

# Banking Strategies for the Future: Looking Ahead to 2020

A complex web of interdependent trends is threatening U.S. retail banks but also creating new opportunities. Now is the time to carve out a path forward—informed by four likely scenarios.



*ATKearney*

As U.S. retail banks stabilize their balance sheets and navigate an increasingly complex regulatory environment, it is hardly time to sit back and take a breather. The uncertain global macroeconomic and geopolitical environments—coupled with the rapid pace of technology evolution and changing customer preferences—are challenging traditional business models. Factor in customers who expect an experience that is more like doing business with Google and Amazon, and pretty soon the business environment is one that retail banks have not faced for decades (see sidebar: Trends in U.S. Retail Banking on page 4).

How should banking executives untangle the complex web of interdependent trends that are creating new opportunities but also threatening their business models? What is the best approach to carving out a path into the future informed by these trends?

The answers to both questions lie in painting the likely scenarios for the year 2020 based on an understanding of the trends and the direction of their impact. With this in mind, A.T. Kearney in conjunction with its Global Business Policy Council has developed four possible 2020 scenarios for banks in the United States. These scenarios are designed to sharpen the “strategic lens” with which a banking executive views the external environment when developing business strategies.

This paper outlines the four scenarios as well as the implications and changes to the foundational business and operating models that will be necessary to succeed in 2020.

## Building the Foundation

Before going into detail about our four scenarios, it is important to spend a few minutes on the foundational business and operating model changes that will be necessary to compete effectively within each scenario. The following “no-regret” adjustments will be instrumental to developing viable strategic planning processes and operational blueprints.

### 1. Foster comprehensive, cutting-edge financial solutions

Over the past decade or so, the retail banking sector has introduced several financial innovations—from money management and online bill payments to remote check deposits. But the pace of innovation lags that of online competitors such as Yodlee, Simple, and Mint.com. In addition, the big digital players like Apple and Amazon threaten to go beyond their consumer-oriented products (Apple’s Passbook, Amazon’s 1-Click) to offer retail financial services.

In response, banks need to focus on disrupting their own marketplace by continually innovating new product and channel solutions that solve unmet needs. Armed with a formal innovation capability, this means truly breaking down product silos and potentially sharing the benefits (and revenues) of new innovations with customers.

### 2. Simplify the customer experience

Customer expectations continue to exert tremendous pressure on banks to become more customer-centric—to not only retain existing customers but also convert them to loyalists and advocates. Banks correctly interpreted this to mean interacting with customers via their channel of preference, offering a personalized experience, and rewarding them for their loyalty. Unfortunately, this added to the complexity of banks’ operating environments. In 2020, customers continue to want banks to make it easy to do business with them, and successful banks are those that identify and dramatically simplify those experiences that matter most to the customer.



