GLOBAL BANKING : WAY FORWARD TO 2020

Viruli de Silva

Former Director Studies, Institute of Bankers of Sri Lanka

1. Introduction

Global banking industry is ever exposed to many challenges. Just as it appears to be recovering from the recent financial crisis, the banks all over the world are facing a threatening future. Sovereign debt crisis in Europe, sluggish economic growth in many developed countries and increased volatility in global markets send shock waves through the industry. As a result banks face significant regulatory, economic and political headwinds, which are likely to remain for the foreseeable future. Rapidly increasing competition from emerging markets and non-financial companies, shrinking of traditional business lines and expansion of promising new business lines, urgent need to invest in cutting-edge latest information technology, decreasing customer loyalty and trust, strongly increasing cost of funding and maintaining of the banking facilities are just a few of the many challenges faced by the present global banks.

With all the above challenges and many more expected in the foreseeable future, what strategies should the global banks adopt to succeed over the next decade ? In the global banking industry what is the way forward to 2020 ? Many reputed institutions on global banking research and development have undertaken extensive studies spending large resources, to find solutions to the above questions. This article provides insight on same, based on a comprehensive scenario-planning study conducted by the Ernst & Young Global Banking and Capital Markets, in collaboration with the Wharton School of the University of Pennsylvania, USA during the period 2011/2012. This study was designed to address the above needs of present global banks which are generally large, diverse banks, as well as other banks aspiring to this status. The study considered a wide spread of products and services the global banks offer today and might wish to offer in the future. To name a few, traditional retail banking (collecting deposits, making consumer loans and wealth management), commercial services (lending, asset management and risk-management activities), investing banking activities (securitization, advisory and underwriting) and proprietary trading. However, to be focused on the scope, it had not included alternative-investment firms (hedge funds, private equity/venture capital) and non-bank institutions (mutual fund sponsors/broker-dealers) in the study.

The above study had identified five overarching trends, 12 key uncertainties and four possible scenarios that the current global banks will face over the next ten years. The key findings of the study are a variety of strategies unique to each of the above situations global banks might adopt, to face the challenges in the next decade. Even if the local banks actual events do not precisely match with the above scenarios, the insights of this study will help them to re-visit their Corporate Plans to be ready for the challenges of the next decade.

2. Overarching Trends in Global Banking

Presently, the global banking industry is dominated by many overarching trends. The above study revealed the following five overarching trends that will continue to dominate the global banking business over the next ten years.

(i) Banking regulations in the global banking industry :

Banking regulations will be more tedious than in the past and will have a major impact on the cost of funds and operations of global banks in the future. Regulators around the world have set out to fundamentally change the way traditional banking operations are conducted. For example, some regulatory bodies in the west have focused on altering the structure and business models of large, cross-border banks, which will have a great impact on the global banking industry.

(ii) Emerging markets will account for a much larger share of global economic activity.

This trend will be posing challenges as well as opportunities for the cross-boarder banks traditionally based in developed countries. As a result the competition among banks in the global industry will intensify in the next decade.

(iii) The volatile and unpredictable nature of the global business environment will remain.

The present volatile and unpredictable nature of the global business scenario of the post- financial crisis era will continue in the next ten years. This trend will affect the new global business opportunities and healthy expansion in the global banking industry.

(iv) The global banks' profit margins will shrink.

*Global banks' profit margins will be thinner than in the pre-fi*nancial crisis period. This will affect the expansion into new business lines, investments in cutting-edge technologies, and innovative new products and services, maintaining customer loyalty and trust etc. in the future.

(v) Technology will be critical in the next ten years.

Technology will play a crucial role in the next ten years, impacting positively, as well as negatively in the global banking industry. Innovative systems will allow larger banks to become more efficient across the industry, becoming closer to their clients creating new opportunities. However, at the same time the competition from non-banking institutions will increase as a result of innovative systems. The growth of on-line and wireless technologies will help them create new opportunities in some services like transaction processing by using innovative systems, which will intensify the competition from the nonbanking segment.

