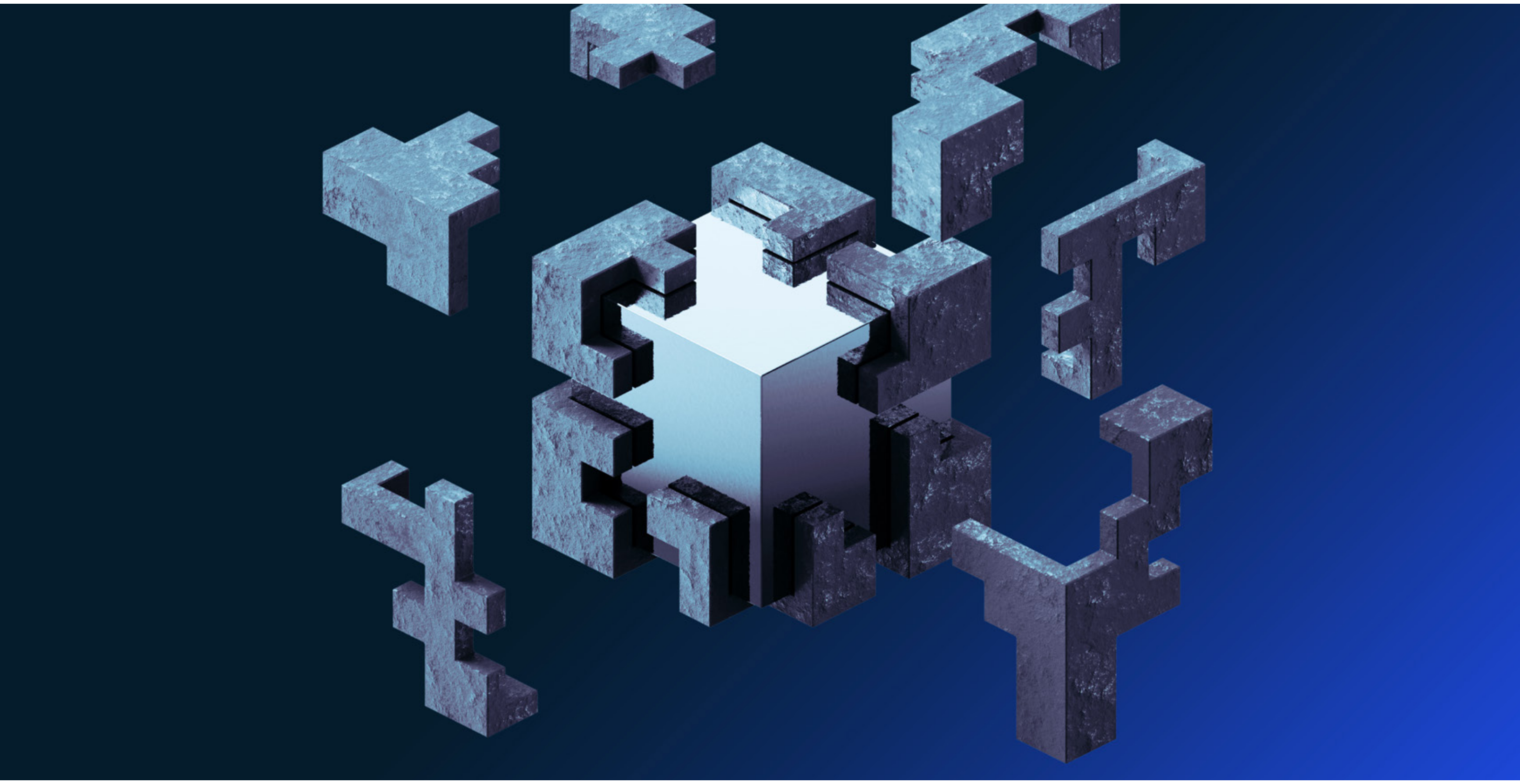
Financial Services Practice

Reshaping retail banks: Enhancing banking for the next digital age

The current model of universal retail banking is unsustainable in the digital world. Banks will need to reinvent themselves, focusing on businesses where they can achieve and extend market leadership.

This article is a collaborative effort by Ashwin Adarkar, Stefano Cantù, Klaus Dallerup, Vito Giudici, Enrico Lucchinetti, and Zaccaria Orlando, representing views from McKinsey's Financial Services Practice.



October 2022

Retail banks have experienced respectable growth as the pandemic has abated, and it is tempting to declare that the state of global retail banking is healthy. However, taking a disaggregated view reveals the unsustainable economics of the universal banking model, in which an institution offers a full range of financial services, from daily banking (deposit accounts, payments, and credit cards) to more complex lending, wealth management, and even insurance. To supercharge their financial performance and defend market share, banks will need to target profit pools in specific businesses—daily banking activities, navigating life events, or building and protecting wealth—where they can define and deliver a value proposition that can win in our new digital age.

While much has been made of the threat from fintechs and Big Tech, we believe incumbent banks will continue to lead in retail banking. Banks running the old playbook, however, will not survive; the new winners will operate like tech companies, with advanced data capabilities, a cutting-edge tech stack, and an agile operating model.

Banking has rebounded but faces severe challenges

With profit pools surpassing $680 billion, according to McKinsey's Global Banking Pools, global retail banking delivers 48 percent of total banking profits and is larger than entire sectors such as pharmaceuticals/chemicals, telecommunications, and food manufacturing. Banking overall has rebounded from the shock of the pandemic: total shareholder returns (TSR) of the world's top ten banking groups in January 2022 were 20 percentage points higher than in January 2020. While the TSR for these banks have edged downward recently due to macroeconomic uncertainty, they remain in line with prepandemic levels. The average return on equity (ROE) for global banking has also improved steadily from the second quarter of 2020 and is projected to continue climbing above the ten-year average of 8.9 percent (Exhibit 1).