3. Get lean, agile, and integrated

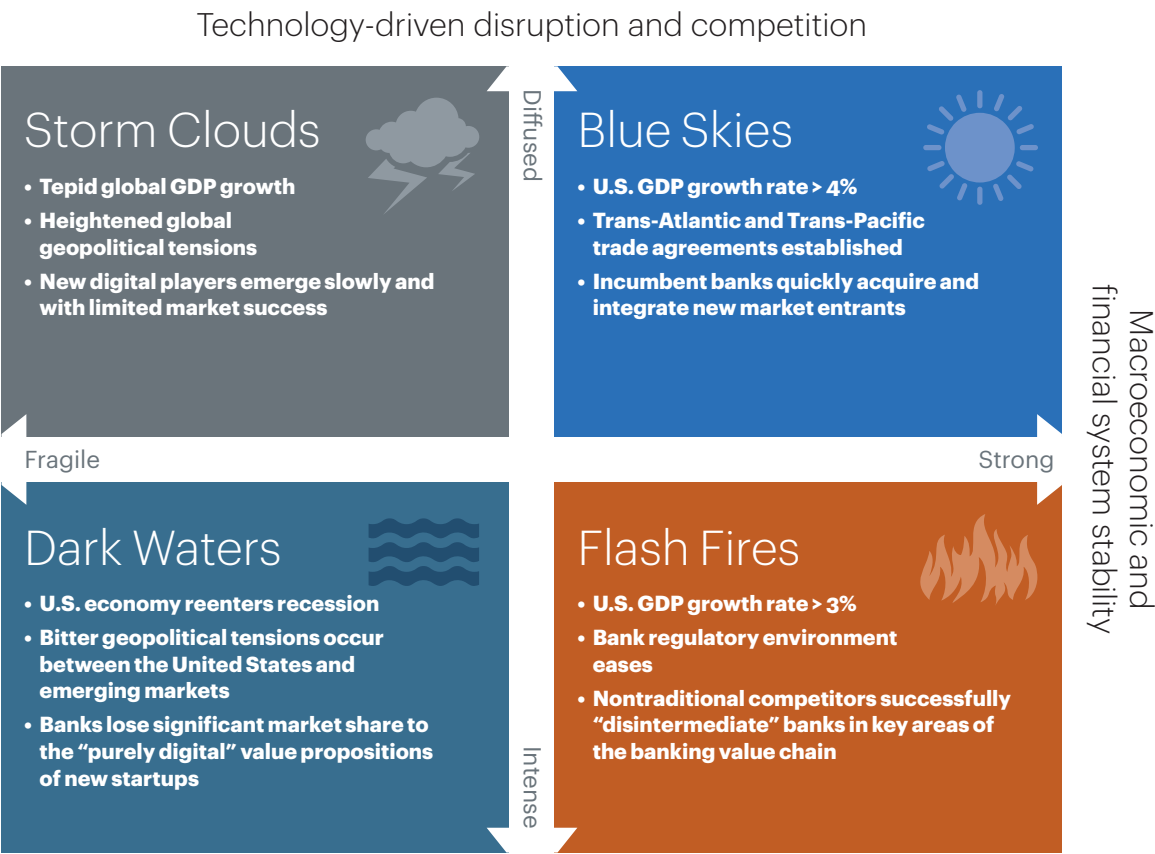
In six years, it will no longer be enough to deliver an efficiency ratio in the low 60s or high 50s. By then U.S. leaders will have learned from today’s European and Australian peers and target efficiency ratios in the 40s. This push will necessitate developing insights into the true costs of end-to-end value streams, creating a nontraditional view of the cost base, and most importantly protecting revenues by distinguishing “good” costs (those that drive customer value) from “bad.”

Factories and technology platforms will continue to be consolidated globally. Branch footprints will get smaller and the associated costs lower as retail banks shrink the size of the branch (though perhaps not the number of branches) and begin realizing the true potential of digital channels.

2020: U.S. Retail Banking Scenarios and Implications

Over the next six years the U.S. retail banking sector will adapt to changing conditions and evolving trends. With this in mind, we developed four forward-looking scenarios—Storm Clouds, Blue Skies, Flash Fires, and Dark Waters (see figure 1). Within each scenario, we outline the would-be trends and triggers, the potential implications (where to play), and the appropriate responses (how to win) for success in the market.

Figure 1  
Four possible scenarios for U.S. retail banks in 2020



Source: A.T. Kearney analysis

# Scenario 1: Storm Clouds

In our first scenario, the U.S. economy continues on its path of anemic growth with a constant threat of financial system instability. The federal government maintains a stringent regulatory environment and continues to enforce significant penalties on national and regional banks for noncompliance. Interest rates remain depressed for an extended period.

In Europe, growth remains stagnant. Forced to reduce assets and to clean balance sheets in line with regulations, European banks increasingly look to exit international operations.

