ATKearney

The 2014 Retail Banking Radar

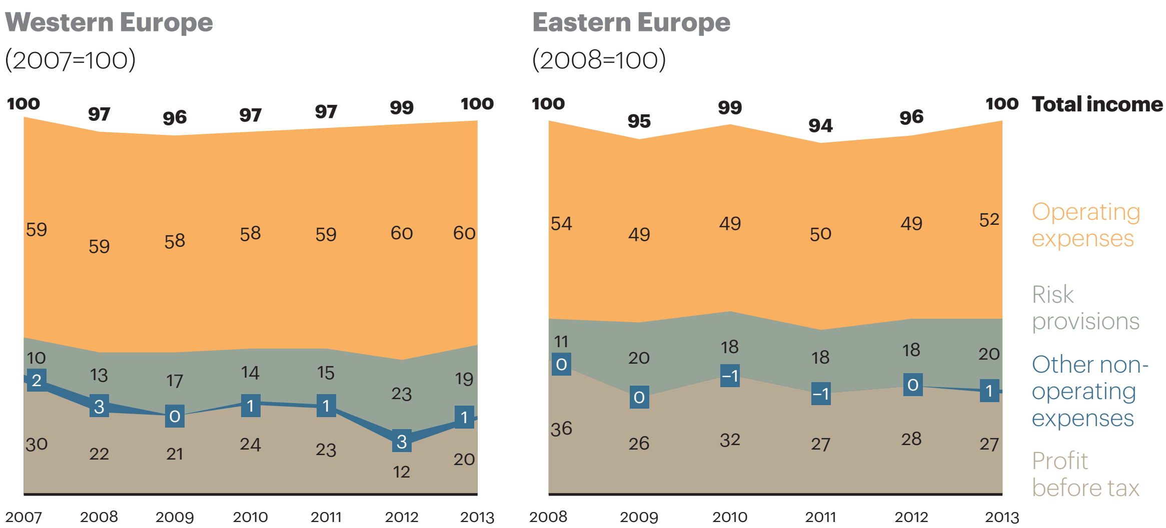
Cold Front Dissipating

Retail banks will not turn around quickly. Even as Europe's economic recovery begins, banks hesitate to tackle the massive change ahead. Success will require smart strategies in vital areas—distribution, digitization, and cost efficiency.

In mid-2013, Europe's economy finally seemed to turn the corner. A slow, fragile recovery set in, with GDP expanding at a moderate 0.2 percent quarterly rate. Unemployment—still high at 11.8 percent in the eurozone—stopped rising. Consumer price inflation began trending downward on the back of falling energy prices. All forecasts for Europe's economy are pointing up, and long-term recovery, while not within immediate reach, seems more realistic than it has in five years.

The retail banking sector is seeing a mild uptick as well. Rates of savings remain high and personal deposits rose again amid lingering economic volatility in early 2013, yet the pace was slower than in the recent past. Loan volumes declined slightly below 2012 levels. Europe's retail banks achieved small income increases compared to 2012, driven more by fees than by increases in net interest income.[1] Profitability rebounded to €127 per client as risk provisions declined, especially in Spain and select Eastern European countries. Still, profit margins remain well below the pre-crisis mark of more than 30 percent (see figure 1).

Figure 1
Retail banks' incomes are back to pre-crisis levels, but profits are still depressed by risk provisions



Source: A.T. Kearney 2014 Retail Banking Radar

Retail banking was marked by two interesting developments in 2013, both related to costs.[2] First, the retail banks in our sample continued their headcount reductions, shedding approximately an additional 1.5 percent of the workforce. Over the past six years, according to European Central Bank statistics, the banking sector in Europe has cut more than 250,000 jobs—or 7 percent of its workforce—which has led to a corresponding rise in productivity and efficiency. Secondly, Europe saw the net closure of more than 4,500 retail branches in the past year, close to triple the usual closure rate. Spanish and Italian banks, continuing their transformation journeys, shed 14 and 7 percent, respectively, of their distribution network this year. More notably, Benelux institutions

[1] In this paper, **income** refers to net banking income, which includes net interest income, net commission income, net trading, and other income.

[2] In this paper, **costs** are operational and administrative expenses without impairments and remain as stated. There is no normalization for different accounting principles applied.

have reduced their networks by 13 percent in the past five years, while the Austrian banks in our sample closed more than 3 percent of their branches in 2013, with more announced for 2014. Today, the average branch in Europe has 5,000 clients, close to 750 clients more than the average in 2008.

At the regional level, we continue to see four realities. In the Nordic countries and Switzerland, banks are operating at higher profit levels than their European peers. In Western Europe, low growth and margin compression continue, and "challenger banks"—including retailers, online banks, and peer-to-peer platforms that operate with either existing clients or significantly lower costs—are making inroads and ramping up the pressure. Southern European banks have been active in cleaning up their balance sheets and remain on an ambitious restructuring route. Although the results of transformation are visible in profit-and-loss statements, the aspirations for and speed of change differ significantly across the region. And in Eastern Europe, recovery is slow due to economic dependency on the large European players and their ramp-up pace, but the outlook for the region remains positive in the medium term.

