Setting the bar higher

206 banking and capital markets (BCM) CEOs in in 60 countries countries participated in PwC's 20th CEO Survey

***84%** of BCM CEOs believe that technology will completely reshape or have a significant impact on competition in their industry over the next five years*

The disruptive challenges of this new competitive era are highlighted by the proportion of BCM CEOs who see the speed of technological change (75%) and changing customer behaviour that comes with it (69%) as threats to their growth prospects, but there are also huge opportunities to sharpen innovation, get closer to customers and drive down costs

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Introduction

Banking and capital markets (BCM) organisations are striving to get to grips with a new competitive era in which the bars for innovation and customer expectations keep rising, while costs have to be cut further and faster than ever before.

The challenges are heightened by the extent to which the new rules are being set outside BCM. Customers expect the same easy and intuitive experience they get from tech companies and online retailers. Further pressure is coming from lean and nimble FinTech players, which are developing innovative new ways to get closer to customers, while still being able to undercut established businesses on cost and price. Incremental innovation and marginal cost savings won't be enough to sustain profitability and growth in this disrupted marketplace.

Yet, this is also a marketplace that offers huge opportunities. Analytics and artificial intelligence (AI) are transforming the speed, precision and capacity of trading operations. They also make it possible to target and tailor products and services for mass market consumers in ways that would until recently only have been available to high net worth clients. In turn, the leap forward in automation, robotics and blockchain offers cheap and reliable ways to run routine processes, which can not only strengthen efficiency and productivity, but also free up staff to focus on higher value openings.

"Through automation and the use of new technologies, our people will be able to focus on their clients rather than wasting precious time on administrative tasks. Furthermore, the increased use of big data will enable us to provide our clients with tailor-made products."

Wolfgang Kirsch
CEO, DZ Bank AG

As the CEO Survey findings underline, the BCM organisations out in front recognise that keeping up with the furious pace of disruption and change demands more than just systems investment. They're seeking out new capabilities, not just technological, but also the skills that can't be replaced by machines including creativity, problem-solving and emotional intelligence. They're forging partnerships with FinTech players to secure access to cutting edge innovations and differentiate their offering. They're also developing ways for people and AI to work in harness.

Yet, even these front-runners will struggle to deliver target returns without decisive action across a range of business fundamentals. In the face of poor returns and rising capital and compliance costs, the small percentage cost savings that have been achieved so far aren't enough. Costs have to come down by at least 15-20% within many banks[1], and possibly as much as 30-40% if they're to remain competitive and attract investment over the longer-term. The need to drive down costs further than has been achieved so far, while still boosting innovation and customer intelligence, requires a new approach to being 'fit for growth'.

At a time of intense margin pressures, blurring industry boundaries and encroaching competition from outside, many weak and slow moving BCM organisations won't survive the gathering shake-up. But the ones that embrace the possibilities of this new era will be able to use their considerable data, infrastructure and customer reach as a platform for innovation and competitive regeneration.

Kevin Burrowes
Global Banking and
Capital Markets Leader
PwC UK

1 Our analysis shows that the return on equity (RoE) in most of the global systemically important banks (G-SIBs) in Europe and the US fails to cover the cost of equity (CoE). To bring the RoE above the CoE would require 15 G-SIBS to reduce costs and charges by at least 15%, and 11 of these by more than 20%.

