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Inflection point:

Seven transformative shifts in US retail banking

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Ten years ago, the US retail banking industry was in the depths of the global financial crisis, with many one-time leading institutions struggling to survive. Since then, after bringing in billions in fresh capital, US banks have made a return to stable ground and greater liquidity. Despite this progress, aggregate return on equity is at the lower bound of sustainability, and the industry's price-to-book value is about 1.4, not far above where it stood in 2009. Customer trust has improved from the downturn but is still well below pre-crisis levels. Though most banks were able to avoid unsettling challenges in the following ten years, few were able to break out and significantly outperform the industry.

Now, however, several major forces are accelerating the evolution of the US banking industry—the encroachment of new competitors, rising expectations from customers on service levels and corporate responsibility, and an intensifying war for talent—and promising to make doing business more challenging in the coming ten years. Further, US banks have yet to go through the restructuring that has already swept European and Asian markets, where a majority of services are delivered digitally. In this report, we describe seven transformative shifts reshaping US banking.

About the research

We conducted proprietary surveys of 2,036 US consumers and 100 banking executives to understand how they have reacted to the seven transformative shifts.

The **2019 Future of Banking Consumer Survey** included a population-representative sample of US banking consumers across age group, household income levels, and geographic region. The consumer respondents also represented a diverse mix of educational and industry backgrounds. Survey questions covered three themes: banking product and service preferences, openness to Big Tech and integrated ecosystem offerings, and perceptions and expectations about the role of banks in society.

The **2019 Future of Banking Executive Survey** included banking executives in chief executive and select business unit or functional senior leadership roles. Survey questions covered four themes: general industry outlook, perspective and approach to Big Tech expansion into the industry, considerations of consumer expectations around both products and banks' role in society, and practices related to risk management and talent.

The current state of US retail banking can be thought of as an inflection point for the industry. Coupled with the difficult macroeconomic environment, and political and economic uncertainty, the seven shifts will decisively alter the operations, economics, and efficiency of US retail banking.

Banks face a steep climb

To rank the relative performance of companies, McKinsey uses the Power Curve, which measures value created in terms of economic profit (defined as firms' returns less their cost of capital). From 2010 to 2017, we assessed close to 2,400 companies across multiple industries on the Power Curve and found two surprising results. First, companies ranking in the top 20 percent generated more than 30 times the profit of those in the middle 60 percent, while the lagging firms made only marginal economic profit. Second, the curve is broadly stable over time, and a company's position on it is persistent: between 2010 and 2017, only 1 in 12 companies rose from the middle ranks to the top of the Power Curve, while approximately 40 percent of companies in the bottom third stayed there.

While 50 percent of a company's Power Curve position was determined by its starting point and its success in navigating industry trends, the other half was determined by its strategic choices: resource allocation; mergers, acquisitions, and divestments; productivity improvements; and investment for differentiating future growth. Critically, we also found that success is typically not the result of a single strategic move, but rather the interaction of several good choices.

Focusing solely on banks, the Power Curve shows a similar distribution of results. In banking, the top 20 global firms captured 95 percent of economic profit. Moreover, few firms managed to escape the sector's non-value creating middle quintiles: Nearly 90 percent of bottom and middle quintile banks were unable to lift their rankings from 2003-2007 to 2013-2017. In other words, banking has been a breakeven business over the past 15 to 20 years.

Looking forward, banks will have to contend with not only an uncertain economic environment, low interest rates, and increased capital requirements, but also emerging structural shifts, including new competitors, technology and risks, and social dynamics (Exhibit 1). To move higher on the Power Curve, banks will have to make big and bold strategic choices. However, the climb may become easier—at least for those firms that can harness the dynamic forces at work in the industry.

Shift 1: Big Tech is a growing disintermediation threat

After experimenting for years with various offerings, "Big Tech" companies[1] have recently picked up pace in launching banking products. Notable product launches include:

— Amazon providing a credit card for underbanked consumers—the Amazon Credit Builder—in partnership with Synchrony Financial

— Apple and Goldman Sachs teaming up to launch the Apple Card

— Google obtaining an e-money license from Lithuania, enabling it to expand Google Pay capabilities across the European Union

— Facebook announcing its own digital currency, Libra, to be offered through a consortium of large, mostly non-bank firms from Uber to Kiva to Vodafone.

[1] In this report, "Big Tech" is used refer to Google, Apple, Facebook, and Amazon.

