TATA CONSULTANCY SERVICES

Building on belief

Banking trends for 2022 and onward

Abstract

Powering economies toward robust recovery amid recessionary threats

TCS analyzed the performance of select US and non-US banks across key aspects: turnaround after the pandemic, key global trends (both established and emerging), and the underlying challenges and opportunities to determine how they will influence banking in the coming years. This research paper reveals that the financial performance was initially impacted by the turbulence caused by the pandemic. However, global banks staged a significant comeback, driven by strategic initiatives aimed at propelling top-line growth, improving cost and operational efficiency, accelerating digitalization, and enhancing risk management to cover potential losses.

Banks and financial institutions demonstrated strong resilience in an abnormal scenario, rising to the occasion with innovative solutions to unlock alternative revenue streams. Digital transformation through advanced technologies such as artificial intelligence (AI) and analytics, strategic acquisitions to drive inorganic growth, and a collaborative approach leveraging partnerships with big techs, fintechs, and insurtechs were key features that contributed to the vigorous recovery. However, it is time to prepare for the future, where banks will need to grapple with geo-political uncertainty, growing inflation, and the threat of an imminent recession. The time for action is now.

Based on the findings of our analysis, this report offers banks, key takeaways that will help them capitalize on emerging opportunities and scale new heights.

Research scope and methodology

We analyzed the annual reports and press releases of over 20 global banks and financial institutions with an asset size of over $200 billion across parameters such as financial performance, strategic initiatives to drive growth, business expansion, transformation, digital innovation for cost and revenue gains, and business restructure. To identify patterns, draw logical inferences, and compare and contrast pre- and post-pandemic performance, we considered quarterly data of a few banks (see Table 1) from Q1 2019.

US banks	Non-US banks
1. Bank of America (BofA)	1. HSBC
2. Capital One	2. Lloyds Banking Group (LBG)
3. Citigroup	3. Barclays
4. Fifth third Bank	4. Royal Bank of Canada (RBC)
5. JPMorgan Chase (JPMC)	5. TD Bank
6. PNC Financial Services	6. BNP Paribas
7. Silicon Valley Bank (SVB)	7. Deutsche Bank
8. Truist Financial	9. Commonwealth Bank of Australia (CBA)
9. US Bancorp	10. ANZ
10. Wells Fargo	11. National Australia Bank (NAB)
	12. Westpac
	13. Macquarie Group

Table 1: List of banks considered for the research

Banking overview 2021: Emerging stronger from the storm

COVID-19 severely impacted global economic activity, resulting in significant loss due to business interruption. Virtual working requirements and a sudden need for every banking product and service to be available online posed challenges to banks. In addition, a drop in gross domestic product (GDP), job losses, and industrial slowdown resulted in increased loan losses. Recessionary trends and reduced spends dented earnings for some segments. However, volatile markets, alternative revenue sources, emphasis on cost, and efficiency optimization helped big players remain competitive while the small and medium business (SMB) segment thrived on stimulus from the government.

However, banks experienced heavy inflow of deposits, especially in the first half of 2020. Top banks continued to exploit the favorable market scenario to increase their trading income to partially offset the impact of prolonged near-zero interest rates that dented their core income. European banks initially lagged behind their US counterparts, reporting lower profitability and losses but started scripting a turnaround in 2021, with market-beating results across income and profitability.

In 2020, the performance of banks was significantly impacted by an unprecedented near-zero interest rate environment and business disruptions, resulting in lower revenues, which can be attributed to a drop in net income along with an increase in cost of operations.

Global banks demonstrated resilience during the pandemic and in the subsequent recovery phase. A resurgent global economy rapidly put the woes of the pandemic-induced turbulence behind.

In 2020, multiple factors contributed to the drop in profit, notable amongst them being restructuring costs associated with divestments as well as ongoing regulatory and remediation costs and the rising loan impairment charges and credit loss provisions. While the results reflected a sequential decline in provisions for credit losses, earnings also benefitted from strong performance in capital markets and wealth management businesses.

The banking industry's turnaround in 2021 can be attributed to financial stability, redefined strategic priorities, enhanced focus on customer experience, and resilience with emphasis on cost and innovation.