Despite the signs of recovery, banks must take a disaggregated view of retail businesses and understand the variation in the profitability of their major product groups. Differences in the profitability of key retail banking businesses have always existed to some extent, depending on the market, and daily banking has often served as the foundation for building lifetime relationships that generate revenue from mortgages and from wealth and protection services[1] to subsidize the cost of daily banking. However, with digital entrants focusing hypercompetitive value propositions on highly attractive customer and product segments, the universal model is threatened. Absent this

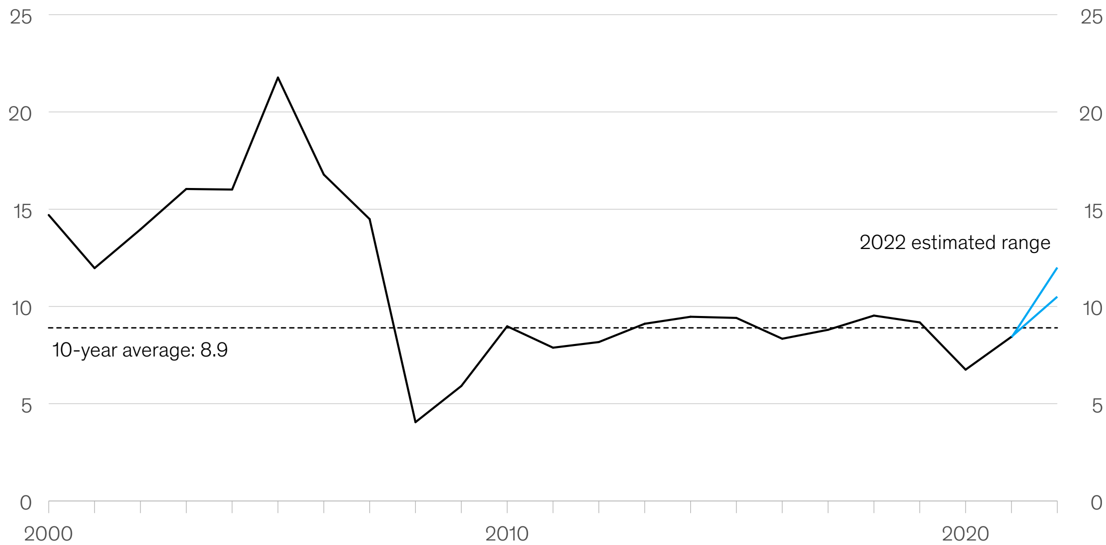
To supercharge financial performance and defend market share, banks will need to target profit pools in specific businesses where they can define and deliver a value proposition that can win in our new digital age.

[1] "Wealth and protection" is shorthand for two types of services: (1) wealth accumulation, management, and protection; and (2) insurance/protection.

Exhibit 1

Return on equity has been stable over the past decade and is rebounding from the shock of the COVID-19 pandemic.

Return on equity for global banking 2000–22, %



Source: McKinsey Panorama—Global Banking Pools; S&P Capital IQ

granular view, a bank risks the hollowing of its profits as the most valuable segments are cherry-picked. To succeed in this context, which leaves little margin for underperformance, it is imperative for banks to know where they make a profit and where they don't, as well as to protect and expand their most strategic revenue streams.

Although the need for this type of thinking is global, the severity of the challenges to the traditional model of universal banking and the implied strategic imperatives vary based on the markets served (Exhibit 2). In developed Asia,[2] North America, and Western Europe, daily banking has become highly unprofitable. While rising interest rates may help somewhat, they do not fundamentally change the situation (see sidebar, "Inflation and rising interest will not change the overall picture for banks"). Moreover, in North America, there is increasing social and regulatory pressure to limit account fees. Many banks are seeing diminishing returns on their cost reduction programs as they push against the limits of their core technology platforms and branch network configurations.

In China and the emerging markets of Asia,[3] where digital-first models have reached maturity and banks have shrunk their already thin branch networks by more than a third in five years, daily banking revenue per customer is roughly equal to the average cost per customer. However, profit pools for complex lending and wealth and protection services are low by global standards, and challenges to incumbent banks remain as innovative Big Tech and fintech organizations continue growing in terms of consumer adoption and product diversification.

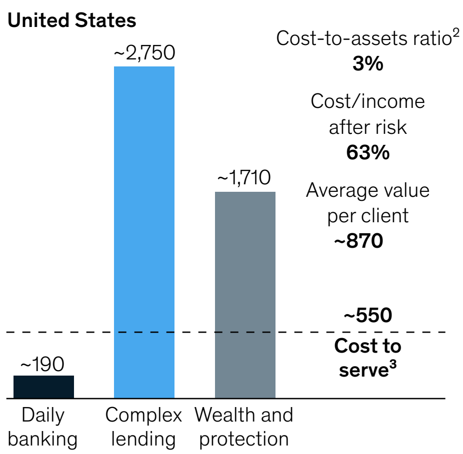
In most retail banking markets of Latin America and the Middle East and North Africa (MENA), higher interest rates for consumer lending

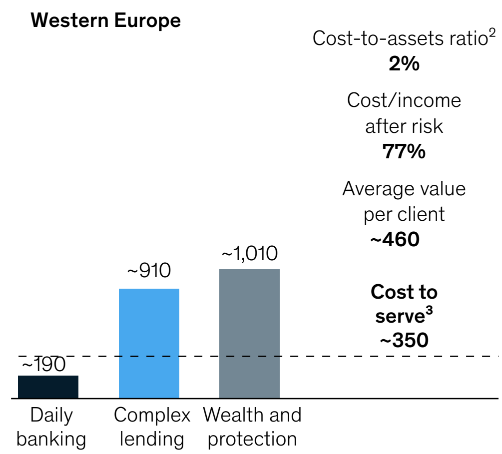
[2] Includes Australia, Hong Kong, Japan, Korea, Singapore, and Taiwan.
[3] Includes India, Indonesia, Malaysia, Thailand, and Vietnam.

Exhibit 2

In developed markets, high costs are making daily banking unprofitable.

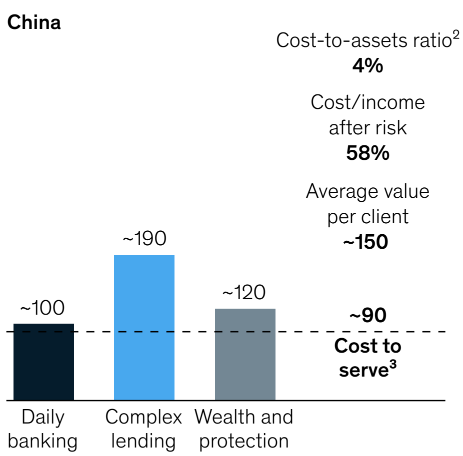
Revenue by product,[1] $ per holder (2020 estimates)

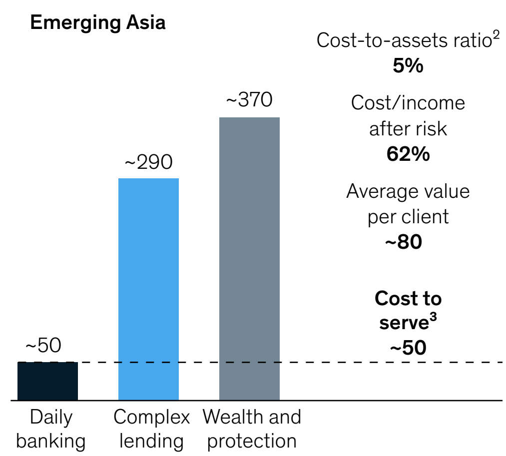




In China and Emerging Asia, a digital-first approach has controlled costs, but complex products can be further developed.