Exhibit 1

Seven transformative shifts in US retail banking

Shift	Known trend	Signs of acceleration
Big Tech is a growing disintermediation threat	Large technology companies are expanding their footprint in retail banking, disintermediating banks	Major moves by technology companies like Amazon (accounts), Facebook (Libra), and Apple (Goldman Sachs) have occurred while customer trust has now surpassed more than 50% of consumers
Banks are creating and joining ecosystems	Banks are entering adjacent ecosystems such as mobility and housing at an accelerating pace	Over the past two years, a majority of bank executives have become convinced to move beyond banking into new ecosystems and develop platforms-as-a-service
All banking customer groups now prefer digital channels	Digital investment has been focused on younger demographics and credit and savings products	Older customers are now increasingly driving the shift to end-to-end digital delivery by banks
"Good banks" will be rewarded for demonstrating genuine social responsibility	Social responsibility is a "nice to have" for banks	Actions that consumers consider "good" are now table stakes for banks
Next-generation technologies have arrived and will reduce the cost scale of US banks	Core banking technologies have been aiming to deliver significant cost reductions	Next-generation platforms are no longer experiments, but are enabling banks to radically automate and run at fractions of historical costs
Managing an expanding set of risks requires integration across the bank	New risks, driven mainly by technological evolution, are of increasing concern	Complex risks like cyberattacks and social media incidents have the potential to rapidly deplete a bank's profits, capital, or reputation
A skilled digital talent base is now crucial in banking	Digital skills are increasingly needed across all sectors	Accelerating technological change has led to a critical shortage of more complex digital skills

Source: McKinsey

Clearly, Big Tech companies are ready to move into banking in a big way, with strong brands and familiar products. This new competition represents a double threat to banks' established relationships with customers: By providing convenience and transparency, Big Tech firms have established sufficient trust with consumers, and are strengthening their own links (Exhibit 2).

While consumers are likely willing to do financial business with technology companies, they show strong preferences. Our recent Future of Banking Consumer Survey indicates that nearly two in three consumers would trust Amazon to handle their financial needs, and among those, one in three would likely open an Amazon checking account.

This is not to say that tech firms will take over traditional banking. Banking is a capital intensive and heavily regulated business that earns low valuations, thus making it an unattractive and unlikely new business line for Big Tech firms accustomed to high profitability. Instead, they are more likely to establish positions from which they can disintermediate customer relationships and cherry-pick banking's best products and highest margins.

Exhibit 2

Consumer willingness to buy financial products from Big Tech players.

Respondents who trust Big Tech players to handle their financial needs

% of respondents; n = 2,036

Willingness to then purchase products from Big Tech player

< 15% | 15%–25% | > 25%

	Respondents who trust	Credit card	Checking	Savings/ deposits	Payment solution	Personal loan	Auto loan	Mortgage	Wealth management
Amazon	65%	> 25%	> 25%	> 25%	15%–25%	15%–25%	15%–25%	15%–25%	< 15%
Google	58%	> 25%	15%–25%	15%–25%	> 25%	15%–25%	15%–25%	15%–25%	15%–25%
Apple	56%	15%–25%	15%–25%	15%–25%	15%–25%	15%–25%	15%–25%	15%–25%	15%–25%
Facebook	35%	< 15%	15%–25%	< 15%	< 15%	< 15%	15%–25%	15%–25%	< 15%

Source: McKinsey 2019 Future of Banking Consumer Survey

Irrespective of their strategic and product choices, Big Tech companies present a serious financial threat. Fifteen years ago, the stock market capitalization of banks outweighed that of the tech sector by ten to one, but since then the technology sector as a whole has grown to a greater value. Along the way, these companies have also accumulated enormous stores of cash.

It is also important to remember that five years ago, banks were preparing for a competitive invasion from fintech startups. Fintechs have indeed brought innovation and operational efficiency to banking, but they have often been more welcomed as partners than feared as competitors.

Big Tech, on the other hand, is a real challenge. With such financial firepower and large and engaged customer bases—for example, 100 million Amazon Prime households—Big Tech firms could rapidly reach significant scale in financial services through their digital platforms, leveraging their rich knowledge of potential customers.

Shift 2: Banks are creating and joining ecosystems

Banks have become active in ecosystems that reach into adjacent markets—a sign that they are ready to meet Big Tech companies on their own territory. Increasingly, banks are beginning to think of ecosystem expansion as the development of platforms-as-a service, where the objective is to be the platform of choice for consumers. In our 2019 Future of Banking Executive Survey, 44 percent of US bank executives said that in five years they expect to realize 10 percent or more of profits from non-financial products delivered through ecosystems.

However, banks may not qualify as the natural leaders of broad-based ecosystems. Our consumer survey showed that while as many as half of consumers would gravitate to bank-led platforms in mobility and housing, fewer than 25 percent would turn to bank-orchestrated ecosystems for health care, travel, and digital content (Exhibit 3).

Our recent Future of Banking Consumer Survey indicates that nearly two in three consumers would trust Amazon to handle their financial needs, and among those, one in three would likely open an Amazon checking account.

