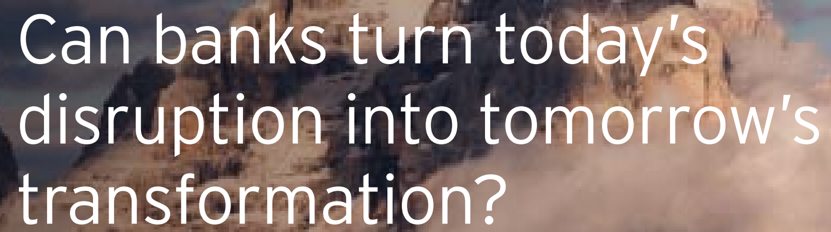

Can banks turn today's disruption into tomorrow's transformation?

Global banking outlook 2021

The better the question. The better the answer.
The better the world works.

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Chapter 1

Beyond the pandemic: creating opportunity from uncertainty

In our 2020 Global Banking Outlook, we hypothesized that banks would continue to struggle to maintain returns on equity. What we did not expect was a global pandemic which presented banks with even more volatility and uncertainty. Certainly, the COVID-19 pandemic has meant a challenging year but it has also highlighted a once-in-a-generation opportunity for banks to transform themselves. An opportunity to get leaner and grow at the same time. An opportunity to connect more deeply with customers. And to drive a more sustainable future. Those banks that seize these opportunities and accelerate innovation will accelerate growth.

We already see banks stepping up to play a leading role in these challenging conditions by helping sustain the economy by facilitating support programs, including paycheck protection. And, the banking system has proven remarkably resilient during the pandemic. Capital and liquidity have generally been strong across the industry. Within exceptionally short timeframes, large banks moved the vast majority of their employees to remote work. Institutions have effectively managed surge demand from customers seeking support, and acted as pipelines for government economic stimulus packages. The industry has shown an astonishing ability to manage change in the face of an unprecedented crisis.

Understandably though, financial performance across the sector has been weak throughout 2020. Globally, average returns on equity (Figure 1) for banks were in single digits for the first half of the year, as banks shored up provisions to manage emerging asset quality risks, which added to the profitability challenge.

Additionally, lending fell in the first half of the year, despite government stimulus measures, as did net interest income on lending and deposit products, amid a weakening interest rate environment. Within wealth management, revenues were negatively impacted by margin pressure in the first half, but a sharper recovery in Q3 looks likely to offset any profitability challenges for the segment for

The industry has shown an astonishing ability to manage change in the face of an unprecedented crisis.

the full year. Universal banks have also been bolstered by the performance of trading businesses and issuance fees. That said, a return to lower volatility in 2021 would see investment banking revenues revert to more normal levels.

Recent progress on vaccines is good news, but given the time it will take to roll out mass inoculation programs, banks will continue to be central to supporting the economy

Figure 1: The return on average equity of banks globally decreased due to growth in loan-loss provisions and a fall in revenues

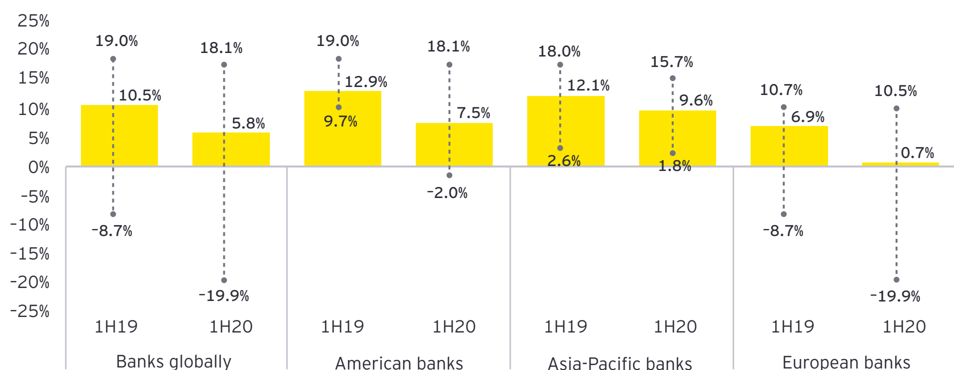
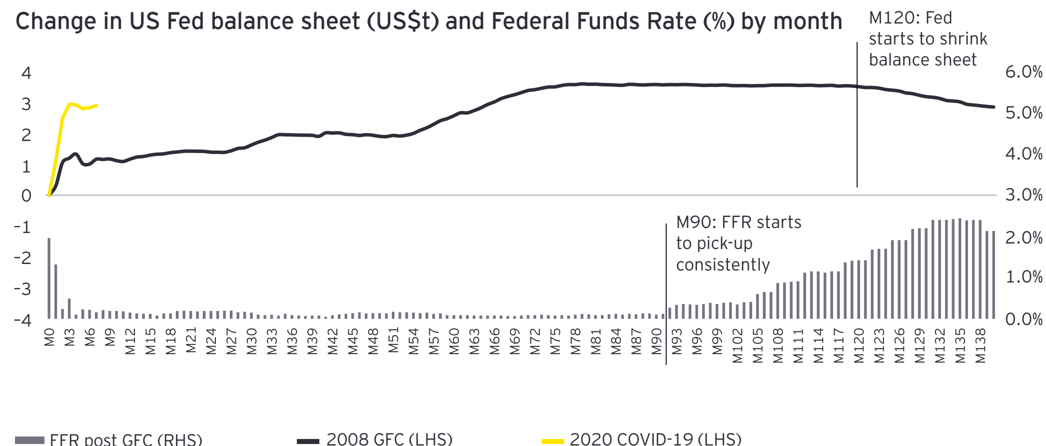


