



Banks: road to *Exponential*

Capacity for Change as the key boost
towards superior performances

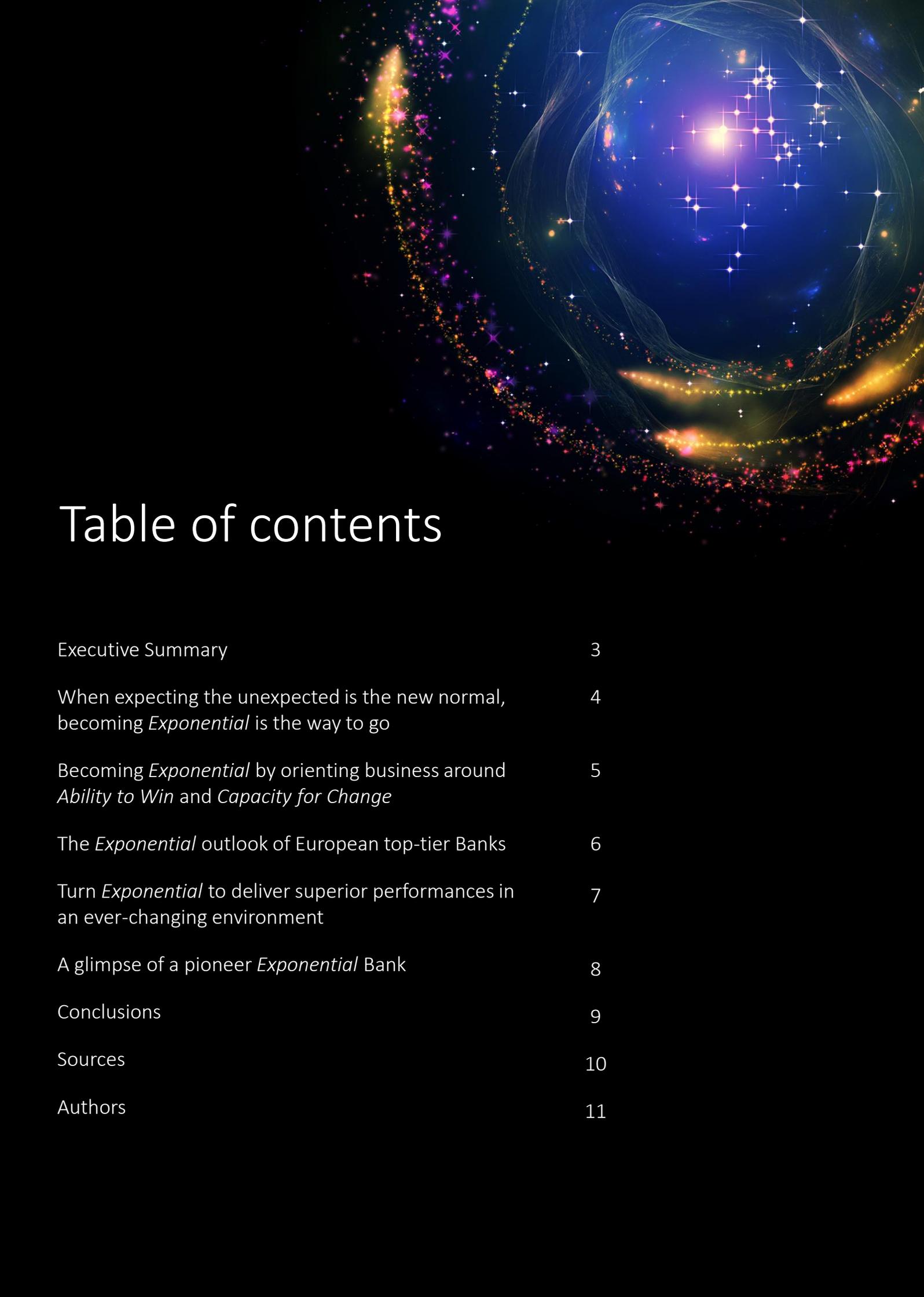


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Executive Summary



The world is changing – fast. We live and operate in a constant state of **relentless uncertainty, volatility and disruption**. When change is the only constant, it is **survival of the fittest and the triumph of the agilest**.