Still, joining ecosystems developed by others will be an opportunity for banks to extend their reach to consumers, and to respond to non-traditional competitors aiming to siphon off a part of the banking profit pool.

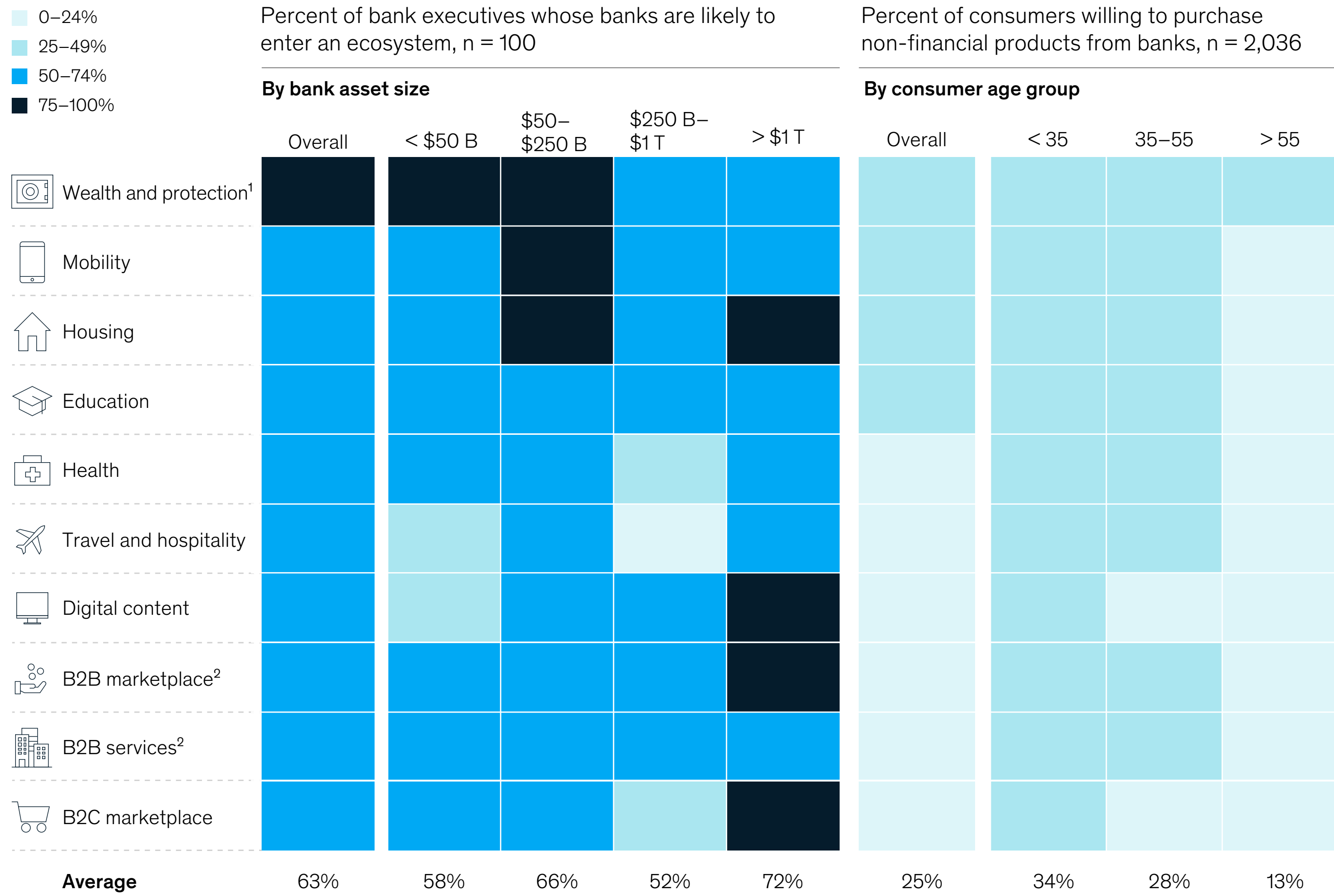
A few important points stand out from these surveys. First, the move to ecosystems would appear to be a supply-led transformation, where banks' actions are ahead of the expectations of customers. Second, younger customers appear three times more likely to accept banks as the natural orchestrator of ecosystems. Third, the trend does not involve just big banks, but regional banks as well. Finally, although broad-based ecosystems have made inroads, focused platforms also are taking flight (in one case, for financial and non-financial services for dental practices).

Shift 3: All banking customer groups now prefer digital channels

US consumers have been conditioned by their experiences with leaders in technology and online commerce to expect sophisticated digital services across the board—including from banks. To date, the natural audience for digital banking has been Millennials. In the past couple of years, the appeal

Exhibit 3

Enthusiasm for ecosystem offerings from banks.



