The Reinvention of Retail Banking:

How focused business models can unlock value

Is it finally Retail Banking's
turn for real transformation?

2025 Outlook

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UK Retail Banks are broad across many dimensions. Broad in terms of their offerings; the segments they serve and the products they provide. And broad in terms of the role they play in the value chain to fulfil that offering; banking remains one of the most vertically integrated industries.

In contrast, many other industries, even the most regulated, have all been forced to focus; both in terms of their offering and their role in the value chain. While the performance of the major UK banks has been relatively strong since interest rates began to rise in 2021, a combination of external forces now potentially means that UK banks' journey through a similar transformation will accelerate significantly.

This could lead to a fundamental change in the structure of the industry. The consolidation that is currently ongoing is unwinding an industry structure that emerged in the years following the financial crisis. Over time, this will be replaced with new industry archetypes, each of which could come with different focuses in terms of their offering, where they play on the value chain and consequently how they make money.

Succeeding in this new world will increasingly require concentrating on a smaller number of areas which make the most of each player’s differentiating capabilities. If there is a role for the broad business models of today (the Department Store Banks), only the largest and highest performing players will be able to sustain it.

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Temporary respite: Bounce back in returns begins to lose steam

After the exceptionally challenging period that followed the global financial crisis, UK banks have bounced back strongly since 2021.

In the 2010s, a combination of factors constrained the performance of UK banks compared to international peers. The challenges included low economic growth, near-zero interest rates and high reliance on net interest income (NII). At the same time, capital and regulatory demands increased significantly. This combination of factors constrained UK banks' capacity for transformational investment. As a result, total shareholder returns from UK banks grew at a lower rate than peers in the US, Australia and the Nordic markets, see Exhibit 1.

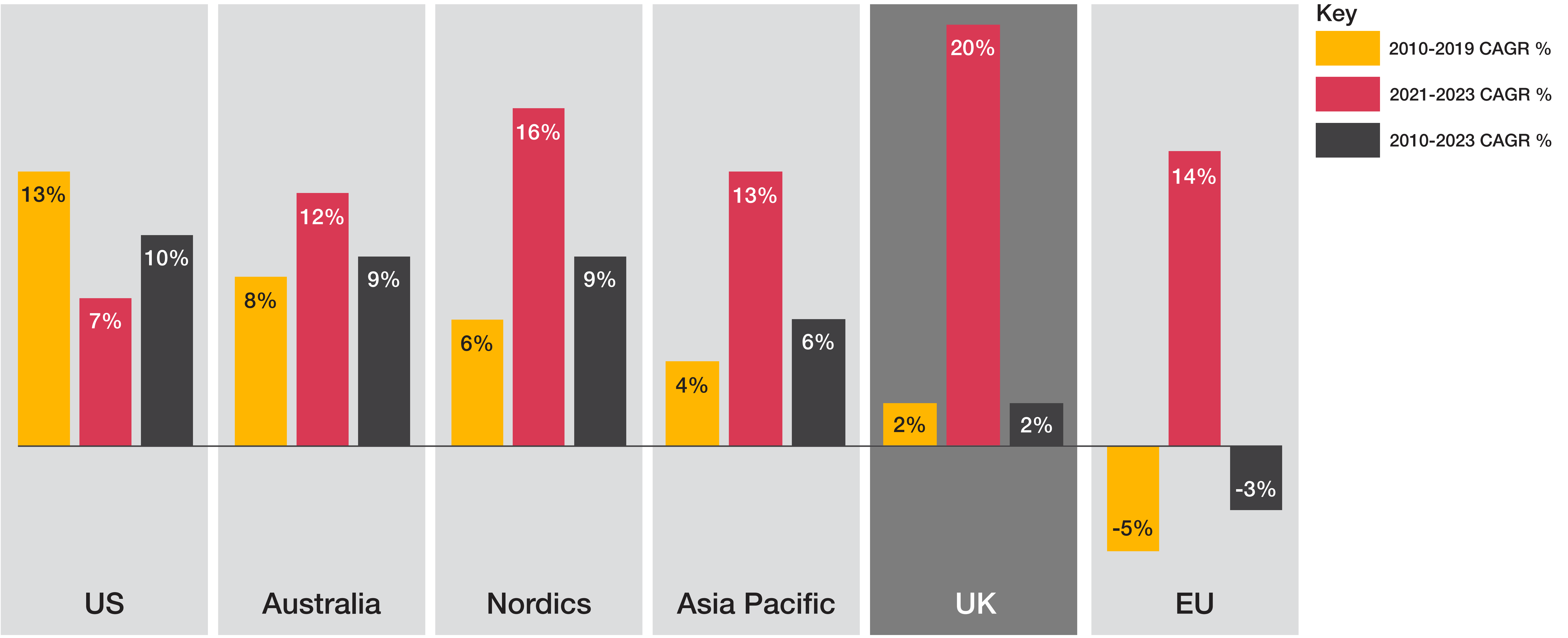
In contrast, as interest rates and NII began to rise from 2021 onwards, UK banks have outperformed peers in many other markets.