Based on the above overarching trends, the following twelve uncertainties that will affect the global banking industry for the next ten years have been identified.

3. Uncertainties in Global Banking

With the above five overarching trends dominating the global banking business, many critical factors will impact bank strategies over the next decade. The above study identified the following twelve critical factors which are the most vital variables in the business, most likely to determine the future of global banking.

(i) Regulatory environment

In the post-financial crises era, many regulatory changes have been implemented or proposed. However, the future of regulatory environment of the global banking industry still remains unclear. In the study under the above uncertainty, two scenarios foresee a regulatory environment similar to that in place today or much likely under laws and rules proposed for the future. Two other scenarios envisage worlds in which regulations are more tedious than in the current global banking environment.

(ii) Economic shift

The world's economic activity in the next decade will provide great opportunities and major challenges for the banking industry. Growth markets such as India, China, Brazil and others are likely to play a critical role in the world's economic activity. According to the four different scenarios assumed in the study, the role of emerging markets will either evolve at a relatively slow, incremental pace or may shift economic power, which will significantly determine banks' prospects over the next ten years.

(iii) Globalization

Due to globalization and market integration, many banks over the world now compete in global markets, where global strategy acts to their advantage as well as to disadvantage. Global strategy will help global banks to increase their revenues by expanding their market boundaries. At the same time it will apply pressure on earnings and draw criticism from locals concerned about lost jobs and unfair competition, anticipating a turn towards protectionism around the world.

(iv) Type and degree of competition

The competition in the banking industry is ever increasing with the emerging of new competitors, such as institutions in emerging markets and nonbank companies. For example, banks face many new challenges as a result of utility companies, retailers and mobile service providers entering into traditional consumer banking services. This competition can happen in many ways, according to different scenarios. There may be limited impact from new, non banking competitors moving into some of the lucrative market niches in the industry. In another scenario, competition from nontraditional banking providers will be significant mainly in emerging markets.

(v) Financial crises

Many financial crises have occurred in the past and mainly two in the last ten years. Regulators and banking executives in the global banking industry are concerned whether any of similar events will occur in the foreseeable future. In the above study four different scenarios have been considered : no financial crises will happen over the next decade; a major crisis with worldwide impact will occur; smaller crisis with limited impact will occur and a massive crises affecting mainly the developed world will happen over the next ten years. Accordingly, strategies have been suggested.

(vi) Lender of last resort

Lenders of last resorts or the Central Banks over the global banking industry have stepped-in to stabilize the financial system in many recent crises. For example, in the most recent credit crises occurred in the United states due to sub-prime mortgages, and credit crisis in Europe the lender of last resort of those countries came forward to strengthen their financial system. The two scenarios were assumed in the above study. One scenario is the Central Banks will continue to provide back-up funding to strengthen the financial system and the other scenario is these funding or the safety net from 'lender of last resort; will no longer be available.

(vii) Debt situation

In the global banking environment in United States and Europe, rapidly increasing government debt is a serious issue. In many cases the governments have shouldered private sector (including bank) liabilities. In formulating strategies in the study, four different scenarios are assumed. Two assumed this debt will be contained to manageable levels; a third assumed a moderate worsening of the situation and the fourth assumes the situation will worsen.

(viii)Securitization market

The recent global financial crises have changed the fate of securitization market in the global banking industry. In the United States, mortgage-backed securities have ceased leaving most of this market to government-sponsored entities. More standardization of these and asset-backed securities are encouraged while driving business from OTC markets to exchanges, by introducing new regulations in the industry. The scenarios assumed for the next decade are : Private securitization market will recover; it will continue to be limited; and it will find equilibrium in between.

(ix) Retirement environment

The retirement population will increase in many parts of the world over the next decade. Aging population in many developed countries will put stress on government sponsored programs such as Social Security and Medicare, specially in countries like the United States. This situation will also increase the demand for retirement-oriented products and services from the banking industry. Different scenarios were assumed in the above study. One is, the government-funded programs for senior citizens will be financially stretched, but will be capable of delivering most of the services promised. The other scenario assumed is many of these systems will collapse in the next ten years.