[1] Only consumer respondents who own wealth and investment products from banks (n = 783).
[2] Only consumer respondents who own SMBs (n = 100).

Source: McKinsey 2019 Future of Banking Consumer and Executive Surveys

for digital banking, as part of an omnichannel experience, has broadened rapidly. Now, even consumers age 50 and above are hungry for simple, seamless digital experiences (Exhibit 4). This universal demand across age groups and wealth segments has prompted two major changes. First, all banks offer digital channels for some customer journeys, and many are moving to end-to-end digital delivery. Second, customers are putting them to work: Usage has accelerated to the point where 60 percent of customers under the age of 70 are using digital channels across wealth segments.

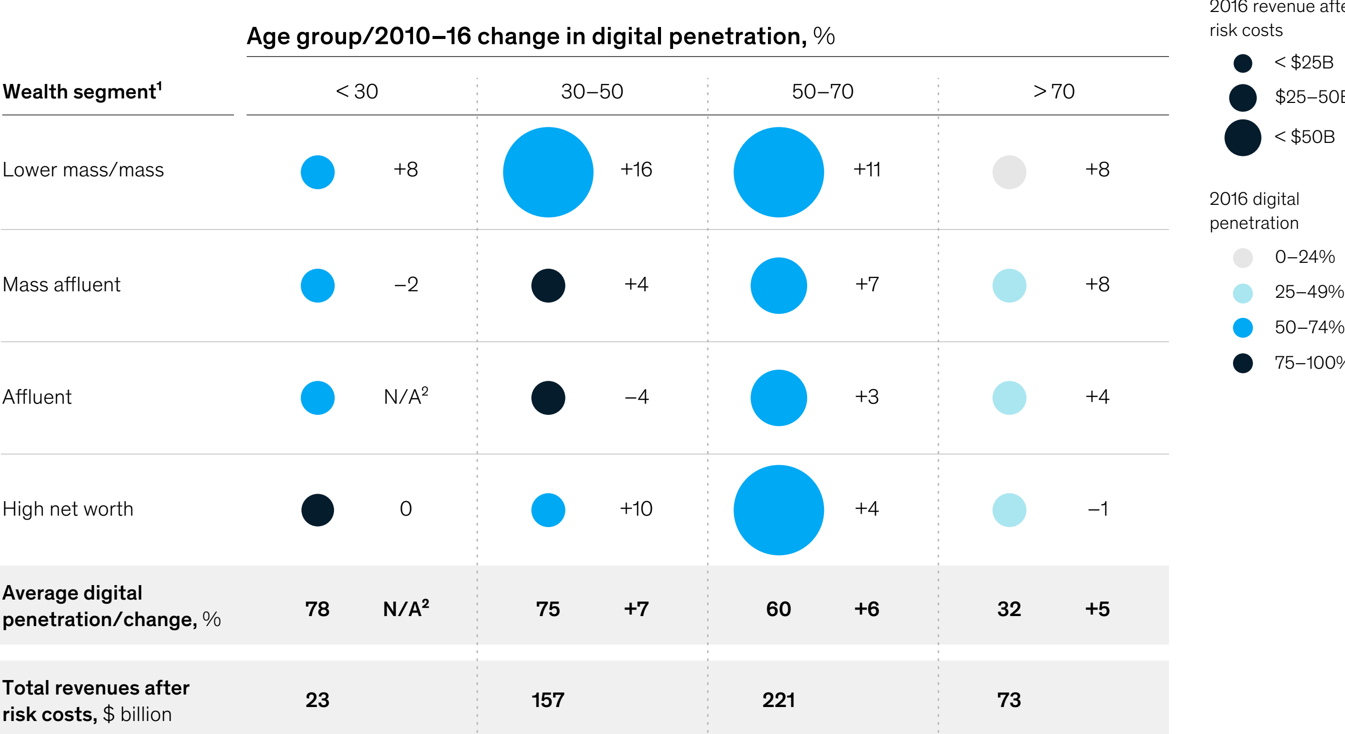
That said, large and important customer segments are unsatisfied with their digital experience: A recent survey of banking consumers found that despite a 5 percent increase in digital banking penetration in the over-70 segment, across wealth segments, more than half of consumers in that age group are unsatisfied with the digital experience. Affluent and high-net-worth consumers are now open to digital wealth management offers and remote advice, but they crave a better experience. Banks should not give up on face-to-face financial advice; rather, they have an opportunity to differentiate themselves to these consumers, by coupling personalized digital solutions with personal engagement.

Shift 4: "Good banks" will be rewarded for demonstrating genuine social responsibility

A significant proportion of US consumers believe that the behavior of banks has contributed to economic and environmental issues, especially high prices for housing, excessive student debt,

Exhibit 4

US retail banking digital penetration and profit pools.