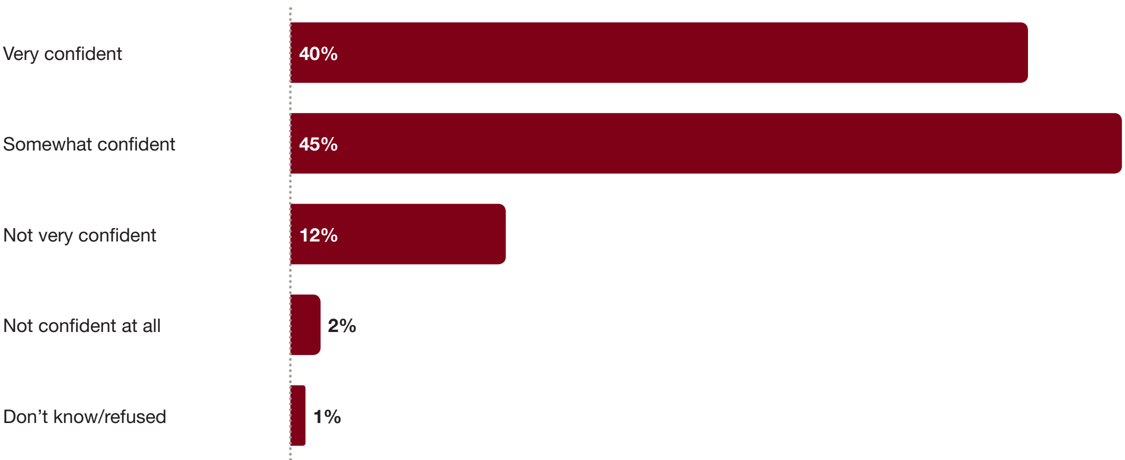
Confidence tempered by gathering upheaval

BCM CEOs are encouragingly optimistic about their prospects. Forty per cent are very confident that they'll achieve revenue grow over the coming 12 months (see Figure 1), up from 31% last year. Nearly half of BCM CEOs (48%) are very confident that their revenues will increase over the next three years.

The scope for optimism includes further rises in interest rates in the US, along with a move away from the near zero rates that have prevailed in many other developed markets, which would give an immediate boost to long subdued net interest income. There is also the possibility of renewed fiscal stimulus, which would provide fresh impetus for lending, deal and trading activity.

Figure 1: Prospects for growth

Q: How confident are you about your company's prospects for revenue growth over the next 12 months?



Source: BCM CEOs participating in PwC's 20th CEO Survey

Yet, BCM CEOs are mindful of the tough challenges ahead. More than 80% see uncertain economic growth as a threat to their company's prospects (see Figure 2). Underlying concerns include geopolitical uncertainty – 80% see this as a threat to growth, one of the highest proportions of any sector in the CEO Survey. Uncertainty holds back corporate investment and the market-making and credit demand that stems from it. Some BCM organisations may also be affected by possible changes in access to key markets in the wake of changes in the global political landscape.

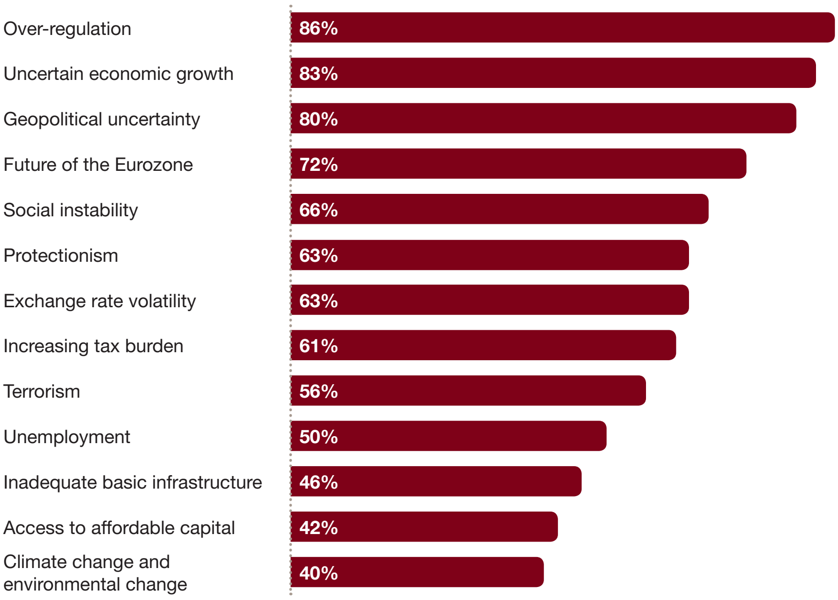
And all the time, disruption and change keep mounting. When concerns over the potential threats to growth from over regulation, the pace of technological change, shifting customer behaviour and competition from new market entrants are put together, BCM comes out as one of the three most affected sectors in the CEO Survey (see Figure 3).