(x) Role of Technology

Technology plays a critical role in the global banking environment. Advances in front and back-office technology make banking operations more efficient, improve real-time opportunities and safeguard banks from operational risks. The study assumed four different scenarios. In the first scenario, in both front and back offices will be incremental; in the second scenario significant advances will centre on risk assessment and improving back office operations; in the third assumption, technological advances will transform operations throughout the business and in the fourth scenario the technology transformation will mainly take place in the front office. Strategies for the next decade have been formulated according to above different scenarios assumed.

(xi) Customer empowerment and posture

With the help of internet, now bank customers can easily shop around and access banking facilities, read reviews and critiques of products/services by experts and other customers, find information about fee structures and contract terms of facilities etc. Consumer power has increased and the recent regulations are also forcing credit card issuers, mortgage lenders and other banking facility providers to be more transparent about their product/services details. Different possible scenarios are assumed in the study for the 'Global Banking way forward to 2020', and strategies are suggested accordingly. Scenarios assumed are : low-pressure environment for increased consumer power; high-pressure environment with empowered customers who will adopt an adversarial attitude towards financial service providers and where customers will gain power, but will not act with adversarial attitude when dealing with their banks.

(xii) Credit protection rights

In the recent global financial crisis, the governments of developed banks came forward to protect creditors' rights. As a result, often the creditors became owners of bonds and debt-related securities, making equity holders to suffer great losses. It is argued that in the future, creditors should share such losses. Strategies are formulated for the next decade assuming four scenarios. Two assumptions are that creditors' rights will be relatively low or diminished from the present levels. The other two are that they will be relatively high or as strong as or stronger than the present level.

4. Four possible scenarios in Gobal Banking

Based on the above five overarching trends and twelve uncertainties discussed, four scenarios are assumed that the global banks would be exposed to in the next ten years. Namely, (i) Business as Usual; (ii) Financial Issues; (iii) New Markets; and (iv) Change, Change, Change. These environments range in their position from conservative, incremental shifts to urgent, crisis-driven changes. Now we will see how the above uncertainties will play around in each scenario and how global banks could respond to meet the new challenges.

(i) Business as Usual

This is an environment similar to the present situation, with tight margins and predictable changes, such as current regulations in the pipeline. It is assumed that in this environment the future regulatory conditions would be virtually unchanged from those of today's; there would be a moderate shift in economic power and opportunity from developed economies to high-growth emerging economies; that the competition from new markets such as nonbanking institutions would be non significant; and that the turn towards protectionism would not be strong. Further, it is also assumed that : there would be no further financial crises and Central Banks would be available to shoulder the burden if necessary; the government and other related debt and retirement schemes would not be affected and remain manageable; the securitization market would recover; no major technology-driven changes and there would be small changes in consumer empowerment and credit-protection rights, compared to the current environment.

Following strategies are suggested for the above scenario.

a. **Focus on non-balance sheet-intensive products and services :** Banks could focus on fee-generating services, such as Asset Management, which are not affected by tougher capital and liquidity requirement regulations. Therefore, banks should concentrate on opportunities that are not balance-sheet-intensive.

b. **Expand operations in emerging markets, focusing on retail products and services, while establishing low presence in wholesale markets :** In this scenario, growth and competition in emerging markets would not be as strong as in the other three scenarios. However, it would be substantial for banks to establish a wide array of products and services for an emerging middle class as well as corporate, while watching for regulatory changes. Over time, as individual per capita income rises in emerging economies, global banks would want to have a meaningful presence in those countries and be well positioned to take advantage of all aspects of the markets

c. **Allocate resources evenly between developed and emerging markets, wholesale and retail :** Although this scenario envisions a relatively stable economic situation unexpected shocks could occur at any time. Therefore, diversification would be a wise strategy.