[1] Wealth segments are based on investable assets: Lower mass/mass $0–100K; Mass affluent $100–500K; Affluent $500K–$3M; High net worth (HNW) > $3M.
[2] 2010 data point not available due to small sample size.

Source: McKinsey Panorama—Global Banking Pools

Customers expect that banks should truly act on relevant societal issues, rather than just be pro forma good corporate citizens.

and income inequality. These attributions are more prevalent among affluent consumers, who are presumably banks' most attractive prospects. Importantly, surveys suggest that banks have an opportunity to improve their standing with consumers and point to several areas for remedial action. Customers expect that banks should truly act on relevant societal issues, rather than just be pro forma good corporate citizens.

In parallel, banks are realizing the potential benefit in customer affinity and promoting social commitment to an executive level. These efforts have expanded from internal initiatives, such as policies for employment diversity and facilities' carbon footprints, to strategic priorities for investments and product strategies—for example, green deposit products and commercial lending policies and community economic development initiatives.

Our recent surveys compared the views of both bank customers and executives on social priorities—that is, "good bank" activities—and found that the two groups were aligned. Both constituencies identify the same three critical activities: providing transparent and fair services, enabling financial literacy of consumers, and offering innovative products for the economically disadvantaged or underbanked populations (Exhibit 5).

Shift 5: Next-generation technologies will help banks reduce costs

US banks have made modest improvements in productivity in the last few years, but they have far to go to match the efficiency of global competitors. More important, today's cost base is not future-proof, and will not enable banks to stand up to the emerging competition of new bank archetypes, fintechs, and Big Tech.

However, several technology trends have reached critical mass, and will enable banks to drastically reduce costs and complexity:

— Next-generation integrated platforms, such as Mambu, 10X, Finxact, and Thought Machine, have moved from experimental stages to delivering significant improvements in productivity

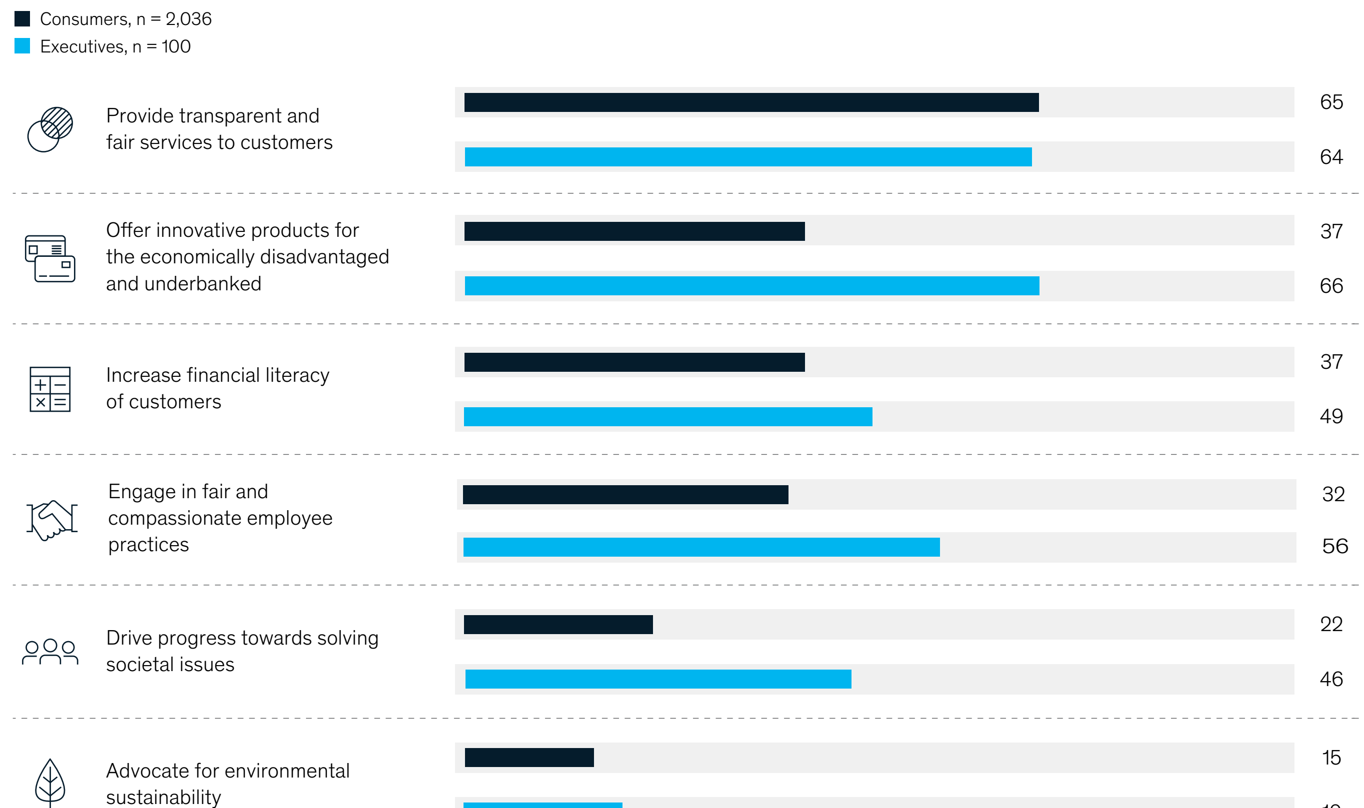
— Cloud computing has matured substantially in scope and durability, enabling banks to achieve economies of scale without significant initial capital expenditures

