Banking 2020
As the Storm Abates,
North American Banks Must
Chart a New Course to Capture
Emerging Opportunities
As challenging as the current operating environment is, we believe the banking sector in 2020 is a land of opportunity.
For North American banks, the storm has passed, but they’re still taking on water. Five years after the global financial crisis, many banks have made significant strides to recover, but they are struggling to generate sustainable organic growth and return to pre-crisis profit levels. Gone are the 20 percent-plus rates of pre-tax return on equity (RoE). In the current environment, some are still straining to achieve profitability levels above their cost of capital. As a result, they cannot easily and consistently create shareholder value.

Unfortunately, the next decade doesn’t look to be any easier. A number of emerging trends—including digital technology and rapid-fire changes in customer preferences—are threatening to weigh down those full-service banks that limit themselves to products and services that get distributed primarily through physical channels, particularly branches. Given the scale of these disruptions, our analysis shows that full-service banks, as a group, could lose about 35 percent of their market share by 2020.¹ Who gains this market share? Digitally oriented disruptors that are far more agile and innovative—the equivalent of speedboats competing against schooners. Some of these will be new entrants to the market, and others will be today’s full-service banks that revamp their business models—or some parts of their organization—by streamlining operations to better meet consumer needs.

However, as challenging as the current operating environment is, we believe the banking sector in 2020 is a land of opportunity—provided that banks trim their sails to better adjust to emerging headwinds. In fact, banks that can match the agility and innovation potential of other industries could consistently reap pre-tax RoE levels as high as 18–25 percent by 2020. That represents a huge jump over the average 11 percent Pre-Tax RoE the largest banks in North America managed at the end of 2012 (see Exhibit 1).

EXHIBIT 1
Agility and innovation are becoming critical for banks, and high performers can regain ROE levels as high as 18–25 percent.

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Source: Accenture Research Analysis Using SNL Financial Data. Historical, Current and Projected Financial Performance of Today’s Top 22 NA Banks With >$50bn in Assets
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What makes the current environment so challenging is a set of disruptions that currently impact banks from all sides, a phenomenon that we call convergent disruption (see Exhibit 2.) Externally, new competitors are quickly emerging in the market—often from outside the traditional banking sector—creating new threats for traditional full-service providers. At the same time, ongoing convergence between banks and other players, in areas like payments, telecommunications and retail, is creating new competition and innovative ways to do business.

Regulations are a factor as well. New rules will increase capital requirements and cost the average bank 2.5–3.5 percent in pre-tax RoE. A grim economic outlook for the next few years—with the Federal Reserve aiming to keep benchmark interest rates at historically low levels—will prolong the industry’s current headwinds. New entrants, once regulated, may not survive if they fail to price for the impact of regulations early. And consolidation will continue to play out between now and 2020, by which point we estimate that 15 to 25 percent of today’s roughly 7,000 North American financial institutions could be gone.

Most notably, digital shifts—both inside and outside of the industry—are rapidly redefining information flows and the way that service providers and customers interact, while dramatically cutting distribution costs to unprecedented levels. Digital banking is becoming essential. Consumers view online banking as the single most important area in which banks should invest and develop. Meanwhile, mobile banking activity has increased nearly 50 percent since 2012 (see Exhibit 3).
Social media is also changing the way people buy and sell, potentially relying less on traditional bank advisors and more on friends and others who offer advice through digital platforms. Technology tools (e.g., tablets and smart phones) and greater transparency regarding pricing and services are empowering customers like never before. As a result, large full-service banks run the risk of being outmaneuvered by digitally oriented competitors. Placing their strategic focus on best serving customers, these emerging competitors operate and adapt more quickly, creating new tools and services that quickly become the industry standard.

The focus on digital, like the other trends, represents both a threat and an opportunity. The era of physical scale is over, and banks can no longer win through size and operational footprint alone. Instead, leaders will win by finding innovative ways to improve the customer experience and adapting to market changes—they will feature both scale and flexibility. The current era of convergent disruption may ease in time, but “permanent volatility” will increasingly become the norm. This volatility in the external environment—marked by factors in the external environment such as an unstable housing market, interest rates, and economic and market cycles—is severely impacting the banking industry, creating risks for slow-footed banks but opportunities for those that can become more agile and innovative.