Just as the UK banks' relatively high reliance on NII held back returns during the near-zero interest rates of the 2010s, this boosted earnings as base rates rose sharply from 0.25% in early 2022 to 5.25% in 2023

Despite this recent uplift in performance, growth in UK bank total shareholder returns has lagged peers in the US, Australia, Nordics and Asia when looking over the whole period from 2010 to 2023.

Exhibit 1 Comparing UK bank performance with international peers

UK Banking total shareholder returns vs. international peers (2010-2023)



The biggest winners from this base rate increase have been the major banks, which have benefited most from the low cost of funds from their sizable current account deposit base, their cost of funds only rising from 0.5% in 2022 to 1.8% in 2023. This contributed to pre-tax profit at the major UK banks increasing by nearly 40% between 2022 and 2023.

By contrast, Specialist Lenders and Challenger Banks have faced a larger increase in cost of funds, which rose from an average of 1% in 2022 to 2.8% in 2023, partly contributing to a fall in their pre-tax profits by ~20% from 2022 to 2023.

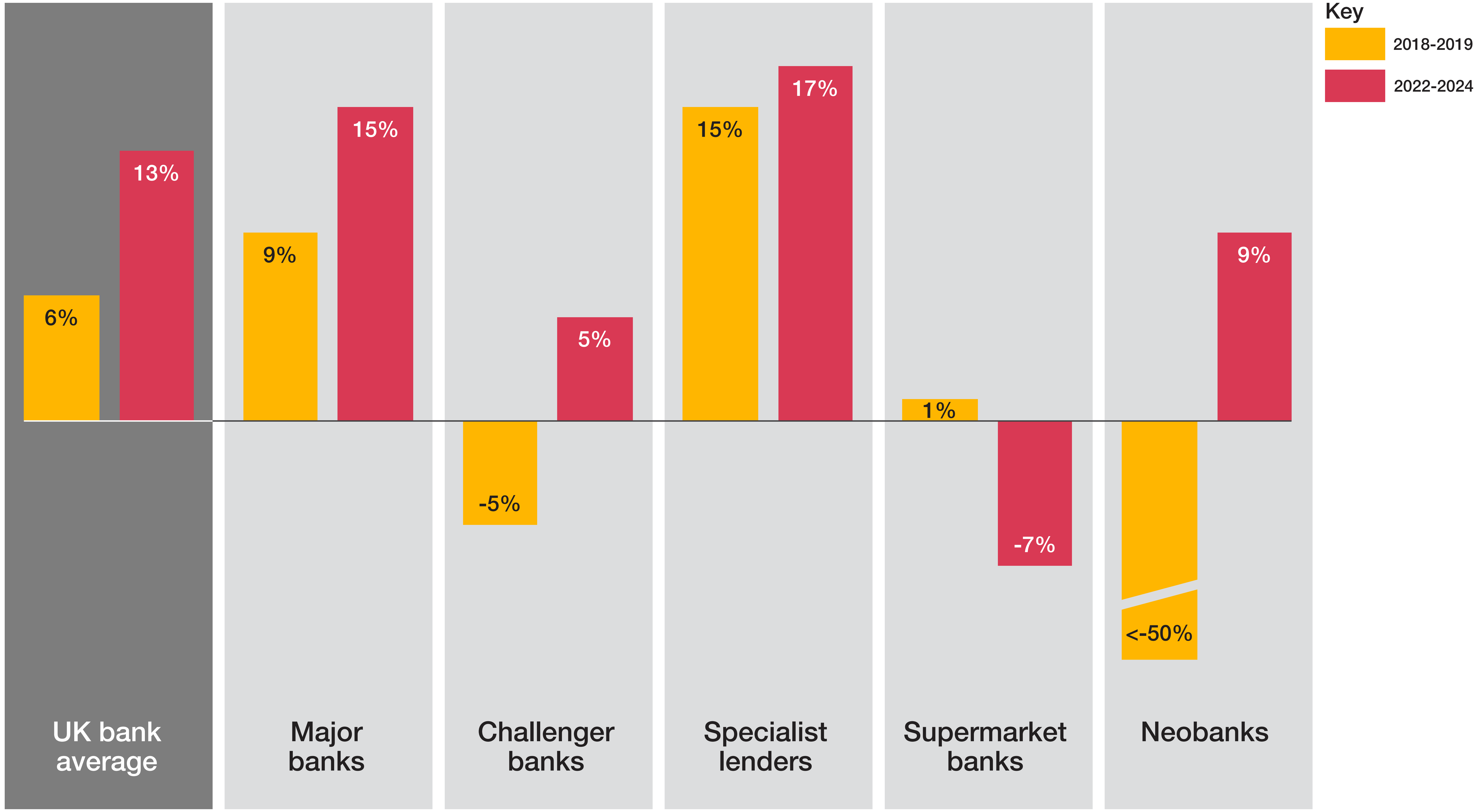
Impetus for change

Whilst shareholder returns have increased since 2021, the major banks still face challenges from a cost and customer experience perspective, which is explored further below. As the uplift in NII-generated returns begins to recede, there will be a growing imperative to address these structural issues and seize the opportunities.

In the coming sections, we explore the forces driving change and the openings for transformation this creates.

Exhibit 2 Comparing recent performance across UK Retail Banks

Return on Equity (RoE) of UK Banks (2018-2024)



02

Age of change: Rethinking how and where to compete

If you look beyond banking, it's clear that the sector has become something of an outlier in a fast-changing economy.

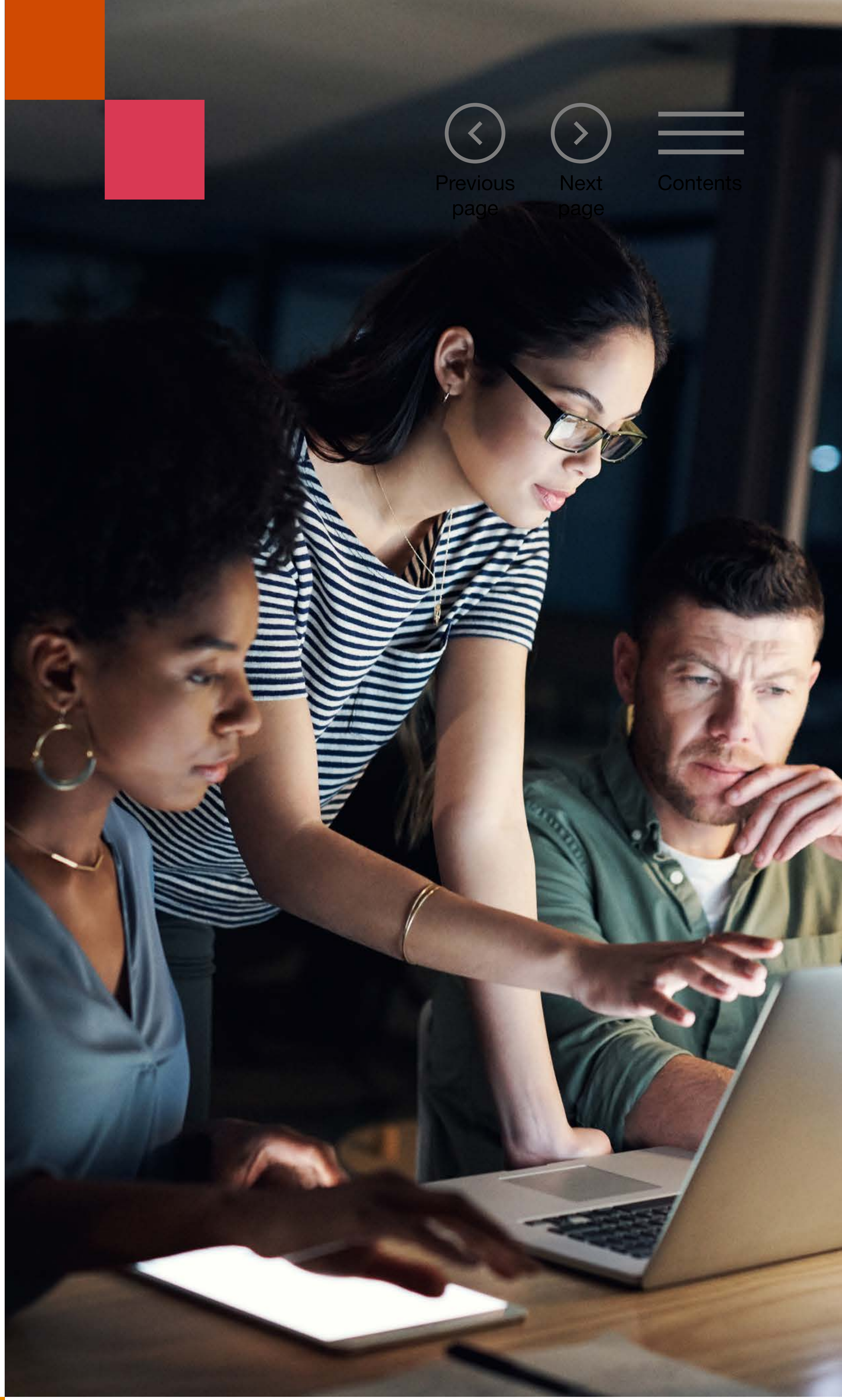
When comparing UK banking to other industries, two factors stand out:

1. UK banks have an exceptionally broad offering and there is limited differentiation in the eyes of the customer. This breadth includes both the segments they serve and the products they offer.

2. UK banking remains one of the most vertically-integrated sectors in the UK economy.

   Most banks still own and manage the end-to-end value chain; from product manufacturing, distribution and servicing through to underwriting and funding. While there has been a steady increase in outsourcing and partnerships, these moves tend to be made on a case-by-case basis to address specific issues.

   To make a real difference, the moves would arguably need to be faster, more all-encompassing and built around a coherent strategy.



These broad dimensions contrast with the prevailing trend in other sectors. In both more and less regulated industries there has been a decisive shift towards greater specialisation and differentiation within increasingly fragmented value chains.

Retail

Over time, mass market department stores have been gradually replaced by more specialised and often Direct to Consumer businesses. Following the lead of big-tech players like Amazon, various large retailers have successfully pivoted into platform-driven businesses, serving both their own needs and other players in the ecosystem, including competitors. A prominent example of a platform-driven retail business is Next's Total Platform.

Pharmaceutical

GSK has recently carved out a part of its business to increase their focus on specific segments of the market.

This has been driven by the different segments of the market requiring different capabilities to reach their full potential.

Entertainment

No longer dominated by a small number of studios who controlled the market, from production to screening.
Now, the studios focus on content creation, while outsourcing specialist capabilities such as visual effects and distribution. The recent rise of streaming companies are shifting the landscape again.

Energy

The sector had already been broken down into its component parts of generation, transmission, distribution and supply by the late 1980s. The industry was further opened up to competition in 2010.

We've recently since seen the emergence of new players such as Octopus, which is both a UK retail energy supplier and a platform provider, providing operations, technology and data services to other energy suppliers in the UK and internationally.

Telecoms

Historically leading telcos bring together a diverse array of activities, each of which requires distinct management skills, talent, have their own capital requirements and operate on a unique planning horizon. For example, the capital planning process for a direct to consumer subscription service differs significantly to that of a B2B systems integrator business or foundational network provider.

Telco leaders are recognising that value can be unlocked through reconfiguring capabilities and resources to distinctly support and run each of the different elements of their business, and in some cases they are making bold portfolio choices and refocusing what the business does.

