 2007 that allows Kenyans without bank accounts to make money transfers and payments via their cell phones.

Called M-PESA, which means "mobile money" in Swahili, East Africa's lingua franca, the service already boasts more than 6 million customers. Many are urban migrant workers who want to send money to their families in the countryside. But because M-PESA is safe, swift and cost-effective, it is also attracting plenty of small businesses—strong evidence that mobile telephony can help boost GDP growth in the developing world.

Vodafone plans to expand M-PESA to other African markets and India. Meanwhile, the company has launched a similar service, M-Paisa, via its local affiliate in Afghanistan. Because literacy in that country is below 30 percent, Vodafone is testing out an interactive voice response technology for handsets that can enable markets with lower literacy levels to take advantage of the service as well.

Focus, focus, focus

There will be fewer successful business models in 2012 as all banks become much more focused, simplified and specialized. The most common model: the retail or commercial bank serving a local or regional market.



Source: Accenture analysis

(Continued from page 3)

acquiring software as a service, banks will not need to develop and manage their own systems; this will lower costs while improving productivity.

Low-cost and aggressively priced business models also offer a way to win market share. CheBanca!, a high-tech, low-cost retail bank, launched in 2008 by Italy's Mediobanca, offers a good developed-market example of such an initiative. In Kenya, M-PESA is leveraging cell phone technologies to provide financial services in rural areas (see sidebar, page 4).

Redefining success

The impact of technology will go well beyond improving cost-

effectiveness. By 2012, successful banks will embed new capabilities of all kinds into their operating models—risk analytics, customer analytics, pricing optimization and industrialized management of nonperforming loans—so they can pursue marketing more effectively.

Such capabilities will help deliver more personally relevant products and services based on customer needs. They will also enhance pricing management and the new customer propositions, like low-cost, aggressively priced banking, that will define success in the industry.

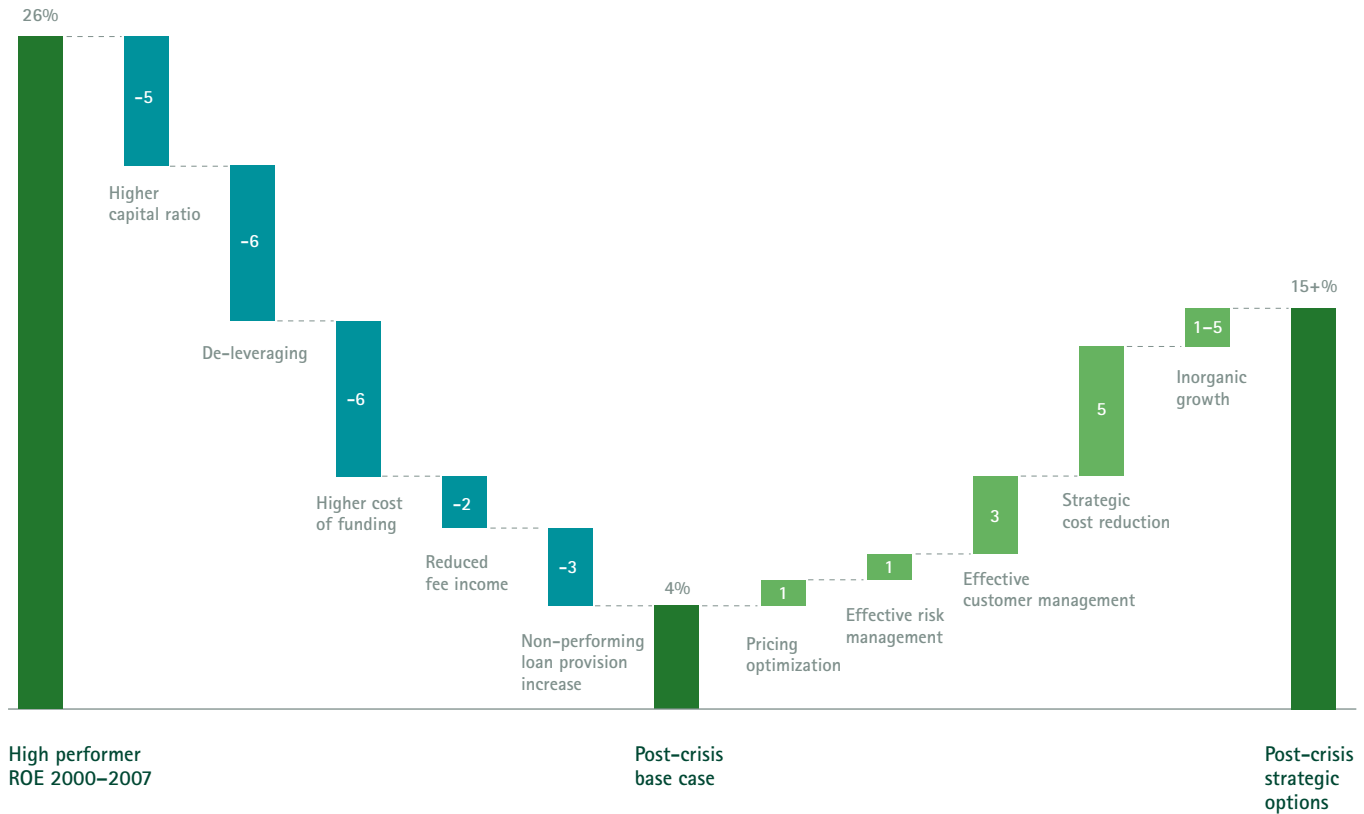
Accenture research indicates that even before the current crisis, only 25 percent of bank customers believed