Figure 2: Interest rate recovery is likely to be a long process



Source: SNL Financial, EY analysis

and helping the business recovery through 2021. At the same time, they must remain focused on capital prudence, while managing profitability. This will not be easy should net interest margins remain depressed. If the global financial crisis (GFC) of 2008 is any indication, interest rates are likely to stay low for the foreseeable future (it took about 90 months for a sustained interest rate recovery post the GFC) (Figure 2).

The pandemic has also driven some shifts in the competitive landscape. Its impacts have exposed weaknesses in the challenger sector in several markets, where challengers have historically delivered impressive growth in their customer base but not accompanying profitability. The challenger banks' "race to scale" has hit turbulent water, and some firms may need to revisit their long-term strategy for achieving profitability. Specifically, in some Asian markets, investments in these business models continue, but firms are looking at partnerships with players outside the sector, such as telecoms companies, to address the scale challenge.

In parallel, incumbent banks also face a profitability challenge, which greater scale through industry consolidation may offer them a way to overcome. We now expect increased emphasis on mergers and acquisitions (M&A) among incumbent banks, particularly in Europe.

As banks look ahead to 2021, the trajectory of the world's recovery will remain critical to their profitability. Subsequent waves of the virus and accompanying lockdowns would require more provisions and a further squeeze on lending books — scenarios which banks should prepare for now.

An opportunity to transform

But while the COVID-19 pandemic has created challenges for banks, this time of unimaginable disruption is leading to new opportunities. Banks have been through a live stress test, highlighting areas of weakness in operating models and where banks can improve performance. Many of these issues — for example, the need to transform processes heavily reliant on manual intervention — were already in view, given the long-term shifts within the sector (Figure3), but the crisis has accelerated the need for action.

Incumbents also have a chance to catch up in an area where challengers have historically led — in the "race to innovate." While many challengers are focused on a path to profitability, traditional banks have an opportunity to accelerate their digital transformation, particularly while expectations around short-term returns are lower than normal. Meanwhile, challenger banks must race to scale — but they can no longer do so at the expense of profitability.

More broadly, the crisis has also highlighted a societal change. EY's Future Consumer Index has shown how many individuals are increasingly placing their values and the

environment at the center of purchasing decisions. Banks are in a unique position to finance a recovery that leads to an economy that is not just revived, but reimagined and reflects this heightened emphasis on societal purpose. The sustainability agenda is already a high priority for many banks but, as public sentiment and regulations evolve, this will increase. Over the next year, we are likely to see bold commitments from banks to rebuilding a more sustainable society post pandemic.

In 2021, we believe banks should seize the opportunity to transform by accelerating investments in technology and embedding agile and scalable business models. But reframing their future requires banks to build a strong core. Last year our global banking outlook highlighted how the world's most consistently profitable banks focus on three key pillars – resilience, cost and customer centricity. As banks accelerate their transformation plans, they should double down on their investments in these areas:

1. **Resilience to enable agility:** The COVID-19 pandemic has stress tested banks' resilience and prompted updates to crisis management and business continuity plans. Building greater strength across the enterprise will require banks to expand testing for scenarios around third parties, technology, operations and regulations, and develop new performance metrics. Environmental and social factors that create material events will need more active monitoring. A particular focus on evolving cybersecurity measures is critical, with regulators increasing scrutiny around best practices and governance. The pandemic has shown that you cannot predict all risks, but that building resilience means building an organization that can respond with agility and flexibility when they occur.

2. **Cost management as the foundation of profitability:** An agile organization needs a flexible cost base. For most banks, this means completely reimagining their existing cost structures, including talent models. Banks that consider the crisis as an opportunity for holistic cost reduction across three levers – operational; structural; and strategic – can find strategic ways to align resources to maximize potential. Even in weaker conditions, investment in transformation remains critical.

3. **Greater customer centricity enabled by internal and external data:** Banks that want to create long-term value will need to adapt business models to help customers navigate through the crisis and its aftermath. They must build new revenue streams; find ways to give customers the products and services they want in a post-pandemic world; and deliver these in the ways they demand. This requires financial institutions to consider how to leverage data to hyper-personalize the value they offer to retail, wealth and business customers, embrace the potential of platforms and become more attuned to the changing needs of corporate customers.