In emerging markets, growth resumes primarily due to favorable demographics. These countries also establish robust regulatory mechanisms that permit overseas investment and participation. China continues to build on its global economic dominance. Its participation in the Trans-Pacific trade agreement provides a significant economic boost, but its growth rates fall to the 6 to 7 percent range as domestic consumer demand fails to offset weak U.S. and European demand.

While technology advances and niche digital banking players emerge, they do not achieve the required level of scale to be successful, primarily because of an inability to develop trust with consumers.

## Where to play

In a fragile macroeconomic environment and an increasingly regulated global financial market, customers seek high-yield investment products and a reliable, credible banking partner to meet their needs.

Pressure from shareholders to improve cost efficiency while incrementally improving revenue productivity persists. This is coupled by incessant demand to ensure compliance and meet all regulatory burdens.

## How to win

Success in this scenario depends on playing a “safe defense” against non-bank entrants and a “patient offense” against traditional competitors—and doing so while cleaning the attic.

The first banks to embrace disruptive products, such as alternative and virtual currency and payment mechanisms, will differentiate their positions, attract market share, and minimize customer attrition. Reinforcing customer trust and bank credibility are also extremely important success factors under this scenario.

## Storm Clouds

### Scenario highlights



#### Financial system stability

- Fragile and disintegrating

#### Technology-driven disruption

- Diffused; mediocre competition from non-bank entrants

#### Key triggers

- Tepid global GDP growth
- Heightened global geopolitical tensions
- New digital players emerge slowly and with limited market success

Three capabilities will differentiate the winners from the also-rans in this scenario.

- 1. Improve cross-silo and pro-customer product innovation, particularly around higher-yield products. For example, innovation opportunities exist in peer-to-peer lending to offer customers the ability to invest alongside their bank in consumer or small business loans.
- 2. Strengthen operational risk management techniques to deliver regulatory compliance and improved credit ratings. This includes improving the transparency of operational risk at the executive level to ensure key areas of risk are clearly understood and not buried in mountains of paper.
- 3. Achieve industry-best cost efficiencies that make it possible to compete on price. This means dramatically simplifying the end-to-end customer experience.

While the threat of disintermediation from nontraditional competitors is low, now is the time to differentiate from peers by embracing lower-cost, technology-driven offerings. Doing so will not only attract new customers but also reduce costs.

Trends in U.S. Retail Banking

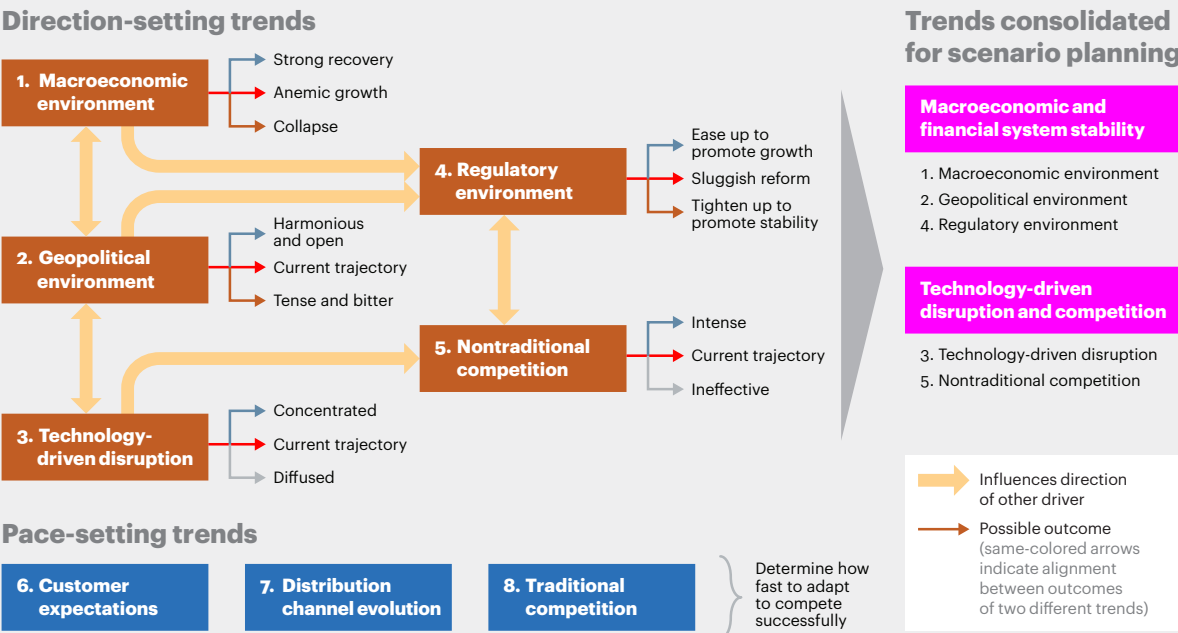
Our prophecies about the future of U.S. retail banking are built on a deep knowledge of current trends shaping the sector and what they are pointing toward. Five main trends require thought-