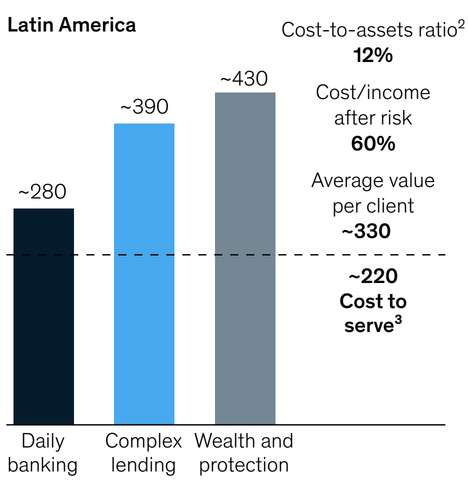
Revenue by product,[1] $ per holder (2020 estimates)

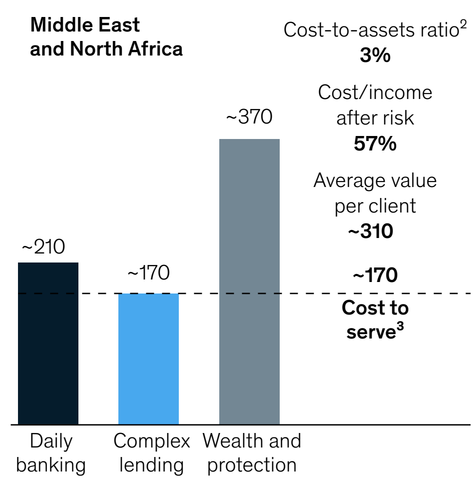




In Latin America, the Middle East, and North Africa, revenues exceed costs for now, but profitability needs to be defended from digital attackers.

Revenue by product,[1] $ per holder (2020 estimates)





[1]Daily banking includes basic products, credit cards, and unsecured loans. Complex lending includes mortgages and car loans. Wealth and protection includes wealth accumulation, insurance, and pensions.
[2]Operating expenses/assets for complex lending and unsecured loans, including credit cards.
[3]Total global operating expense (number of banked population x average number of banking relationships).
Source: McKinsey Global Banking Pools; World Bank; McKinsey analysis

Inflation and rising interest will not change the overall picture for banks

The cost of essential goods has risen rapidly in many parts of the world, with several economies recording the highest rates of inflation seen in decades. To combat inflation, central banks in diverse markets have been raising interest rates, and as a result, growth in bank assets and deposits will likely slow. However, higher rates should improve net interest margins on banks' existing balance sheets. At the same time, higher inflation and higher loan prices may increase the risk of banks' loan portfolios, especially in the mass-consumer and small-business segments.

Looking ahead, McKinsey's Banking Practice foresees two main scenarios. In the first scenario, inflation remains high in the midterm with interest rates rising too slowly to contain it, thus muting economic growth—a condition known as stagflation. The second scenario is characterized by inflationary growth: prices continue to rise for the next few years, and central banks raise interest rates to optimal levels, thus averting excessive constraints on economic growth.

We expect that higher rates will generate additional interest income for banks but with a limited impact. In the eurozone, for example, we anticipate an increase of approximately 2 percent in net interest income following an increase of 150 basis points in European Central Bank rates.

Given the risks associated with these conditions, improving risk scoring and underwriting capabilities is crucial, not only to offer competitive lending rates to a broader population but also to predict more accurately which customers pose a risk of default. This is particularly important for averting a possible rise in nonperforming loans (NPLs) and risk costs, in the event that economic conditions deteriorate.

contribute significantly to per-customer daily banking revenues, which exceed the cost to serve by more than 20 percent. The main vulnerability for incumbents—particularly in Latin American markets, where the penetration of complex lending and wealth advisory is less than 10 percent—is that an innovative bank or nonbank attacker might launch a compelling offering in one of the less well-penetrated product groups and scale rapidly.

By comparing the average cost to serve each retail bank customer with the balance of revenues from complex products and daily banking, we have identified three regional archetypes of retail banking economics (Exhibit 3). Banks in each archetype face distinct imperatives:

— *Europe, North America, and developed Asia.* Embrace new technology—including a digital-first business model and hybrid-cloud core technology stack—to move to a fundamentally lower cost curve, fight attackers on innovation, and identify new sources of revenue in complex lending and in wealth and protection via end-to-end journeys and personalization.

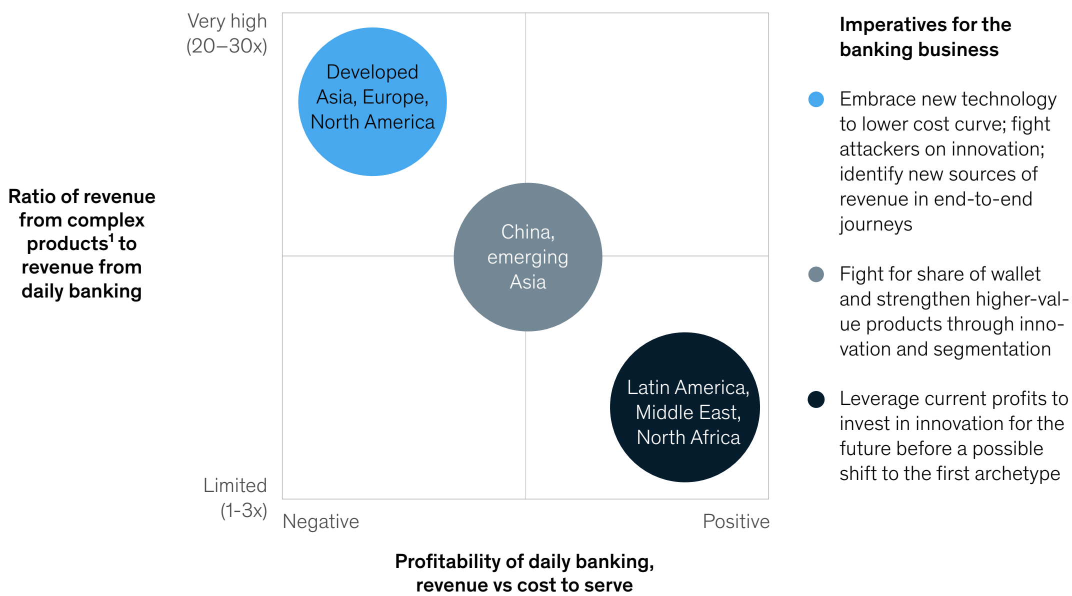
— *China and emerging Asia.* Fight for share of wallet while also focusing on increasing the penetration of higher-value businesses, especially complex lending. Improve the economics for complex lending and for wealth and protection through product innovation and segmentation.

