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The future of banks: A $20 trillion breakup opportunity

Banking is radically transforming. Many banks can thrive by fundamentally changing the way that financial services are embedded into daily life.

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The banking sector is at a turning point. Key measures for banks are at a historical low point. The sector's price-to-book value has fallen to less than one-third the value of other industries. That gap is less the result of current profitability and more about uncertain profit growth in the future. While banks have pushed for great improvements recently, margins are shrinking—down more than 25 percent in the past 15 years and expected to fall to 30 percent, another 20 percent decrease, in the next decade.

Regulation and increasing intersectional competition are still worries, but the bigger threat is a global trend: new challenges—often from different industries and often benefiting from the kind of cross-industry platforms behind the recent success of companies such as Amazon, Google, Microsoft, PayPal, and Spotify—with a vastly superior economic model. The market believes that banks are headed in the wrong direction, without a future-proof strategy.

We believe that the skeptics are right about today—and wrong about tomorrow. Banking is facing a future marked by fundamental restructuring. But we also believe that banks that successfully manage this transition will become bigger and more profitable and grow faster while leading to a value creation opportunity of up to $20 trillion.[1]

In the next era, banks can realign to compete in new arenas, organized around distinct customer needs. These arenas will expand far beyond the current definition of financial services, and they will also be hotly contested by a wide range of tech giants, tech start-ups,

[1] Figure assumes that the sector average multiples' discount to the rest of economy goes back to historical levels, in the 20 to 25 percent range.

and other nonbanks. But this daunting reorganization, or breakup, could also provide banks with a huge opportunity: higher margins, new revenue streams, and loftier valuations. Ambitious banks can break free from stagnant valuations, thrive, and grow if they are willing to embrace the platforms of the future and make a few strategic, informed big bets.

Why break up? First, economic forces and technology have ended the run of the universal-bank model, and investors already are recognizing radical specialization to be greater than the traditional one-stop shop. By contrast, the future model relies on breaking up into four specialized platforms we will describe. Organizing around these areas will be a structural advantage.

In this article, we aim to draw a picture of what the future of banking could look like. We examine the forces currently squeezing bank revenue, value, profits, and usefulness to customers. We identify five distinct areas where banks may well have to transform to thrive.

Of course, we don't know exactly what banks will look like in the future. Regulation, technology, geopolitical shifts, and unforeseen innovations could radically alter the way that the industry develops. But we do believe that the banks that successfully manage the coming transition will use tech and data to embed themselves deeper into customers' lives with real-time services that were unimaginable just a few short years ago. The opportunity is great for those who move fast into this new future.

Banking is losing its traditional advantages

Until recently, big banks drove profits and growth by applying synergies, economies of scale, and access to huge pools of capital. This massive industry already manages an estimated $370 trillion in worldwide assets, and its growth is accelerating. We project that global assets will grow to between $500 trillion and $550 trillion in the next decade.

While traditional banks have been convenient one-stop shops for businesses and consumers, many haven't evolved their products in a way that matches the tech-driven pace of change in other industries. Products such as checking accounts, loans, and even corporate advisory can seem undifferentiated. And people increasingly feel frustrated by the financial fragmentation that banks have imposed on many consumer processes. For instance, buying a home once required navigating a confusing world of disconnected real-estate brokers, mortgage lenders, insurance companies, lawyers, renovation contractors, and so on. Our grandparents tolerated those frustrations, but they also used pay phones. There were no other options. Today, we are awash in new ways to reach and connect with consumers. Banks need to identify and engage these customers—as their newer competitors are doing.

To compete, most banks will have to embrace cross-industrial platforms. These new platforms dismantle the barriers between traditional industries, reshaping customer behavior and turning formerly linear value chains into ecosystems that fulfill customer needs in new ways. The process has already reached critical mass in industries such as healthcare, media, music, and retail, where diverse players are connected by platforms created by global leading companies that have been amply rewarded by the global capital markets. In contrast, banks have been consistently undervalued by the capital markets, making banking the lowest-valued sector in the world in 2021.[2]

Because of cross-industrial "platformization," banks must now compete with any organization that has the capacity and desire to offer any kind of financial services. Global tech giants such as Google and Tencent have used their platforms to offer banking services seamlessly to their millions of customers. But new competition is booming exponentially around the world.