Figure 3: Banks must simultaneously adapt to short-term challenges and prepare for longer-term trends

	Macro	Regulation and compliance	Sustainability	Customer	Technology and operations	Talent
Short-term (12-18 months)	**Growth makes a sharp recovery, but flattens out** 5.2% global GDP growth in 2021. Source: IMF	**Increased scrutiny of support programs** 7x reported monthly fraud in business loans July 2020 compared to 2014. Source: Pogo.org	**Consumers remain concerned about sustainability** 62% of consumers will buy from organizations which focus on positive impact. Source: EY Future Consumer Survey	**Preference for digital channels will continue to grow** 56% of consumers will make use of mobile banking. Source: EY Future Consumer Survey	**Operational resilience will be high on the agenda** 80% of financial institutions reported an increase in cyberattacks over the past 12 months. Source: Vmcare	**Remote working will become the norm** 90% average bank employee base working from home since March 2020. Source: EY analysis
Near-term (18-36 months)	**A weak interest rate environment could limit growth** 0.0%–0.25% expected US interest rates until 2023. Source: US Fed	**Prudential reforms – currently on hold – will gain traction** US$50m estimated costs for legal and contract remediation for IBOR. Source: EY	**Sustainability-related disclosures will become standardized** 30% of banks currently have the appropriate quality of sustainability disclosures. Source: EY	**Customers will need greater support with their finances** 20% average collections rate pre-COVID – lowest in 25 years. Source: EY	**Real-time decisions will become business as usual across most processes** 94% of bank CROs expect AI/ML to automate most operational tasks. Source: Tenth annual EY/IIF global bank risk management survey	**Demand for emerging technology skills will increase** 6–11% average increase in spend on new technology at global banks. Source: Celent
Long-term (36-60 months)	**Geopolitical risk management will remain high on agenda** 60% of chief risk officers (CROs) consider geopolitical risk as a priority over five years. Source: Tenth annual EY/IIF global bank risk management survey	**The regulatory perimeter will expand and cost of non-compliance will increase** 371 likely number of new legislative initiatives for financial services firms by 2021. Source: Marklogic	**Focus will shift toward more sustainable solutions** US$2t per year cost of achieving net zero green house emissions by 2050. Source: Energy-transitions.org	**Focus will shift toward solutions which help address holistic needs** ~40% of US customers want financial products to link other aspects of their life. Source: EY NextWave Financial Wellbeing	**Banks will need entirely new infrastructure** 1.4b 5G connections by 2025. Source: EY Mega Trends report	**Building diversity across the organization will be paramount** 30% average female participation in bank boards currently. Source: EY analysis

Chapter 2

Building a more resilient enterprise to enable agility

The pandemic has stress tested banks' resilience, with many banks adapting crisis management business continuity plans. With most staff moving to remote working, they have faced surges in demand that put unprecedented pressure on operations and technology, as well as those of critical third parties that support significant operations. Banks have also seen a fast and sizeable rise in the use of digital channels. They have adapted quickly to new ways of working and of monitoring teams, and have faced increased threats of cyber-attacks.

More than a decade after the GFC, the pandemic has again redirected attention to tail, or low probability risks, and ways that banks can build resilience against them. Currently, the paucity of available historical data and non-linear relationships between risk drivers and impact make it difficult to model tail risk events, such as coronavirus. Still, this challenge is likely to push banks to think about stretching their existing models to build reliable estimates and stress test for such events. They may need to build in alternative or novel data sources that enhance their models. Fundamentally, regulators and leadership teams have a tendency to focus on building resilience against the last crisis. But to guard against future (as yet unknown) risks, banks need to build levels of agility into their business and operating models to help them respond to any risk.

Finally, as highlighted by the EY Financial Consumer Index, the pandemic has reinforced a focus on sustainability and corporate responsibility, including ensuring the health and wellness of their workforce and customers, and managing through social unrest.

As more familiar business patterns resume, regulatory supervisors will be expecting banks to have maintained their compliance and risk management discipline, around operational resilience, cybersecurity, third parties, in-house monitoring, surveillance, and ongoing change programs, such as the interbank offered rate (IBOR) transition.