— *Latin America and MENA.* Leverage current profits from daily banking to defend market share against digital attackers and avoid the economic challenges to daily banking seen in, for example, North America. This could be done either by diversifying the source of profitability within daily banking or deepening relationships with daily banking customers by cross-selling complex lending or wealth and protection services.

Exhibit 3

Imperatives for retail banks generally differ by region.

Current positioning of macroregions



[1]For example, complex lending, wealth, and protection.
Source: McKinsey Global Banking Pools; World Bank; McKinsey analysis

The traditional model of universal banking, with its reliance on cross-subsidization between more and less "profitable" products, generally served well in branch-centric contexts. Now, however, three key shifts are fundamentally changing the competitive environment and forcing banks to compete on a digital battleground:

1. *Scale shift.* Historically, banks achieved scale through the famous S-curve associated with branch density: if a bank's share of branches in a market exceeded a certain threshold, it would gain a disproportionate share of deposits. This heuristic has broken down as other factors, such as digital share of voice or brand visibility, have become more important.[4] Scale benefits have shifted from physical to digital networks, depriving incumbents of the barrier to entry afforded by robust branch infrastructure and pitting them against tech-intensive organizations built for continuous innovation and infinite scalability. With the current economic model, even a typical megabank with a technology budget of $9 billion to $10 billion does not have the resources to compete head-to-head on innovation, speed, superior service, and pricing against a Big Tech organization, which typically spends some $20 billion to $30 billion annually on technology. And while a megabank typically spends no more than 3 percent of revenue on marketing, a neobank may spend more than 8 percent of revenue to engage with new and existing customers.[5]

[4] Shital Chheda, Aditya Dhar, Marukel Nunez Maxwell, and Pradip Patiath, "Customer mindshare: The new battleground in US retail banking," McKinsey, February 2019.
[5] The figures in this paragraph are based on diverse sources, including expert input, company websites and press releases, and EMI Strategic Marketing analysis of Federal Financial Institutions Examination Council (FFIEC) call reports and bank financials.

2. *Digital-native challengers.* Digital attackers have taken the first bites out of traditional banks' revenue streams. Wielding massive sets of data gathered from diverse sources and applying advanced analytics to respond in near real time to individual customers' emerging needs and preferences, digital-native challengers have established a strong foothold in all areas of retail banking. According to McKinsey's Global Banking Pools, fintech and Big Tech companies now capture 45 percent of gross revenues from payments, and digital investment apps handle a quarter of assets in the mass-affluent segment of $250,000 to $2 million (and are growing at twice the rate of traditional providers). According to McKinsey's Payments Map, nonbanks in the United States account for 56 percent of point-of-sale financing origination balances. Similarly, in the Nordic countries, more than 30 percent of total transaction value is originated from buy now, pay later (BNPL) service providers.

3. *Consumer demand for digital.* Customers increasingly gravitate to digital platforms: McKinsey research shows that the share of global bank customers purchasing personal loans via digital channels jumped from 34 percent in 2020 to 44 percent in 2021.[6] In Europe, consumer willingness to purchase diverse banking products via digital channels increased by as much as six percentage points from 2018 to 2021 and by up to 15 points in the United States over the same period. Some of the biggest gains in digital sales were observed in investments, cash loans, and mortgages,[7] and in these markets, the share of consumers willing to purchase financial services digitally now ranges from 60 to 80 percent. Our research also shows that 75 percent of customers in Latin America and 59 percent in Western Europe are willing to share data in return for a better offer and experience. However, if banks are to convert consumer interest into digital sales, they must deliver services that meet precise needs and offer fast response times and streamlined end-to-end journeys seamlessly integrated with partner applications.

With banks' current cost structure and consumers' increasing willingness to transact business via digital channels, many banks are ill-equipped to defend their market share on the digital battlefield. Banks will need to fortify themselves with new, reimagined, fit-for-purpose value propositions and business models. This is a battle banks cannot afford to lose.

Winning on the digital battleground

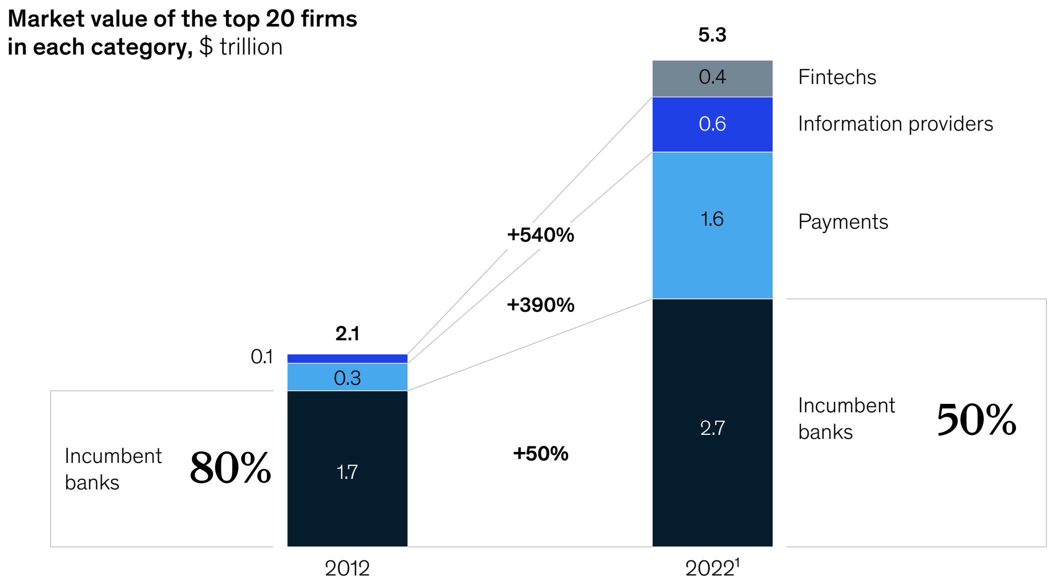
As they think about how to build a compelling offering, bank leaders should consider how recent winners have added value. Over the past decade, more than two-thirds of market capitalization has been created by payments companies (including credit card companies and payment processors), information providers (including ratings agencies, market intelligence organizations, and data and analytics companies), and fintechs (Exhibit 4). Leaders in these financial services subsectors have more than tripled their valuations in the past ten years, while incumbent banks have grown by "only" 49 percent.[8]

In some respects, this should not be surprising, as the digital wave first hit in payments and information services. It is instructive to see that while fintech organizations were among the winners, the majority of the value was created by incumbent payments and information service providers that innovated and adapted. Even more striking are the common themes of value creation for customers. Top performers increased value by simplifying and improving the customer experience—for example, by transitioning from cash to electronic payments and offering more flexible point-of-sale lending and peer-to-peer payments—and by leveraging data and analytics to deliver insights.