Tech advances have eliminated size as an advantage in providing excellent services, winning customer loyalty, aggregating and analyzing data, and building networks of capital. Roughly 200 digital banks have launched since 2015, as have new brokerages such as Robinhood, wealth-advisory services such as Betterment, alternate investment banking paths such as special-purpose acquisition companies, payment platforms, and start-up capital platforms such as SeedInvest Technology.

The new competitors have raised the bar on customer expectations. Both individual and organizational customers now seek a long list of attributes from their financial-service providers. Surveys show that these desires include high levels of personalization, zero friction, and a commitment to social and environmental impact.[3] The markets believe that the newcomers can meet their customers' demands. As of September 2022, there were at least 274 fintech companies with a unicorn valuation of more than $1 billion, up from just 25 in 2017. Collectively, they have a market value of more than $1 trillion.

Many traditional banks, on the other hand, face stagnant or decreased revenue and profits. The average global banking ROE was around 9.5 percent in 2021—a significant recovery from 6 percent in 2020, but a sharp decline from 15 percent prior to the 2008 crisis. By 2030, we project that it will fall below 7.2 percent.

These falling margins are contributing in turn to weaker stock market valuations. Banking stocks trade at an accelerating discount to other industries—from a 15 percent discount in 2000 to a 70 percent discount in 2022. This means that global investors are voting with trillions of dollars *against* the future profitability and sustainability of the existing business model of universal banks.

Competitive arenas and business models are emerging in banking

The era when all financial services were dominated by monolithic banking entities is over. What, then, will arise to take its place? We believe that the future of banking will be contested by banks and nonbanks in five cross-industry competitive arenas: everyday banking, investment advisory, complex financing, mass wholesale intermediation, and banking as a service (BaaS).

While these arenas encompass the products and services provided by banks today, they will be redefined and reinvented by different customer needs. This new competitive

[2] McKinsey Panorama research; S&P Global.

[3] "The value of getting personalization right—or wrong—is multiplying," McKinsey, November 12, 2021.

landscape has transformative potential. In the next decade, revenues for all these arenas could grow dramatically, by as much as three to 30 times.

In each of the five arenas, we see the potential for at least two platform business models. These ten platforms aren't theoretical models. They are trends that we already see in progress among organizations that are winning better valuations in the capital markets.

Everyday banking

Everyday banking encompasses day-to-day financial services, such as checking and savings accounts, credit cards, personal loans, payment processing, and lines of credit on the traditional-banking side, for individuals and for small and medium-size enterprises (SMEs). This arena will also include e-commerce ecosystems, loyalty programs, discounts, advertising, and peer-to-peer marketplaces—making banking not a chore or obligation but something easy and even enjoyable (see sidebar "A full-fledged e-commerce bank: Kaspi"). For SMEs, it will include tools to help organizations manage their finances.

The common thread of all these services is that customers want them to be hassle free, reliable, highly automated, and inexpensive in their day-to-day life (see sidebar "A multi-pronged approach: Royal Bank of Canada"). The ultimate goal for everyday banking is *invisibility*—offering services that are cheap and easy and accessible through all channels via business models such as the following:

- *Commerce marketplace specialist (CMS).* Specializing as a commerce marketplace offers everyday banking for individuals and many nonbanking services via a marketplace platform (see sidebar "Commerce marketplace specialist: From WeChat to WeBank"). It can be a single access point for anything from consumer goods and electronics to home-cleaning services and movie tickets, all connected to bank accounts, or niche solutions embedded into selected specialized journeys. A CMS uses automation and personalization to make everything simple—online, offline, and eventually in the metaverse. It will have to compete with the generalist and specialist e-commerce platforms of tomorrow.

- *Business gateway provider.* Serving as a gateway provider offers everyday banking for SMEs via an integrated online portal, aggregating services that facilitate payments, cash flow financing, accounting, taxes, and so on. It allows organizations to focus on their core activities by automating many of the basic activities of running a business. A business gateway provider will compete with online accounting platforms, software companies, and even telcos for the small-business service ecosystem.

Investment advisory

Investment advisory is the arena to provide investment and insurance products for all kinds of customers, from young people just starting to build wealth to older people who need sophisticated investments and protection to institutions. This includes financial planning, brokerages, trusts, retirement plans, and many kinds of insurance. People crave tailored advice and trust-based relationships that make them feel understood, even when dealing with virtual advisers online.