Over the next year, banks should focus on taking a comprehensive approach to building a more resilient enterprise, including:

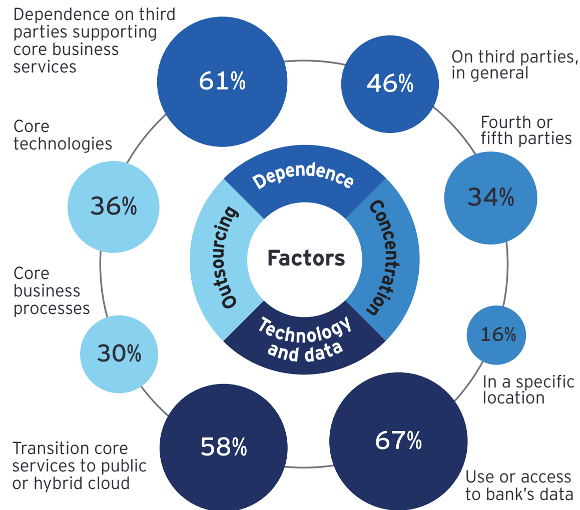
Evolving and expanding stress-testing and scenario planning exercises: The current crisis has highlighted a need to expand the coverage of stress testing beyond banks' financial position to cover a broader set of challenges. This includes testing extreme, but plausible scenarios for third parties (Figure 4), cyber, operations, and regulations. The types of scenarios considered need to be expanded, and banks may involve critical vendors more directly in their simulated testing. The key focus will be on the continuous delivery of core services during disruption. Boards must work with management to consider developing new reporting metrics that relate to talent, culture, climate change, supply chains, cyber-attacks, and data breaches. Financial reporting around adequate liquidity measures will need to be strengthened.

94%

of respondents to the EY annual risk management survey highlighted cyber-risk as the top resiliency challenge.

Source: Tenth annual EY/IIF global bank risk management survey

Figure 4: Third-party factors materially affecting risk profile over the next three to five years



Testing and enhancing cybersecurity measures: As banks recognize that working from home is now a mainstream feature of their operating model, they will need to reconsider their cybersecurity strategy. They will be under increased scrutiny by regulatory supervisors, who are looking to banks for best practices and improved controls. The Financial Stability Board has launched a consultation on a toolkit of effective practices to assist financial institutions before, during, and after a cyber incident. In the US, the Securities Exchange Commission is focusing on several key elements that can reduce risk, including enhanced vendor management. The overall message is that banks should review and improve governance and assessment across all aspects of cyber-risk to address lessons from this crisis.

Prioritizing the sustainability agenda: In the months leading up to the COVID-19 pandemic climate change had dominated the agenda, as banks began to realize they are central to the transition to a zero-carbon economy. The pandemic suddenly shifted the immediate focus to workforce resilience and banks' contribution to building a stronger economy and society. However, sustainability remains a high priority. As we move toward a post-COVID-19 environment, banks can expect to be under more intense pressure from shareholders and stakeholders to prioritize and disclose environmental, social and governance (ESG) factors. Investors and customers will increasingly use this information to determine a businesses' value, considering not only its resiliency against short-terms shocks, but how a company's purpose aligns to long-term value creation. Meeting these expectations will require banks to build stronger connections between financial and nonfinancial performance. Banks will need to identify not just risks, but new opportunities presented by ESG, notably in sustainable finance. Greater consistency and transparency in reporting on how progress is being made will also be important.

67%

of investors surveyed make "significant use" of ESG disclosures that are shaped by the Task Force on Climate-related Financial Disclosures (TCFD).

Source: EY Climate Change and Sustainability Services (CCaSS) fifth global institutional investor survey 2020

Chapter 3

Rethinking cost management as the foundation of profitability

Most banks will struggle to increase revenues in the current operating environment. Instead, with cost management and efficiency high on the board agenda, the focus will be on managing balance sheets, and reassessing and prioritizing investments. The pandemic has also highlighted the need for banks to have more flexible and scalable cost bases. Budgets are likely to come under pressure as banks look to cut costs to support profitability.

At the same time, even amid weaker conditions, investment is critical, particularly as the need for transformation is greater than ever. Banks can free up capital to fund changes by realigning cost allocations and driving efficiency programs. A pause on dividends, in some cases regulatory-mandated, also creates an opportunity to direct internal investment toward transformation.

20-25%

cost reduction required by banks to maintain FY19 performance in 2021.

Source: EY Analysis

In fact, the current environment may even provide banks with a fresh opportunity to re-think cost transformation. Investors are likely to expect more than just announcing a two-to-three-year cost reduction program. Banks should instead seek to understand their performance in the context of the market, reflect on how past cost programs have, or have not, delivered intended outcomes, and understand how to align resources most effectively to maximize potential. With that understanding, banks can then identify targeted operational, structural, and strategic cost-reduction opportunities (Figure 5).

In 2021, these are ways that some banks can improve cost management:

1. Operational

Reshaping a flexible workforce to build a more variable cost base: Optimizing talent by moving to a more flexible model – with flexible rewards – can position banks to better match future customer and work demands, while reducing fixed costs. This will require more investment in the digital tools that improve productivity, motivation, and wellbeing to enable sustained remote working.