These are among the main findings of the A.T. Kearney 2014 Retail Banking Radar, an annual index that monitors the dynamics of Europe's retail banking sector (see sidebar: About the Study). This year's findings point to gradual stabilization of the sector, but at lower profit levels than before the crisis. European retail banks differ significantly in terms of performance, and only a few institutions have embarked on widespread structural changes capable of bringing a turnaround. Depending on the speed of the economy's rebound and individual institutions' financial strength,

About the Study

For the 2014 Retail Banking Radar, we have tracked 104 retail banks and retail banking divisions in 24 European countries. Forty-six banks are in 13 Western European countries we have analyzed for past editions of the Radar—Austria, Belgium, Denmark, France, Germany, Italy, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and the United Kingdom. (The Nordics and Benelux are clustered to obtain meaningful regional samples.) This year, for the second time, we have assessed retail banking in 11 countries (covering 58 banks) clustered into four markets: Central and Eastern Europe (the Czech Republic, Hungary, Slovakia, and Slovenia), Southeastern Europe (Bosnia and Herzegovina, Bulgaria, Croatia, Romania, and Serbia), Poland, and Turkey.

The Radar covers more than half of the retail banking market in 24 markets; in some countries with high banking concentration, it is as high as 80 percent. The study includes almost 580 million retail banking clients served in more than 115,000 branches across Europe.

The study analyzes banks in several dimensions: income per customer, income per employee, interest income relative to total income, cost-to-income ratio, risk provisions relative to total income, and profit per customer (before tax). The data comes from official bank records and covers January 2007 through December 2013. The reports include different definitions of retail banking, especially in the treatment of business and commercial customers and the thresholds at which such customers move to separate wealth management and corporate banking segments. A few banking groups are included despite the absence of segment reporting because of their importance to their individual markets (for example, savings banks in Germany and Austria). In a few cases, we apply expert assumptions in the absence of a wider segment report.

In this paper, **customers** are the total number of individual customers counted by the bank, not account numbers or relationships and independent of the level of client activity. They typically include affluent clients with assets under management up to €1 million, and business clients with annual turnover of up to €5 million. **Employees** are total front- and back-office staff on the bank payroll, as reported by the bank. In a few cases, we estimate numbers at the segment level.

we consider a mild recovery possible in the next two years—though clearly not sufficient to ensure leaps in financial performance and bring profits back. Banks that best manage risks and costs could find considerable advantages, in terms of both immediate performance and the financial strength to invest in further long-term improvements.

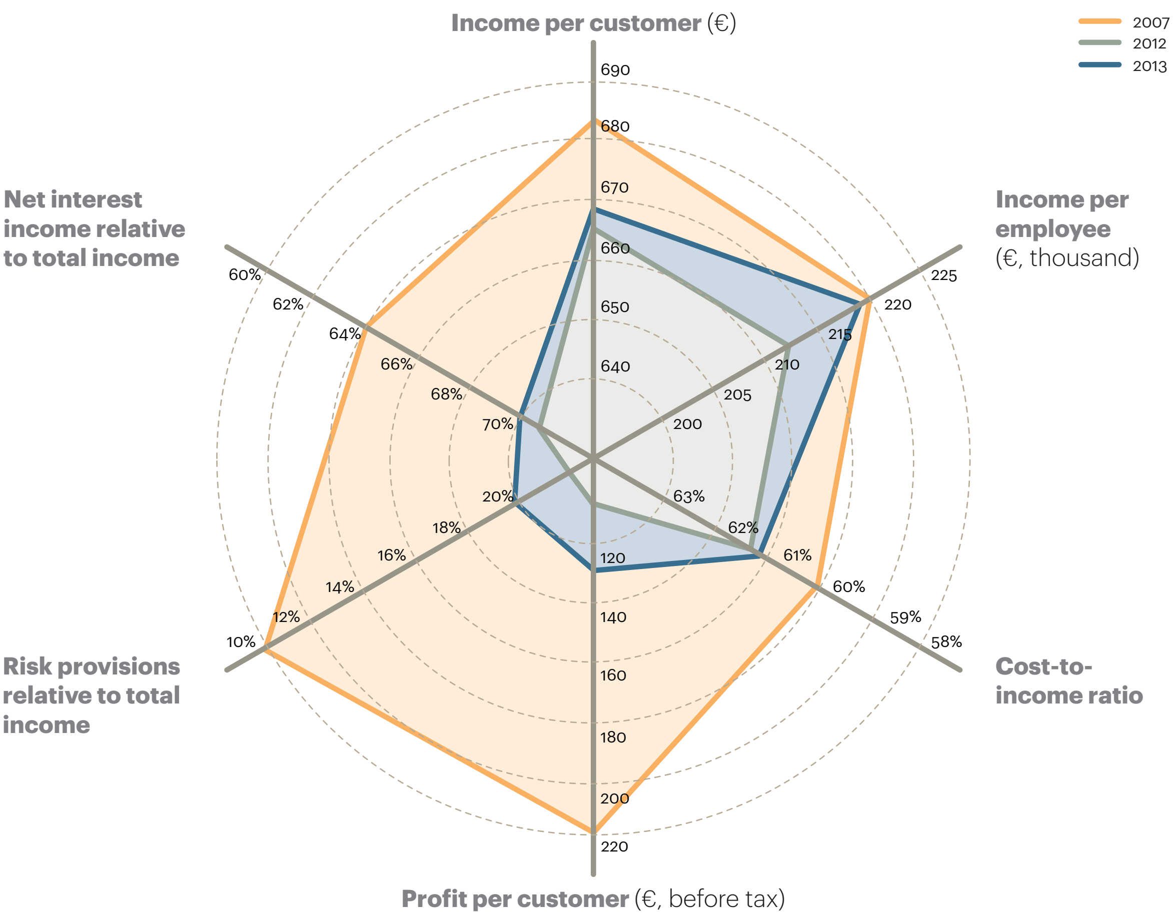
In this report, we start by examining the state of Europe's retail banking industry, identifying some of the primary country-to-country differences. With an understanding that challenges and opportunities never lie far apart, we discuss our expectations about the future of the industry, including pending structural changes and untapped opportunities.