At first, enterprises reacted to these disruptive events by entering in “survival” mode, but it is now clear that surviving the crisis is no longer the answer. Enterprises need to find a way to **adapt and stay ahead of time**. As the philosopher Eric Hoffer observed, *“the only way to predict the future is to shape it.”*

In this context, a recent study from Monitor Deloitte US has found that the answer lies in a redesigned **Exponential enterprise** [1]. A new paradigm in which organizations define their businesses around two dimensions: **Ability to Win** and **Capacity for Change**. The first - **strategic positioning** - comprises the few and only distinctive factors enabling the business to win the competition in the market/ segment in which it deliberately decided to play, the latter – **strategic activation** - provides the foundation for the enterprise to adapt continuously and advantageously in the face of change and emergent context.

Taking off from the outcomes of this study, we wanted to narrow the focus of **Exponential** in the **banking industry**, which now finds itself in the make-or-break momentum to transform.

To achieve this objective, we have investigated a **panel of top-tier European Universal Banks** to evaluate their performances across the eight underlying drivers of the **Ability to Win** and **Capacity for Change**, adequately tailored to fit the peculiarities of the banking industry.

The research found that **Exponential banks**, those with top performances across all drivers of both dimensions, are **more profitable** and **cost efficient** than peers: on average they achieved **3p.p higher RoTe** and **13p.p. lower cost/income**.

This result clearly shows that banking players have an **opportunity to improve their profitability and cost efficiency** by undertaking a **transformation program** aimed at fortifying their **Ability to Win** through their **Capacity for Change**. In fact, what the US research has found, and our study confirmed, is that **Capacity for Change** is **catalyst for boosting the Ability to Win**: investing in the first is **4 times more effective**, in terms of value premium gains, than investing in the latter. This means that banks can follow a **linear path to Exponential** by focusing on **Capacity for Change**.

Moreover, non-exponential banks now have a clear advantage compared to pioneers in the industry: they can **accelerate their transition to Exponential** by adapting successful initiatives undertaken by first-movers.

The message is clear: banks are in the ultimate momentum to scale **transformation programs**. And they should act by following a **linear and accelerated path along the Capacity for Change**. The secret ingredient in the recipe on how to stay competitive in the market for the long term.

When expecting the unexpected is the new normal, becoming Exponential is the way to go

The **21st century has imposed new challenges on enterprises**, on their leaders and - more broadly - on their entire business ecosystem. Among these, the ability to operate through more **uncertainty, volatility and disruption** that constantly re-design the “borders” of the playing field. **The rules of the game have changed**, and enterprises must understand how to play, and how to win in this new arena.

| UNCERTAINTY | VOLATILITY | DISRUPTION |
|---|--|--|
| 3x | 18 years | 60% |
| Global uncertainty has tripled in the last 60 years | Lifespan of corporates from 33Y in '65 to 18Y today | of CEOs believe disruptions will repeat in the near future |

In the last couple of years, **global uncertainty has surged to a record high**, tripling from the average level of the last 60 years [2]. Perhaps sensing the years coming up, on January 2020 Kristalina Georgieva, the Managing Director of the International Monetary Fund, noted “If I had to identify a theme at the outset of the new decade it would be **increasing uncertainty**”.

Moreover, CXOs are more and more aware **that being successful today is no longer a guarantee for tomorrow**. With a steady churn rate of companies disappearing as new entrants join the ecosystem, **corporate lifespans continue their downward trajectory**: the average lifespan of companies listed in S&P’s 500 was 33 years in 1965. Today, it is less than 18 years. **By 2026, the average tenure is forecast to be 14 years** [3].

Businesses around the world are aware of the urgent need to re-invent themselves for the “New Normal”. With **76%** of executives being **pessimistic about global economic outlook** [4] and **expecting disruptions** as those seen in the last few years to **repeat in the future** [5], it has become clear that this “**New Normal**” is not the next *status quo*, but rather a **perpetual condition of change**. The two latest crises we were confronted with, the Covid-19 pandemic and the Ukraine War, although very different in nature, had a similar impact on businesses, forcing enterprises and their leaders to **shift overnight from business-as-usual to a very different reality**.