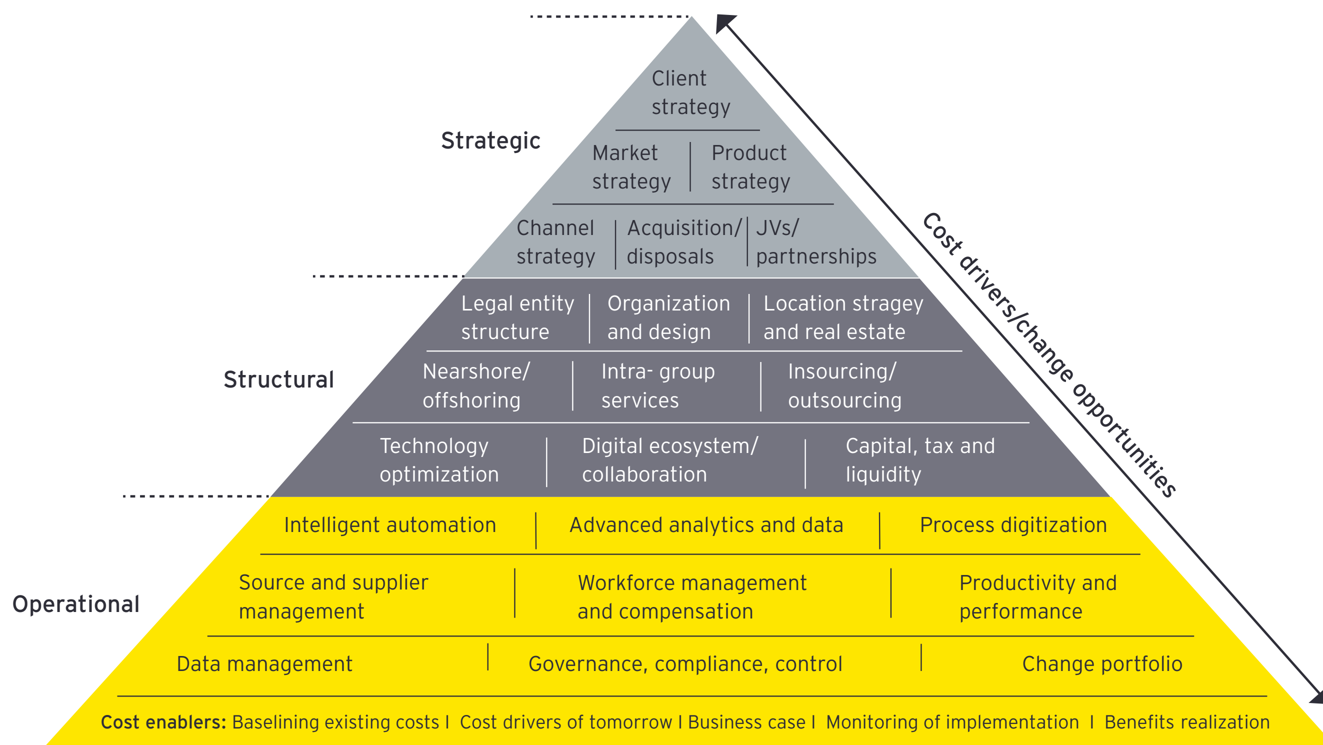
40-50%

contribution of compensation ratio to banks' overall cost base.

Source: EY Analysis

Laying the groundwork for more intelligent operations: For many banks, legacy technology is holding them back from making operating model changes or creating a more flexible, scalable cost base. We expect banks to start tackling this issue with urgency as they prepare to build more intelligent enterprises. The starting point is to assess their processes against their performance over these past months to determine productivity, potential for improvement and opportunities to automate. The outcomes

Figure 5: Banks need to look at cost transformation across the three levels – strategic, structural and operational



of this exercise will help banks redesign operating models to optimize the balance of internal vs. external providers, decide how to use artificial intelligence (AI) to automate or accelerate manual processes, adjust their level of straight-through processing, and deploy automation to reduce dependence on individual third parties. Within the banks' wealth functions, intelligent automation could help enhance efficiency gains, as well as build resilience in the overall system. Some of the clear opportunities in this space include automating processes for client set-up, core order platforms, and compliance guidance coding.

3,000 sq.ft.

average size of a free-standing bank branch in the US.

Source: Bancology

2. Structural

Realigning fixed costs in a changed operating environment: Remote working has been surprisingly effective for banks, with many now considering how they can make this a more permanent part of operations. Many are reviewing their real estate footprint. While doing so requires an assessment of the feasibility and financial cost of exiting prime office space, there are significant opportunities in the longer term. Banks will still need to consider meeting the needs of those staff members who either do not want to work from home, or find it challenging. Organizations that adopt a flexible, hybrid approach to working can both reduce costs and retain a competitive edge in the talent market. Away from large cities, some banks may consider establishing cheaper suburban or regional offices that are closer to peoples' homes. Similarly, the surge in demand for digital channels, identified in EY Future Consumer Index, which is more likely to become embedded the longer the pandemic endures, suggests that banks may be able to radically scale back branch networks, especially in densely populated areas.