So, if BCM organisations are competing in a new playing field, with new rules, how can they come out on top?

Figure 2: Economic, policy, social and environmental threats to growth

Q: How concerned are you about the following economic, policy, social and environmental threats to your organisation's growth prospects?

BCM CEOs who stated 'Somewhat Concerned' or 'Extremely Concerned'

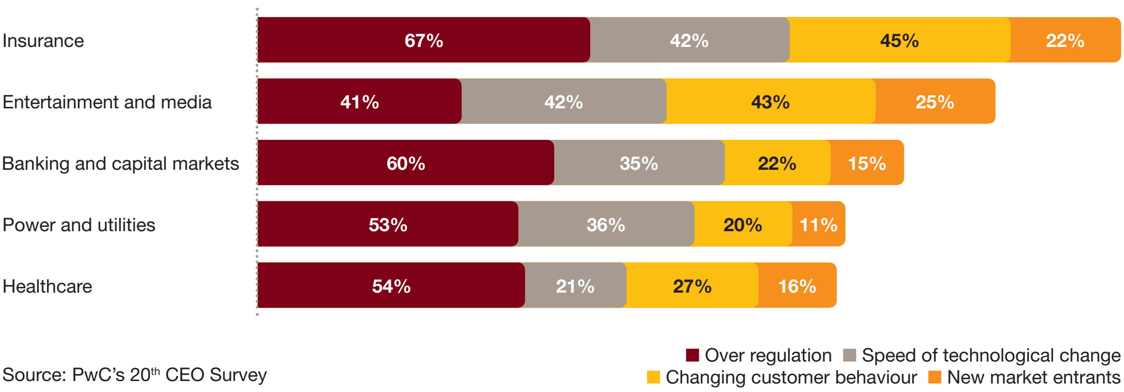


Source: BCM CEOs participating in PwC's 20th CEO Survey

Figure 3: Five most disrupted sectors

Q: How concerned are you about the potential threat to your growth prospects from the following?

CEOs stating 'extremely concerned' (only includes commercial sectors with more than 50 respondents)



Source: PwC's 20th CEO Survey

Disruption brings customer intelligence to the fore

From mobile banking to robo-advice and algo-trading, BCM is in the grips of a technological revolution and resulting shift in customer behaviour every bit as disruptive as the one faced by the entertainment and media sector. Twenty nine per cent of BCM CEOs believe that technology has completely reshaped competition in their industry over the past five years and a further 45% think it has had a significant impact. Over the next five years, an even bigger 42% believe it will completely reshape competition and a further 42% have a significant impact.

Technology opens up immense, yet still largely untapped, opportunities to get closer to customers and operate more efficiently. The rapid advances of recent years have also made customers more receptive to innovation. What customers don't want is the same old thing dressed up as innovation or being encouraged to move onto cheaper digital channels when the service is actually worse than what they had before – they'll will quickly switch if they can get something better for less elsewhere.

FinTech entrants are accelerating the shake-up within BCM by raising customer expectations and driving down cost benchmarks below where many more established organisations' ageing legacy systems are able to compete. A 2016 PwC survey looking at the impact of FinTech found that 95% of banks believe that at least part of their business is at risk from standalone FinTech firms[2] (a follow-up report is due later in 2017). Within the EU, the updated EU Directive on Payment Services (PSD2) is set to lower barriers to market entry and put customer relationships up for grabs by requiring banks to offer third-party providers greater access to their customer data and payments infrastructure. PSD2 thus sets the stage for open banking across Europe.

BCM CEOs cite digital and technological capabilities as the area they would most like to strengthen to capitalise on new opportunities. But they're struggling to get up to speed. For example, only 40% of BCM CEOs are considering the impact of AI on future skills needs and only 6% to a great extent, despite the impact that AI is already having on trading desks and its potential to reshape customer interactions. Only 31% of BCM CEOs are planning to collaborate with entrepreneurs or start-ups over the next 12 months, despite the value of the innovations these enterprises can provide. If we compare BCM to the technology companies it now increasingly competes against and the insurance and entertainment and media businesses facing comparable levels of disruption, the CEO Survey indicates that BCM is behind the curve on these measures of tech readiness and development. The challenges of keeping pace mean that disruption is primarily seen as a threat within a lot of BCM organisations, rather than the opportunity it should be. For example, three-quarters of BCM CEOs see the speed of technological change as a threat to growth – only communications and insurance is higher. More than a third (35%) are extremely concerned.

