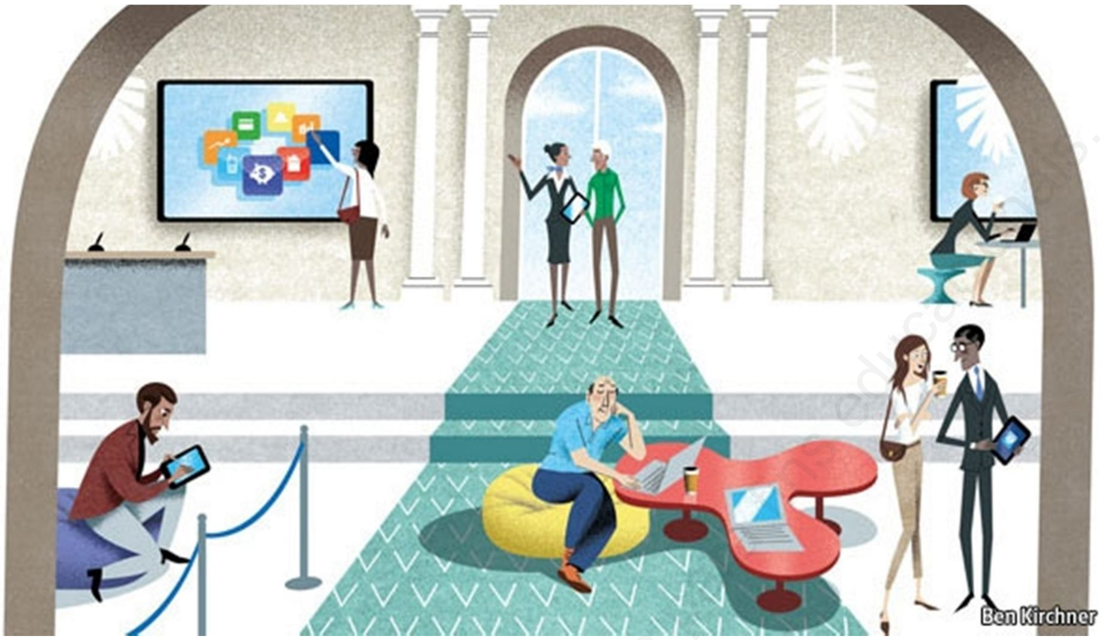
Retail renaissance

The internet and mobile phones are at long last turning boring old retail banking into an exciting industry, says Jonathan Rosenthal



"If your bank could start over, this is what it would be," trumpeted the marketing campaign for the launch in 1999 of Wingspan, an internet bank. The following year the bank was gone. In September 2000, a few months after the dotcom bubble burst, it was absorbed by its boring American bricks-and-mortar parent, Bank One (now part of JPMorgan).

For all the high hopes that the internet would transform banking, most other internet banks launched around that time met with a similar fate. Citi f/i, an online bank started by Citigroup, was folded back into its parent in 2000. NetBank, an American pioneer of internet banking, soldiered on for longer than most but was shut down by banking regulators in 2007. On the other side of the Atlantic, Egg, Britain's first stand-alone internet bank, shook the market in 1999-2000 when it gained more than 2m customers within months of starting up. But within a few years it, too, had in effect disappeared, its customers having been sold first to Citigroup and then to Barclays and the Yorkshire Building Society. It was an ignominious end to a bold experiment in online banking that had caused palms to sweat in banking centres around the world.

The promise of internet banking had seemed obvious. More than most other industries, banking was already largely digitised. In most rich countries the cash that people carry in their wallets represents only a tiny fraction of their assets and is used for only a small portion of their spending. The rest exists only in the pattern of magnetic charges and flickering electronic impulses of banks' data centres.

Moreover, banking is something few people enjoy. If offered an alternative to queuing up in a branch to get served, surely customers would take it up avidly? After all, large numbers of bookshops and music stores have already closed as people have taken to buying online, even though browsing in such places was rather fun. Going to the bank is not much fun. All the more reason to do your banking from your armchair.

Yet, except in a very few rich countries, there are 10-20% more banks today on main streets the world over than there were a decade ago. Instead of superseding banks, the internet has simply made them a little more convenient. Conventional banks have added internet banking, mobile banking and even video banking to their offering. Yet all the while they have expanded their branch networks.

In retrospect, the years in the run-up to the financial crisis were a golden age for banks. Even the dullest of them could earn high returns by taking big risks. And few really bothered to try to cut costs when their revenues were being massively boosted by a debt-fuelled bubble. Since the mid-1990s Europe's big retail banks have managed to cut their costs relative to income by an average of just 0.3% a year, reckons Simon Samuels, an investment analyst at Barclays. Yet even that modest figure flatters the banks. He calculates that costs over the period increased by an average of 8% a year. The only thing that saved them was that revenues increased a little faster.

The effect of the debt bubble was more insidious than it appeared at first glance. In encouraging universal banks to build up their investment side, and some retail banks to dabble in exotic instruments that they did not always understand (demonstrating that even boring retail banks can blow up), it made them take their eyes off their bread-and-butter business. Yet basic retail banking was, and remains, their main engine of profitability. McKinsey, a consulting firm, reckons that it accounts for more than half banks' worldwide annual revenue, which in 2010 amounted to $3.4 trillion (see chart). It has also proved, in the longer run, to be the most reliable generator of consistent profits and high returns on equity. A ranking of the world's biggest banks by return on equity correlates closely with the proportion of revenue they make from retail banking, rather than from racier investment banking.