The Past: The Cold Front Starting to Dissipate

To help us understand retail banking today and get a glimpse into its probable future, we start by examining the market's development since 2007 and, in particular, during the past year. As in previous years, we look at six indicators, summarized in figure 2, that highlight many crucial issues for the industry, including the ability to realize customer potential, employee productivity, cost

Figure 2

Retail banks improved in all dimensions in 2013, yet the only sizable change was in productivity

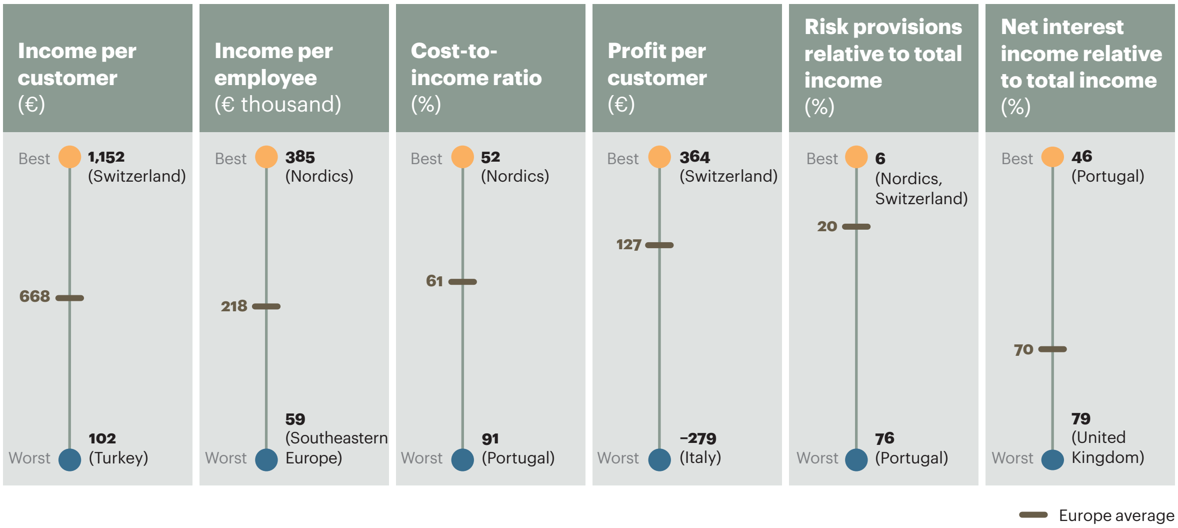


Source: A.T. Kearney 2014 Retail Banking Radar

management, quality (in terms of risk provisions), balance in income sources, and overall profitability. This year's picture is fairly positive at first sight, as all six indicators improved compared to 2012. However, a closer look reveals only one true "winner" among the six—income per employee. Three others—income per customer, cost-to-income ratio, and net interest income to total income—had only marginal improvements. The remaining two—provisions to total income and profitability per client—improved because of particularly bad performances in 2012.

Following is an in-depth look at the six indicators (see figure 3).

Figure 3
The gap between Europe's best and worst performers remains sizable



Source: A.T. Kearney 2014 Retail Banking Radar

Income per customer. Clients of large retail banks remain hesitant about making important financial decisions and sizable investments. As a result, income per client has improved slowly, from €667 in 2012 to €668 in 2013. A few markets with more pronounced uptake stood out, namely France and Benelux, but Portugal, Spain, Poland, and Southeastern Europe had sizable declines. Eastern European banks took a double hit, as falling interest rates put pressure on interest income while new regulations for interchange fees and in some cases the accounting treatment of insurance revenues impacted commission income sources.

Income per employee. Income per employee is one of two indicators in which Europe's retail banks improved both in 2012 and 2013. At €218,000, it is also the only indicator where retail banks almost managed to return to pre-crisis levels. Workforce reductions played a greater role in this improvement than income gains. In 2013, retail banks slashed 1.5 percent of their staff, resulting in higher individual productivity. Not surprisingly, Southern Europe made a big leap in productivity, as retail banks continued internal restructuring efforts and reducing branch networks. Banks in UK, France, and Benelux made sizable gains as well.

