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Banking disrupted
How technology is threatening the traditional European retail banking model

REGULATOR

1
European banks' ability to earn **returns above the cost of capital** in the long term will depend on whether they can **pass on the cost** of holding higher regulatory capital.

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This largely comes down to the **degree of competition** in the market and, specifically, the **threat posed by new entrants and substitutes**.

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Banks' ability to raise margins will also depend on the regulatory environment. The UK, which is home to Europe's largest financial centre, has placed **customer outcomes** at the **heart of its regulatory agenda**. It is also **pursuing competition** as a way of achieving its objectives. And the UK's Financial Conduct Authority is using **behavioural economics** to ensure that banks do not rely on behavioural biases to **gain financially at customers' expense**.

4
European banks may be taking comfort from the fact that they **saw off similar threats in the past,** notably the challenge of Internet banks in the late 1990s, and the encroachment of securities markets that radically changed the structure of US financial services.

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However, the first phase of Internet banking competition was supplier driven. Customers are now used to **engaging directly and immediately** with retailers, and to their **needs being anticipated** across a range of products and services. They expect **similar responsiveness from their bank.**

6
The two **core competitive advantages** that banks deployed in the past to fend off previous **attacks from new entrants and the capital markets** have been **dramatically weakened.** By contrast, **non-bank challengers are notably stronger** than those of Web 1.0.

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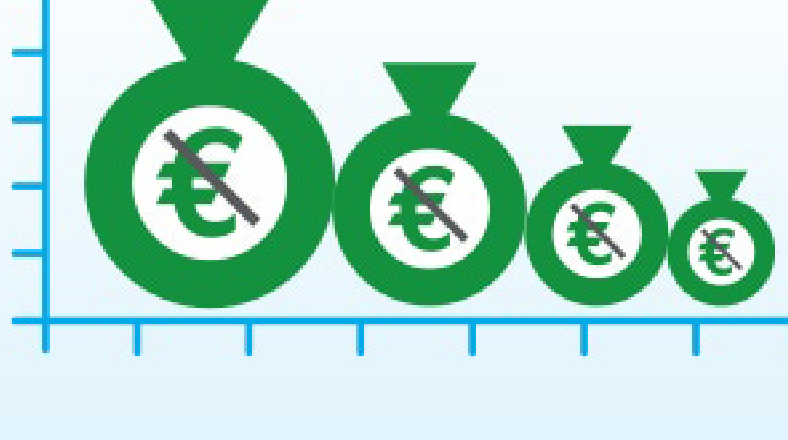
Oligopolistic access to **cheap funding** is **under threat.** New, technologically-enabled forms of competition and the regulatory agenda **limit** banks' **privileged access to customers** and, therefore, their **ability to cross-subsidise loss-leaders** through high-margin cross-sales and back-book pricing.



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This will **shrink the revenue pool** available to incumbent banks materially and, in turn, **expose the significant inefficiencies in banks' cost bases.** These forces will undermine the traditional integrated banking value chain.

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Consolidation would be the natural response, but **regulatory conditions may preclude** this approach. Banks are, therefore, likely to end up having to **re-engineer their own business models** and **customer value propositions.**

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Deloitte fears that banks **risk being caught out** as market sentiment shifts to **favour business models** better-suited to this new order. Banks must, therefore, begin a more **radical transformation** of their **cost base** now.

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Banks will also need to **focus on developing distinctive capabilities in those markets** where they can maintain **sustainable competitive advantage** across the cycle. This is separate from more transactional products, where profitability will ebb and flow, and where banks should resist building excess fixed costs at the top of the credit cycle.

12
Banks should also use **analytics** to exploit their **treasure trove of customer data** and match the experience provided in other industries.

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In short, Deloitte believes that banks need to **expand their strategies** from cyclically-driven balance sheet optimisation to a **longer-term vision** suited to a world where the way in which people bank, invest and borrow, will be very different from the past.

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