Redefining strategic investments to drive digital transformation

A study of the strategies of top global banks (see Figure 1) revealed a firm inclination toward digital transformation, cost efficiency, branch modernization, product expansion, risk management, and environment, social and governance (ESG) compliance. These banks leveraged advanced technologies like AI and analytics aimed at improving overall customer experience.

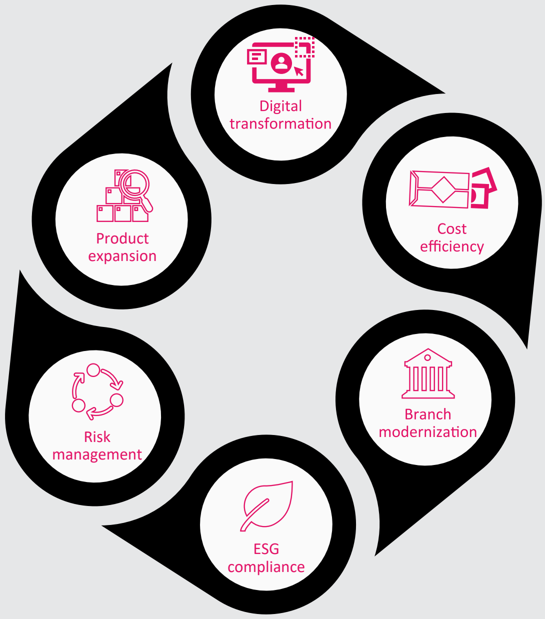

Figure 1: Strategic initiatives – Common themes

Banks' strategies were influenced by a surge in payments, wealth management, and trading and change in customer behavior due to increased digital adoption across demographic segments. These strategies typically centered on:

- Driving expansion within markets and across geographies.
- Increasing personalization to cater to next-gen consumers.
- Modernizing branches to provide a digital perspective.
- Implementing digital solutions to enhance payments to make it faster (real-time and instant), cheaper, and convenient.
- Driving collaboration with ecosystem players such as fintechs to leverage their customer base and design best-in-class digital solutions.

An unprecedented level of digitalization and accelerated pace of execution has pushed the industry ahead by at least two-three years. Top-line growth was driven by the adoption of advanced technologies, innovative products (contactless, financial wellness), digital assets, embedded finance, and aggressive mergers and acquisitions (M&A).

However, this turnaround was not without challenges. Disruptive technologies, demographic changes, new pandemic-driven customer expectations, increasing need for security and data privacy, oversight of regulatory compliance obligations, and threat from niche players posed serious difficulties. Banks adopted a transformative approach with strategically bold initiatives (see Figure 2) to deliver value and drive long-term growth.