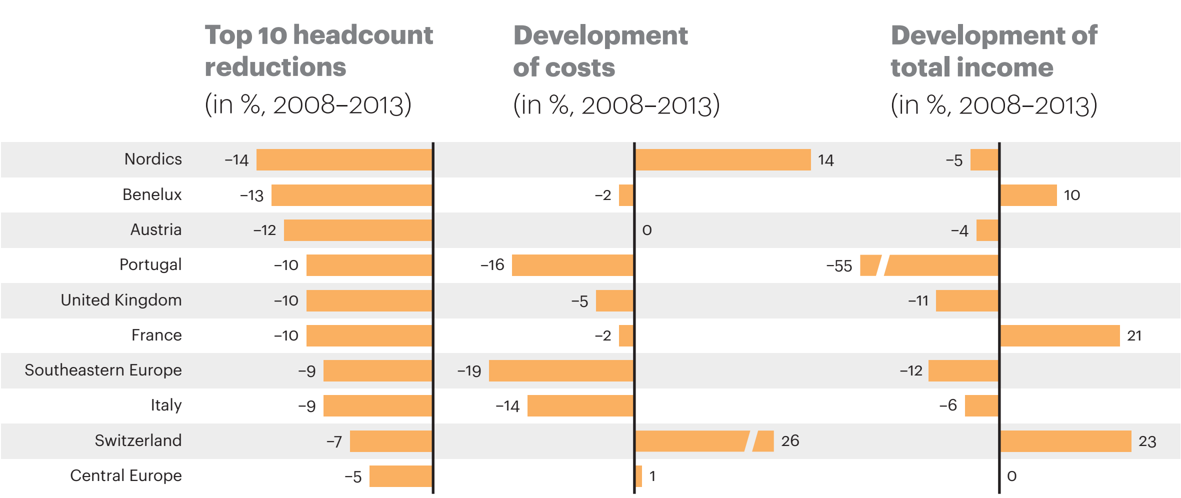
Interest income relative to total income. Net interest income relative to total income declined half a percentage point to 70 percent; the ratio has oscillated between 70 and 71 percent for five years. Limited growth on the lending side and persistently low interest rates continue weighing on interest income. Slow growth in capital market products keeps movement on the commission side sluggish. Existing and forthcoming regulations—including limitations on lending fees, free current accounts, and interchange fees reductions, among others—will likely negatively impact banks' ability to rely on fee income, which is typically more stable. A convergence of factors across Europe—the economic crisis, low interest rates, and a push to implement the same regulatory guidelines—has been gradually reducing the differences in revenue generation models among countries.

Cost-to-income ratio. Since 2008, cost-to-income ratios have stayed within a narrow band between 60 and 62 percent; it was 61 percent in 2013, slightly lower than in 2012 but still way above best-in-class ratios of 40 percent. In some cases, costs in Southern Europe have increased due to restructuring efforts—such as integration costs or redundancy packages. In some Central European countries, branch changes and digital shifts have required investments whose cost advantages—if any—will take a few years to realize.

Interestingly, our results show little correlation between headcount reductions and costs, even though personnel accounts for at least half of costs for most European retail banks (see figure 4). Only half of the banks that consistently reduced headcount since 2008 have lower costs today. We also find no correlation between headcount reduction and cost-to-income ratio, indicating that lower headcounts not only failed to translate to consistently lower costs but also did not limit banks' ability to generate revenues. We believe that many of the banks that did reduce costs effectively have reinvested the gains into system and process improvements or other growth themes and are preparing for more sizable structural changes.

Risk provisions relative to total income. After peaking in 2012 at 24 percent, risk provisions are slowly headed down. The increase in 2012 was driven by significant new provisioning for banks in Iberia and Italy and select Eastern European markets. In 2013, Spanish banks transferred sizable non performing portfolios to the national "bad bank," Sareb, which was created to cleanse local banks' troubled real estate holdings. Although artificial, Sareb helped reduce Spain's local provision levels by 60 percent in one year. In Italy, Intesa Sanpaolo and UniCredit,

Figure 4
Headcount reductions do not necessarily translate into decreasing costs and revenues



Source: A.T. Kearney 2014 Retail Banking Radar

among others, reported write-downs again in an attempt to come clean about the state of their balance sheets ahead of the stress tests and asset quality review conducted by the European Central Bank. Measures to clean up the legacy portfolios along with stricter risk policies and risk models tuned to the new reality offer hope that 2015 might be the year the industry returns to lower levels for provisioning of 16 percent. Still, banks are far from the pre-crisis provision level of 10 percent and with economic difficulties lingering and the unemployment rate in Europe at an all-time high, continued caution remains advisable.

Profit per customer. Relief in provisions from a 2012 peak positively impacted profitability. At €127 per customer, profitability has rebounded but is not yet back to 2010–2011 levels. Despite their extensive transformations, banks in Southern European have the lowest profit per customer, with institutions in Portugal and Italy deep in the red at minus–€160 and minus–€279 per client. Banks in Switzerland and the Nordics, on the other hand, lead the continent at more than €260 per client. For banks in the countries in between, building a profitable mass retail franchise remains a challenge.

Different Weather Zones in Europe

For retail banks, 2013 brought everything from moments of sunshine to clouds and rain. Different parts of the continent experienced different developments, and the performance gap between the top and bottom quartile of banks widened again in 2013. As the economy trends up, the gap may widen even further, and the banks that managed to transform their business models during the downturn will start to pull ahead.

Consumers continue to show a limited appetite for investment products in Western Europe. Loan volumes are stagnating—and, in 2013, slightly declining—which is taking its toll.

Mostly sunny in the Nordics and Switzerland. Retail banks in the Nordic countries and Switzerland historically excel in several performance dimensions, but why that is the case differs. Swiss banks lead in income per customer, consistently above €1,000 over the past five years. While costs are only slightly below the industry average, Swiss bank portfolios have limited risk, with remarkably stable provisions of about 6 percent of income, Europe's lowest rate.