Specifically, we think that three new business models will emerge to take market share away from traditional, full-service banking institutions that fail to adapt:

- Niche Digital Provider
- Digital, Full-Service Bank
- Big Box Bank

A few of today’s full-service traditional providers will have the foresight and financial and operational wherewithal to evolve from their existing market position into one of these models. Others will begin making the required investments to also move in that direction—advancing their existing business models to effectively compete with new competitors.

Those that do nothing and try to cling to the status quo risk losing significant market share and leave themselves vulnerable to a potential acquisition by the nimbler banks—those that we envision in this paper.

The Telecom Parallel

While banks are currently in an extremely dynamic operating environment, other industries have undergone similar disruption, and winners have emerged. In some cases traditional players completely redefined themselves to remain relevant, while in other cases new entrants took dominant roles as they revolutionized the customer experience in the gaps that traditional players left unoccupied.

For example, the telecom industry has been upended in the past 20 years by new technology, evolving consumer preferences, and industry convergence. And like banking, telecom is heavily regulated. Traditional providers like AT&T have been forced to evolve significantly, through divestitures, mergers, and restructuring. Yet AT&T is the largest communications holding company in the world, with revenue from wireless, wifi, high speed Internet, voice and cloud-based services. Meanwhile, new telecom entrants like Skype—owned by Microsoft—have carved out a profitable niche as well.

Skype now handles a significant portion of the world’s global phone traffic. And the convergence between media and cable have allowed a company like Verizon—itself once part of AT&T during the “Ma Bell” period—to soon begin airing National Football League games over its customers’ smart phones.²

The telecom industry offers several clear lessons. First, digital technology accelerates the pace of change, all but requiring players to become more agile in order to continually adapt. Second, the era of scale, particularly physical scale—i.e., winning through size alone—is over, and today, leaders win by finding innovative ways to improve the customer experience. Last, innovation is key—companies that fail to innovate and adjust to industry disruptions will miss key opportunities for growth.

Although convergent disruption challenges banks, it also opens significant opportunity to those who take advantage of the highly dynamic environment.
To avoid being marginalized, traditional banks must take three distinct steps to give themselves a sustainable advantage in 2020: 1) optimization and simplification, 2) agility, and 3) continuous innovation (see Exhibit 4).

Exhibit 4
Three building blocks would give banks a sustainable competitive advantage by 2020.
Today's "baseline":
Driving efficiency through optimization and simplification
Almost all banks are already taking steps to optimize and simplify their business, in order to drive efficiency across the organization. For example, they are eliminating redundancies; improving processes and technologies across business units, products, and operations; and managing regulatory requirements more effectively. However, while these measures are worthwhile, they are not enough to provide a sustainable competitive advantage. Instead, they are the new baseline—the table stakes required for banks to merely maintain their current position, not improve it. We believe that most banks are currently operating at this stage.

2020 table stakes:
Adapting through agility
Very few banks have already achieved the level of agility that will be needed to outperform in 2020. Moving forward, if banks are to identify and seize new opportunities, it is critical to adopt a mindset of agility, allowing them to manage change quickly. Agility is not merely a synonym for digital—it also includes mobile platforms, social media, and analytics. For example, banks should transform their IT platform to overcome the constraints of legacy technology in the back office, and empower an analytically driven front office. Robust analytics should be embedded in all processes throughout the organization.

Banks should also become far more customer-driven—instead of product-driven—making decisions to improve their offerings and proactively meet customer needs. And they should shift their mindset from managing unit costs to managing units consumed. Yet in the long term, agility itself is not the goal either. This building block will allow banks to succeed, but we anticipate that agility will be the table stakes of 2020—the new baseline.

Leadership in 2020: Differentiating through continuous innovation
The highest performing banks in 2020 will differentiate through innovation. Many North American banks currently innovate, but not on a consistent basis across the organization. By 2020, the industry leaders will separate themselves from the pack through continuous innovation across the enterprise. That means they will have the ideas, vision, and leadership to not only stay ahead of the market, but to actually reshape it, likely in the context of a broader value chain than envisioned today.

IT as an enabler
Technology is critical to this progression, its effects as profound as adding steam power to a sailing ship. At the first building block—optimization and simplification—banks need to invest in capabilities such as digitizing their finance and HR functions, along with logistics and operations, to make them more responsive to the shifting requirements of a dynamic market.

At the second building block—agility—banks need to rebuild their IT platforms outside-in, rebooting outdated legacy systems to better leverage digital technology in their back office (to make operations more efficient) and to power an analytically driven front office. Virtualizing the bank's network, along with strong capabilities in data analytics and mobility across the distribution spectrum will be crucial as well.