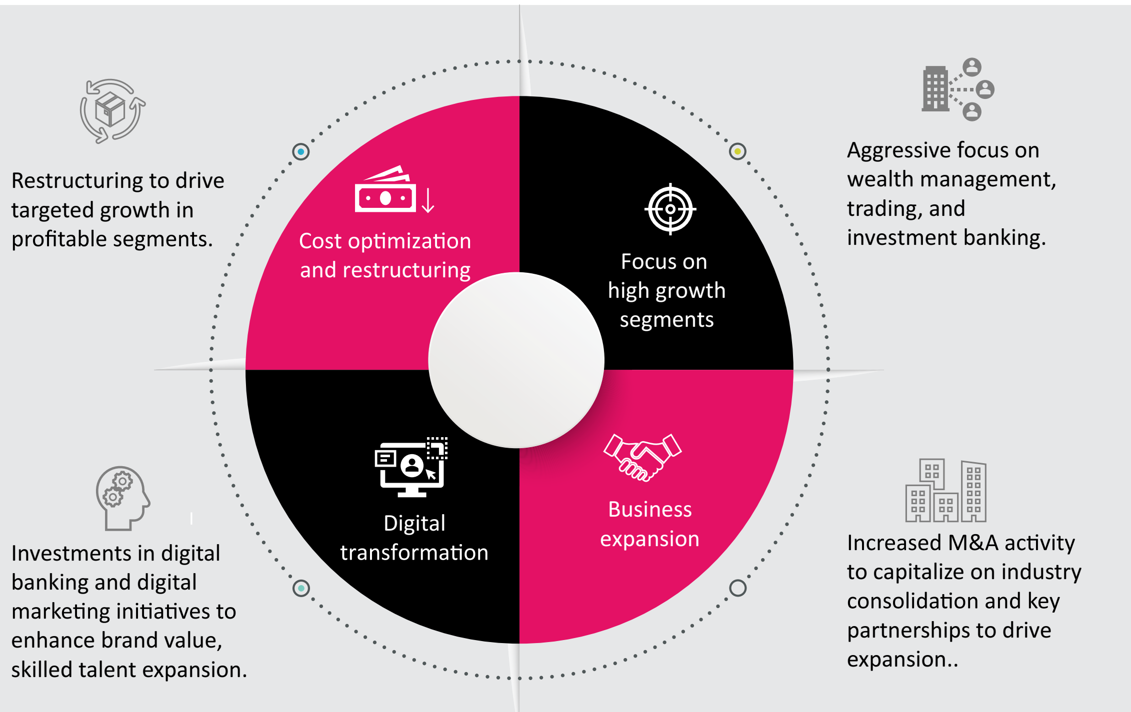

Figure 2: Initiatives that drove growth

Trends shaping the global financial services industry

Changing market dynamics have created a new battleground as the industry is exploiting existing technologies and exploring newer, emerging options to rejig the digital experience. Various factors have influenced the industry, especially the unprecedented digitalization witnessed during 2020-21 due to the pandemic. The accelerated pace of digitalization has teleported the industry two-three years ahead in terms of technology adoption. Given the alacrity with which next-gen consumers adopt digital as well as the changing preferences of the small and medium business (SMB) segments and corporates, the industry stands to gain by sustaining the momentum through increased investments in technology.

Open banking APIs will emerge as a new source of revenue

The use of application programming interfaces (APIs) is witnessing increasing adoption across various segments (see Figure 3) in the financial services industry.

Efficient API management and monetization are creating innovative offerings and are key sources of revenue.

Collaborating with fintechs to facilitate data aggregation will elevate the role of banks to payment information service providers in an interconnected economy.

APIs are also becoming prevalent in the risk function. Given the growing risk of money-laundering, using APIs to integrate data and behavioral analytics into know your customer (KYC) processes is helping to identify the legitimacy of transactions and entities involved. The increasing number of transactions and the constant foray of new participants indicates that open banking adoption is rapidly heating up around the world.