When **change is the only constant**, leaders should develop the ability to **operate more ambidextrously**, balancing the need to protect their operations and grow their Core businesses while making foundational investments to seed long-term growth [6]. It means that they need to **become Exponential** by adopting an “**always-on**” transformation strategy.

After Covid we are more resilient and optimistic regarding our ability to navigate through disruption. Two out of three executives, although being very pessimistic towards the future of global economy, are **relatively confident about the performance outlook** of their organizations, confiding in their ability to adapt to unfavorable circumstances [7].

“In an ever-changing world, leaders need become Exponential by adopting an “always-on” transformation strategy”

Chart 1 | Global Uncertainty Index 1990 – 2022¹



The two latest crises although **very different in nature**, had a similar impact on businesses, forcing enterprises to **shift overnight from business-as-usual to a very different reality**

¹ The World Uncertainty Index (International Monetary Fund) is a measure that tracks uncertainty across the globe by text mining the country reports of the Economist Intelligence to capture uncertainty related to economic and political events, regarding both near-term and long-term concerns

Becoming *Exponential* by orienting business around *Ability to Win* and *Capacity for Change*

In this ever-changing environment, **competitive edge becomes more difficult to create and preserve**. During the crisis, many companies have applied a shorter-term, more tactical lens to strategic planning, mistakenly believing this would make them nimbler. In reality, it emerged clearly that to become truly adaptable and resilient, enterprises need to take a step-back, refocus on their purpose [7], and **rethink the way they do business and operate** becoming *Exponential* by orienting their business around two essential dimensions: *Ability to Win* and *Capacity for Change*.

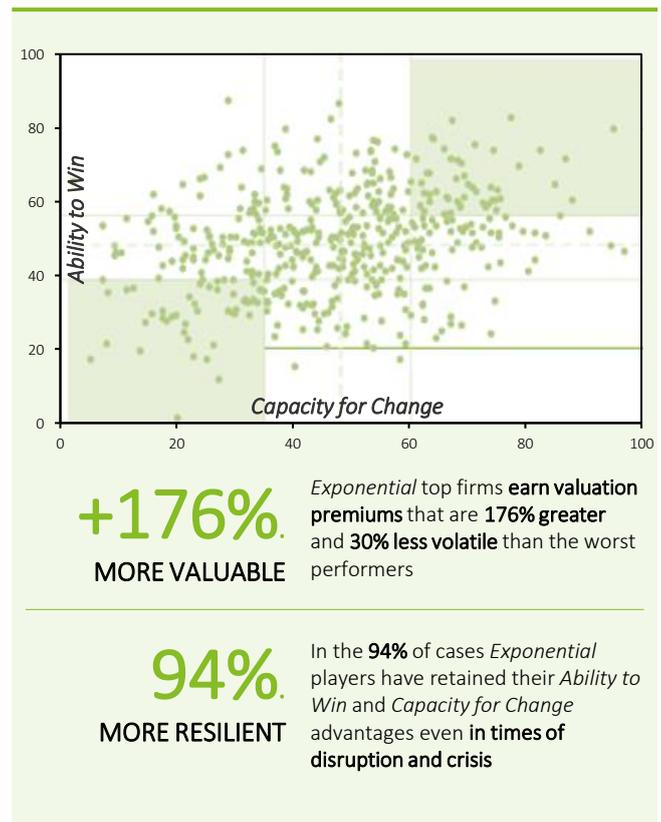
Ability to Win comprises the **few and only factors** the business needs to **sustain a distinctive strategic positioning** in the market.

Capacity for Change provides the foundation for the enterprise to **adapt continuously and advantageously** in the face of change.

These are independently valuable dimensions, but **neither is ultimately sufficient**: enterprises **that fortify their *Ability to Win* through their *Capacity for Change*** are better positioned to create value and see higher gains in performance and valuation, especially during periods of adverse market conditions.