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Rebuilding the banks

Return on equity has plummeted from about 26 percent for banks Accenture has determined were high performers in 2007 to about 4 percent today. To rebuild their returns, banks will need to make a number of operating and business model changes. The numbers in the bars indicate the breakdown of the decline (left side of chart) and the potential rise (right side of chart) of bank ROE, respectively.

Return on equity evolution



Post-crisis operating and business model changes

Pricing optimization

- Existing loan book re-pricing
- Pricing optimization by product/segment

Effective risk management

- Risk management integration across risk types and business units
- Risk analytics to improve predictive management of loan loss ratio
- Nonperforming loan factory

Effective customer management

- New fee income streams (product innovation, new profit pools)
- Marketing capability enhancement (maximizing cross-selling, up-sell, acquisition and retention)
- Need-based offering

Strategic cost reduction

- Direct channel push
- Branch rationalization to maximize performance
- Process simplification and reengineering (increasing sales capacity)
- Cost governance
- Procurement rationalization (IT, telecom, utilities, etc.)
- Product rationalization
- Shared services implementation
- Outsourcing and offshoring of noncore functions

Inorganic growth

- M&A
- Divestitures
- Geographic expansion
- Low-cost bank creation

Source: Accenture research

(Continued from page 5)

their bank was acting in their best interests. In our 2008 global survey of customer satisfaction, 42 percent said they had switched banks because of poor service.

Successful banks in 2012 will have responded to the erosion of customer trust by going back to basics. They will become more transparent in their approach to service. They will also greatly simplify their product offerings. A customer-needs-based approach will replace the current product complexity typical of many large banks today.

Product innovations like so-called green mortgages, which offer discounts for energy-efficient homes, will address consumers' growing environmental and social concerns; surveys indicate, for instance, that customers are prepared to pay a premium for products and services that help cut carbon emissions. These and similar customer- and community-focused product initiatives will not only create new income streams but also provide banks with the opportunity to build and improve customer relationships.

For example, microfinance (providing financial services to low-income customers and small- and medium-size enterprises, mostly in the developing world) is a low-volatility lending model with limited risk that more banks are likely to adopt. Currently, between 50 percent and 80 percent of adults in many developing countries have inadequate access to financial services, along with up to 10 percent of the population in developed economies, according to The World Bank. So the extension of services to the bottom of the pyramid represents a market with significant growth potential.

Another example of an emerging new business: Islamic banking, the provision of financial products

and services in compliance with Sharia law, which prohibits charging interest. The Asian Development Bank estimates that the combined global value of Islamic assets held by governments (including sovereign wealth funds), financial institutions and individuals is approaching \$1 trillion and growing at an annual rate of 10 percent to 15 percent.

Global consolidation

By 2012, the world's banks will be managing profitability and growth under significantly higher capital, risk, liquidity and balance sheet constraints. They will also be competing with some strong emerging-market players—banks from Brazil, Russia, China and India that have performed better during the current crisis and that will leverage the higher growth of their domestic and regional markets over the next three years to consolidate their strengths.

To be successful, all players will need to redefine their business scope—bolstering core businesses and finding optimal exit strategies for the rest. This will demand exceptional post-merger integration skills for the next three years and beyond (see sidebar, page 8).