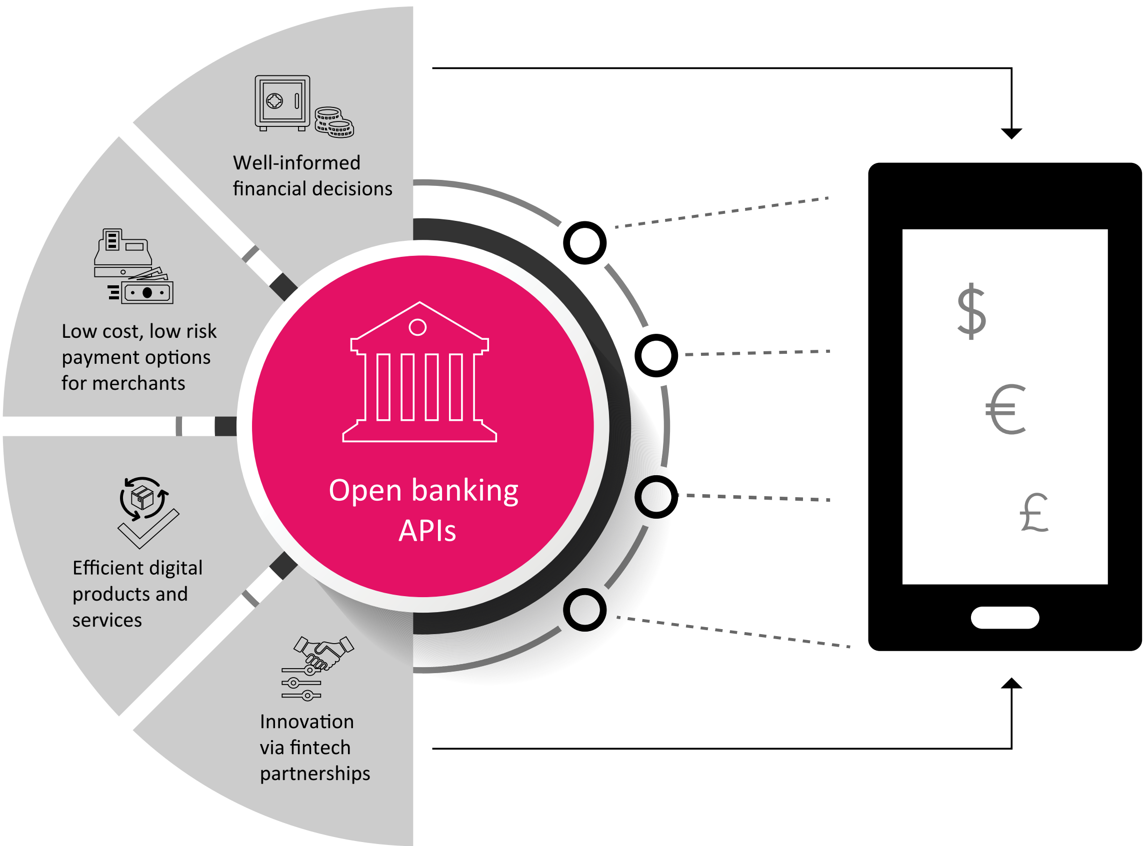

Figure 3: Benefits of open banking

While banks and financial institutions can leverage APIs to drive growth through embedded banking, real-time data exchange, and real-time payments, they must take steps to ensure information privacy and security once the data leaves their gates.

Branch modernization set to become the norm

Modernizing legacy branch networks by harnessing advances in technology is emerging as a priority. By leveraging face-to-face interactions, banks can offer tailored offerings to boost sales.

Banks are right-sizing and transforming their branch network using new tools such as chatbots, biometric identification, interactive branch kiosks, pop-up branches, and more.

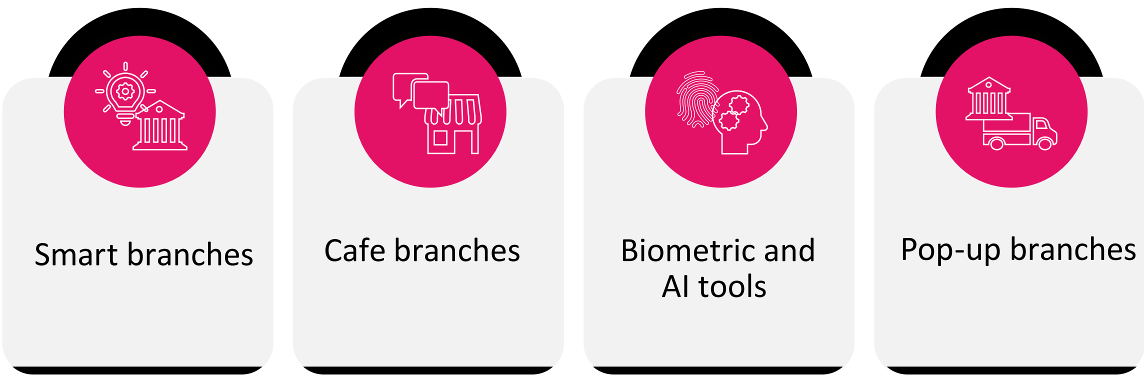

Figure 4: Branch modernization themes

Setting up lean digital branches will drive a shift in focus from a service center to a sales hub in turn creating newer revenue streams. Targeted investments in omnichannel integration, setting up smart branches with more self-service features, establishing pop-up branches at commercial outlets, and upskilling the workforce to adapt to the change will help add more value to the branch.