Monitor Deloitte [1] recently conducted a research on a panel of 500 large-cap US firms **across industries** aimed at assessing how *Exponential* enterprises — those that rank highly on both *Ability to Win* and *Capacity for Change* — performed relative to others in their industry. The study found that *Exponential* firms benefit from **higher and more stable shareholder valuations** and **more consistent financial performance**, allowing them to attract more capital and talent by signaling an ability to create **durable competitive advantage**.

Chart 2 | Monitor Deloitte US Research on *Exponential*



Banking Players now find themselves in the make-or-break moment to transform towards *Exponential*

Among other industries, **banking** is undoubtedly in the **make-or-break moment to orchestrate change at scale** and become *Exponential*.

- The pandemic was the ultimate gut punch, testing banks' resilience in unforeseen ways: FS executives agree that **lack of adaptiveness is the most urgent challenge they'll have to face in the upcoming years**. Arguably, this shock was what the industry needed to give rise to an urge for change and transformation.
- The global **financial system is being re-configured by tectonic shifts** that can either turn into deal-breakers or game-changers depending on players' ability to become *Exponential*. Systemic

risks, talent shortage, technology disruptions... these are only few of the challenges banks are getting ready for.

- From the analysis of the strategic plans that firms have elaborated for the upcoming years, it seems like **the call for action has been answered** with sense of urgency: driving transformation for a more dynamic and uncertain future is the *file rouge* upon which strategies of banking leaders are being re-defined.

But **the window for decisive action is closing soon**. Either they start their transition to *Exponential* today, or they will likely find themselves unable to successfully compete in the market.

The *Exponential* outlook of European top-tier Banks

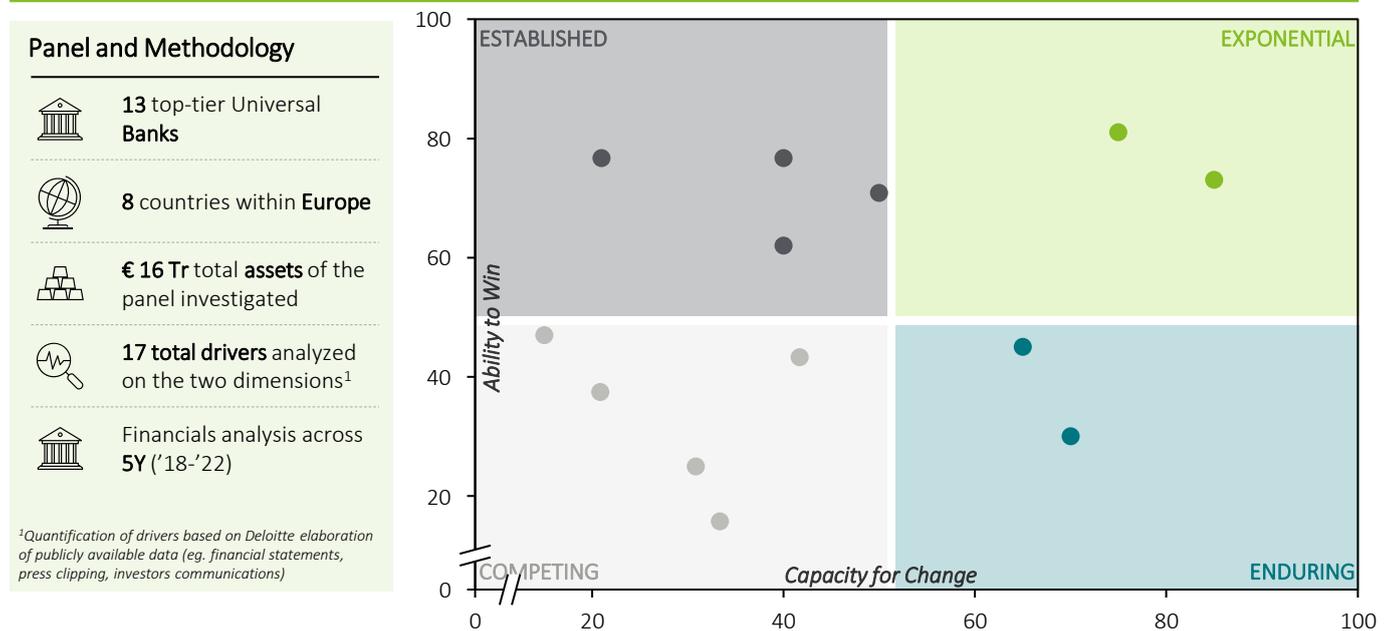
The research conducted by Monitor Deloitte US, gave rise to two key questions: what does it mean to be **Exponential in the banking Industry?** and how are Europe-based **banking firms positioned** within the *Exponential Enterprise* framework?