[6] Finalta Digital and Multichannel Benchmark Study, 2021.
[7] McKinsey Retail Banking Consumer Survey, 2018 and 2021.
[8] Fintech companies have lost significant market value in recent months and face new challenges in accessing funding, as investors increasingly favor profitability over growth. Despite these changes in valuations, fintech organizations have raised the bar for traditional banks.

Exhibit 4

The top value creators have been information and payments providers, thanks to data monetization and improved customer experience.



[1]Valuation of fintechs as of July 4, 2022; valuation of other categories as of September 29, 2022.
Source: Market data; McKinsey Fintech Investment Radar; McKinsey analysis

How customers will engage with the retail bank of the future

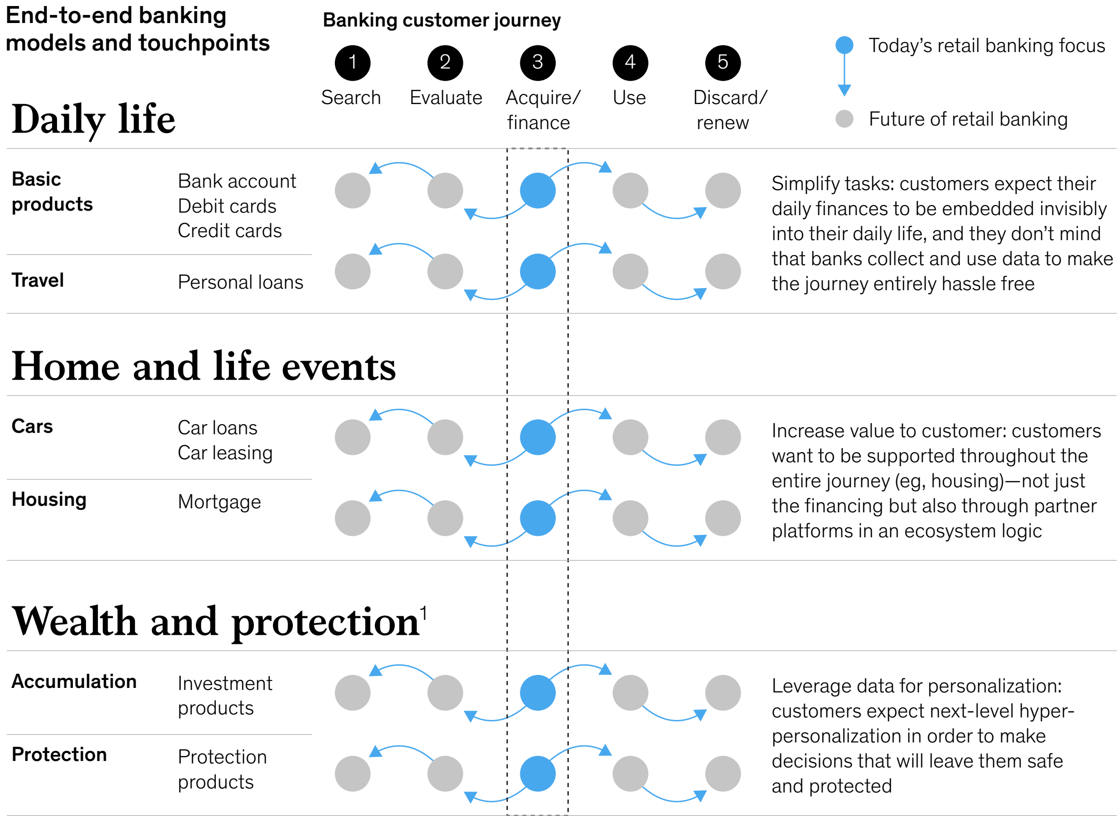
To thrive in the new digital environment, banks will need to rearticulate their value proposition, bearing in mind the winners' lessons on the power of simultaneously simplifying and upgrading the customer experience and creating value through data. The historic value propositions of convenience, low cost, and personal relationships in the old, branch-centric world must be reinvented for a world of digital ecosystems. If convenience was once a matter of physical ubiquity, it now depends on mobile-first experiences enabling customers to complete tasks quickly, at any time, from anywhere. In the old world, trusting relationships were underpinned by interactions with a personal banker; today trust may be founded on transparency (for example, real-time status updates) and the bank's use of data analytics to understand individual needs and address them with highly personalized solutions. Cost efficiency, another element of differentiation, was once achieved through operational excellence and end-to-end process discipline; in the digital world, leveraging digital scale to slash costs requires a modern architecture and cloud operating model.

As banks rethink their value proposition, they will need to cascade it through the business lines they prioritize—daily banking, complex lending, or wealth and protection—and develop a digital platform that supports the full search-shop-manage value chain of that priority business (Exhibit 5):

— *The daily banking platform* would focus on simplifying daily shopping activities by embedding transactions seamlessly, and often invisibly, within customer journeys and giving customers fast, convenient access to diverse retailers and service providers.

Exhibit 5

Banking models centered around customer journeys allow for expanded engagement.



[1]Wealth and protection includes wealth accumulation, insurance, and pensions.
Source: McKinsey analysis

— *The home and life events* (or complex lending) platform would increase customer value through ecosystem partnerships supporting end-to-end journeys for major life undertakings, from search and selection to financing and ongoing management and maintenance.

— *The platform for wealth and protection* services would compete on the appropriate use of customer data to deliver hyperpersonalized advisory support, enabling investors to make well-informed decisions about increasing and protecting wealth over decades.

One of the key challenges in the digital environment is to create customer experiences that are strong enough to make customers want to use more digital services. Our research shows that banks often fail to engage adequately with customers who express a willingness to purchase new services through digital channels,[9] particularly mobile. Banks must ensure that customers can use the mobile app to complete practically all banking activities, including tasks that once would have required a visit to a branch. Our research indicates that for complex transactions, most customers will expect human support and advisory services on demand through a variety

[9] See, for example, Sonia Barquin, Eric Buntoro, Vinayak HV, and Ignes Pricillia, "Emerging markets leap forward in digital banking innovation," McKinsey, September 2021.

of channels, including video calls and online chat. Some will prefer in-person consultation at a branch or advisory center. To create superior customer experiences, it will be crucial to design entirely new journeys with minimal steps, rather than simply digitizing existing journeys.[10]

What is more, each of the three business models shown in Exhibit 5 will enable the bank to engage more frequently and deeply with customers by expanding core offerings from accounts, transactions, and financial advisory to include digital platforms where consumers can conduct business with participating merchants and service providers. As an example, to support customers in navigating life events through a complex lending platform, banks can simplify end-to-end journeys for major life events such as buying a home or automobile or pursuing an education. A bank-owned housing platform would serve as a one-stop shop addressing all links in the value chain, including property search, virtual and in-person tours, choice of and communication with a real-estate agent, mortgage financing, hiring of contractors (for pre-move repairs or renovations) and movers, and assistance in preparing the property for rental.