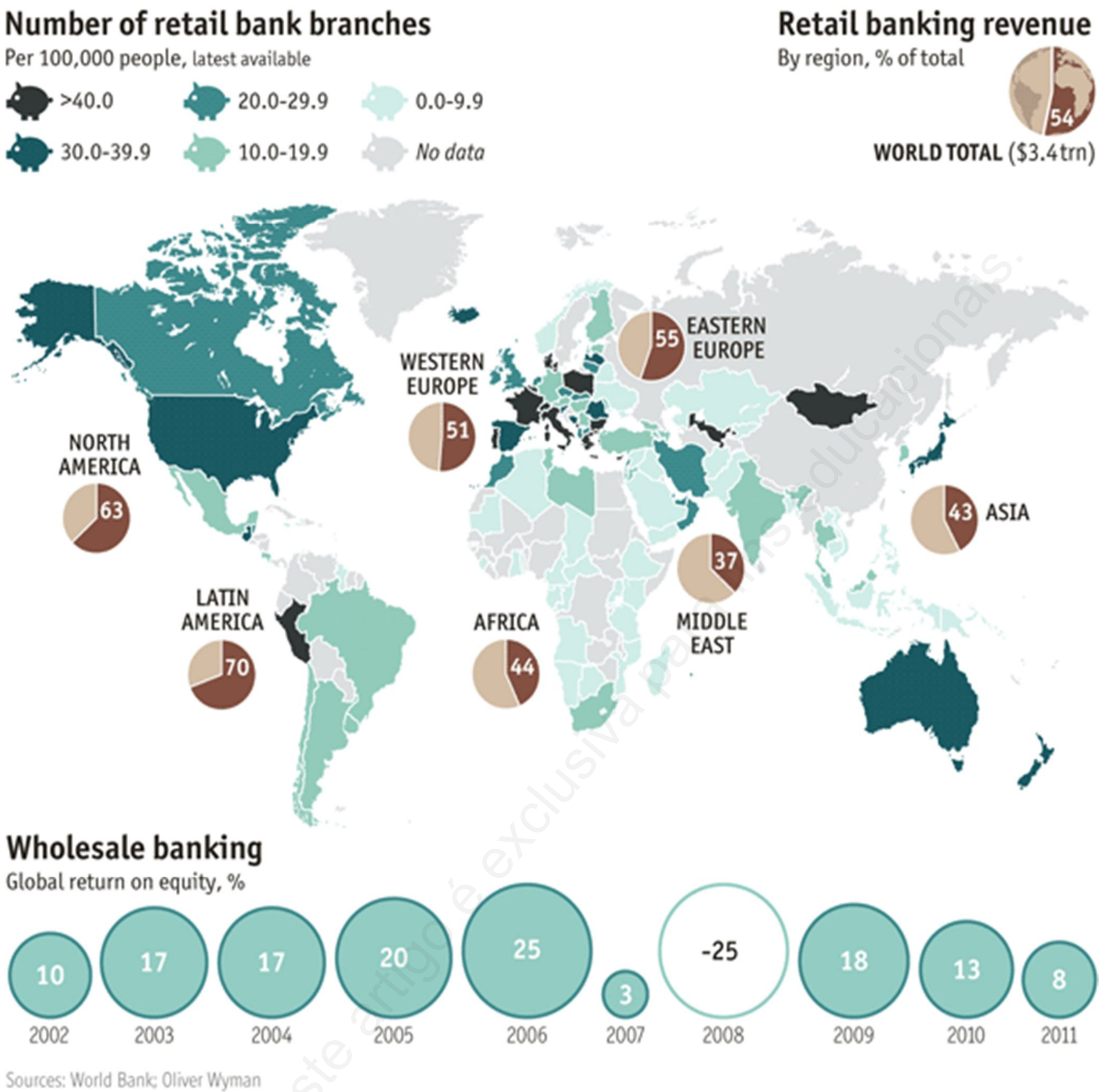
During the bubble years retail banking was a dead end for ambitious managers. Pay was higher at investment banks, and the corner offices at universal banks would go to executives who had climbed up the ranks of the investment banks. But recently retail banking has been getting a lot more attention, for several reasons. The first is that it needs it. In the rich world the bursting of the debt bubble, slowing economies and low interest rates have changed the economics of the business. Banks are now having to put their best talent to work at the retail end to reduce costs and restore profitability.

Second, technology is changing fast. Smart mobile phones are encouraging customers to interact with their banks in new ways. Technology also promises fundamentally to alter the economics of low-margin banking staples such as processing payments. With new tools to store and crunch massive amounts of data, banks and technology firms such as Google and PayPal hope to transform the business of swiping a credit card. Rather than merely generating an instruction to move money that might be worth a few small coins, the information that comes with such a payment might open up new sales and advertising opportunities that could we worth hundreds of times as much.

Money is special

This report will argue that retail banking is going to be the most exciting part of the banking business over the coming years. Yet unlike the bricks-and-mortar bookshops, travel agents and record stores that have been swept away by the internet, banks have two enormous advantages in adapting to change and adopting new technologies. The first is that in the minds of consumers, money is still special. Few customers like to switch banks, even if they are unhappy with their own, and even fewer seem ready to trust one without a physical presence. That is changing with time, but slowly enough to allow banks to adjust.

The second is that, in a sense, banks are technology companies. Many have hundreds, if not thousands, of people working in huge information-technology departments. Most are ready to adopt new ways of serving their customers. The most obvious sign of this is the changing nature of bank branches.



Fonte: The Economist, London, v. 403, n. 8785, p. 3-4, 19-25 May 2012.