At the third building block—continuous innovation—banks will need to build their business around technology as an enabling tool for generating new ideas and insights across the enterprise. They will also convert these ideas into digital banking products and services that can meet the evolving demands of customers. At all three stages, the challenge for bank leaders is to balance the innovation needs of the business with ongoing scale and efficiency requirements of the corporation.

A clear path for success exists for North American banks that choose to start now.
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The Emerging Landscape of Opportunity

The banking industry today is comprised of traditional full-service banks (which make up the vast majority of overall market share) monoline players and small/community banks. We think all three will survive and even thrive in the future. Small/community banks are likely to consolidate, and monoline players will likely grow in number, because of more niche opportunities and specialization. But three new banking models will emerge, which will have the biggest impact on traditional full-service banks (see Exhibit 5).

There are more than 500 traditional full-service banks today with more than $1 billion in assets, comprising 85 percent of the current market space. Burdened with sizable infrastructure, they are not particularly nimble. They generate business largely through physical channels, a product-focused approach, and aggressive marketing to customers. When seeking to develop new products, these banks often rely on proprietary, internal investments.

By comparison, the digitally driven players that we see taking market share by 2020 will operate from a different playbook. Rather than basing decisions around a large network of physical locations, they will have the flexibility to expand their footprint via digital strategies, even across borders. (Some of them will likely still have physical locations—instead of a 100 percent digital operation—but they won’t rely on those locations as heavily as traditional, full-service banks do today.) These agile, innovative banks will also be more customer-centric, and organize their businesses around customer segments, rather than around product categories. Last, instead of proprietary investments, they will partner with other companies, both in and out of the banking industry, to leverage best-in-breed innovation.

We project that traditional banks could lose more than one-third of their market share by 2020, either to banks partnering with new entrants (such as Google, Apple, or Amazon) or to “adopters” (current players that adopt new business models, such as large banks today that become highly digital and agile). Given this competitive threat, it is critical for traditional full-service banks to proactively decide how best to compete in order to protect and grow their business.

To be clear, many traditional full-service banks will succeed by advancing their existing business models and combining them with superlative execution. However, we think three new models will also emerge as highly successful, competitive strategies by 2020.
EXHIBIT 5
Agility and product commoditization expand the business models for success in the future.

- Most business generated through online/digital channels
- Highly nimble
- Flexible infrastructure
- Social media an integral part of strategy
- Optimized and simplified
- Customer-centric

Highly Agile

- Most business generated through traditional, physical channels
- Less nimble
- Heavy infrastructure
- Less optimized and simplified

Less Agile

100+ Players
~9% market share*
(Ally, Amex, CIT, Discover, Simple)

Small Banks
6,500+ players
~8% market share*

* Market shares are based on enterprise-level revenues

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First is a Niche Digital Provider, meaning a highly agile bank that offers extremely specialized products at scale. These players benefit from a flexible infrastructure and a strong emphasis on social media and mobile technology. They will compete through a deep product offering, including advice. For example, a technology provider could collaborate with a wealth management firm to create a new joint venture that offers money management services and advice through digital channels more easily and cost effectively across borders. While there are clear opportunities in this model, we estimate that it will be limited to a few dozen providers by 2020.

The second business model option is a Digital, Full-Service Bank, meaning highly agile institutions that rely on technological solutions to deliver a range of products. These banks will compete on the digital experience they can provide to customers while offering a broad product set with some depth, similar to the products offered by traditional, full-service banks today. They could be existing institutions (such as large, full-service banks that redouble their investments in digital platforms and use that opportunity to retire existing legacy platforms) or new entrants (such as an established technology firm that moves into the banking space).

Across both categories—new entrants and existing players—we believe that digital, full-service banks could make up about 15 percent of the market in 2020, across four to six institutions.

The third new business model in 2020 is Big Box Banks, meaning those that compete largely on price and offer commodity products to mass-market customers. Notably, big box banks can operate with a range of agility levels. As with the second category, these can also be existing banks (e.g., one of the top four players in the current market) or new entrants (such as a large retailer). In both cases, they will have the benefit of immediate market share and low pricing across a range of products, making them appealing to existing customers.