A full-fledged e-commerce bank: Kaspi

Kazakhstan's Kaspi is proof that even in a country far from the centers of global finance, it's possible to transform everyday banking. It launched an e-commerce marketplace in 2014 and home-delivery service in 2015. Kaspi has captured roughly half of the nation's online sales in just eight years and has steadily expanded the breadth of its offerings, all tightly integrated. There are four main pillars in its ecosystem: fintech, marketplace, payments, and government services.

Kaspi customers have access to millions of products from more than 400,000 partnering merchants, ranging from low-price clothing and cosmetics to higher-price electronics, furniture, and jewelry. It enables easy, discounted shopping at retailers. Kaspi charges its partners a 5 to 11 percent fee, and its users pay nothing. For frequent purchases, they get cash bonuses deposited directly into their Kaspi accounts—a strong incentive to make Kaspi their primary bank.

Kaspi offers a shopping club, Kaspi Red, whose main component is credit. Financing terms are determined by user activity, including browsing and purchase history. Kaspi's advantage is leveraging proprietary data collected across its ecosystem and applying sophisticated analytics to them. Some credit decisions can be made within ten seconds of a completed application.

Kaspi Pay, its app, enables customers to pay for household needs, make online and in-store purchases, and manage peer-to-peer payments. It bolsters Kaspi's profit margins by removing the intermediaries that previously handled payments for Kaspi. Through launching its own terminals with QR codes, the app has marginalized payment networks in the country and now has around a 70 percent share in transactions and payments. It offers current account and bill payment, including payments for taxes and public utilities. Its peer-to-peer service has drawn many new customers into the Kaspi ecosystem. The platform is growing fast, with the total volume of payments up 111 percent in 2021.

The fintech pillar is the biggest driver of Kaspi's revenue. It applies AI and big data to reduce Kaspi's risks on many kinds of loans, including small-business loans and short-term consumer loans for marketplace customers. Within its fintech area, the most widely used service is to buy now and pay later. Kaspi's fintech portfolio grew 42 percent in 2021, and the related average customer savings rose 34 percent.

Kaspi has been especially effective in integrating its different platforms and services via its Super App, which hosts all services. Kaspi has introduced a travel platform for airline tickets, moved into e-grocery, has strong offerings in government services, and is planning to add hotel and vacation packages. Its strategy as a commerce marketplace strategist is paying off, with total 2021 revenue up 46 percent.

On the business side, this arena comprises the advisory aspects of investment banking and other financial-advice services. The goal for investment advisory is superb *personalization*—blending the human touch with digital efficiency through business models such as the following:

- *Personal wealth and health guardian.* Guarding personal wealth and health means offering investment and personal-protection advice in the broadest sense, including health insurance, virtual care, and life insurance. It features a blend of human experts and highly personalized AI that can guide customers through a broad range of investment and protection options. Imagine a retirement plan, aid in college savings, and protection against surprise medical costs—just a few of the services a guardian provides.

- *B2B advisory boutique.* Serving as a specialist in B2B advising means offering tailored investment advice for corporate customers, with high-level expertise in specialties such as asset management and debt options.

Complex financing

Complex financing is the arena for individual and business services that require more sophistication than everyday banking. Examples include mortgages, home equity loans, car loans, and start-up loans. Such services are complex because many kinds of players are part of each ecosystem.

While familiar, these products and services are used less frequently than others, but they have a big impact on the customer. For instance, getting a mortgage is just one aspect of buying a home, which requires navigating a maze of real-estate brokers, lenders, insurers, attorneys, and other professionals. Consumers crave a trusted expert to help them get through that maze and simplify it, weaving it into a single touchpoint.

The end goal for complex financing is *journey integration*—making these processes convenient, efficient, fast, and low cost yet also as personalized as possible from start to finish via business models such as the following:

- *Real-estate-journey orchestrator.* Serving as an orchestrator of the real-estate journey means handling the complex process of buying, renting, operating, and selling real estate for both individuals and companies and coordinating across mortgages, insurance, utilities, and maintenance with seamless integration. The orchestrator can compete to become the end-to-end "concierge," integrating mortgages or rents and all other services into a subscription model.