'Customer intelligence' is set to be one of the main predictors of revenue growth and profitability[3] as BCM organisations strive to get up to speed with competitors from both within and outside

2 PwC Global FinTech Report 2016: Blurred lines: How FinTech is shaping Financial Services (pwc.com/fintechreport)

3 Financial Services Technology 2020 and beyond: Embracing disruption, PwC, 2016 (www.pwc.com/fstech2020)

the industry. Even if a business has a dominant market share it will still need to get closer to customers and be able to tailor products and services around their individual demands.

The data at BCM organisations' disposal is the envy of most other sectors. But most are only capitalising on a fraction of the potential, leaving them vulnerable to competition from businesses that are more adept at forming and exploiting customer intelligence. The BCM organisations that are making innovative and productive use of their data are developing the predictive modelling, machine learning and other advanced analytical capabilities needed to sharpen customer targeting and create more personalised and relevant solutions. They're also organising around individual customers, rather than a single product or channel, as they look to take advantage of opportunities for greater customisation and cross-selling.

Rather than being a threat to mainstream businesses, working with FinTech offers them opportunities to strengthen customer intelligence and develop new business models. A capacity for collaboration and a close eye on emerging trends and possibilities are the keys to realising the partnership potential. Armed with these insights, BCM businesses can look at how to take advantage of the latest developments and bring in the talent and connections with innovators needed to make this possible.

"We have many opportunities in the field of data development. We are already well aware of our client's data and the data that, although we currently do not possess it, we can access one way or another. We believe that we can deliver more value to our customers by doing a better job with this data."

Alexey Marey
Member of the Board of Directors and CEO, Alfa-Bank

Are your people up to the job?

As transformation takes hold, BCM organisations aren't just asking "do we need fewer people?", but also "to what extent does our remaining workforce need to be re-engineered?" These questions are complicated by the fact that when we talk about the 'workforce', we could just as easily be talking about machines as human beings.

While the need for data analysts, robotics engineers and other tech specialists is clearly growing, it's just as important to ensure that leaders understand the possibilities of today's ever more sophisticated technology and how to harness the potential. Are they sufficiently tech-savvy? Most BCM CEOs (58%) believe they have strong digital skills, but only 12% see them as very strong.

And as operations become more automated, the value of skills that can't be replicated by machines is increasing. BCM CEOs now rank adaptability and collaboration on a par with traditional market skills such as problem-solving and risk management (see Figure 4). Yet, creativity, digital capabilities and emotional intelligence are seen as less important, which is surprising given the vital importance of innovation and customer-centricity in today's marketplace.

"…some of the skills that will become really crucial are digital skills, people who are really adaptable and agile, you don't get trained in one thing and keep doing that for the rest of your life, and you've got to keep adapting."

Anthony Healy
CEO, Bank of New Zealand

Figure 4: Prized skills

Q: In addition to technical business expertise, how important are the following skills to your organisation?