Deploying managed services especially in areas that do not provide a material competitive advantage, such as anti-

10-20%

expected FTE cost savings through workflow automation for IT, employees and customers.

Source: EY Analysis

61%

of banks are looking to co-source tax-related activities with third-party vendors.

Source: EY Tax and Finance Operate (TFO) global survey

money laundering (AML) or know-your-customer (KYC) checks, offers an opportunity to both reduce costs and achieve greater scalability.

For banks considering managed services, a good place to start may be the tax and finance operations (TFO) function. Sixty-four percent of banking respondents in EY TFO survey say they lack a sustainable plan for data and technology within their tax functions. Addressing these gaps internally would require significant effort on multiple fronts – filling a skills gap, building more digital capabilities, and automating standard processes. Managed services, or a hybrid outsourcing or co-sourcing approach could instead run TFO more effectively and efficiently, giving banks the confidence and freedom to make bigger strategic changes.

3. Strategic

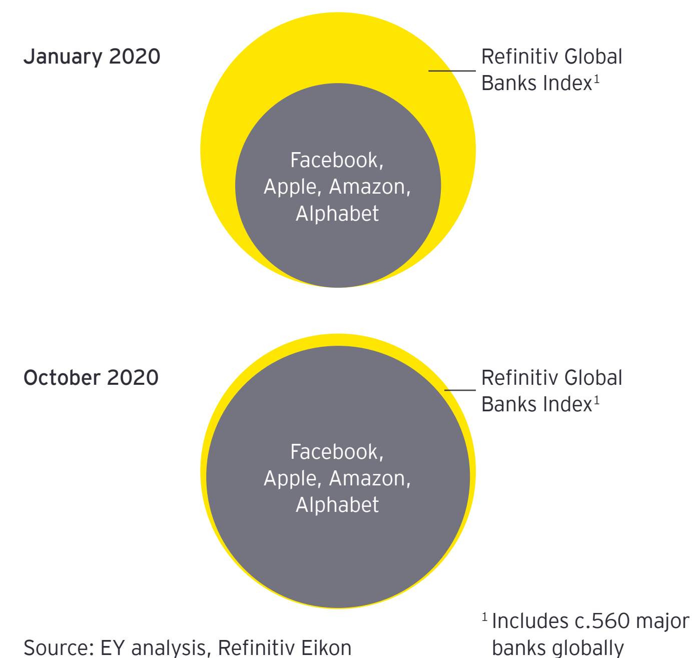
Portfolio realignment: The implementation of the Current Expected Credit Loss (CECL) accounting standard in the US and International Financial Reporting Standard (IFRS) 9 in Europe means banks have had to significantly increase provisioning costs in line with economic scenarios. So far, the impact on capital has been restricted due to forbearance rules, as well as governments' lending support. But as banks emerge from the crisis, identifying strategic growth and divestment opportunities to free up capital will be important. Some banks may sell stressed loan portfolios to strengthen the balance sheet.

In addition, we see some firms using the crisis as an opportunity to expand their product portfolio and diversify. Specifically, some are looking to bulk up private banking and wealth management divisions. The opportunity in the wealth management and private banking space is clear, with 77% of wealth and asset manager respondents to the EY Global Corporate Divestment Study saying that they planned to initiate a divestment over the next two years.

Market consolidation: We also expect consolidation across almost all markets. In the US, there has been slow and steady progress, with some significant mergers in recent times. Across the Atlantic, it is widely acknowledged that consolidation is needed, and weak valuations mean acquisition opportunities for stronger banks. Similarly, in the Asia-Pacific, many markets are also overbanked. A dramatic fall in banks' valuations may be a catalyst for consolidation in 2021. The price-to-book ratio for the largest North American banks is about 0.95, but it is below 0.5 for their Asia-Pacific and European peers. By contrast, the average price-to-book for Alphabet, Amazon, Apple and Facebook is 12.3. In fact, the value of those four technology firms is nearly the same as more than 550 of the world's largest banks globally.

Regulatory fragmentation may limit appetite for cross-border consolidation in Europe and Asia-Pacific. However, in-market consolidation may be accelerated, especially in Europe, following European Central Bank guidance on the treatment of negative goodwill (where the acquisitions price is lower than book value) in acquisitions. The region has already seen the announcement of several major in-market mergers.

Figure 6: Market capitalization ($US; bubble area represents total market cap)



Source: EY analysis, Refinitiv Eikon

[1] Includes c.560 major banks globally

77%

organizations looking to initiate a divestment by 2022.

