

HONEY, I SHRANK THE BANK....

November 2011

How are the mighty fallen!

From dreams of global dominance to backyard only.....From “universal banking” to “stick to your knitting”.....

As the ambitions fade, so does the rhetoric. The talk today is about “core banking”, “a retreat to reality”. In parallel with the narrower vision, there’s a drive to sell off precisely the business units that once were ballyhooed as being the base for a new empire.

Every day, there’s more evidence: many banks are scaling down

Over the past few weeks alone, we’ve seen

- ING transfer ING Direct, America’s largest stand-alone internet bank, to Capital One for \$9 billion
- HSBC sell off its \$30 billion US card book to Capital One, its upstate New York branches to First Niagara, and its Russian retail business to Citigroup
- Bank of America sell its Canada consumer cards business to TD, and put its UK MBNA operation on the block
- PNC of Pittsburgh pay less than tangible book value to Royal Bank of Canada for 420 branches in the South Eastern US
- Barclays’ decision to quit retail banking in Russia
- The dismemberment of Dexia

These decisions affect people: by late August, global banks had announced close to 50,000 job cuts in recent months, with some expected to extend into 2012. Worrying enough: then came the news that BoA, hard hit by \$1 trillion of problem mortgages associated with its disastrous acquisition of Countrywide, plans to lose 30,000 staff over the next few years. Even the mighty Santander is rumoured to have put its UK business on the block.

Question: what is the rationale for these divestitures? Clearly, very many banks need to rebuild their capital ratios to meet tougher Basel III requirements: given a choice between reducing assets or raising equity, it seems that the majority are going for the first alternative.

But apart from repairing damaged balance sheets, there’s also a hunger to restore profitability to pre-crash levels.

We have to ask how realistic a goal this is. Banks’ historic profitability was based on generous spreads, a plentiful supply of wholesale funds, unprecedentedly high consumer borrowing, and a voracious appetite for fees and charges.

All now gone.

And, to the accompaniment of outrage from bankers who have been happy to pocket the profits while nationalising the losses, politicians around the world are busily planning yet more new taxes and constraints for the industry.

Leaving aside the more extreme postures from both sides of the regulatory divide, there's still a practical question: what are banks to do?

Apart from selling off non-core assets, the answer that always appeals to embattled CEOs is, Cut Costs. We've already mentioned the staff cutbacks. But cost reduction could well go further, affecting product content. As often, we can see the first movements in the US: Wells Fargo is only the latest issuer to cancel its debit rewards programme.

In a variant in the same theme, bankers are very seriously considering charging for what previously has been provided free. In the UK, Barclays are withdrawing off-us ATM facilities from their basic debit card holders. Again in the US, BoA plans to hit many customers with a \$5 monthly fee for its debit card. Starting in December, Citi will charge up to \$20 a month for a range of checking accounts unless customers start keeping higher balances.

*Fire sales, cost cutting – now
product content is suffering*

Meantime, those who had hopes that new entrants to banking would transform competition in the industry are finding that the wait may be longer than they expected. Tesco Bank continues to underline its plans to launch full retail financial services, but the date keeps slipping: start-up for a current account is now slated for some time in 2012. One major problem faced by Tesco, Metro Bank, NBNK, Virgin Money and others who headline their ambitions to break the mould is that the cornerstone of retail banking in the UK is the fee-free current account: that's an expensive proposition to match.

Across the Atlantic, some had predicted a banking revolution led by mega-retailer Walmart. And in fact the company has just announced a further expansion of its check-cashing service at more than 650 stores throughout the US. But it still won't cash personal checks, and although it has gained full banking licenses in Canada and Mexico, has yet to convince the American authorities of its case.

So maybe we shouldn't expect too much too soon from new competitors.

Fire sales, cost cutting, new charges: no doubt, much of this activity from existing banks is justifiable. But are these negatives really the best we should expect from an industry under siege? Are there truly no ways to build revenues?

In fact, there are. And, all praise to them, some institutions are vigorously taking up the challenge.

- In retail banking, consider the case of TD. This Canadian institution is doing an outstanding job of attracting retail deposits in the NE US by focussing on outstanding customer service.

- In the UK, Capital One has announced its commitment to competitive card issuing by launching a cashback card carrying an eye-popping start rate of 5% return.
- In mobile banking, American Express is setting a formidable pace in its efforts to lead the payments industry into the digital century.
- In the US, Citi has launched an aggressive credit card mail campaign, dropping nearly 350 million pieces in Q3. Intriguingly, this initiative accounted for 33% of offers sent to borrowers with FICO scores under 660 in the period.
- Overall, according to Equifax, by the end of June US banks had issued 5.4 million new credit cards to subprime borrowers, up 64% from a year earlier.

There's a pattern here: in each case, the institution concerned has identified what it feels is a vacuum – a market segment that is currently underserved and open to leadership.

Here are some more open questions for banks to ponder:

- Consumers need a convenient payment mechanism: it's less and less clear that bank cards are the only solution. What should replace them?
- Many banks have to build profits and deposits: what is the best CRM strategy to achieve this?
- In developing markets, how should banks build products and communications to reach out to the emerging middle class?

Bold institutions see this as a great moment to build their business

- The pace of change in personal technology is relentless: will it replace bank branch networks or complement them?

So, there is a choice to be made: think negative (and take the risks: BoA's debit card charge has prompted denunciation from President Obama on down), or seize the opportunity?

STOP PRESS

In an unprecedented PR debacle, Bank of America, Regions Bank and Sun Trust have bowed to a storm of public criticism and backed down on their plans to introduce fees for using debit cards. Shame they didn't apply their energies to building a product that customers would willingly pay for.