- *Equipment and vehicle marketplace specialist.* Specializing in the equipment and vehicle marketplace means providing complex financing of cars, trucks, and industrial equipment for individuals and businesses. It can create marketplaces for these high-price goods and support a customer's journey from selection to financing, insurance, maintenance, and resale.

Mass wholesale intermediation

Mass wholesale intermediation is the corporate-focused arena. It's a combination of expertise and new, efficient systems. It includes corporate finance, cash management,

A multipronged approach:
Royal Bank of Canada

Royal Bank of Canada (RBC), Canada's largest bank, approached the challenge of everyday banking with an entrepreneurial mindset, building several start-ups and exploring partnerships. RBC is committed to having a presence in multiple ecosystems. The bank introduced the following initiatives, among others:

- **RBC Ventures** launched in 2017 as the bank's semi-independent venture capitalist function to find and finance new projects. It had a start-up-like culture and decision-making process separate from the core RBC business. Within two years, it reached 3.2 million Canadians with various value propositions—and prompted tens of thousands to become new RBC banking clients.

- **Ownr**—an end-to-end small-business gateway focused on start-ups—offers, for example, web design, business registration, and banking services on one platform.

- **GarbageDay** is a tool to help residents remember their garbage and recyclable collection days, seasonal tasks, and parking information. Roughly 200,000 Canadians now use it.

- **RBC Rewards** became the top program in Canada, with an app providing personalized offers. It operates now as a marketplace, with merchants not only funding rewards but also paying a markup and using the program as part of their distribution strategy.

- **NOMI,** a free, AI-driven personal financial-management tool, launched in 2017 and is now part of the main RBC app. The product has three differentiating factors: NOMI Find & Save learns transaction patterns and automatically sets aside money (up to CAD $50 per day) for use in the future. NOMI Insights summarizes a user's banking activity, while NOMI Budgets categorizes spending into five categories and compares the user's current spending with benchmarks.

portfolio management, M&A advisory, equity and debt financing, and other traditional investment banking offerings. The ultimate goal for mass wholesale intermediation is *extreme efficiency—and know-how*—which banks can pursue through business models such as the following:

- *Automated trading and funding marketplace.* Serving as an automated marketplace means offering mass wholesale products and services for corporate customers. This model automates large marketplaces of liquid capital via superefficient, frictionless, low-cost platforms, including "tokenization" through smart contracts.

- *Integrated enterprise services platform.* Serving as an integrated platform means offering corporate customers deep integration with enterprise systems such as SAP. The platform can personalize and coordinate services such as accounting, commodity trading, and enterprise resource planning.

Banking as a service

BaaS is the only arena that's not customer facing. BaaS providers create highly efficient tech and infrastructure platforms, which they can license to customer-facing organizations. Some will offer credit to nonfinancial institutions, enabling them to act as banks; and some will bolster the balance sheets of existing financial institutions. The goal for BaaS is *utility*—giving clients robust, secure, and efficient services and liquidity through business models such as the following:

- *BaaS utility provider.* Providing BaaS utilities is the same kind of relationship that an anonymous food company has with companies such as Costco or Target, creating white-label products for retailers to market under their own brands. BaaS can provide regulatory know-how and back-office services, such as customer service, documentation, and HR.

- *BaaS balance sheet provider.* Providing BaaS balance sheets gives both banks and nonbanks access to distinct pools of capital and offers asset liability management and regulatory-required licensing for nonbanks. By bolstering the balance sheets of banks' customers, this kind of BaaS greatly reduces their need to keep raising capital.

An inside look at the biggest arena: Everyday banking

The new arenas will require banks or nonbanks to ramp up their presence on new platforms, create touchpoints with customers, and mine and capture data in new ways. To understand how these concepts will play out, let's examine the biggest arena: everyday banking.

Imagine that a forward-looking bank or a new fintech competitor offers an app we will call "MyLifeAssistant." MyLifeAssistant will take many existing technologies that customers find on their phones—and many still to be developed—and fold them into a single offering that addresses a whole range of users' daily needs. For instance, it might send an alert that today is the birthday of a friend, along with a gift recommendation. Users could order the gift through MyLifeAssistant and arrange for same-day shipping, or they could shop for alternatives.

Commerce marketplace specialist: From WeChat to WeBank

WeBank, owned by the Chinese technology and social-media conglomerate Tencent, is an example of a commerce marketplace specialist (CMS) that leverages the strengths of big tech, especially network effects.