Such a platform would deliver distinctive value to customers in three main ways. It would provide access to service providers who have been rigorously vetted by the bank and rated by platform users. It also would increase transparency across the full home-buying journey. Finally, it would offer competitive mortgage rates and personal assistance with the loan application journey. Banks can also leverage customer data collected through the housing platform to help service providers deliver personalized offers to home buyers and owners.

Each of the three models, if executed successfully, could provide a much-needed boost in profitability for retail banks, with target cost-to-income (C/I) ratios between 40 and 50 percent (Exhibit 6). Cost reduction levers would differ for each model but would include optimization of branch networks and maximum automation of customer acquisition and onboarding, credit underwriting, servicing, and more. In addition to increased product penetration across the customer base, income levers include new revenue streams with ecosystem partners.

The adoption of platform-based business models will unleash a kind of internal disruption, requiring banks to give up revenue in some areas as they position themselves for fast growth in the target business. Traditional sources of revenue, including net interest margins, transaction fees, and commissions on securities trading, could shrink as banks compete on price to draw users to their platforms. Banks offering a merchant-financed deferred-payment option may need to tolerate a weakening in consumer lending volumes—a worthwhile trade-off if this option sufficiently increases their platforms' value by providing consumers with greater choice in funding purchases and merchants with tools to boost sales.

Further, banks that focus their transformative investments on a single business may observe a decline in revenue for less well-funded businesses. As shown in Exhibit 7, our projections assume a revenue decline of 15 percent for these secondary businesses. The goal for these businesses should be to match market expectations well enough to prevent customers from leaving the bank, as they may respond favorably to personalized offers from the high-growth business. It may be counterintuitive to take steps that lead to the shrinking of reliable revenue streams; however, the gains to be made by focusing investments on a carefully defined platform business far outweigh the forgone revenue.

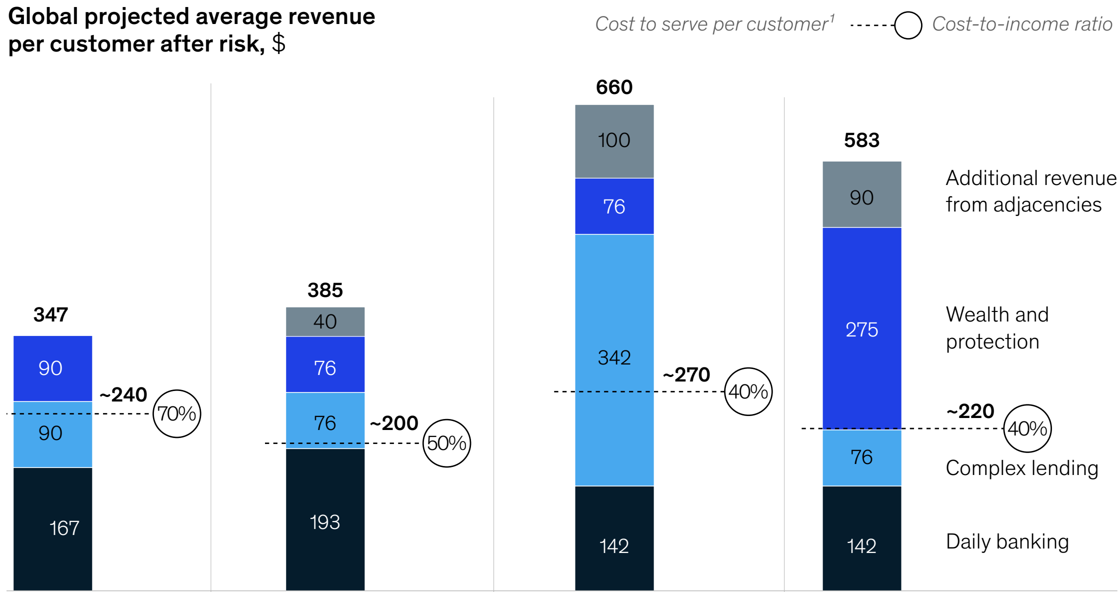
Operate like a tech company

To win on the digital battlefield, banks will need to work like a tech company to deliver a platform-based value proposition. Banks are at varying stages in their technology transformations, and now

[10] Sergey Khon, Ahmed Nizam, David Tan, and Zubin Taraporevala, "Best of both worlds: Balancing digital and physical channels in retail banking," McKinsey, July 2022.

Exhibit 6

Banks can lower cost and income ratios to 40–50 percent by developing value propositions for one of three specialized business models.



2020 **Average bank today**	2027 **Bank focused on 'daily life'**	2027 **Bank focused on 'home and life events'**	2027 **Bank focused on 'wealth and projection'[2]**
Key initiatives	● Cost reduction with branch network optimization ● Banking functionality seamlessly embedded within customer journeys ● Additional revenue from marketplace services (eg, commissions, ad revenue): ~$40 per customer	● Increase product penetration in customer base ● Complex lending-centered vertical platform or marketplace ● Expansion with ancillary end-to-end solutions for life events: ~$100 per customer	● Increase customer base penetration ● Cost efficiency and increased penetration with personalized digital advisory ● Expansion of offering (eg, nonlife insurance): ~$90 per customer

[1]Total global operating expense (number of banked population x average number of banking relationships).
[2]Wealth and protection includes wealth accumulation, insurance, and pensions.
Source: McKinsey Global Banking Pools; World Bank; McKinsey analysis

is the time for leaders to take advantage of strong financials and double down on three key capabilities essential to a platform-based business model:

— leveraging data for personalization and stronger customer engagement

— a cutting-edge technology stack to reduce costs and speed up innovation

— an agile operating model to respond to fast-changing markets

These key capabilities are crucial to each retail banking business line, and it is important to approach them holistically—that is, to adopt the customer perspective in taking inventory of the full range of the end-to-end journeys that have the most impact on value creation and customer experience. According to McKinsey research, companies that design their technology transformation to deliver measurable business outcomes aligned with enterprise strategy earn a higher return on investment.[11]