Nordic retail banks boast superb productivity fueled by high income per employee and a disciplined cost approach. The cost-to-income ratios for most institutions in the region range from 37 to 55 percent, well below the European average of 61 percent. Nordic banks have reduced the number of branches by more than 30 percent since 2008, which hardly impacted their revenue generation power but did change how they interact with clients. Branches have become points for advisory and brand marketing, with the real competition for clients' attention and retention moving into the digital space.

Overcast in Western Europe. Mild economic recovery is underway, and retail banks are trying to cast off the spell of slow growth. Revenues increased by almost 2 percent in 2013 after a three-year drought, led by France and Benelux. Germany was stable, while Austria and the UK continued to struggle, with banks contracting slightly. Consumers continue to show a limited appetite for investment products, and stagnating—in 2013, slightly declining—loan volumes are taking their toll as well. Western European retail banks are also facing increasing competition from "challenger banks"—such as retailers, online banks, and peer-to-peer platforms—that are vying for their clients and a portion of their revenues (see sidebar: Challenger Banks).

Western European banks have faced intensive competition and margin pressures for years, so they have long paid close attention to costs. Efforts to improve cost efficiency through processing factories and outsourcing, and more recently through headcount and branch

Challenger Banks

Despite the recent difficulties faced by legacy banks, retail banking has remained attractive for new entrants that see long-term potential in financial services and sense an opportunity in consumers' disillusion in traditional banking.

While these new entrants have not yet made a significant dent in market share, they are dramatically impacting the expectations of customers in terms of service, digital distribution, and product design, and thus are forcing banks to spend in order to catch up. It seems inevitable that the influence of challenger banks will increase as more enter the market and more customers switch banking providers.

We see five broad types of entrants in the market:

Greenfield entrants. These banks, such as Metro Bank in the UK, are startups seeking to leverage their simpler, customer-focused product offerings, underpinned by new, more efficient systems, to challenge incumbents in areas where they are weak. This can happen with better-designed, better-positioned branches, and easier product application processes such as in-branch debit card printing.

Disruptive challengers. Payday lenders such as Wonga as well as peer-to-peer lenders are developing innovative business models that take small segments of the market and respond better than banks to customer needs. Payday lenders, for all of the criticism they attract, provide funding to an underserved segment of the population, and peer-to-peer lending has been attractive both to borrowers and to savers looking for higher rates of return.

Tech firms. PayPal and other online banking systems have led much of the march of digital and technology into the banking sector. To date, this has had less impact than some predicted as consumers have also moved more slowly than expected to digital solutions and banks have also upped their game. Yet there is evidence of banks losing ground to tech players such as PayPal and Google, and Facebook is gearing up for a launch into European financial services over the next year.

Retailers. With big brands such as Tesco leading the way, supermarkets and other retailers are realizing that they can increase their connection with customers and boost their brands by moving into financial services. Their ready-built distribution networks give them a distinct advantage, as do their brands that have been undamaged by the banking crisis.

Divested brands. Following government initiatives to break up larger banks and force them to divest brands and assets, an increasing number of new brands will come to market over the next few years, vying for customer loyalty and looking to increase market share.

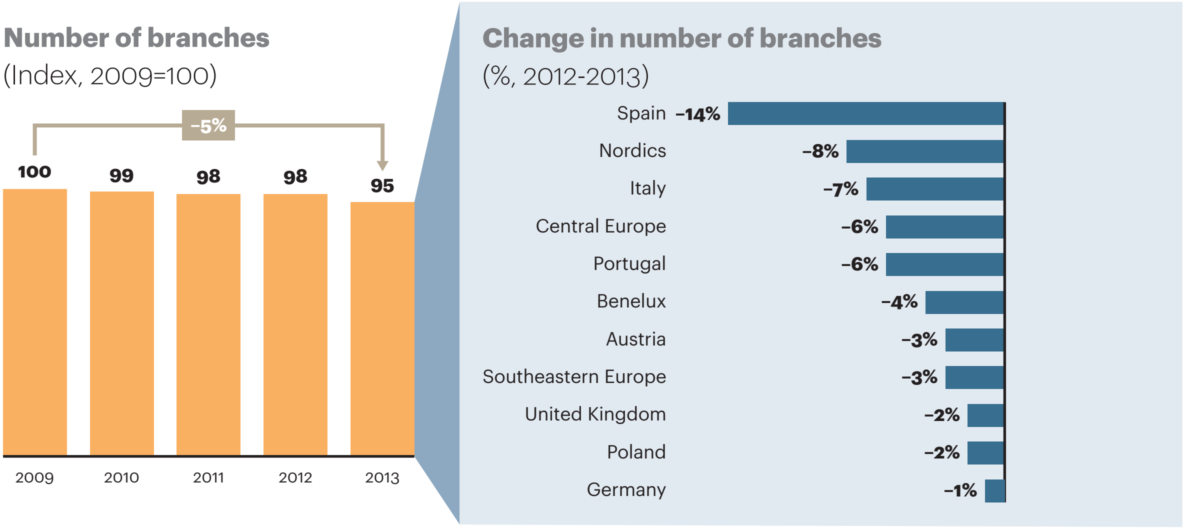
restructuring, are commonplace. These efforts are evident in cost-to-income ratios for British and Benelux banks, but less so in the more fragmented markets of Germany and Austria, where banks have been slower to change their branch networks and organizational structures. Given the advances of lower-cost competition, there is a growing need for action, although the urgency and timeline will differ by country.