Tencent owns both one of the largest social-media companies and one of the largest video game companies in the world. Its instant-messaging apps WeChat and QQ have about 1.3 billion and 570 million monthly active users, respectively. Tencent is also changing how people access banking through WeBank.

WeBank's strategy is built upon "the three *As*." Its services are easily "accessible" via 24/7 mobile banking. They are "affordable" enough to appeal to underbanked demographics. It uses big data to target "appropriate" products and services for different customers and reduce risks to the bank. WeBank leverages the gigantic customer base and data from the Tencent ecosystem.

WeBank offers preapproved loans to qualifying users of QQ and WeChat, based on proprietary credit scores generated from Tencent data. The bank's algorithm draws a customer portrait by analyzing many kinds of customer behaviors—what and how much a user buys, what games they play, whom they interact with on QQ and WeChat, and more—up to 200 different variables per customer. As a result, its non-performing loan (NPL) ratio was just 1.2 percent in 2021, significantly lower than the average NPL level for unsecured retail loans.

This platform-centric approach to banking enables WeBank to offer various types of loans to prospective customers from the Tencent ecosystem, supported by its partner bank network. WeBank evaluates loan risk via its advanced risk model and then sells the vetted loans to partner banks that participate in its platform for a small fee. For investing, customers can also purchase mutual funds, money market funds, or other investment products offered by various financial institutions via WeBank's marketplace.

To further enhance the efficiency of the giant platform, WeBank is committed to investing more than 10 percent of its annual revenue in top-notch IT infrastructure every year. These investments have already paid off massively: WeBank's IT cost is now only one-tenth that of other leading banks in China to achieve the same level of transaction capability.

As a result, WeBank's growth is remarkable: a 36 percent rise in revenue and 39 percent jump in profit in 2021.

Later in the day, when a user visits a local café, MyLifeAssistant might preselect their favorite coffee or lunch, giving them one-tap access to their favorite repast—with discounts and rewards. In fact, MyLifeAssistant is so easy to use that customers use it for investing, planning, shopping, socializing, and more throughout the day. As a customer keeps using MyLifeAssistant for more kinds of shopping and services, the app increasingly knows their friends, how their money is spent, and what they do in their free time. It will also follow them into the metaverse or virtual reality.

Of course, MyLifeAssistant is far more than just a simple app. In fact, MyLifeAssistant is the front-end evidence that the institution that created the app has decided to compete aggressively as a CMS. Behind the scenes, while coordinating all this activity, MyLifeAssistant is constantly adding to its database so that it can improve its future predictions via advanced analytical models.

The more appealing the app's personalized recommendations become, the more money its users will save via discounts and loyalty programs—and the more commissions the bank will earn from its vendor partners. Everyone involved benefits from MyLifeAssistant's constantly improving analytics and its ability to automate customer experiences. The more invisible and embedded its services become, the happier its customers.

There are limits. MyLifeAssistant and its parent have strong incentives not to take advantage of their customers. The more partnerships and personalized services that they offer to both individuals and businesses, the more that everyone involved benefits. The key to the parent institution's competitiveness and profitability is constantly upgrading its data analytics to improve convenience, customer care, and hypertargeted offerings—without attempting to overcharge or exploit its customers.

By processing both e-commerce and consumer finance transactions (including peer-to-peer payments, car loans, credit cards, and so on), a CMS can begin to predict what customers want even before those desires become conscious. Banks can also sharply reduce their own risks because they will know each customer's creditworthiness better than most credit rating agencies do.

Again, MyLifeAssistant isn't a banking app. It's a core component of being a CMS. It goes far beyond everyday banking services to offer tight integration with e-commerce journeys. It can serve as the hub of an ecosystem that blends banking with shopping and other highly personalized services.

A thriving CMS will offer more than mere personalization, simplicity, and affordability. It will go all the way to *invisibility*. CMSs will have more access to their customers and much more data about those customers than traditional banks have ever had. Because they will become primary touchpoints for a wide range of transactions, they can build an unbeatable edge in collecting and analyzing big data.