d. **Emphasize wealth management in retail banking :** In developed countries, core retail banking, with low interest rates on loans etc., operate on increasingly thin margins. This is because customers have increasingly grown up being used to free banking with a huge range of product choices. Therefore, fee-generating services such as asset management and wealth management operations would be more profitable, as the capital at risk would be little compared to retail banking.

e. **In wholesale banking, allocate resources equally between developed and emerging markets :** In this scenario, economies in developed countries would recover, increasing demand for wholesale services. In developing economies, growth will have the same effect.

f. **Heavy investments in information technology is crucial :** Though this scenario would be less threatening than the other three scenarios, banks would be operating on tighter margins. Need to know their customers well and operate efficiently and effectively from front and back offices at peak level would be vital. Therefore, heavy investments in cutting-edge information technology are essential to gather information and analyze them on a global basis.

g. **Rebuild some business lines that shrank during the financial crisis :** This scenario would be supportive to revive some highly profitable business lines, such as securitization business, to raise capital to support growth.

h. **Become the best in class in as many categories as possible :** It would be important to be widely diversified among products and services and in domestic and emerging markets.

i. **Focus on deposit-based operations, and maintain a wide spread of retail banking products and services :** In a relatively less volatile environment, it would be very cost-effective to rely on deposits than on continually accessing capital markets. Focusing on retail customers offering basic services would create cross-selling opportunities like lending and wealth management, increasing the fee-based income.

(ii) Financial Issues

This is an environment predicted with additional challenges, a financial world more challenging than today's. For example, major financial crisis and drastic new regulatory changes are assumed. This environment would be different from the 'Business as Usual' scenario, the main difference would be a major, widespread financial crisis and tighter regulations. However, the 'lenders of last resort' would be capable of handling the situation effectively. Moreover, it has been assumed that, in the above scenario the government debt and retirement programs would not be affected and remain manageable and there would not be a significant shift in economic power from developed to emerging markets. However, some moderate changes are assumed in this scenario. For example, there would be some development in protectionism in some segments; customers would be more empowered with an adversarial attitude toward banking service providers; there would be more competition from nonbanking institutions, but only in few niche markets; credit –protection rights would be strengthened and the securitization market would remain constrained. Under the above scenario it has been suggested that the banks should address the issues very early in the cycle, and the management should be able not only to anticipate the situation, but also to move and deliver fast.

Following strategies are suggested for global banks to compete in the above scenario.

a. **Seek retail banking opportunities in emerging markets :** This strategy would be similar to that in the 'Business as Usual' scenario, but would be more aggressive as the banks in developed markets would be facing much difficulties and challenges in the above scenario.

b. **Focus on wholesale products and services in the developed world :** It is prudent to focus on wholesale markets in developed countries, as the consumer-protection initiatives in these countries would make retail operations more difficult and costly.

c. **Emphasize investments in growth markets :** This strategy would carefully differentiate each emerging market from the others. But, it is necessary to be cautious in identifying fast-growing "emerging" markets, as some countries like Brazil, have some of the features of developed countries.

d. **Make modest wholesale investments in developed markets :** This included offering standardized forms of derivatives and financing growth for corporate clients. Since many corporates have large cash reserves, these might not be necessary immediately. However, there are opportunities in the post-crisis market, as some of the wholesale market players have disappeared or merged, leaving fewer players to fight for the stake.

e. **Increase emphasis on cost controls :** It would be prudent to examine the cost of funds in all lines of business and consider alternative, cost-effective measures such as outsourcing. Under the above 'Financial Issues' scenario the Return on Equity (ROE) would be even lower than what is currently forecast to be. Therefore, reducing cost of doing business would be crucial.

f. **Emphasize on large clients in wholesale banking :** It is assumed that larger companies are more likely to recover faster from a financial crisis, than the small and medium-sized companies.

g. **Further emphasize efforts to be the best in a wide variety of products and services :** In an adverse economic environment, weaker players would find it difficult to survive. Therefore, it is vital to remain in the top position so that the market remains confident in the institution through volatile times.