ful consideration. Yet, even as we outline the trends here, our scenarios suggest significant variation in outcomes is possible, and that several pace-setting factors—customers, distribu-

tion, and new competitors—will determine how quickly change must be accomplished (see figure below).

[sidebar continued on page 5]

Figure  
Trends that will impact retail banking by 2020



Source: A.T. Kearney analysis

# Scenario 2: Blue Skies

In our Blue Skies scenario, the U.S. economy recovers fully and is experiencing strong growth. Unemployment is below 6 percent, driven primarily by the expansion of next generation manufacturing in the United States.

The banking system stabilizes at the national, regional, and community levels supported by growth in consumer and commercial lending. Branches focus on providing advice and successfully integrate digital channels to allow consumers to perform both sales and service activities in the channel of their choice. U.S. banks also begin to emerge as global leaders in delivering a differentiated customer experience.

European banks are stable, with growth driven by fast-growing Eastern European markets, many of which are integrating into the EU. They expand into emerging markets in Asia and the Middle East to capitalize on the growth in commercial and consumer lending in these regions.

*[sidebar continued from page 4]*

**Macroeconomic.** Although unemployment rates are creeping down and GDP growth seems to be sputtering back to life, the U.S. economy is in a slow crawl back to its heady days of the late 1990s, when GDP growth was 4 to 5 percent. Economists largely expect a prolonged anemic recovery, with 2 to 3 percent annual GDP growth over the next few years.

**Geopolitical environment.** The current trajectory will continue, with the United States rolling back its involvement in the Middle East and its position of building alliances, and Europe stabilizing its economic foundation, while China and Russia continue to assert their increasing geopolitical influence in an effort to enhance their standing in the new world order. Escalating geopolitical tensions in the Middle East, Eastern Europe, and Asia, which could have ripple effects on the global economy, have to be monitored.

**Technology-driven disruption.**

Although the branch remains key to acquiring new customers, customers expect to interact with their banks through the channel of their choice. The more disruptive digital payments technology (digital wallets and until recently Bitcoin) threatens to upend banks' traditional roles and currencies. As more customers—especially millennial and gen X cohorts—perceive these as de facto standards for retail banking, catering to these expectations is essential.

**Regulatory environment.**

Tightening regulations and compliance-related penalties will continue to place unprecedented requirements on retail banks and impact the profitability of several regional and community banks. The recent requirement (under the Volcker rule) for banks to build new capabilities to manage risks and operations means bigger challenges for smaller banks and higher operating costs for larger banks.

**Nontraditional competition.**

Nontraditional competitors—including the micro- and peer-to-peer lenders, technology firms, and telecoms—will continue intruding on the domain of established retail banks. These competitors are real threats; it is important to remain focused on fixing business models and driving improved operational efficiencies.