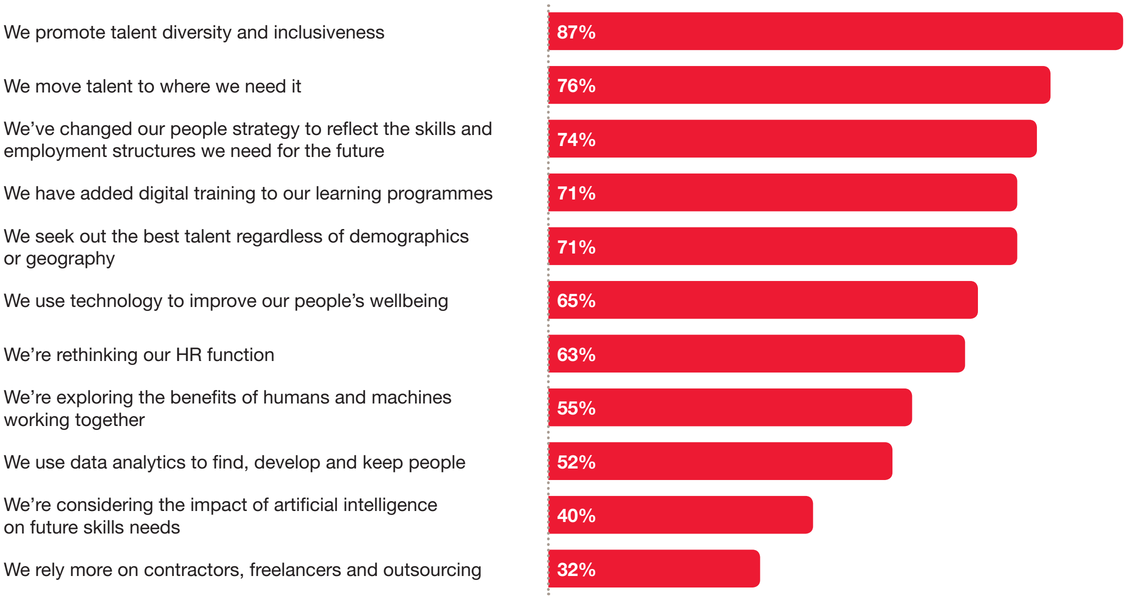
BCM CEOs who stated 'Very important'

Source: BCM CEOs participating in PwC's 20th CEO Survey

Figure 5: Rethinking people strategies

Q: To what extent do you agree or disagree with the following statements about your organisation's talent activities?

BCM CEOs who stated 'Agree' or 'Agree Strongly'



Source: BCM CEOs participating in PwC's 20th CEO Survey

68%

of BCM CEOs see the limited availability of key skills as a threat to growth

With so many sectors vying for the same prized skills, recruitment and retention challenges are mounting. And a combination of a dented industry reputation and less returns to fund high salaries mean that BCM organisations no longer have first call on the graduate cream.

How are they responding? Nearly three-quarters of BCM CEOs (74%) have changed their people strategy to reflect the skills and employment structures they need for the future (see Figure 5), but only around a quarter (26%) report a significant shift[4]. Failing to bring people strategies up to speed can only heighten the risk of skills gaps and falling behind more agile and farsighted competitors. Moreover, only around a half of BCM organisations (52%) use data analytics to find, develop and keep talent, and only 10% to a great extent, even though this would improve their ability to anticipate changing skills demands and respond proactively.

Diversity and inclusion are moving up the agenda as BCM CEOs look to broaden their talent pool and bring in the fresh ideas and experiences needed to foster innovation. More than 80% are keen to promote talent diversity and inclusiveness. Yet, many women and other people from groups that have traditionally been underrepresented within senior management still face barriers to promotion. Policies alone won't overcome them. What's needed is a change of mind-set that stretches from more agile ways of working to how targets are met and performance and potential are judged.

4 We explore the priorities for forging a fit for purpose workforce in The power to perform: Human capital 2020 and beyond, PwC, October 2016 (www.pwc.com/hc2020)

Fit for growth

"It's no secret that banks have left it a little bit too long to optimise processes. So, as the first step, we're optimising, and then as the second step we'll be automating."

Helene von Roeder
CEO Germany, Austria and CEE, Credit Suisse

"If you only apply technology to drive people onto cheaper channels, you will ultimately be driving customers away. I think about the companies that do it really well, how they think about technology making customers' lives easier, and how they align the physical delivery and the technical delivery across all channels to really make a difference. That's the companies I think will win long-term."

Craig Donaldson
CEO, Metro Bank PLC

While most BCM organisations need to go much further in driving down costs, the resulting savings are still only 'table stakes' – the price of staying in the game – rather than a route to long-term profitability and growth on their own. More than ever before, sustainable growth stems from differentiated products and services, along with the innovation and customer intimacy that underpins them, all of which require on-going investment – in other words, being 'fit for growth'. Rather than cutting costs in isolation, the key priority is therefore differentiating the capabilities needed to fuel growth ('good costs' targeted for investment) from low-performing business and inefficient operations ('bad costs' targeted for overhaul or elimination).