AI-powered analytics to elevate banking into a hub of value-added services

Banks are using AI to bolster analytics as well as to better serve customers and streamline internal functions (see Figure 5). Robotic process automation (RPA) is widely being adopted to automate time-consuming operations, thereby improving operational efficiency. AI is also used to enable smart underwriting and provide real-time trading insights.

Conversational AI-powered virtual assistants or chatbots have risen to prominence while AI-backed data analytics is being widely used to combat fraud and enhance compliance.

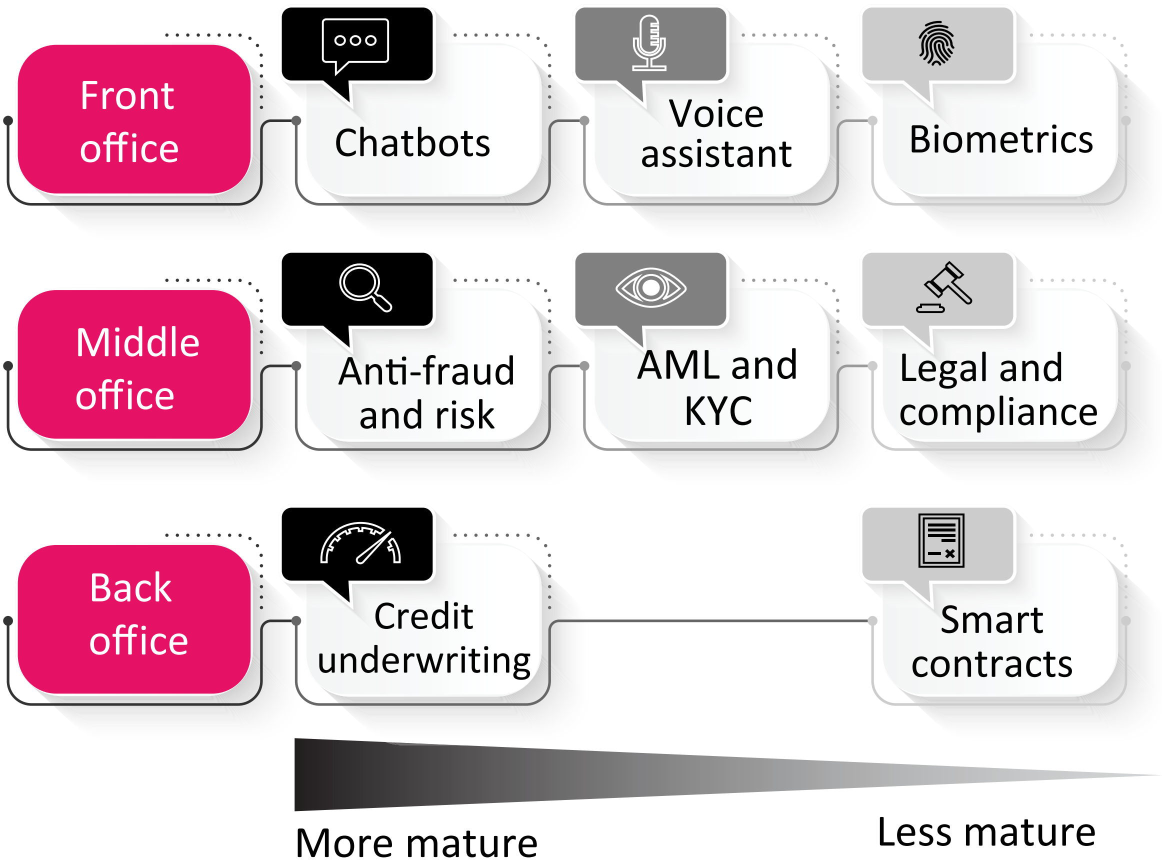

Figure 5: Key use cases for AI and analytics

AI and analytics will redefine the innovative value-added services offered by banks. Smart apps can facilitate digitization of document checks in trade finance and eliminate manual processing in onboarding of dealers and custodians in custody services. Wealth managers can leverage AI-driven digital marketing solutions to enhance advisor efficiency and in turn personalize interactions with customers, resulting in better engagement and increased satisfaction.