Needed upgrades within the traditional model

We understand that a complete transformation to a new digital business model is not realistic for many banks. They have too much institutional heritage and momentum tied to their existing model, and in many cases they may lack the investment capital and risk-tolerance required. However, doing nothing as the market undergoes such radical shifts means that this segment will lose market share and experience a continued slowdown in revenue growth. In addition, they will find themselves competing against a wave of new upstart competitors, which will have a built-in financial competitive advantage in the form of lower operational costs.

To meet this challenge, traditional full-service banks can succeed within their current business model, provided they strengthen specific capabilities in order to become more agile. Specifically, they will need to revamp their operations by 2020 to become more digital, truly customer-driven, omnichannel (allowing banks to interact with customers through all available means, including new mobile technologies), and innovative. The question is not whether these changes will need to happen but how fast. Early movers will have a clear advantage.

Implementing such measures—and executing at a best-in-class level—would allow these banks to achieve a higher level of profitability, and move them closer to adopting a new business model without undergoing a complete strategic transformation (see Exhibit 6). It is akin to a migration instead of a radical reboot of the institution, in which some business units will adopt key traits of the three new emerging models. In fact, the right approach may be a custom solution in which different business models get adapted for different business units, depending on the market requirements of that unit’s customer base (see Exhibit 7).

Banks can succeed in any of these business models; they simply need to chart the course today.
EXHIBIT 6
Six business models can be highly successful in 2020.

EXHIBIT 7
Banks can apply different business models to different units within their overall structure.

Today's Traditional Full-Service Bank

Retail Banking

Commercial Banking (Small and Midsize)

Wealth / Asset Management (Private Banking)

Corporate & Investment Banking

Equipment Leasing/Asset Financing

Enterprise Functions (e.g., HR, Finance, Legal, IT)

A traditional full-service bank today has many options for how to achieve a sustainable competitive advantage by 2020

(Extreme) Example of a Potential Year 2020 Traditional Full-Service Bank

Big Box Retailer

Retail Banking

Digital Commercial Banking (Small and Midsize)

Wealth / Asset Management (Private Banking)

Corporate & Investment Banking

Boutique Treasury

Niche Wealth Manager Provider

Enterprise Functions (e.g., HR, Finance, Legal, IT)

The future bank ecosystem will be comprised of networked relationships with different brands targeting different customers with different pricing, strategies and marketing

Partnership Opportunity

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Go-to-Market Strategies

Each of the three business models can apply innovative new approaches to go to market, allowing them to further boost returns.

1. **Consortium/Utility Strategy** – Combine front and/or back offices with other banks to reduce costs. For example, three traditional full-service banks can share human resource or transaction processing services.

2. **White-Label Strategy** – Offer front and/or back office personnel, products, and processes for others to sell under a different brand. A good example is a Starbucks Bank, which is run by a traditional full-service bank.

3. **Product Expansion Strategy** – Offer non-traditional products in branches and online to increase foot traffic, generate new revenue streams, and ultimately increase revenues from core banking products. A good example is having post office branches in existing bank branches (or vice versa), or offering real estate agent services for people buying or selling homes.

Given the scope of the disruptions impacting the market, institutions need to start today if they are going to succeed in the landing of opportunity that is banking 2020. These measures are difficult but well within the grasp of most traditional banks. Companies that prepare now have time on their side.

The Future is Now

No matter how banks undergo the journey to sustainable competitive advantage, or what business model banks choose to pursue, they should start to re-rig their ships for success today. The table stakes will soon be much higher, moving from optimizing and simplifying the organization today to truly becoming an agile business in 2020. That shift creates very real opportunities for banks that can get ahead of their competitors, provided they make the proactive investments needed to build the business. To capture the emerging opportunities, traditional full-service banks must shift their operating philosophy from a product-oriented organization to a customer-driven organization able to engage with customers anywhere, anytime on their terms. Most fundamentally, they must embrace and integrate new technologies, channels, and strategies.

Given the scope of the disruptions impacting the market, institutions need to start today if they are going to succeed in the landing of opportunity that is banking 2020. These measures are difficult but well within the grasp of most traditional banks. Companies that prepare now have time on their side.
Further Reading

“New Size, New Shape, New Role: How Banks Can Rise to the Global Transformation Challenge”

“Banking 2016: Accelerating Growth and Optimizing Costs in Distribution and Marketing”


“Consumer Mobile Payments Survey: Driving Value and Adoption of Mobile Payments—Consumers Want More”

References

1. We calculated lost market share by projecting the impact if a few of the largest traditional full-service banks were to successfully assume one of the new operating models prescribed in this paper.


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