— Open APIs enable banks to plug in innovative solutions from external partners (e.g., fintechs) while continuing development of internal solutions.

Exhibit 5

Consumer and executive ranking of banks' social priorities.

Percent of respondents that think banks should engage in the "good bank" activity



Source: McKinsey 2019 Future of Banking Consumer and Executive Surveys

This constellation of new technologies will allow for significant reductions in IT costs, as well as the realization of the long-sought goal of end-to-end automation in banking, and its positive effects on regulatory compliance, risk management, and customer experience (Exhibit 6). Banks still have to contend with the burden of their enormous historic investments in complex and inflexible legacy architectures, which may require development and maintenance of two systems in parallel. By leveraging leading-edge technologies, banks stand to make substantial potential gains: cost-to-income ratios going below 25 percent, cost-to-asset ratios approaching below 50 percent, and marginal costs effectively dropping to near zero.

Shift 6: Managing an expanding set of risks requires integration across the bank

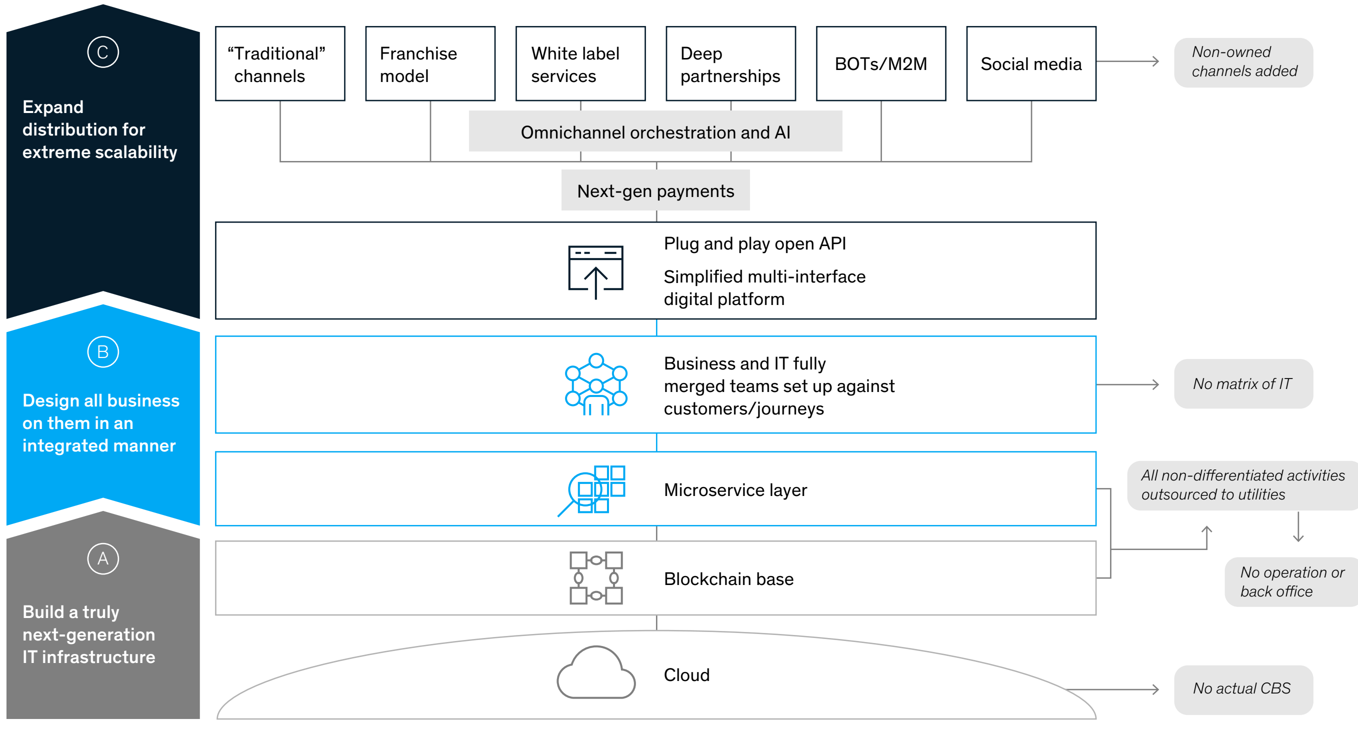
Risk management in banking has been traditionally focused inward, on the challenges of managing capital and mitigating losses in the asset portfolio. Those risks will remain in place, but new risks with particularly acute impacts are emerging. Recent examples are widespread:

— A large European bank lost nearly a tenth of its share value following a false social media rumor on its financial health

— Several Latin American banks were the targets of hackers aiming to steal over $100 million

Exhibit 6

Illustrative architecture of a next-generation bank.



Source: McKinsey

— One Asian country's banking system was attacked repeatedly over several years, and hackers made off with $80 million before being detected.

These emerging risks are dynamic and complex. Managing them calls for new methods of identification and prevention, a new pool of talent, and integration across all banking activities. Once they have charted the new landscape, the most successful banks will build superior risk management into a source of competitive advantage.

To expand beyond traditional capital risk management, banks will need to take three key actions:

— Identify and prioritize new digital risks and allocate meaningful resources to innovative risk management. In our survey of senior bank executives, 60 percent stated that their firms emphasize traditional risk management spending on compliance and audit, while only 16 percent cited more innovative risk management. While innovation need not dominate risk budgets, it likely deserves greater attention. Further, banks need to keep an eye on the risk management practices of non-bank competitors, as their risk controls will shape general consumer expectations.

— Replace traditional force-fit rules and checks with new and overarching methodologies integrated within customer journeys. Risk management should be handled in the background, and invisible to customers. Systems should be developed to rapidly assess risks and deliver frictionless and personalized control measures.

— Attract new talent and skills to execute new risk management strategies. Risk teams at most banks are dominated by conventional compliance and audit functions. Future risk management will call on a more diverse and integrated set of specialists in social media, cybersecurity, and crisis management.

Bank executives will need to reimagine their risk management capabilities, and expand in all three directions. More important, however, is bringing risk management from the back of the enterprise forward—weaving it into all activities and anticipating an evolving risk climate.

Shift 7: Skilled digital talent is now crucial in banking

Based on an analysis of public job profiles of staff at banks, McKinsey estimates that digital roles, including digital marketing, make up only 7 percent of total US bank staff. The proportion rises to 15 percent at more digital-forward banks, but falls far short of large tech companies, where a digital staff density of about 40 percent prevails. Relative to tech firms, banks also trail in the training and skills of their digital teams. Moreover, bank executives may fail to appreciate the digital talent shortfall (Exhibit 7).

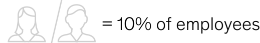
Looking out five years, we anticipate the talent composition within banks will more closely resemble those at tech companies. However, this evolution will hinge on the ability of banks to attract and retain the right digital talent. Banks will also need to promote the skills of their top digital talent—from basic technical and project management skills to more advanced digital skills, including agile development, product management, user experience design, data science, and digital marketing analytics.