h. **Step up analysis of all business lines :** It is vital to have near-real-time insight into risk-adjusted returns in each line of business. This is because tighter regulations and other adverse conditions may force drastic, quick changes to businesses. Analysis of business lines and prudent allocation of resources would be very important in this scenario. For example, a bank that reduces focus on retail customers when they become less lucrative, would be prepared to quickly allocate their resources elsewhere (services to corporate clients, wholesale markets, securitization, property trading etc.).

i. **Quickly determine what business sectors will feel the heaviest impact from the financial crisis and redeploy resources accordingly :** Banks need to take quick decisions according to market or regulatory changes that affect their business. For example, a crisis impacting customers would make retail banking less attractive, and a bank might react by de-emphasizing deposit-gathering activities, or increase regulatory pressure in the host country could lead a bank to quickly move its headquarters to another country, where regulatory pressure is comparatively low.

(iii) New Markets

In the above scenario it has been assumed that the banking world would face much greater difficulties, such as a sovereign-debt crisis. However, it is also predicted that this environment will present new opportunities to global banks from widespread growth in emerging markets. When there are only limited opportunities and no future in the developed economies, at some point global banks in developed countries would see their strategic view being emerging markets. In this environment, challenges in the developed world would be more severe. Moderate collapse in government debt and retirement systems would be most painful. However, a significant shift of economic power to the emerging economies would create many new opportunities and the domestic banks in these countries would cause a significant threat to banks based in developed economies.

Further, in the above environment protectionism would not be severe. The regulatory conditions would be similar to the present environment, emphasizing on preparing for and avoiding many risks. The financial crisis expected would only have a limited impact, though the Central Banks would not be able to support effectively. Moreover, there would be extensive changes in technology, in both front- and back-office operations. Customers would be greatly empowered than they are at present, but would not hold an adversarial attitude towards the financial service providers. Credit-protection rights too would be relatively low, and the securitization market would continue to be constrained.

What strategies could the global banks adopt in the above scenario 'New markets' ?

a. **Consider structural expansion in emerging markets :** Due to strong growth in these markets, global banks should acquire domestic banks in these markets, by using mergers and acquisition opportunities. This will help them to grow more rapidly than through organic growth and allow then to keep up with competition.

b. **Reduce operations in the developed world :** Returns in developed markets become smaller due to various difficulties faced by them. As the returns could be too small to compete with those in emerging markets, it would be prudent to reduce operations in the developed markets.

c. **Place a strong emphasis on wealth management in emerging markets:** As a result of growing wealth among the affluent and middle class clients in emerging markets, opportunities for asset management and other fee-generated advisory services will be greater. For global bank this would be more lucrative than competing with domestic banks in other retail operations such as checking, savings and lending.

d. **Increase wholesale banking operations in fast-growing emerging markets:** There will be a growing demand for loans, asset management and risk management services for corporate clients in above markets.

e. **Take care in considering retail and wholesale investments in the largest of the emerging markets :** Emerging markets with large populations like China, India, Brazil and Russia provide many retail and wholesale customers. But, they often pose severe competition to non-domestic banks in their countries.

f. **Hand-pick the best of the middle-tier of emerging market countries, looking for local partners to help gain contracts, personnel, and access:** The decisions taken by global banks in this regard are vital. For example, countries like Indonesia and Vietnam are growing fast and are more inviting to non-domestic banks. At the same time, Malaysia and Thailand are less inviting and not growing fast enough to make lucrative investments.

g. **Consider mergers, acquisitions, and joint ventures to speed moves into emerging markets:** Global banks should act fast and should conserve capital to fund moves quickly into emerging markets, as opportunities arise. In the crisis scenario and quick pace of change, bank will pay heavy penalty for delays. The most quickly and, cost-effective way to enter these markets would be through mergers and acquisitions.

h. **Consider alliances with technology firms to quickly build front- and back-office operations:** This alliance will be crucial for global banks, as building and managing relationships with customers will be critical to success in emerging markets. In this scenario, banks will need cutting-edge technologies to improve efficiencies in their operations, to flourish in a troubled business environment.