Source: EY 2020 Global Corporate Divestment Study

Chapter 4

Enabling greater customer-centricity through data

The COVID-19 pandemic has dramatically changed how we access services. For banks, a significant reduction in branch traffic has been balanced by a surge in demand for digital financial solutions for all client groups. Digital payments have soared – achieving as much as 10 years' growth in just four months. Will these changes stick? Perhaps, with the EY Future Consumer Index highlighting a reluctance by many people to return to traditional physical settings.

Banks will need to address increasing pressure from all customers – retail, corporate and small and medium-sized enterprises (SMEs) – to provide a more engaging, contextual, and frictionless experience, while maintaining complete financial trust, integrity, confidence and transparency at scale.

At the same time, governments are turning to the banking industry to support the economic recovery. In doing so, banks must be cognizant that a global slowdown in growth, extended lockdowns and increasing levels of unemployment will put many customers – both consumer and corporate – at risk. They will be challenged to maintain a fine balance between risk management, treating customers fairly, and building trust.

Together, these factors have heightened the need for banks to focus on using data to increase the customer-centricity of their business models by:

1. Helping customers navigate through the crisis and its aftermath.
2. Building revenue streams and offerings beyond the traditional business model.
3. Serving customers with propositions they want, and how they want them.

Meeting customer needs through personalized products and tailored services: The impact of the pandemic means that a significant portion of banks' retail customers are worried about their financial health but, at the same time, keen to consider their overall wellbeing beyond just finances. For banks, it is critical to assess how these changing needs shift demand for banking products, including, for example, for subscription services, holiday features, income insurance, risk management, and legal and tax services. Banks that make greater use of data to proactively adapt their product offering to meet the needs of more uncertain customers – to help them spend, save, invest, and ultimately build their financial security – can help boost customers' confidence while strengthening their own competitiveness.

Building a more customer-centric wealth management proposition is also an opportunity for banks to differentiate, according to recent EY research. The majority of respondents in the EY 2019 Global Wealth Management Survey said they did not trust that they were fairly charged by their wealth management advisers. At the same time, lack of holistic propositions is driving customer turnover within this market, with clients currently using an average of five different types of wealth management providers. In the challenging conditions ahead, wealth management customers are likely to seek support as they reassess financial plans. Banks will need to step up with new product and pricing propositions, especially as wealth moves toward younger customers with different preferences.

And, adapting products and services is only one part of the challenge. Banks will need to think about how to adapt distribution channels to suit different needs of different customers. The foundation to all of these changes will be a

strong data capability that connects the internal data banks have on their clients and supplements it with external data to create unique customer experiences.

Helping corporate customers navigate tough times: Many corporate, commercial and SME banking services' customers continue to be challenged by historic low levels of consumption across key sectors, such as travel and hospitality.

As these customers evolve their business models to new conditions, they will expect banks to also adapt to serve them better. Banks will need to consider how the needs of the corporate, commercial and small and medium-sized enterprises (CCSB) market has changed, and ensure products and channels meet these needs and address specific pain-points.

Beyond traditional corporate, commercial and SME offerings, many will also seek banks' support around nonfinancial services to address broader business needs. This might include advice on industry partnerships, fraud prevention, or risk-hedging. This will be particularly important as they restructure portfolios and re-align priorities for a post-COVID environment.

38%

of people are extremely concerned about their finances.

Source: EY Future Consumer Index 2020

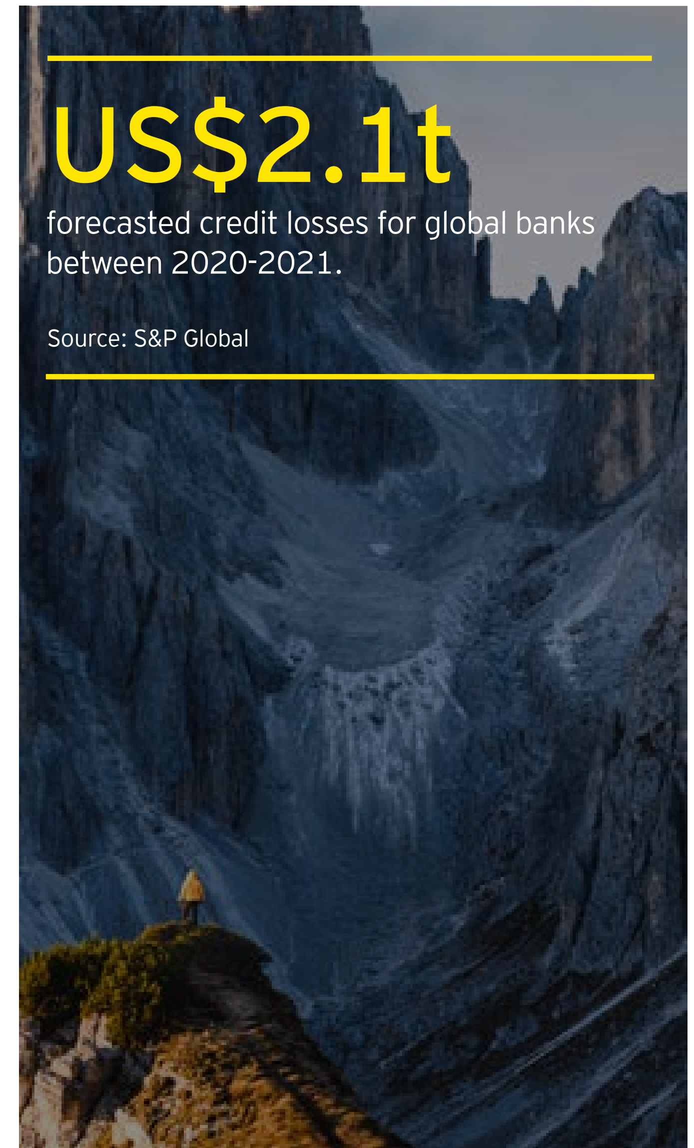
Protecting the bank while supporting the economy: With tough times ahead, banks will need to strike the right balance between protecting their interest and reputation (through aggressive collection) and playing their part in building systemic support for economic recovery and boosting financial confidence.