To provide a meaningful answer to these questions, we carried out an industry-focused benchmark on a **panel of 13 top-tier European Universal Banks**. The study aimed at assessing the performances of firms along **Ability to Win** and **Capacity for Change**, by investigating a set of key drivers tailored to account for the **peculiarities of the banking industry** (focus below).

The analysis, based on both **financial and nonfinancial parameters**, found that:

- only **two banks** fall within the *Exponential cluster* - less than the 16% of the panel;
- European banks are generally **better positioned along the Ability to Win**, with almost half of the firms ranking above the panel average of 52,6 points out of 100;
- **Less than one third** of the panel has a performance of at least **50 points out of 100** along the *Capacity for Change*, falling within the Established and Competing clusters.

Chart 3 | Exponential Index of EU top-tier Banking Players



Focus on the underlying drivers of Ability to Win and Capacity for Change in the Banking Industry

ABILITY TO WIN | *Strategic Positioning*

- **Long-term ambition** | a clear **strategic vision** enabling the bank to maintain a **coherent footprint** while capturing **new market opportunities** (eg. payments, Open Banking...).
- **Resonant Purpose** | strong **values and mission** (eg. be a real-economy bank) that are **strongly recognized** by internal and external stakeholders.
- **Stakeholders** | commitment in generating, through the bank's activity, **shared value among all stakeholders** (eg. shareholders, employees, partner, community...).
- **Innovation** | business model strongly imprinted around **innovative services, products and operating models** using technology as a core pillar to **explore and address new needs**

CAPACITY FOR CHANGE | *Strategic Activation*

- **Strategic nimbleness** | a **flat organizational** model and **lean processes** fit for **fast decision making** while ensuring **resilience** of operations and adherence to **compliance** requirements.
- **Operational scalability** | next-gen and **zero-legacy** architectural and infrastructure models **facilitating integration** with third parties (eg. API based infra) and **lowering cost-base**.
- **Organizational optionality** | flexible operating models based on **open collaboration** among **internal resources** (eg. cross-functional teams) and within the **ecosystem of partners and fintechs**.
- **Performance stability** | resilient bank able to meet its **performance objectives** also under adverse / unpredicted circumstances (eg. stable / improving RoTE).

Turn *Exponential* to deliver superior performances in an ever-changing environment

1. Exponential

Banks stand apart from industry competitors by sustaining a superior *Ability to Win* and *Capacity for Change*. These players started their transformation long before the pandemic, establishing themselves as European pioneers of *Exponential* paradigm. In turn, they now secure **more profitable** and **cost efficient** businesses, with **RoTE** that is, on average, **3p.p. higher** and **cost/income 20p.p. lower**.

