TEN THEMES IN RETAIL BANKING A SUMMER UPDATE

A half-year review on trends defining European retail baking

David Gillespie
Simon Low

In December we highlighted ten themes we expected to be on top of mind for Europe's retail banks, in addition to a laser-like focus on commercial management and costs.

Now that we've reached the half-year mark, it's time to evaluate how our predictions are faring and what the latest outlook is.

1. **"The next year will determine how the industry is perceived for the next decade"**
   We said this in the context of an expected economic downturn which — so far — has been more muted than anticipated. Banks continue to invest in increased support for customers in financial difficulty even though the near-term focus has been on the liability side of the balance sheet. In the coming months we'll begin to see the effect of higher interest rates on borrowers, and we expect leading institutions will be able to demonstrate their 'social contract' between the bank and society is stronger than ever.
   "We think the best performing retail banks will lead on deposits — it's that simple"

2. **Steer the balance sheet — deposits, deposits, deposits**
   Rising rates, coupled with events in the United States, highlighted the criticality of effective liability and liquidity management. Those banks with strong relationship franchises benefit from a flight to scale and increased margins. Those more reliant on non-relationship funding comparatively struggle. With the ripple effects of Silicon Valley Bank still being felt this polarization could increase, and we expect European players will continue to invest in this area. Expect developments in propositions, processes, analytics, liquidity management and pricing as banks optimize their liability strategies. The bottom line?

3. **Adjacent growth — affluent customers**
   Adjacent growth strategies are a priority for many European banks, with the affluent customer segment a key battleground given their natural adjacency to retail franchises, high returns and centrality to deposits. Will the full-service players be able to make progress ahead of specialists remains to be seen but whether through new propositions, partnerships, or merger and acquisitions (M&A), clients should be the beneficiary as more of Europe's banks expand further into affluent and the associated Wealth sector.

4. **Unlocking value from data — payments**
   What's clear this year is that more banks are investing in payments and data-monetization capabilities. Generalists are looking to catch up with the specialists by leveraging proprietary bank payments data to go beyond transaction processing and provide more personalized offerings to customers. With leading banks exploring new business models and leveraging AI and machine learning tools to gain deeper insights from their data, we expect this trend will continue in the second half.

5. **Innovating for growth — embedded finance and ecosystem plays**
   While leading banks are looking to leverage their banking capabilities through links with other sectors, global tech players are challenging traditional value chains by expanding into “bread and butter” financial products. Will the latter be able to build the sophisticated ecosystems required to win consumer trust, previously thought to be held exclusively by banks? We expect this to be answered over the long term but also wouldn’t be surprised if more pieces of the story unfold later this year. Definitely a case of “watch this space.”
   “How quickly banks spot changes and act on them is a key point of differentiation”

6. **Distribution — digital, hybrid, and back to the future**
   A fascinating debate is starting to emerge as Europe’s banks look to adapt their distribution strategies to a higher-rate environment in which both inflation and margins are at their highest point in more than a decade. We expect greater innovation in the use of hybrid and person-to-person models, on top of ongoing digitization of low-value-add activities. These are multiyear endeavours, so don’t expect to see significant change by end of this year. One for the longer term.

7. **Accelerating the climate transition**
   Retail banks are continuing to bring their work on climate transition firmly into business as usual as more organizations seek to offer new propositions that help their customers reduce their own emissions. We expect more to come in this fast-moving topic and a great source of innovation.

8. **M&A — a strategic buyer’s market**
   Did we get this right? Maybe, maybe not. While it continues to be a strategic buyer’s market on both sides of the Atlantic in many respects, global M&A was materially down in the first quarter and a number of high-profile deals have recently been pulled. Bolt-on capability acquisitions, in-market or market/segment-entry deals all remain a possibility given that the big players have the financial muscle to implement them. But perhaps we called this a year early.

9. **Stick or twist — the transformation conundrum**
   Which of Europe’s retail banks will focus on a steady-as-you-go, cost-first approach, and which will invest in a faster pace of change? It remains unclear. Will higher inflation drive the former or will increased margins give greater capacity to transform legacy architecture and bring forward top-line expansion plans? As ever, the answer is likely to be a bit of both, but on average we think the effects of SVB are likely to lead to increased caution in the near-term.

10. **Agility as a core competency**
    Well, we got this right. Events in the first half of this year underlined just how unpredictable financial markets can be. It would be nice to think things will be calm and predictable in the second half but we doubt anyone is planning on it. The winners will be those firms taking conscious steps to increase their organizational agility.

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For more information, please contact the marketing department by phone at one of the following locations:

India, Middle East & Africa	Americas	EMEA	Asia Pacific
+971 4 425 7000	+1 212 541 8100	+44 20 7333 8333	+65 6510 9700

AUTHORS

David Gillespie

Partner
david.gillespie@oliverwyman.com

Simon Low

Partner
simon.low@oliverwyman.com