Technology is set to play a crucial role in bringing costs under control while still driving growth. This includes opportunities to simplify legacy systems, increase the deployment of robotics and adopt fully integrated SaaS-based models. Distributed ledgers (blockchain) could in turn create a single, shared view of transactions and information exchange between different parties, the possibilities of which include reducing the huge expense dedicated to the gathering and verification of records within BCM. Overall, our estimates suggest more than half of the activities people are paid to perform can be automated by adopting advanced robotics and AI – either now, or surprisingly soon[5].

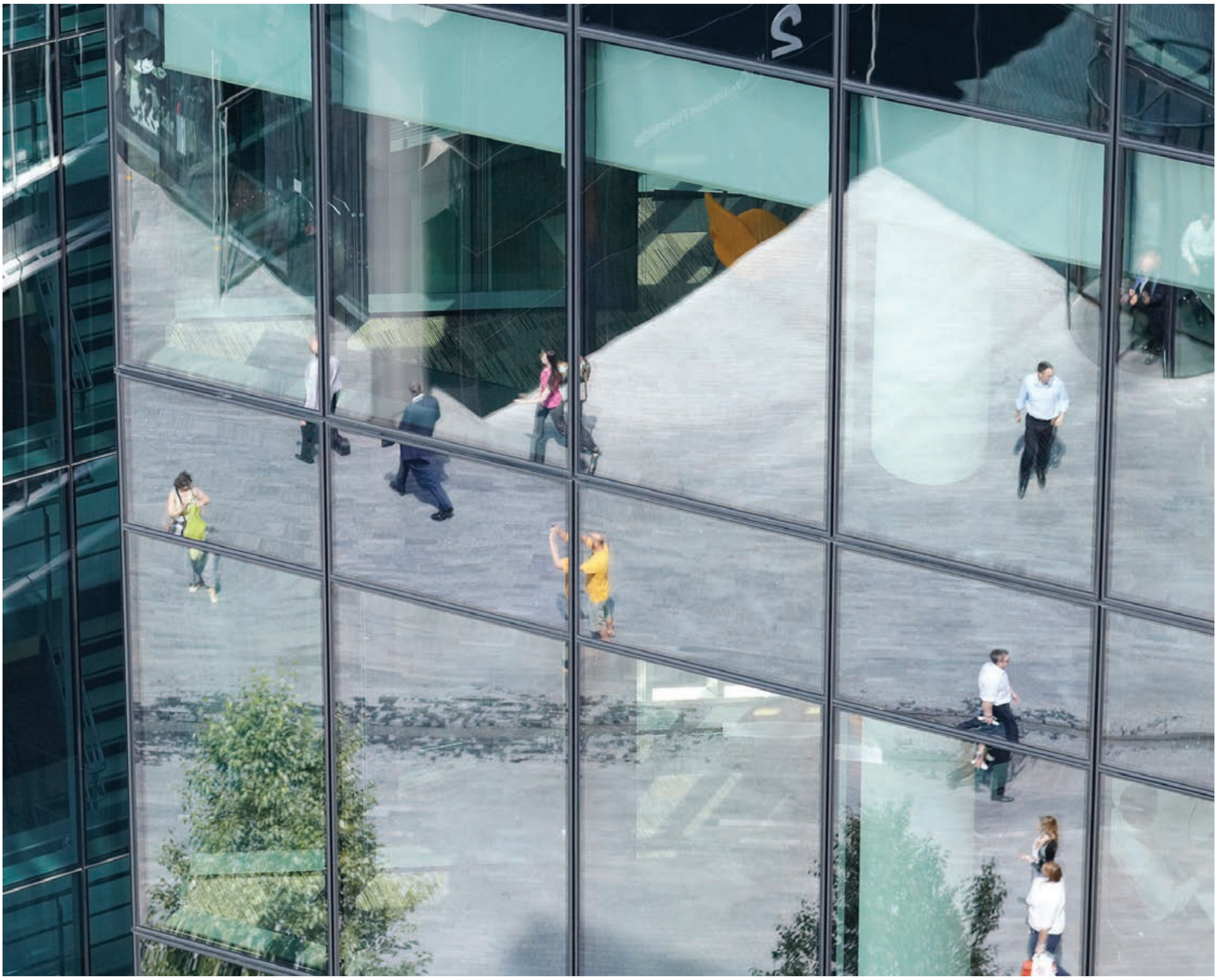
5 Financial Services Technology 2020 and beyond: Embracing disruption, PwC, 2016 (www.pwc.com/fstech2020)