Beyond 2012, we foresee a fundamentally reconfigured banking industry: an environment of technology-enabled banking “ecosystems,” where non-bank players and peer-to-peer networks will compete with mainstream providers to service the needs of ever more demanding consumers. The high performers will be those that can overcome the immediate challenges and maximize the opportunities presented by the dramatically changed banking landscape of 2012.

In the more distant future, the new banking virtues—sustainable profitability, renewed customer-centricity and a more realistic approach to risk—will be more important than ever.

Happily ever after: Successful M&A in the new banking landscape

By Andy Tinlin and Alberto Verga

Consolidation will be an important feature of the emerging banking landscape. Yet in Accenture's experience, as many as half of all bank mergers fail to add value. They fail, for the most part, because the acquiring bank's rush to capture cost synergies often takes precedence over the need to maintain customer confidence—now more of a priority than ever as the banking industry struggles to rebuild (see main story).

Given that the bar for success in M&A will be significantly higher in the post-crisis industry, this is especially worrisome. To create economic value, Accenture estimates that acquirers will need to cut twice as much in operating costs through synergies (20 percent, on average) than in the past.

Accenture research shows that cost synergies and customer-centricity don't have to be in conflict when banks merge, however. On the contrary, by focusing on seven catalysts of effective execution, newly merged banks can resolve the complexities of post-merger integration and help build sustainable profitability and high performance.

Effective execution is not only about traditional cost synergies (sourcing rationalization, IT integration, consolidation of business and group functions, transfer of best practices, and overlapping products and services). It also includes a more transformational agenda spanning which business units or assets to sell, restructure or close, and which noncore capabilities to outsource.

Post-merger integration typically can be divided into two distinct phases. The first, which can last for up to three months, concerns deal closure and mainly involves mobilizing and planning activities, hence the organizational nature of its three catalysts:

- **Effective governance and fast decision making.** This is essential to balancing the conflicting priorities of multiple stakeholders—including customers, whose views should be represented on every relevant board and committee. Lines of accountability must be clear and coherent as well, and transparency and consistency are critical to maintaining the trust of all stakeholders.
- **A well-defined target operating model.** The model should be designed pragmatically and by a small, central team. Key decisions on the business side should focus on business unit selection and boundaries, distribution channels and how to manage overlaps, product range simplification and accelera-

tion of the overall integration agenda. On the operations side, the industrialization agenda and the rapid setup of shared services are now more relevant than ever.

- **The "keep list" and migration approach.** Companies that pragmatically forced themselves to agree to a "keep list" before the closure of the deal by means of an independent, specific and multifunctional task force reporting to top management achieved a faster, more efficient integration with better chances of success. This demands early decisions about which brands, products and core systems to keep and which to eliminate, divest or migrate. Sticking to those decisions will help deliver cost synergies and enable more effective integration planning.

Four additional catalysts help determine the success of the core integration delivery phase, which typically takes between 12 and 18 months after the deal is closed:

- **Targeting and implementing achievable quick wins.** This is critical to building and sustaining momentum. Focusing on pricing, procurement, property and credit control—concentrating on accounts receivable—has been shown to deliver cost synergies early, without affecting the overall speed of integration.
- **Effective customer retention programs and alignment of skills.** Most customers have a fundamentally negative view of bank mergers. Customer churn rates may go up by 50 percent. In the current environment, changed customer attitudes and issues of trust and savings and investment security must be addressed by the right products and services, and delivered by people with the right training and understanding.
- **Effective management of country and regional differences.** Bringing together the cultures of two organizations is a major challenge and requires up-front preparation, strategic planning, regional and local knowledge, and execution expertise. It is important to make organizational decisions as soon as practical and manage internal communications with care.
- **Engagement and training of employees to serve a new customer base.** This requires the commitment of frontline staff, in particular, as a key determinant of customer satisfaction and loyalty. Frustrated and confused employees frustrate and confuse customers. So it's essential to be clear with the workforce about goals and expectations, however unwelcome or disruptive, and to communicate changes early and often.

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Noel Gordon, managing director of the Accenture Banking industry group, has worked for and consulted with some of the world's largest and most diverse banks for more than 30 years. His experience includes organizational transformation, strategy, merger integration, back-office rationalization, and credit and risk reengineering. Previously, Mr. Gordon worked at major US and UK banking groups, where he led a range of retail and corporate banking teams. He is based in London.

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For further reading

"Can a new business model save investment banking?" *Outlook*, June 2009

"Computing in the clouds," *Outlook*, May 2008