Leveraging data for personalization and stronger customer engagement

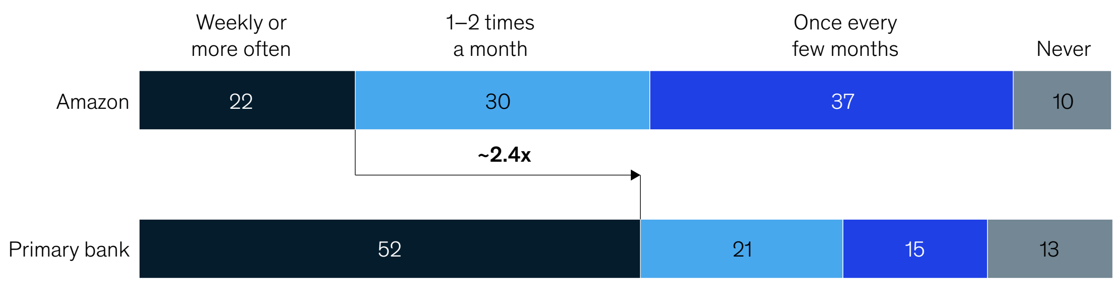
Retail banks must become rigorously customer centric and match leading tech companies in extracting insights from customer data. Thus far, banks have been slow in learning how to use their unparalleled stores of customer data to leap ahead of new challengers. Crucially, banks have real advantages against Big Tech in terms of customer engagement and data; for example, 52 percent of customers report engaging with their bank weekly or more often, while only 22 buy on Amazon that often (Exhibit 7). However, banks have yet to extract the full value of data assets, as they have not tapped all types of customer data. They should act fast while the window of opportunity is still open.

The stakes could not be higher. To compete for data on an equal footing with technology companies, banks will need a comprehensive data infrastructure to support data collection, storage, and advanced analytics, as well as a digital marketing engine to translate analytical insights into personalized messages that anticipate individual customer needs and intentions. This ability to identify individual customer needs and intentions in the moment, at scale, and deliver highly personalized messages to the customer at the right time through the preferred channel is what we mean by "customer centricity."

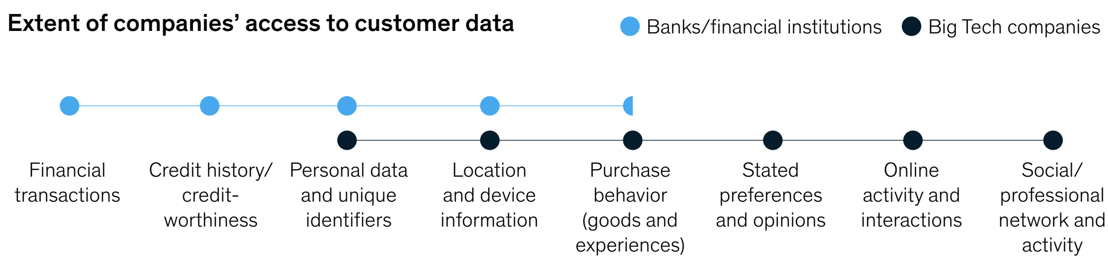
Exhibit 7

In collecting and using customer data, banks have a window of opportunity to compete with Big Tech organizations—at least now.

Customers' digital engagement with primary bank's mobile app or website and Amazon,[1]
% of respondents (n = 1,049)



Extent of companies' access to customer data



[1]Questions: How often do you use your primary bank's mobile app or website? How often do you buy things from Amazon?
Source: McKinsey People and Money Survey; expert input

[11] Anusha Dhasarathy, Ross Frazier, Naufal Khan, Kristen Steagall, "Seven lessons on how technology transformations can deliver value," McKinsey, March 2021.

Building these data capabilities is, admittedly, a massive undertaking. It also pays dividends many times over. For example, at banks that have leveraged cutting-edge engagement capabilities to strengthen customer loyalty, we've seen satisfaction ratings improve by up to eight times among high-value customers at risk of attrition, and intention to leave the bank has declined more than 50 percent.

A cutting-edge technology stack to reduce costs and speed up innovation

Each of the main retail banking business models requires an IT infrastructure that is flexible, scalable, and resilient. Such an infrastructure is capable of handling significant variations in demand for streaming and processing capacity and delivering new solutions through fast innovation cycles.

In the process of designing the new architecture, the initial challenge is deciding which components should be developed in-house to strengthen competitive differentiation and which elements of the infrastructure can and should be outsourced to reduce the cost and the risk of service interruptions attendant to updates and upgrades. It is also crucial to identify which applications will be licensed "as a service" from third parties and integrated with in-house systems using APIs.

In previous decades, most banks were inclined to own and develop in-house as much of their technology as possible. However, today's cloud services have reached a level of maturity and accessibility that affords banks diverse options for meeting the requirements of a maximally automated, digital-first business. It is crucial to seize this opportunity promptly.

According to a 2022 McKinsey Global Survey of technology and business leaders,[12] top-performing companies are much more likely than other companies to have pursued five of the ten key transformation moves that form part of our "tech forward" approach. This is especially true for scaling up data and analytics and changing the delivery model for IT to accelerate and stabilize the development, testing, and deployment of innovative solutions (Exhibit 8).[13]

Rethinking a bank's technology approach is an ambitious and far-reaching endeavor, and it is crucial to design each initiative to address specific end-user needs and create value. In our experience, organizations that implement their technology transformations according to carefully defined business goals can shrink time to market by more than 70 percent, to between two and four weeks. They also see an average 20 percent reduction in IT costs and a 100 percent improvement in developers' overall productivity. All these improvements contribute to world-class user experiences.

An agile operating model to respond to fast-changing markets

The digital environment changes as fast as new code can be written and innovative applications downloaded by the millions. Winning banks will develop speed as a core competitive advantage. They can do this through two main avenues: implementing an agile operating model and managing a carefully planned migration to the new mix of talent and skills required to win.