Occasional showers in Spain, Italy, and Portugal. Retail banks in Iberia and Italy are still confronting the aftermath of the economic and banking crises, with balance-sheet cleanup remaining a clear mandate everywhere in the region. The region historically has had one of the densest branch networks in Europe, so closing branches reined in costs without significantly reducing client comfort (see figure 5). Still, despite far-reaching measures, profitability is still dismal. Spanish banks' efforts led to a profit of €11 per customer, but Italian and Portuguese banks are still in the red. After almost three years mostly focused on capitalization and non performing loans, Portuguese banks are now redirecting their attention to profitability, tackling more profitable affluent and SME segments and adjusting their size and cost structure to their current income potential. Italian banks have registered sizable losses due to new provisioning but give hope that the industry there is getting ready to turn the page.

Hazy conditions in Eastern Europe. While Eastern Europe was a profit engine for many banking groups prior to 2008, margins have come down significantly since then. Some markets, such as Poland, the Czech Republic, and Turkey, have maintained solid performance over time despite slipping slightly in the past two years. Retail banks in Romania, a trouble spot in 2012, shed a lot of their costs and nonperforming credits and are now recovering on the back of the country's nearly 3.5 percent economic growth in 2013. Slovenian and Hungarian banks are still struggling and have a difficult year ahead for 2014.

While the difficult economic environment locally is amplified due to the countries' small size and their dependency on exports to EU partners, the potential for growth in the region in the mid-term is clear, and the gradual rise of client income and profitability to levels of the rest of the continent seems likely.

Figure 5
Branch networks are shrinking across Europe, and branch closings accelerated in 2013

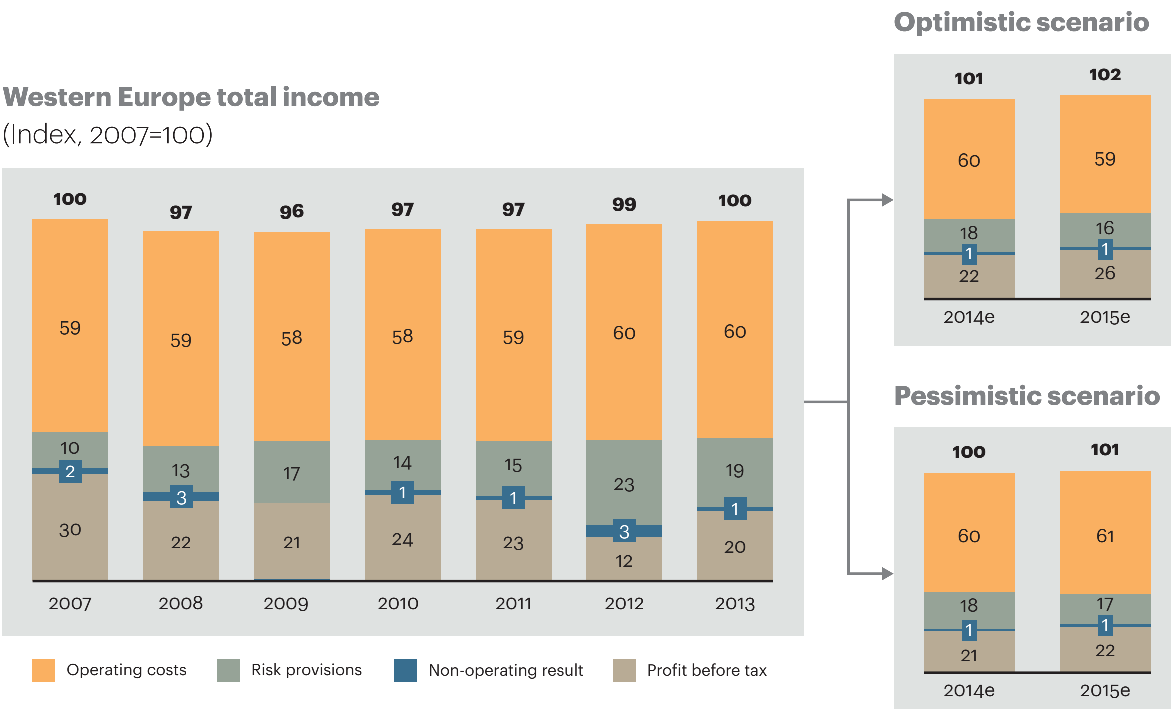


Source: A.T. Kearney 2014 Retail Banking Radar

Looking Ahead: Tomorrow's Weather

Understanding the future of retail banking in Europe starts by examining the economic environment and changing customer behaviors. Retail banks are likely in for a slow recovery in 2014–2015, with performance still lagging pre-crisis levels well into 2015 (see figure 6).

Figure 6
Retail banks will likely have slow recovery in 2014-2015, profitability will remain lower than before the crisis



Source: A.T. Kearney 2014 Retail Banking Radar

Our forecast is based on historical developments of the Retail Banking Radar's indicators, a consensus of key macroeconomic variables tied to economic development and consumer sentiment, and future costs (including personnel, IT, real estate, procurement, and risk). The forecast focuses on how Western Europe's more stable banks will develop, but we believe similar trends will be visible in Eastern Europe's more volatile banking market.

