Covid-19 will intensify the battle of the banks

By Victor Mupunga

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The battle of the banks will intensify in the wake of Covid-19, as both legacy and challenger financial institutions race to use tech innovation to gain a competitive advantage in 2020/2021.

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To some extent, history may be repeating itself, as the financial pressure exerted by the pandemic forces bank management teams to pursue cost discipline while attempting to meet ever expanding customer expectations. As in 2008 following the global financial crisis, all banks will feel the pressure as a result of Covid-19. They will be negatively impacted by the drop in the interest rates and declining business and consumer economic prospects. However, innovative banks that can harness their ability to use technology to cut costs and meet customers' changing needs are likely to navigate the current crisis much better.

Banks already spend more than most industries on technology. Take the US for example where over the last few years, banks have been spending around $150bn a year on technology. The cost savings in doing so are significant - it costs Bank of America about $5 to process a cheque within a physical branch, $0.50 at an ATM and $0.05 via a mobile app.

Increased IT expenditure

The Covid-19 pandemic may favour legacy banks with deep pockets and more substantial cash reserves to invest in technology. Locally, each of the big four banks (FirstRand, Standard Bank, Absa and Nedbank) have steadily increased their annual IT expenditure over the last five years, with IT now making up an average of 21% of total expenses versus the global average of 18.

While a portion of this expenditure is to maintain the banks' current IT systems, a growing share is to better position them against the fierce competition that has emerged from challenger banks. On the other hand, analysts have predicted that the Covid-19 pandemic will change consumer behaviour in profound ways. "Challenger banks have been known for their lean business models and agility to respond to customer needs.

While these banks don't generally offer the full range of complex products provided by traditional incumbents, their ability to address consumers' precise pain points has led to them rapidly gaining customers globally.

Despite the commendable exploits of legacy banks, there may be a limit to how much these financial institutions can do relative to new entrants. The critical inhibitor is often their core banking technology infrastructure, which was built decades ago and tends to operate in product silos. Often, making core system overhauls, which are easy for challenger banks, is too risky, too expensive and almost impossible without any downtime. Because of this, most legacy banks will have to be content with gradual improvements to their clients' digital experience.

Too many new banks

However, that the sheer number of challenger banks in the market also presents a problem for the sector. I would say that globally there are probably too many new banks coming into the market and there isn't enough space for all of them, even before the pandemic unfolded.

A decade ago, global banks were solely focused on how they would recover from the 2008 global financial crisis. Today, they compete against new entrants and need to innovate their legacy businesses to meet their customers' ever-changing needs.

While reducing costs to streamline operations is always laudable, the old adage you can't cost-cut your way to prosperity comes to mind. Innovative banks that strategically position their business models to compete with both legacy and challenger bank will be the winners over the next decade.

ABOUT THE AUTHOR

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