Banks must push ahead with their transition to an agile culture, removing barriers to cross-functional collaboration and creating semi-autonomous teams that can deliver solutions quickly in alignment with enterprise strategy. Consistency in roles, communication, and work patterns across teams enables an organization to reallocate funding and form new teams quickly as new opportunities and priorities arise.[14]

Sustaining this more dynamic operating model while adapting to a new, more digital environment will require a dramatic shift in banks' skill profiles away from processors and toward problem solvers. For example, as branch operations migrate from service

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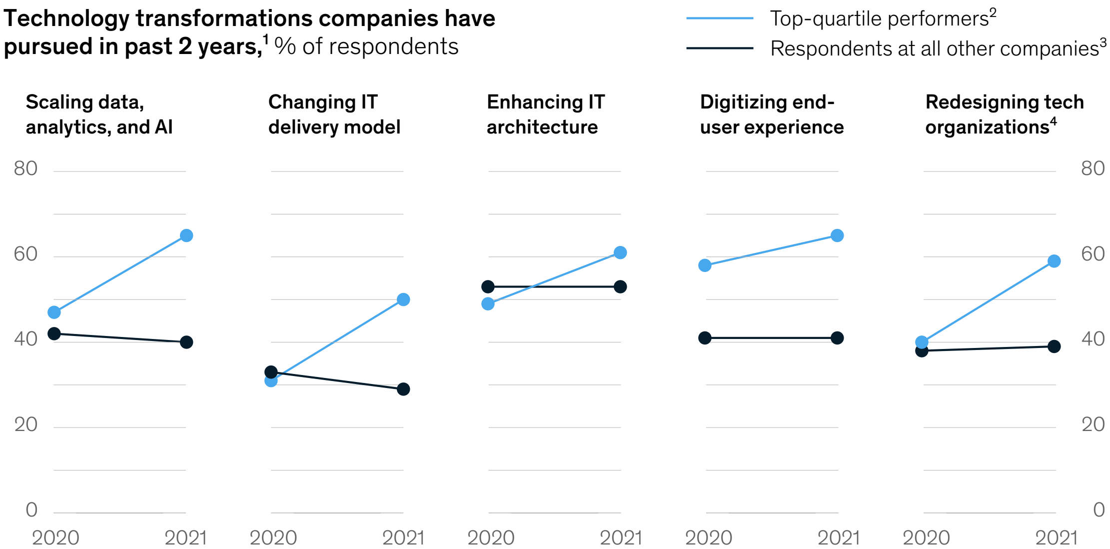
[12] Anusha Dhasarathy, Ross Frazier, Naufal Khan, and Kristen Steagall, "Prioritizing technology transformations to win," McKinsey, March 2022.
[13] "How to become 'tech forward': A technology-transformation model that works," McKinsey, November 2020.
[14] "The five trademarks of agile organizations," McKinsey, January 2018; Andrea Alexander, Aaron De Smet, Sarah Kleinman, and Marino Mugayar-Baldocchi, "To weather a crisis, build a network of teams," McKinsey, April 2020.

Exhibit 8

Top-quartile performers are pursuing transformations much more actively than other companies.

Technology transformations companies have pursued in past 2 years,[1] % of respondents



[1]Out of 10 technology transformation initiatives included as answer choices.
[2]Respondents who reported average effectiveness score in top 25% of sample; based on ratings of 15 key IT activities tested in survey. In 2020, n = 125; in 2021, n = 79.
[3]In 2020, n = 487; in 2021, n = 315.
[4]To better support business strategy.
Source: McKinsey Global IT Survey 2021

to sales, the primary role of branch professionals will shift from teller to universal banker (Exhibit 9). Similarly, banks that transition to an agile tech organization will see their ratio of developers to tech operations and infrastructure specialists flip from 1:2 to 1.5:1. Managing this migration will be a central challenge for banks.

A crucial lever is training existing employees to become proficient in higher-value activities. With demand for new skills over the next three to five years projected to be two to four times greater than supply, upskilling existing talent will be an essential part of reinventing the bank. Moreover, our experience and research show that reskilling can be 20 to 30 percent more cost-efficient than recruiting new talent. It also strengthens employee engagement, measured in higher employee retention and customer satisfaction, which also contribute to financial performance.[15]

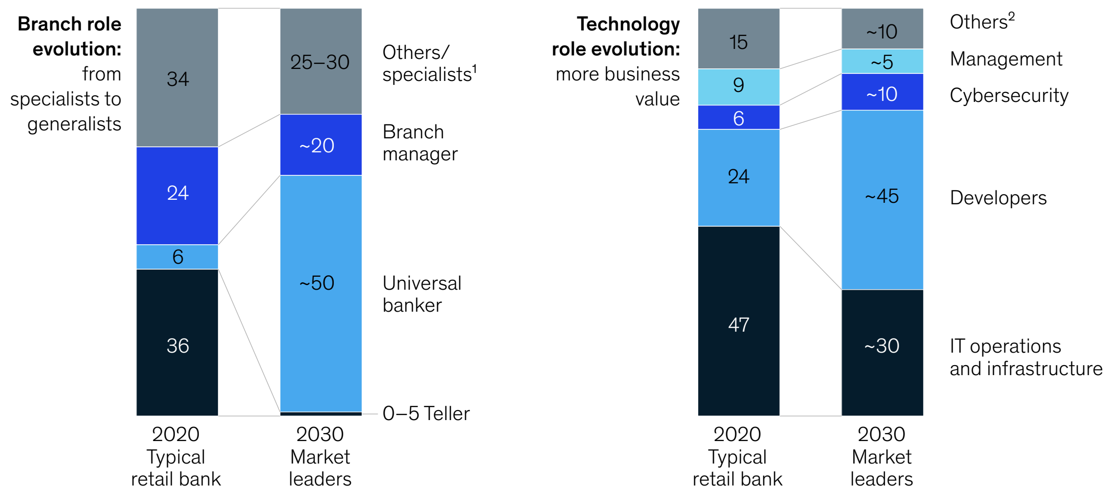
Banks will also need new models for recruiting and retention. For example, to attract developers, winning banks will look beyond compensation and other incentives, focus on removing day-to-day pain points, and create a great environment for developers. Currently, at most banks, putting code into production involves multiple approvals and manual testing, which can take days or even weeks. With a more sophisticated, integrated DevSecOps team—where development, security, and operations professionals work together on software development and launch—testing and refinement are automated, and committing code to production

[15] “Enterprise agility: Buzz or business impact?” McKinsey, March 2020.

Exhibit 9

Retail banks' talent needs will shift dramatically from processors to problem solvers.

Composition of workforce, %



[1]Includes loan officer, financial advisor, small-business banker, personal banker, and affluent banker.
[2]Includes database administrator, research analyst, and hardware engineer.
Source: Bureau of Labor Statistics; Finalta; LinkedIn; McKinsey Future of Work banking research, 2020

can be completed in minutes without manual intervention. By building a superior development culture and continually improving its ability to outpace the competition in bringing leading-edge solutions to market, the bank can increase its appeal to top talent.[16]

Today's retail banking market is vastly different in shape and structure from the old environment, where the traditional model of universal banking was economically sound. In the new world, the winning banks will be those which carefully choose the businesses in which they can lead and commit to building a value proposition, core technology, and operating model fit for the digital battlefield.

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[16] Santiago Comella-Dorda, Martin Harrysson, and Shivam Srivastava, "Moving beyond agile to become a software innovator," McKinsey, September 2021.