This will include taking a more considered approach to collections. Many individuals and businesses are severely challenged in these exceptional times. Banks will need to understand which are fundamentally financially secure, those that will rebuild, and those that need help with a pathway to recovery. Effectively and sensitively managing collections and recoveries demands a focus on intelligent automation, shoring up self-service capabilities, and investing heavily in the customer and agent journey to address information gaps and operational inefficiencies.

At the same time, banks will need to make some difficult decisions. This includes repricing loans or reducing segments of their portfolio that are underperforming, and proactively managing their sector exposures to pivot away from markets and client segments that are less attractive in the longer term.

Helping corporate and commercial clients understand their supply chain: As the threat of the pandemic eases, this will become a bigger priority for companies.

After the GFC, trade finance rebounded quickly. It is likely that, as lockdowns lift, a similar path will be followed now. But, a recovery in trade is likely to bring a rise in credit and counterparty risks. This may lead to a short-term reversal in the move to open account trade, with firms seeking more structured trade finance instruments, as businesses look to enhance end-to-end supply chain visibility and mitigate transaction risks.



In short, uncertainties created by this pandemic are liable to result in increased demand for trade finance products into 2021, driving banks to accelerate the digital transformation of trade finance to meet changing needs.

Embracing the ecosystem: Beyond supporting customers to navigate immediate challenges, banks should consider how to build a more customer-centric model over the long term, including by investing in ecosystems, underpinned by application programming interfaces (APIs). Banks should consider how redefining business and operating models can help them best interact within ecosystems to bundle banking services with other day-to-day activities, thus capturing new revenue streams and growing the customer base. It is also a way for banks to implement what consumer companies have been doing for years and "lock in" their customers.

Platform models – particularly in e-commerce – gained strong traction through the pandemic, and it is now critical that banks consider their strategy in this space. Banks should think about the opportunity platforms offer to drive exponential value creation, accelerate speed to market, create new revenue streams, and deepen client relationships.

Platforms built on a modular technology stack that leverage data from multiple and diverse sources, combined with advanced analytics, can help drive future innovation, particularly by connecting customers to new, more meaningful and hyper-personalized value propositions. For example, providing loan forgiveness solutions, innovative pricing options for products, or value-adding services for business customers.

US$200b

estimated global financial services revenue of major nonfinancial services firms.

Source: EY analysis

Not all banks want to, or can, develop a platform model, but as they seek to modernize their business and find ways to deliver more value to clients, it will be essential to either build one themselves or join someone else's.

Conclusion: race to innovate or race to scale?

The last decade has seen challenger banks and non-banking players lead the race to innovate, by showing that outstanding customer experiences and agile innovation can be achieved at a lower cost. But, this crisis has exposed weaknesses in parts of the challenger sector where, despite rapid customer growth, many of these new banks have yet to achieve the scale and profitability that help build resilience through the business cycle.

As we look ahead, traditional banks, which have generally lagged newcomers in terms of innovation, have a real opportunity to take the lead. They already have scale on their side, which insulates against current tough conditions. Some incumbents will bulk up even further as they take advantage of ripe conditions for M&A, particularly in Europe and the US.

Those banks that seize these opportunities now, will double down on investment in strengthening their core by building resilience, reimagining the cost base, and focusing on customer-centricity. Doing so successfully will demand a clear understanding of where organizations are best placed to drive change internally, and where they should acquire or partner to build capability. And, central to this will be redefining the bank's perimeter. Platforms and ecosystem models that drive seamless interaction between customers, banks, and third parties will help reimagine banking in the next decade.

This is a once-in-a-generation opportunity for banks to accelerate transformation, succeed in the recovery that comes next, and be ready for a future beyond these difficult times. Those that do will win both the race to innovate and the race to greater scale.

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