Finally, as mentioned earlier, changing customer behaviors and demographics will determine the speed with which the trends are addressed. With the prevalence of digital technology, the retirement of baby boomers, growth of the Hispanic population, and as gen X and gen Y become the main drivers of consumer spending, there will be new questions about how to attract, retain, and delight different customer segments.

The geopolitical environment is at its most stable in the past 25 years, which translates to new trade agreements in Asia Pacific and the Atlantic. China is an established military power and recognizes the need to maintain strong relationships with emerging economies across Asia and Latin America in order to benefit from access to these markets.

While several large non-bank players benefit from technology advances and become fully licensed to operate as banks, retail banks continue to maintain strong customer trust compared to the non-banks. A number of digital players make high-profile splashes in their attempts to steal market share, but ultimately end up acquired by incumbent banks after quickly exhausting their capital.

### Where to play

In an environment characterized by strong growth but limited technological disruption, the winners are those with the ability to get a jump on competitors. This means relentlessly focusing on simplifying today's complex technology "spaghetti" and moving to a real-time, integrated core system.

Identifying big digital trends early will also be crucial to building first-mover advantage and retaining core customers.

With strong economic activity and returns in other industries, investors expect banks to deliver above-market ROEs, leading to demand for significant improvements on both the cost and revenue fronts.

### How to win

What differentiates a winning bank in a Blue Skies environment?

Two things: disciplined investment and well-organized execution.

- **Disciplined investment.** In this scenario money is available to invest in replacing the core infrastructure. This should be directed to building a "new" bank focused on reinventing and simplifying the customer experience. Success requires a robust and integrated process to envision and deliver this future, likely led by future leaders of the "new" bank.
- **Well-organized execution.** Execution must be flawless and comes at a premium. There is no time to recover from costly mistakes in core system replacement. This includes migrating the technology group's responsibilities from the job of building systems to the job of expertly facilitating the implementation of technology developed by others.

In short, play "aggressive offense" with other banks and a "safe defense" against nontraditional competitors, which includes acquiring the best digital competitors to strengthen internal digital capabilities.

## Blue Skies Scenario highlights



### Financial system stability

- Strong and integrating

### Technology-driven disruption

- Diffused; mediocre competition from non-bank entrants

### Key triggers

- U.S. GDP growth rate > 4%
- Trans-Atlantic and Trans-Pacific trade agreements established
- Incumbent banks quickly acquire and integrate new market entrants

## Scenario 3: Flash Fires

In our Flash Fires scenario, the global economy rebounds and is experiencing strong growth across all geographies. The U.S. economy benefits the most and is again seeing strong growth. For U.S. retail banks, the rebound provides an opportunity for double-digit growth as the regulatory environment begins to relax. Competition intensifies as international players enter the United States.

Europe emerges from its decade of anemic growth as EU integration and the fiscal discipline imposed by Germany has a positive impact on EU countries. Fiscal and regulatory discipline results in a healthier, stronger, and more integrated pan-European banking model.

China invests its economic and political power in a globally integrated system, leading to a period of geopolitical stability.

Technology innovation is faster than anticipated. Advanced mobile technology, the Internet of Things, and big data create a world that demands advanced predictive analytics. Banks' technology budgets skyrocket as they defend against the oft-threatened but not yet realized "Google Bank." Smaller, niche, digital rivals begin to disintermediate traditional players, causing flash fires of intense competition across key areas of the banking value chain.

Branch networks steadily disappear as customers interact with banks more digitally. Digital wallets cause a rapid decline in cash usage. And while banks still own an advantage in customer trust with respect to the security of financial assets, that advantage is eroding quickly.

### Where to play

Now is the time for banks to disrupt their industry before others disrupt it for them.

Given the speed of change, large multiyear technology transformations are no longer feasible. A rapid and dynamic innovation capability should be established instead.

Now is also the time to showcase your deep financial services expertise, capital reserves, and multichannel distribution networks to prevent customers from being lured away to new competitors.