Embedded finance to enhance access to banking services

Banks are partnering with fintechs and are collaborating with payment giants to facilitate ***buy-now-pay-later*** *(BNPL) options*

Non-financial enterprises have made in-roads into the financial services industry, establishing themselves as providers of a wide range of financial products and services. This actively promotes financial democratization.

For banks, embedded finance creates new distribution opportunities where brands can embed finance into customer journeys. In the business-to-business (B2B) space, embedded finance will help deliver services to SMBs and large corporates at the point-of-presence, reducing processing time and increasing cashflow. Similarly, embedded lending is an efficient means to provide finance at the point-of-purchase by eliminating paperwork. Banks should look for methods to eliminate friction in the customer experience, especially in payments, and use embedded technology as much as possible.

New challenges...

The COVID-19 crisis tested banks in unprecedented ways. However, banks displayed robust resilience and successfully weathered the storm. Banks must now introspect on the last two years and prepare for the future—a future that comes with tough challenges. To address these challenges and rise to greater heights, banks must examine and understand headwinds dominating the macro environment.

Growing inflation

Rising inflation, especially with the US touching historic highs not seen in the last 40 years, is eroding significant value off the stock markets globally. In addition, a growing cause of concern for banks is the rising cost of funds. For instance, the increase in mortgage rates in the US has already resulted in a decline in new applications and refinancing business.

Geo-political crisis

The ongoing Ukraine crisis has caused a severe dent in positive sentiments witnessed in the beginning of the year. Uncertainty around the fate of the war, sanctions and business exits from Russia, adverse impact on trade, and losses due to exposure to Russian banks have culminated into a complex situation. Soaring oil prices are worsening the inflationary trend.

Interest rate hikes

The upward revision in interest rates by the US Federal Reserve is likely to have both a positive and negative impact. While it will certainly boost banks' core interest earnings, it is also likely to drive up the cost of credit which could adversely affect consumer spending through credit channels. Given that banks are already sitting on a huge pile of deposits, they may not necessarily increase rates on fixed deposits, which may trigger a diversion of investment to other products.

Enhanced regulatory scrutiny

The intensity of regulatory scrutiny will be a bigger challenge as cost of compliance is expected to increase—financial crime compliance costs reached record levels in 2021. This coupled with the potential for heavy penalties for non-compliance will pose a big challenge.

Competition in the payments space

Intense competition with faster and convenient payment transactions and price pressures have led to banks losing their customer base. The likes of Visa and Mastercard also face severe threats with the formation of local consortiums breaking their monopoly, which defers price changes. Regulatory restrictions and anti-money laundering (AML) violations add to the complexity even as these areas get more attention in the form of modernization initiatives.

Foray of big techs and fintechs into traditional banking

Big tech players like Amazon, Walmart, Meta, and others are entering the financial services industry, increasing pressure on incumbents to launch efficient super-apps to remain competitive.

Inability to assess the impact of innovation

While banks have undertaken multiple initiatives to provide innovative products and services, they still face challenges in terms of determining the value created and the effect on the customer satisfaction index. Often, innovation initiatives fail to deliver to expectations.

...Lead to new opportunities

Even as banks equip themselves to overcome these obstacles, they recognize their hidden growth potential. To lead in the prevailing dynamic environment, banks must recalibrate their strategy to exploit these hidden opportunities and unlock value.

In the post-pandemic new normal, banks are looking at increasing credit offtake and leveraging the impending interest rate hike. Key trends that are likely to dominate include embedded lending models and redesigned credit card offers and reward programs. In addition, rising focus on autonomous, connected, electric, and shared (ACES) in the auto finance segment and a push for 100% digital onboarding of customers are other notable trends.

In the lending space, the growth of non-traditional shadow banking is increasing as the unregulated market is an easier channel for alternative finance firms. In fact, several players are competing to grab a significant share of the widening gap in financing. Furthermore, there is a certain degree of uncertainty about how the Ukraine crisis will alter the dynamics of global banking. Even as governments closely monitor and evaluate developments, international trade and payments are more likely to witness some change.