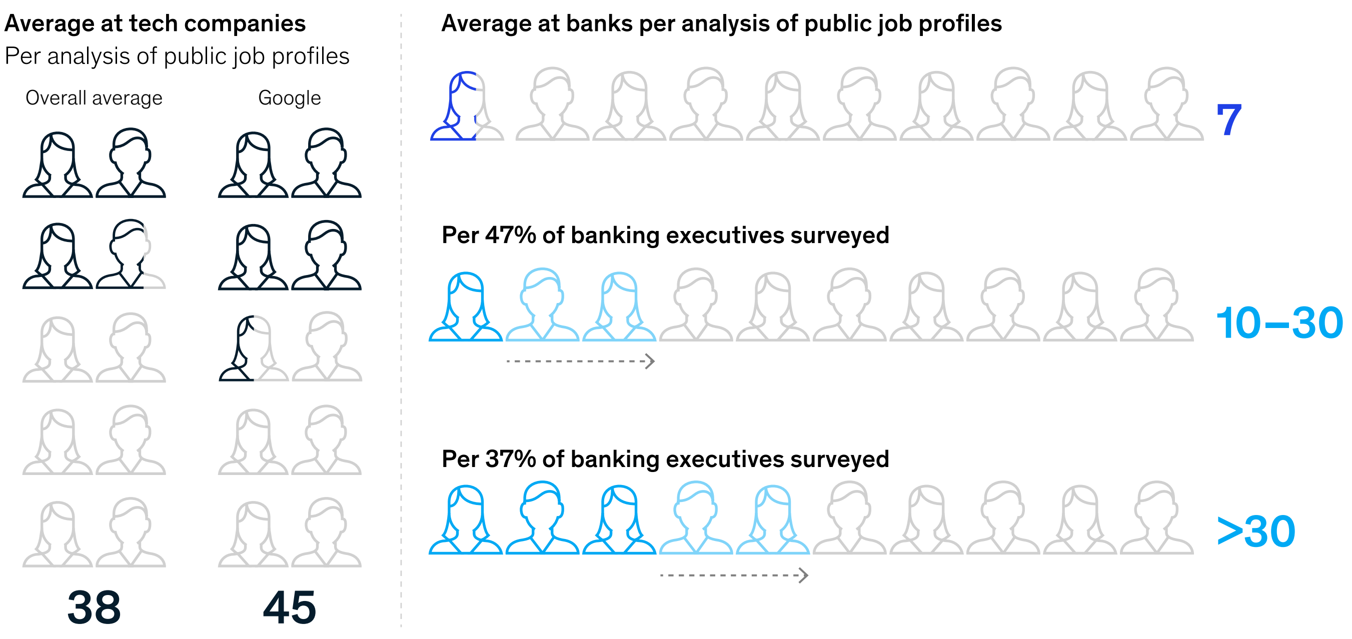
Many banks also suffer from a limited understanding of digital roles. Our recent survey of banking executives suggests that some executives equate traditional IT or data-related roles, such as system administrators and database engineers, to digital roles. Compared to our estimated industry-wide average of 7 percent digital talent, 47 percent of executives believe 10 to 30 percent of their banks' staff fulfill digital roles, and 37 percent place more

Exhibit 7

Real and perceived gap of digital talent in banks.

Percent of total head count in digital roles





Source: McKinsey Banking Digital Talent Index; McKinsey 2019 Future of Banking Executive Survey; public job profiles

than 30 percent in digital roles. Banks need a better understanding of digital skills to effectively transform their workforces and manage the implications on bank culture and operating models.

Confronting the seven shifts requires strategic diligence

The seven shifts described here present many opportunities for transformation, and for banks to square off against new competitors; capture and retain a greater share of customer relationships through delightful, personalized experiences; reduce costs and improve profitability; proactively manage a new constellation of risks; and build the talent base to execute successfully.

It is tempting to think that only the largest and most profitable banks can harness the opportunity inherent in these shifts. It is true that large banks have scale advantages: the biggest banks have the financial and strategic resources to negotiate with Big Tech firms, establish multiple broad ecosystems, and expand "good bank" behavior throughout the organization, and shape the market with each effort.

However, we believe that all US banks, regardless of size or legacy, will have to address each of the seven shifts. Even the smallest banks—with well-thought-out strategies—can position themselves to gain in the changing landscape. They will of course need to make choices that offset the scale advantages of larger competitors—for instance, deciding where to be a pioneer and forge ahead of the competition, and where to be a fast follower with smaller but meaningful investments.

Some of the shifts are as much about corporate culture as allocation of capital. For example, becoming a genuinely good, socially responsible bank calls not for massive spending, but for a redesign of lending and investment policies, and the promotion of social responsibility to a prominent place in corporate culture. Similarly, taking on new risks will be a process of creative thinking and redistributing risk management, and not necessarily requiring a massive investment in systems. Lastly, meeting the need for digital talent is a strategic and cultural shift as well, calling for a redirection of current recruiting, training, and development efforts.

McKinsey estimates that digital roles, including digital marketing, make up only 7 percent of total US bank staff.

In our view, the degree of change in store for US retail banking will require all banks, regardless of size, to embark on a strategic diligence process to assess their preparedness. The goal should be to identify the full potential of the business and define a clear set of big choices about the future direction of the business. There are five steps in a strategic diligence:

1. **Develop a pro forma momentum case** that sets out a view on readiness against the seven shifts (a momentum case enables management to accurately project what happens in a "do nothing" scenario, from a strategic perspective)

2. **Establish calibrated aspirations** for how the bank will respond to the seven shifts over the next five years. Where does management have to win—even at high cost—and where is a limited investment sufficient?

3. **Develop a view on three to five value-creating bold moves** to be made, and the operating model required to support them

4. **Assess the bank's portfolio,** and determine the capital required to support the shifts

5. **Align to a strategic roadmap,** typically spanning 24 months, to execute the plan

A thoughtful strategic diligence process will allow banks to respond to the shifts with strategic clarity and the appropriate sense of urgency and enable management to re-underwrite a company's growth thesis. In our experience, this diligence is typically in the domain of the CEO and CFO and is healthy for a company to do every three to five years. Boards and shareholders are asking for greater strategic clarity from their management teams, given the pace of disruption. The time to take bold action is now.

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