(iv) Change, Change, Change

This is a scenario assumed with extensive challenges and opportunities. There would be a massive financial crisis in the developed world, where the 'lenders of last resort' would not be able to provide much support to banks. However, there would be great opportunities in emerging economies and severe competition from nontraditional bank service providers (utilities and retailers). The growth markets would become 'the engine of the world's economy', providing a noticeable change in the environment, though it would remain volatile and risky around the world. The regulations would be tighter and burdensome on banks, the government-debt position would suffer and the developed world's retirement and social security systems would collapse. There would be much higher customer empowerment than in the other three scenarios and the customers would hold an adversarial attitude towards the financial institutions. Technological changes would be fast and dramatic, but would mainly affect the front office. Credit-protection rights would be stronger and the securitization market would be much healthier than at present.

Following strategies are suggested under the above scenario 'Change, change, change'

a. **To make a massive shift of resources to emerging markets, emphasizing wholesale at the start :** This shift is necessary for survival and growth of global banks in developed economies. With a financial crisis in the developed world and the possible failure of support from the lenders of last resort, it is far more dangerous for the banks to focus mainly on developed economies. It will be more prudent to shift to emerging markets from developed markets, focusing on wholesale markets.

b. **Conserve capital and consider relocating headquarters to countries with less tough regulations :** A global bank should keep high levels of capital to move quickly when needed. In a crisis situation this issue would be more important than in the other scenarios. Regulatory pressure from host countries would probably determine where the global banks would relocate their headquarters.

c. **Look for mergers and acquisitions with financial institutions in emerging markets :** Bank should act fast, looking for opportunities in emerging markets, as there will be less prospects in developed markets in this scenario.

d. **Pull back from retail operations, including wealth management in developed markets:** When it is too difficult to find opportunities in the retail market, it is prudent to pull back at the right time.

e. **Be quick to recognize and act on change:** For survival and growth banks will need large capital reserves and quick, streamlined decision-making process. According to the changing business scenarios, banks will have to take quick decisions, when to scale down or pull back from certain business lines; expand more profitable business operations, enter into new lucrative businesses or reduce headcount etc. Therefore, it will be crucial to recognize and act fast on the change.

f. **Stay true to core strengths and values:** Bank need to ensure that they are there for their customers in good times, as well as in bad times. Retail and wholesale customers must continue to feel that their bank is focused on their needs and responsive and eager to help them through a crisis. To get this assurance a bank should stay true to its core strengths and values.

5. Conclusion

In the above scenario-planning study, researches identified five overarching trends, twelve uncertainties and four possible scenarios in global banking in the next decade. Further, numerous strategies and recommendations are suggested under each of the above four scenarios, which global banks might implement over the next ten years. Three strategies stand out for immediate attention of global banks:

(i) **Move into emerging markets :** Most banks have made significant investments in emerging markets, by offering a mix of retail and wholesale banking products/services, tailored to each country. However, this could take a longer period to develop business relationships, establish brands and create relationships with regulators etc. in those markets. It is suggested that global banks should launch joint ventures with domestic firms in emerging markets as soon as possible as a successful way forward to 2020.

(ii) **Invest heavily in technology :** A highly sophisticated information technology system is vital for a global bank to gain competitive advantage in the market. This is necessary for efficient and effective front- and back-office operations, to meet regulators' tough reporting requirements, to satisfy customer demands and maintain relationships, to compete with nonbanking institutions providing banking services to clients, risk management activities etc. Therefore, heavy investments in technology in the next ten years, stands out from the suggested strategies for global banks.

(iii) **Develop a nimble culture :** In the next ten years the banking business environment will continue to be unusually volatile and uncertain. As a result, access to capital markets will be uncertain, returns likely to be significantly lower than in the pre-crisis era. To be successful in this climate, a global bank should adopt a healthy governance structure and culture that enables quick decisions and timely effective action. Global banks should maintain unusually large reserves to make sure they could face a crisis and quickly act on opportunities. Therefore, it is important for global banks to develop an active, lively culture in the next decade.

6. References

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