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The search for a sustainable banking model

To secure future growth, banks must fundamentally transform their economics, businesses, and cultures.

Banks around the world still haven't fully recovered from the financial crisis that roiled the global economy nearly half a decade ago. Efforts to restore depleted capital and reduce costs have partly succeeded, but the current environment is still a challenge: many banks failed to earn their cost of equity in 2011, and the average return on equity (ROE)—7.6 percent—is only half of peak levels before the crisis (exhibit). Global revenue growth stalled too, dropping to 3 percent from 2010 to 2011, compared with 9 percent in the preceding year.

The triple transformation: Achieving a sustainable business model, McKinsey's second annual review of the banking industry, finds that this faltering performance has both external and internal causes. Although the operating environment has stabilized since the height of the crisis—most banks do not face a struggle for existence—the current problems are almost as daunting when taken together.

- Regulation continues to increase in both complexity and stringency across the globe: new rules for capital, liquidity, and funding; surcharges for financial institutions deemed systemically important; and a raft of consumer-protection initiatives.

- Collectively, the new regulation could have dramatic consequences, including a significant negative impact on ROE.

- Technological advances are empowering both nonbank attackers, which have gained share in traditional banking domains by offering viable alternatives, and consumers, who have never found it easier to switch banks.

- Macroeconomic volatility continues to create uncertainty in the business. Particularly in developed economies, the pace of deleveraging seems to be up, slowing demand for loans.

Cyclical change could, of course, eventually weaken—or reverse—today's macroeconomic headwinds, but banks can't afford to wait. Senior banking executives should focus on the operational and business-culture forces they can change directly, by throwing their weight behind the following goals:

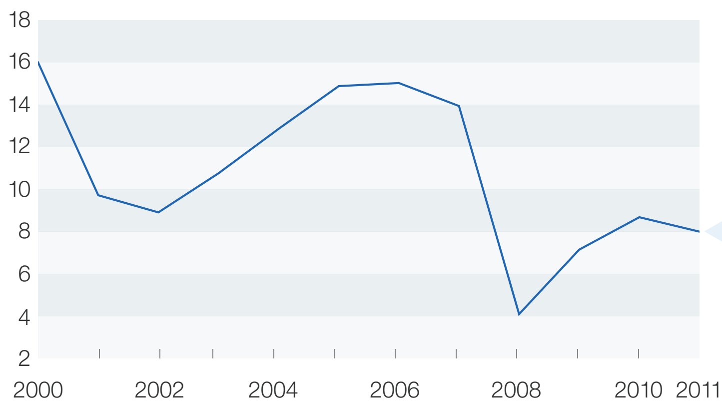
- Accelerate the economic transformation of the business by improving capital efficiency, finding new pockets of growth, and embracing industrial-style efficiency to cut costs sustainably.

- Reinvent the business model to deal with new realities in customer behavior, innovative attackers, and changing global growth patterns.

Exhibit

The industry's profitability has not returned to precrisis levels.

Total global return on equity (ROE),[1]
2000–11, %



ROE minus cost of equity,[2]
2011

Europe	–9 to –10
United States	–1 to –2
Other developed countries[3]	0 to 1
Asia[4]	5 to 7
Latin America	5 to 7

[1]Weighted average of after-tax ROE for listed banks in Thomson Reuters database that reported both net income and total equity in the given year; n = 906–1,961 banks around the world.
[2]Based on a capital-asset pricing model, but with liquidity adjusted to reflect current market situation.
[3]Australia, Canada, Hong Kong, Japan, New Zealand, Singapore, South Korea, and Taiwan.
[4]China, Indonesia, Malaysia, Pakistan, Philippines, Sri Lanka, Thailand, and Vietnam.

Source: Thomson Reuters; McKinsey analysis

- Embrace cultural change and enhance value creation. Rightly or wrongly, the industry's reputation has suffered in the last several years. To reinforce new approaches to the creation of value, banks must examine their organizational culture across four dimensions: balancing the interests of shareholders and the broader society, creating value for customers, ensuring that internal processes are sound, and influencing employee mind-sets.

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