### How to win

In this scenario, banks and non-bank entrants with the "best offense" will win. This is a time to reinvent and reposition by embracing disruptive technologies, expanding into new markets, and enabling customers to seamlessly access products and markets powered by a "wow" digital experience.

Success requires in-house product innovation and a seamless multichannel delivery capability supported by strong customer and product analytics. In addition, an agile operating model is needed that delivers rapid time-to-market for new products and quick growth into new regions.

## Flash Fires Scenario highlights



### Financial system stability

- Strong and integrating

### Technology-driven disruption

- Concentrated; intense competition from both banks and non-bank entrants

### Key triggers

- U.S. GDP growth rate > 3%
- Easing regulatory environment for banks
- Nontraditional competitors successfully "disintermediate" banks in key areas of the banking value chain



To remain cost competitive, partnerships with nontraditional competitors will provide expanded marketplace reach. Some of these investments will be monetized by conversion into utilities for other banks to use where they lack the scale or capability to provide their own platforms.

# Scenario 4: Dark Waters

In the Dark Waters scenario, a second wave of economic slowdown cripples the U.S. economy, led primarily by interest rate rises to address an unexpected surge in inflation. Large national banks scale back operations significantly, leading to another round of mass layoffs. The highly unstable financial environment results in even stricter banking regulations being enforced.

Europe enters into a period of long-term economic decline. The inability of Euro banks to rid their balance sheets of toxic assets further constrains growth and causes additional asset sales.

China successfully transitions from a capital investment-driven economy to a consumer spending-driven economy and its brands displace leading U.S. brands globally. This further intensifies downward pressure on U.S. growth.

Emerging market growth is once again disrupted by currency appreciation caused by the devaluation of the U.S. dollar. This slowdown leads to a new wave of political instability created by a strong sense of anti-U.S. sentiment over the perceived mismanagement of the U.S. economic system.

Rapid advances in technology help smaller competitors offer value propositions that better focus on the customer experience and differentiate them from traditional banks. These propositions include more customized services—developed from customer insights drawn from big data analysis, social lending, and the advent of pure-play digital banks. Cyberattacks are a bigger threat in both frequency and sophistication.

## Where to play

A fragile macroeconomic environment, a disintegrating financial system, and concentrated levels of technology-driven disruption by non-bank entrants make this scenario the least desirable for retail banks.

Customers want low-risk investment products and a reliable and credible partner for their banking needs.

With a tightening credit environment, scale becomes the only way to drive profitability—leading to large-scale consolidation in the industry.

In this environment, investors' demand for renewed focus on cost productivity is only matched by regulators' new demands for fair play with customers.

## Dark Waters Scenario highlights



### Financial system stability

- Fragile and disintegrating

### Technology-driven disruption

- Concentrated; intense competition from non-bank entrants

### Key triggers

- U.S. economy reenters recession
- Bitter geopolitical tensions between the United States and emerging markets
- Banks lose significant market share to the “purely digital” value propositions of new startups

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## How to win

This is the time to play your “best defense.” Banks positioned as the safest, most reliable in the industry—and with a comprehensive customer proposition—will win. However, demand for these scarce positions is intense and success requires a long-term plan and commitment to deliver.

In terms of mergers and acquisitions, patience and perseverance is required to identify “diamonds in the rough” that add value to individual circumstances. Furthermore, strategic alliances and partnerships will assist in warding off the disruption caused by non-bank entrants, while helping all partners survive this cyclical recessionary period.

On the cost front, there are deep and painful actions to further reduce structural costs, particularly in distribution and product management. Ensuring these actions are aligned to the needs of customers and operational risk management is crucial.

## Preparing for 2020

By understanding these four possible scenarios for 2020, the U.S. retail banking industry will be better prepared for the future. It is important to start now—to consider the specific impact each scenario might have on your business and begin to develop the strategies that point toward success.

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