47%
Cost / income

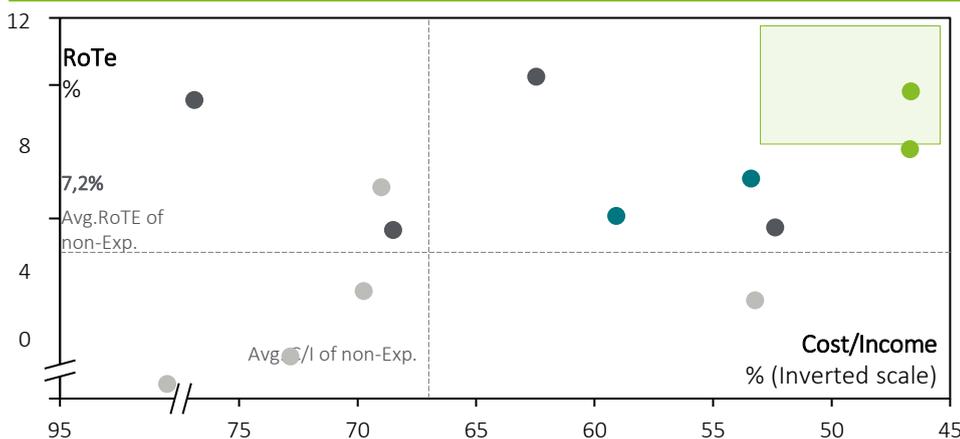
10%
RoTE

From the *Ability to Win* point of view, these players distinguish themselves for their edge in maintaining a **stable strategic direction** and **coherent footprint**, while not compromising their entrepreneurial

and problem solving approach in **innovating** and exploiting **new market opportunities**. Turning to the *Capacity for Change*, exponential banks have been absolute pioneers in experimenting with **innovative organizational and operating models**. They have embraced **change** and **open ecosystems** as core pillars deeply rooted in their DNA, a constant in their strategy-making, rather than “one-off” initiatives.

Although programs and business/ tech initiatives carried out are different from player to player, as tailored to fit the specific needs of each bank, the key objectives they strive to achieve are the same: **organizational simplification**, fast **decision making**, **talent development** and **dynamic allocation**, **open collaboration** and **exponential technologies adoption** – just to name a few.

Chart 4 | Profitability and efficiency ratios - Deloitte elaboration of public data (5Y avg. on 18' - '22 results)



Exponential banks have on average:

-20 p.p. LOWER COST INCOME
+3 p.p. HIGHER ROTe

than their industry peers

2. Established

Banks with a **strong market positioning** that have missed the **first call to transformation**. They are **now moving in the right direction** but still find themselves at the **early stages of transformation** and are **lacking the pervasiveness**, with required Capex that could impact bottom line results. Established banks managed transformations with **siloed approach** and are **slowed down by constraints** such as **cultural friction**, **slow decision making** and **lack of collaboration** – to name a few.

65%
Cost / income

9%
RoTE

3. Enduring

Players have **focused all their effort on the Capacity for Change** but are struggling in sustaining their competitive advantage in the long-term. They pursued and implemented **change as the new status quo** and in turn, as unexpected events occurred, they found themselves **unable to promptly manage the side-effects of change**. Striving to achieve **flexibility “at all costs”**, they at times ended up losing sight of the “bigger picture”.

56%
Cost / income

8%
RoTE

4. Competing

Enterprises that have all recently come out from a period of **deep strategic and organizational restructuring**, with also **volatile performances** in the past years. Nevertheless, enterprises in this cluster have recently presented **ambitious strategic plans** that aim at initiating the transformation. These enterprises still present **traditional operational and organizational models**, often characterized by **heavy, not cost efficient and siloed matrix structures**.

73%
Cost / income

4%
RoTE

Lessons learned from *Exponential* Banks: the voice of the Bankers

The leaders of the transformation share their point of view on what are the few golden rules for becoming *Exponential*



In the European banking industry we face a particular situation compared to other markets such as the American or Asian ones: **incumbents are still controlling the competition** and the threat coming from external market disruptions, such the establishment of ecosystem challengers fragmenting value chains, is not as significant. Here large banking groups often consider themselves “**too big to fail**”.

As a result, the BoDs and the executive teams of most European incumbents are often **not pressured in driving radical transformation** and remain mostly focused on profitability and efficiency enhancement: areas that the market traditionally recognizes as meaningful performance indicators.

Exponential pioneers triggered transformation inside-out as a mean to stay ahead of time and anticipate change, rather than to react to it

In this context, *Exponential* pioneers were those that **triggered transformation** from within the organization as a mean to **stay ahead of time** and anticipate change, rather than to react to it. What made the difference for these pioneers was, almost always, the commitment of an **intuitive and inspired leadership**, that sensed the need to change way before others and led their organization into carrying out a **pervasive transformation program**.