Revenues will recover slowly. Two factors point in favor of revenue improvements: the econ-omy's soft recovery and stabilization of the employment market. This could boost consumers' confidence, including willingness to invest and to take a longer-term view on asset allocation. If loans pick up again and consumers start to prioritize returns over security and fund availability, banks' revenues could grow 1 to 2 percent yearly over the next couple of years. As forecasts also point to interest rate increases in late 2014 and 2015, some additional relief could be in sight. However, regulatory restrictions to consumer lending, free current accounts, and fee transparency will counterbalance the trends and may not permit a major turnaround. This will likely keep income growth forecasts at the lower end of the expected range.

Provisions mirror unemployment. There is a strong correlation between loan repayment and unemployment. With unemployment levels appearing to have hit a ceiling, future provisioning will decline gradually back to 16 to 18 percent of income. Variability across the continent will likely continue, with some Southern and Eastern European banks still above 20 percent.

Cost reduction remains a must. Cost will remain a focus going forward, and all banks have work to do. Costs are more predictable than revenues, which makes optimizing them so effective during a sluggish market. On average, we expect cost savings driven by the decrease of branch numbers, and employment will be offset by additional IT investments and expected increases in remuneration and inflation. As opportunities for branch and headcount cuts may gradually become limited, more costly structural changes will be required. Therefore, on average, costs may even increase in the coming two years. In the medium term, the results of various investments will become visible, and cost-to-income ratios are bound to come down to roughly 59 to 60 percent.

Regulation is a growing factor. As regulations increase in Europe, banks are feeling the impact both in their costs and income (see sidebar: Regulation). Smaller institutions will likely carry a proportionally higher burden for these changes. Regulation was not directly included in our forecast, but we believe it could have a dampening effect, depending on when different regulatory requirements are implemented by each institution and each country.

Profits will not rebound to pre-crisis levels. Profits will improve as income recovers and risk provisions slide. Nevertheless, pre-crisis levels remain unlikely due to sluggish top-line growth and ongoing investments in changing business models. Still, we expect profits per customer to reach €150 to €160 by the end of 2015 as Southern Europe recovers further.

Regulation

Since the banking crisis hit almost seven years ago, regulation has evolved across Europe. Looking forward to 2015 and beyond, regulation levels will not abate and will affect banks' costs and revenues for some time.

Regulation has impacted performance in three major ways:

Revenue reductions. Revenue falls have varied by country, but the large-scale remediation seen in markets such as the UK (notably payment protection insurance) are now trickling down to broader European regulatory guidance. We see this manifesting in interchange fees (which particularly impact Eastern Europe, where levels are historically high), in rulings such as those in Germany to repay origination fees, and in the transparency of current account fees across much of Western Europe.

More widely, regulators are now demanding more customer-centric regimes at retail banks. This has led some banks to remove sales targets completely from branches, accepting the consequences on their revenue lines.

Compliance cost increases. With Basel III regulations along with higher liquidity and capital ratios, banks have no choice but to respond by reducing costs elsewhere if they are to maintain previous levels of profits and returns. Furthermore, the level of change needed to comply with regulation now forms a large percentage of banks' portfolio costs, which are difficult to reduce.

Forced restructure costs. Across Europe, regulators have required radical bank restructuring for many reasons, most to limit "too-big-to-fail" institutions or inject competition into the market by creating new independent brands (such as TSB and Williams & Glyn in the United Kingdom). European bail-in rules, based on the Bank Recovery and Resolution Directive, will also have a significant impact on bank structures over the next few years. Already some banks have taken steps to more clearly separate retail banking from commercial and corporate banking.

Clouds Starting to Break Up

Challenges and opportunities are closely linked. While remaining wary of market developments and stresses, banks also need to capitalize on untapped opportunities.

During the past year, we have seen several important actions for retail urgency grow in importance.

Rethink cost efficiency. Cost efficiency has been on every bank's agenda for five years, even as ambitions and execution vary widely. The steady cost-to-income ratios show that costs have been managed in line with revenue expectations and that many institutions have shied away from fundamental changes in their business models. With growth still slow and regulatory pressures continuing, astute cost management will remain an important way to improve performance. The performance of leading banks in our database, with cost-to-income ratios of 37 to 45 percent, shows the improvement potential.

Going forward, several themes will take shape. Many institutions have done their homework in terms of back-office optimization—for example, process steps, headcount, and productivity level. The next step is to push for agility, including institutionalizing end-to-end process responsibility, and continuous improvement through an "inspect and adapt" approach. On the people front, banks need to move from volume forecasting and capacity management to knowledge sharing and management. Staff is trained for multiple skill profiles to ensure easier substitution and smoothing of peaks; structuring, codifying, and disseminating knowledge is becoming essential for ensuring quick reactions to regulatory changes and improving productivity.

With more non-branch channels emerging, back offices must be re-tuned for a multichannel environment. This starts by digitizing conventional processes—eliminating paper, cutting turnaround times, and providing automated notifications to clients at key process junctions. Technologies, such as smart scanning, will reduce manual data entry and repeat inputs in various systems. As processes become channel-neutral, we believe they will also become location-agnostic. We anticipate a move to multiple locations and away from the traditional hub-and-spoke model. Nearshoring as a way of gaining short-term cost benefits also still has potential, particularly considering Eastern Europe's cost advantage over Western Europe, which will likely last over the next decade.