The key strategic decisions include what functions should be retained in-house and what could be outsourced to more efficient providers. Does app development need be carried out in-house when a dedicated tech partner could do it better for less, for example? Utility functions such as payments processing that provide minimal differentiation can be outsourced to providers with sufficient scale to compete on cost. The cultural considerations include moving from a mind-set of proprietary self-sufficiency to closer partnerships with start-ups, other sectors and even competitors.

"The paradigm of business is changing… big, expensive bureaucratic businesses will die, whereas nimble, capable, disaggregative businesses will survive."

John Patrick Hourrican
CEO, Bank of Cyprus

While risk and compliance teams and the resulting costs have been expanding rapidly, the pressure on returns means that this spending can no longer be open-ended. The 'second line' needs to pay its way, not only through more streamlined and efficient management, but also by ensuring it contributes to improved business performance. This includes ensuring better customer outcomes, which help to improve public trust. The second line should also give frontline teams the right insights and confidence to capitalise on emerging opportunities.



Trust in the digital age

With digitisation comes increased cyber risk – 82% of BCM CEOs see this as a threat to growth. As Figure 6 highlights, more than three-quarters believe that it's harder to sustain trust in this digitised world, but there is also a strong sense that the secure and sensitive management of data is a potential differentiator.

Questions over trust are being given even greater resonance by the anxieties many people feel about globalisation. Most BCM CEOs (59%) believe that globalisation has enabled capital, people, goods and information to flow more freely, but only 11% believe that it's helped to close the gap between rich and poor and nearly half (46%) feel that it's done nothing to promote equality. As the spotlight on inequality and the people left behind by globalisation intensifies, BCM organisations could easily find themselves in the firing line. Yet this volatile public mood also creates opportunities to renew corporate purpose and reassert the value BCM organisations create for society. To make the most of this opportunity, it's vital to recognise that integrity, effective risk management and ensuring fair outcomes for customers are integral to profitable BCM business.

"The context of the values and principles that guide a company's business model are now infinitely more important than in the past. People care about what they buy, where it came from and they increasingly choose brands, products and services that match their set of values."

Sergio Rial
CEO, Santander Bank Brazil

Figure 6: Data and trust

Q: In the context of an increasingly digitised world, to what extent do you agree or disagree with the following statements?

Respondents who stated 'Agree' or 'Agree strongly'

Source: BCM CEOs participating in PwC's 20th CEO Survey

66%

of BCM CEOs see lack of trust in the business as a threat to growth

Conclusion: Survival of the fittest

BCM organisations could easily see themselves as being under siege, threatened by political turmoil and uncertainty on the one side and the pace of technological change and customers' ever more exacting expectations on the other. FinTech rivals are moving into the mainstream and confronting incumbent players head on.

Yet BCM organisations have people who are smart, analytical and good at problem-solving. And the industry has always been good at innovating and adapting. Honing and harnessing these capabilities will enable organisations to get ahead of the curve in a marketplace that's opening up as perhaps never before.

The front runners aren't just doing what they've always done a little better, they're also taking advantage of the new revenue opportunities springing up from technology and data. They recognise that the quality of customer service and experience should reflect the bar being set in other industries including technology and online retail. They also recognise that cost cutting isn't an end in itself, but an opportunity to focus resources on the insight, innovation and service needed to delight customers.

> *"In the banking industry, we see negative interest rates, too much regulation and the need to modernise the whole banking system. You could call it Darwinism, and that means survival of the fittest."*
>
> Wolfgang Kirsc
> CEO, DZ Bank AG

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