Attract CxOs that clearly understand how to execute transformation, and give them the levers to orchestrate change

Looking at the path pursued by these pioneers, there are a **few golden lessons** that players that are now looking to transform should keep in mind:

- Lead **transformation at the core**, starting from the **capabilities** of your organization with the ambition of **substantially rethinking business and operating models**;
- Attract **CxOs with the right background** that clearly understand how to **execute transformation** in a traditional context and give them the **levers to orchestrate change**;
- Build an organization that is “**fit for change**” by **rethinking processes** keeping in mind that **simplification is the key** to set-up a **lean, reactive and nimble** operating model;
- bringing-in **new digital and tech-savvy skills** and putting them in the condition **scaling their approach** throughout their organization by **contaminating more “traditional” banking areas**;
- leverage on **data insights** to drive **customer-focused transformation** and ensure that *Capacity for Change* and *Ability to Win* are always aligned and enhancing one another.

Simplification is the key to set-up a lean, reactive and nimble operating model

The bottom line is that *Exponential* banks are those who succeeded in fostering a **culture of experimentation** throughout the entire organization, getting people to **shift their mindset** and encouraging them to continuously investigate **new ways of running the business**.

Conclusions



What the US-based analysis has detected, and our research on the Banking focused perimeter confirmed, is that in an era dominated by uncertainty and disruption ***Capacity for Change* is key to build a persistent competitive advantage**. Many banking executives could argue that, in the last few years, **efficiency** and **adaptiveness** have impacted on the perceived value of their organizations perhaps more than revenue increase.

In times of disruption, the ability to navigate uncertain waters and effectively absorb shocks secures higher returns than investing in increasing revenues

Companies with the largest improvements on *Capacity for Change* from 2015 to 2020 realized nearly **4x the valuation premium gains** of companies with the largest improvements on *Ability to Win*¹.

This finding sends a message to enterprises: prioritizing improvements on this dimension as a **catalyst for near-term performance benefits**.

***Capacity for Change* is catalyst for boosting the *Ability to Win*: you can follow a linear path to Exponential by focusing on it**

Players that have just recently started their journey towards the Exponential can – and must – act on this advantage. If in the past enterprises had to take a **stairways climb to Exponential**, making incremental steps in both directions – *Ability to Win* and *Capacity for Change* – with a trial-and-error approach, now Banking Players can **accelerate the transformation** following the road that has been paved by first movers and adapting initiatives that they have successfully implemented on the *Capacity for Change*.

First-movers have paved the way: you can accelerate your transition by replicating successful initiatives

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Leadership

CARLO MUROLO

Senior Partner

DCM Monitor Deloitte Strategy Consulting Leader
and NSE FSI Consulting Leader

cmurolo@deloitte.it

ALESSANDRA CERIANI

Senior Partner

Deloitte Consulting - Business Operations
DCM FSI Consulting Leader

aceriani@deloitte.it

Authors

MANUEL PINCETTI

Senior Partner

Monitor Deloitte Strategy Consulting
Strategic Transformation & Organic Growth Leader

mpincetti@deloitte.it

MARIANGELA ZINGAROPOLI

Partner

Deloitte Consulting - Business Operations
Global Operations Transformation Leader

mzingaropoli@deloitte.it

VALENTINA CARENZA

Senior Manager

Deloitte Consulting - Business Operations

vcarenza@deloitte.it

DIANA DE LA FELD

Senior Consultant

Deloitte Consulting - Business Operations

ddelafeld@deloitte.it

Contributors

IGNACIO SISO GURRIARAN

Partner

Deloitte Consulting - Business Operations
Spain Core Business Operations Leader

isiso@deloitte.es

Thanks and acknowledgments

We thank for the support and valuable contribution to the research: Armada Bravo Francisco Javier, Boelen Jean-Pierre, Chattey Christian, Florent Bruno De Saint, Fuhrmann Rainer, Kraus Hans-Martin, Martin Calvo Ramon, Mastrangelo Luigi, Mastrantuono Alessandro, Moreno Ricardo, Perez de ayala Juan, Probst Sven, Santoro Elio, Sanz Gerard, Spiller Patrik and Van Beek Hinko.



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