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The future of banking: towards a new world order?

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Today the environment in which bankers have spent most, if not all, of their careers has changed dramatically. The impact of the global financial crisis on the banking sector is still being examined against a background of weaker economic growth in the west combined with the rise of emerging market powerhouses such as China.

Based on PwC's extensive experience of working with banks around the world, we recently conducted an in-depth review of the knowns and unknowns which will likely shape the evolution of the banking market in the decade to come.

Scenarios range from a potential status quo on the one hand and a complete new world order in banking on the other hand. In the least likely scenario, it could be business as usual, whereby western banks will continue their existing course and the west will remain central to decision making and economic power in global banking.

But in the case of a new world order, and our research shows it is heading in that direction, the emerging markets will become a self-sufficient bloc while western banks will struggle to remain relevant. Banks from emerging markets will be able to enter the west freely and do so aggressively, while their western counterparts are locked out of the major emerging growth markets.

Opinion may still be divided and even often diametrically opposed, but discussing the results of the PwC research will hopefully provide decision makers with facts and fresh insights to enable them to both seize opportunities and identify the threats their organisations face in today's and tomorrow's changing banking landscape.

What is certain today is that there is a rupture between the future and the past and that there are multiple drivers at work that will shape the banking industry.

In the 20 years preceding the financial crisis, banks had become increasingly large and complex. This trend became especially apparent as bank assets worldwide grew disproportionately compared to GDP growth in their respective domestic markets. In Europe, for example, nominal GDP rose 5.9 percent per year on average between 1980 and 2007, while the continent's bank assets surged 19 percent per year on average during the same period.

It was the rise of the universal banking model, whereby lenders tried to achieve economies of scale and scope, and as deregulation became the name of the game, that helped create an asset bubble and trigger a debt explosion. During that era, Western banks such as Citigroup and HSBC no longer only operated in their home markets but spanned the globe and dominated the world of international banking.

While it is impossible to know for sure how the banking landscape will look like in 10 years, there are several important factors that play a vital role in shaping the banks of the future and than can provide a sense of direction.

First, GDP growth in the west will be more subdued after 30 years of sustained growth. Following the global crisis, western nations now face weaker economic prospects, characterised by high unemployment figures, austerity measures and hefty refinancing needs.

In addition, the western financial sector, after continuously outperforming the economy as a whole, is now expected to expand at the same or slower pace. Third, emerging markets could implement lockdown on western banks seeking to do business there and even challenge those financial institutions on their own turf.

Meanwhile, within the banking industry itself, the focus evolves around three key areas: regulation, the rapidly changing external environment and the issue of internal controls.

In terms of regulation, the threat of a breakup of universal banks still looms. Banks are also under pressure as capital and liquidity requirements become more stringent. Furthermore, regulators are also attempting to impose more regulation on the so-called shadow banking industry, for instance hedge funds and investment banks, which were considered by some as part culprits for the financial crisis. Last but not least, banks will have to implement Basel III, posing further challenges for the banks.

The background against which banks operate continues to be challenging. The economic uncertainty persists and China continues to cement its position as a global economic powerhouse. There is also uncertainly about what will happen with the interests many governments took in their domestic banks to help them protect during the financial crisis.

Banks will also have to assume a more introspective look by for example considering pay and reward systems, which also came under scrutiny during the financial crisis. In addition, there is more emphasis on risk, corporate governance and control, all areas banks will have to respond to while reducing their complexity.

As a new world order of financial institutions emerges, far-reaching structural change will be the logical result arising from the need to deleverage. European economies and banks also face the prospect of a sustained period of weaker or stagnant growth because of increasing fiscal pressure and the interconnectedness of sovereign debt and bank risk.

Regulation will change the way banks do business and continue to consume large portions of management time and energy. Banks will not be able to regain shareholder trust without fundamentally changing the way they operate and market themselves. Adopting new technology and updating old systems will inevitably weigh on earnings. Top talent will migrate to the emerging markets, while at the same time the existing banking workforce in the west is ageing. In the short term there are additional factors that could disrupt the industry: fiscal pressure and trying to regain the trust of stakeholders.

Governments will increasingly perceive banks differently, perhaps more as social utilities which will have to provide services for unbanked and possibly less profitable customers. Let's not forget the demographic trends of ageing populations in the west which mean that those markets bear lower growth potential

Banks that are prepared for all these catalysts of change are undoubtedly in a better position to get ahead of the curve and will be able to survive and even thrive in a new world order of banking.

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Note to Editors

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