Today's decisions determine tomorrow's success

Our research shows that the financial services industry is now well-positioned to provide a range of value-driven thematic services that cater to the needs of specific customer segments, and hence, increased investment in technology will be a visible trend. Digital acceleration fueled by the pandemic will continue, especially given consumers will stick with the new digital behaviors they learned during the pandemic. Consequently, investment in technology will rise as banks march forward on the digitalization path to reshape customer experience. Having strengthened their capital base and stabilized their financials, banks must take advantage of the recovering market by continuing to accelerate digital investments and capitalize on new opportunities while also considering aggressive inorganic growth as the industry consolidates further. ***Payment modernization, financial wellness, ESG integration*** and ***sustainability*** are key themes that will be at the center of digitalization programs. ***Trade finance*** too will witness increasing digitalization and has the potential to boost the job market in developing economies while digital lending will see an uptick as banks enhance focus on the ***small and medium enterprise (SME) segment***.

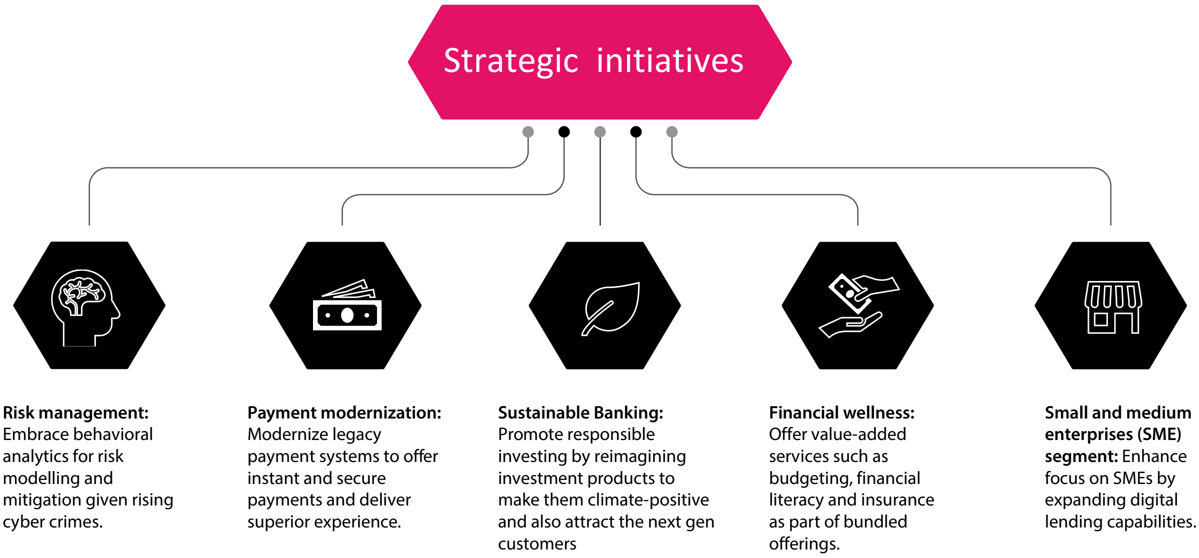

Figure 6: Key focus areas of banks' future business strategies

The post-pandemic new normal will also see the ***boundaryless mindset*** *gaining ground.*

Charting a course through a stormy landscape and boosting transformational growth will require banks to define strategies that factor in initiatives across these themes (see Figure 6). Boundaryless banking goes beyond traditional constructs to explore new opportunities and enhance business outcomes through smart strategies underpinned by ecosystem play, agile and resilient business models, and end-to-end digitalization. For banks, future success will depend on how they ride upcoming trends to their advantage while managing global and local headwinds.

About the authors

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Vasu is principal consultant and head of the research unit at TCS' Banking, Financial Services, and Insurance (BFSI) business unit. He brings to the table over 32 years of industry experience ranging from strategy research to information technology quality management for banking and financial services clients. His areas of interest include strategy research, long-term financial trend analysis, and statistical and AI interpretations. Vasu has successfully managed several IT projects in the past and has worked in production management as well. Vasu is currently pursuing research in Financial Predictions for Forbes 2000 companies using neural networks as part of his doctoral degree.

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Awards and accolades

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Contact

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