Can these changes bring cost-to-income ratios down to 45 percent or less? Alone, likely not. But gaining a holistic view of costs and the business model can make a big difference in creating a more sustainable cost base. Other industries provide evidence that low cost does not necessarily mean low service or low customer satisfaction. Motel One's concept of "coolness" over opulence is a good example—clean, modern design, modern amenities, and affordable prices. Ford's total quality management stands not only for lean manufacturing but also for quality and reliability. For banks, similar moves could mean reducing unused features, simplifying products, processes, and systems, stripping down branch formats, co-locating with other businesses, and introducing lower-cost expertise through video advisory.

Reconsider branches within a multichannel environment. For the first time in 2013, banks beyond the Nordics and crisis-struck countries of Southern Europe closed many branches, a trend that will only accelerate. Future banks will include fewer, smaller, and leaner branches focused primarily on advisory and brand building. More banks will experiment with different formats, such as mobile branches to test out new locations and markets, co-locations with partners in high-traffic areas, and unmanned branches for services or transactions. Branch formats will also evolve as different clients—such as mass retail, affluent individuals, and free professional—require individual banks to manage several different "networks" in parallel. New technologies, such as video, will gain traction despite the slow start in several markets.

Such a transformation will be neither quick nor simple. Cutting branches requires data on a region's potential and competition and a careful plan for transitioning clients if the bank footprint allows so. Reducing branch size and headcount requires understanding client needs and traffic, planning available capacities, multi-skilling, and instituting experts—likely remotely—on more complex topics. The branch's new role as an advisory point also requires rethinking the advisor profile and recruiting focus, including a stronger emphasis on relationship building, need-based advisory, and entrepreneurial approach.

Europe closed 4,500 retail branches in 2013, almost triple the usual rate. **The average branch serves 750 more clients than in 2008.**

As branches become one of a bank's many channels, more changes will come. Clients today enjoy wide access to information over the Internet, and aggregators are easily available to them for gaining transparency into different bank offers. Within this environment, banks must not only engage clients early, but they must also measure their ability to capture client attention from product offer to closing. Simplifying product and purchasing processes is a practical step to ensure convenience and speed and to prevent clients from dropping off halfway. At the same time, a cross-channel focus is crucial. A client may gather information online, sign in the branch, submit documents via email, and seek account updates via text message. Even within this environment, branches will still play a vital role in converting clients more quickly to alternative channels and offering the incentives that can motivate them to stay.

Become digital-ready. Digitization is not merely a nice-to-have add-on to existing products (as sometimes implemented today)—it is a way to run an entire bank, both toward the client and in every aspect of internal organization. Thus the challenge in fully embracing it.

Ideally, digital banking starts with the vision of a superb customer experience and combines the benefits of the online and physical worlds. Clients can benefit from fairer prices derived from easy comparability; real-time, error-free, and secure transactions; and access to information about personalized products and services, including financial advice, new opportunities, and peer comparisons. But making this possible requires back-end support—leaner underlying operating models, streamlined decision making and governance, and an integrated IT infrastructure that allows super-fast processing.

Digital readiness differs significantly across Europe. Everyone, including early adopters, is carefully considering how to monetize digital initiatives. We believe digitization is not simply a defensive strategy against challenger banks, but also a way to drum up new sources of revenue. In other words, banks must protect their biggest asset: their relationships with clients. Customer insights and forward-thinking moves to meet client needs will open up new sources of revenue. Banks must innovate and bring those innovations to the marketplace. They need to be open to partnerships and, in select parts of the value chain, external sourcing.

Become more profitable. Retail banking is by definition about the mass consumer market, yet in many countries the average client is marginally profitable at best. Given the large variance in client profitability even within a single institution—affluent clients can generate up to four times more revenue than average—a differentiated approach is a compelling way to create a profitable retail franchise. This means knowing each client's current profitability, their product usage at other institutions, and their future potential based on demographic, occupational, and psychographic characteristics.

Yet, segmentation remains the easier part of the profitability equation; execution is the primary challenge. How can a bank attract new clients with genuine added value, offer truly differentiated service levels that each segment is ready to pay for, and ensure discipline in regular client contact while still successfully balancing relationship management and sales? By reinforcing segment management and empowering it to shape the end-to-end client experience. We are not advocating siloed organizations based on segments, but rather clear client-facing differentiation while maintaining integrated back offices.

Containing and reducing interaction costs with lower-value customers is as important as nurturing relationships with high-value customers. While migration to alternative channels and self-service is the end game for these clients, getting there takes time. Banks must simplify, automate, and industrialize the sales approach. Using data to understand client behavior patterns can help without affecting client satisfaction. Incentives for and education about alternative channels can assist in the mid-term.

Bracing for the Future

For retail banks, 2014 will be a year of transition. Not every market will experience growth, but the future is looking more promising. Clear, bold moves and disciplined execution will be the crucial element in coming years. Once recovery arrives, those banks that have used the downturn to right-size their organizations, become more efficient, embrace innovation, and prepare for growth will be on the winning side.

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The signature of our namesake and founder, Andrew Thomas Kearney, on the cover of this document represents our pledge to live the values he instilled in our firm and uphold his commitment to ensuring "essential rightness" in all that we do.