Excelling at this transition will require banks to look beyond their traditional metrics of success, such as margins and risk costs. They will need to focus more on performance indicators used by leading e-commerce players, such as the number of customer touchpoints and time of engagement. This business model has enormous economic upside. Any bank that successfully transitions into a CMS can multiply revenues by ten, with higher profit margins for higher-value services.

The impact of data and money regulation around the world is uncertain

The kind of transformations and competition that we have examined in everyday banking are sure to take place in each of the other four arenas. But predicting the winners, as well as how long it will take them to get there, in different countries is extremely difficult. That's because it's hard to say how digital currencies and data will be regulated in the future, especially in a world where countries and regions have such differing approaches to regulation.

It's possible that, over the next decade, customer data will become the new oil—highly regulated, jealously guarded by institutions that capture it, and a key source of business value. A more likely scenario is that customer data will become the new water—a public utility accessible to all and therefore much lower in value.

And while the advance of digital currencies is unstoppable, its regulatory future is similarly unclear. A decade from now, cryptocurrencies, easily exchanged via blockchain and other tech, might be well established as mainstream alternatives to central-bank currencies. Digital currencies might then be far more convenient for all kinds of transactions and deposits, potentially removing a main function and competitive advantage of banks. On the other hand, there might well be a regulatory backlash against cryptocurrencies, with developed nations cracking down on its misuse for illegal activities or financial warfare.

The landscape of currency could fall anywhere on a spectrum between wide open and tightly closed. However, none of the scenarios would stop what's certain to be the breakup of traditional banking. Rather, they would likely determine the shape of the industry and the winning players. If digital currencies become commonplace, banks face a tougher road. If currency isn't a factor, data take center stage and create a more even playing field.

Making things even more uncertain is the fact that banking is a "multilocal" rather than a truly global business. Banking experience and regulation differ greatly by region. The average American still uses checks and spends weeks getting a mortgage. The average Dutch citizen pays every bill from a smartphone, opens new bank accounts online, and gets approved for a mortgage in a few days. Regional rules shape what banks can and can't do.

The next phase of banking for incumbents, challengers, and the rest of us

The successful bank of the future will be defined as a network of platforms. Few banks will capture all of the ten platform opportunities described in this article in their regions, but many will participate in multiple platforms. Given the platforms' enormous value creation scale, getting even one right can unlock tremendous value for shareholders and broader stakeholders alike. But success will come to only those banks willing to move beyond their traditional operating models. Banks should be prepared to evolve through multiple stages on their way to becoming a platform network.

This vision of the coming shakeout may seem daunting. But the challenges are manageable taken one step at a time. The first and most important step is to commit to adapting as soon as possible. Banks and nonbanks that begin to transform themselves now will have a huge advantage over competitors that become paralyzed with indecision and confusion.

The good news is that there's still enough time for most financial institutions to transform their business models. Additionally, the capital markets are likely to be very supportive in valuing those transformations over the next five to ten years.

For incumbent, universal banks, the key steps will look something like the following:

1. Decide which arenas and business models to focus on, based on your strengths.

2. Start to align your organizational resources—especially tech talent—for the coming shifts.

3. Start to develop and test your platform business models.

4. Redefine your purpose (including your environmental, social, and governance impact) to build stronger bonds with your customers and talent.

5. Build a more entrepreneurial culture by protecting your experimental projects from conservative pressures within the organization—and give management incentive to succeed.

For challengers looking to exploit a tech edge as a way of entering banking, the first step is to analyze which arenas offer maximum advantage based on that edge and which platform-based business model makes most sense. These organizations will have the advantage of not being tied to the old standards and practices of traditional financial services. But they need to be mindful that this advantage doesn't guarantee success, even for companies with cutting-edge innovations.

To be clear, this transformation will take time, but leaders who move fast, stay ahead of the curve, and remain patient can break out of today's stagnant growth trajectory and put themselves on a strong valuation path. Many banks already are moving forward and getting recognition from the market. We believe that as more and more banks embrace this kind of transformation, the market will see the change, recognize the increasing potential, and view the industry as one with a bright future.

Ultimately, whether you are the leader of a company that depends on banking or a consumer hoping to enjoy better customer service in your life, there is a lot to look forward to. The new era of banking will arrive after a period of complex, confusing evolution, but it will ultimately raise the quality of life for anyone who interacts with any kind of financial services, including customers, employees, shareholders, and regulators—which, of course, is everyone. Q

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