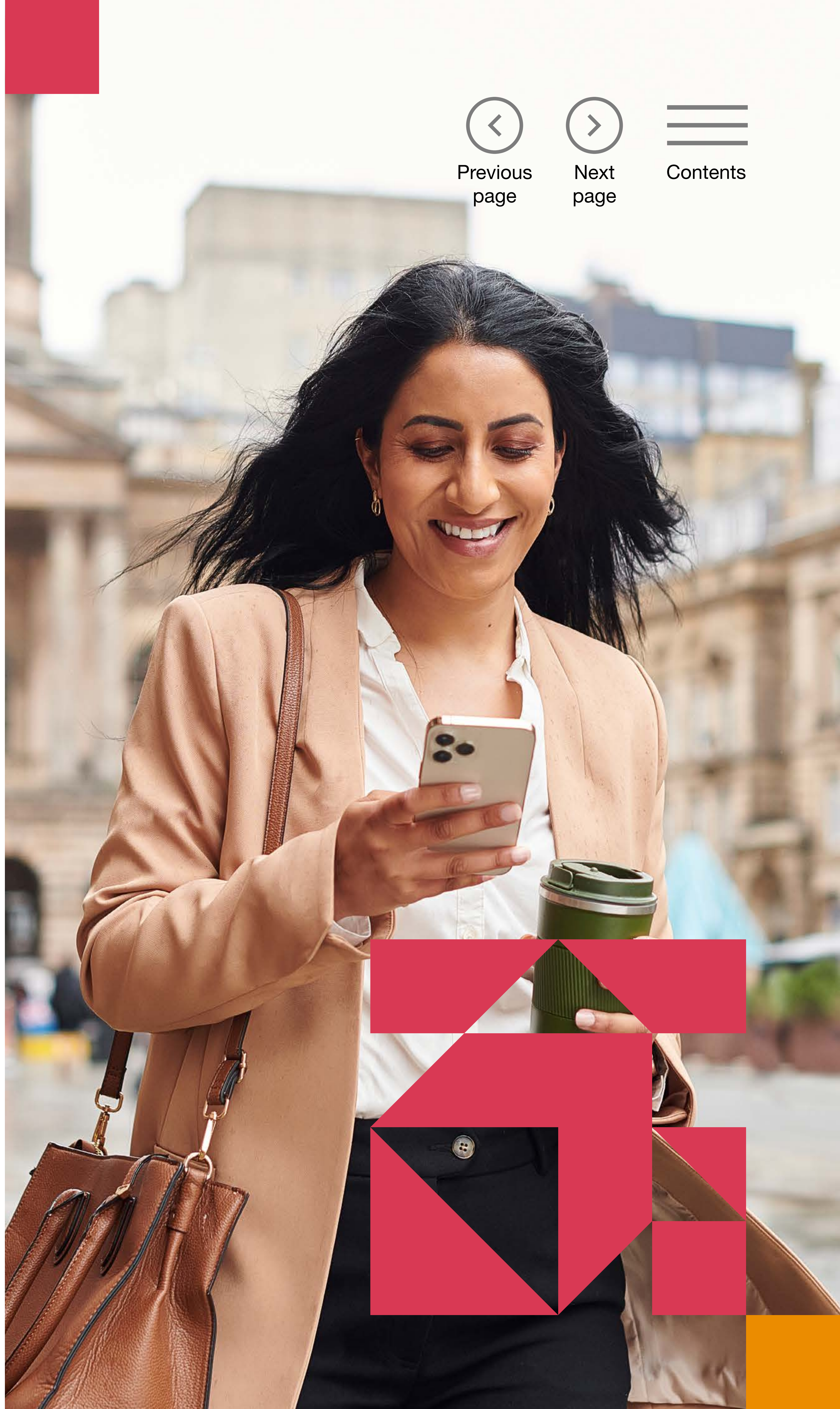
03

Pressure builds: The forces reshaping the banking market

A combination of forces are placing traditional banking business models under pressure.

As these forces continue to build momentum and the investment budgets of incumbents continue to be largely consumed by mandatory regulatory and technological change, banks will find it increasingly difficult to compete on so many fronts.

Four underlying drivers of this change stand out:



3.1 Consumer preferences and expectations

First and foremost, it's far from clear whether consumers value today's broad banking offering. A clear indicator of this is the low level of cross-product holdings across the industry. Banks are striving to deepen relationships but customers appear happy to work with multiple providers as they seek out the best-in-class option for each of their financial needs. Technology and slick onboarding journeys have made it easier for consumers to adopt this multibank approach rather than consolidating all their products in one provider.

3.2 Short and long term pressure on performance

Traditional sources of banking revenue are shrinking in the wake of both short-term and long-term trends. The resulting pressure on performance will constrain banks' ability to invest and force them to make clearer – and tougher – participation choices.

Short term performance: In the short term, growth and returns will be increasingly challenged as interest rates fall and structural hedges roll-off. Whilst the outlook remains uncertain, we are already beginning to see the initial impact in the decline in the average return on equity (RoE) across the largest 14 UK banks from around 14% in 2023 to 12% in H1 2024, primarily driven by average NIMs falling from 2.9 % to 2.5% because of reducing base rates.

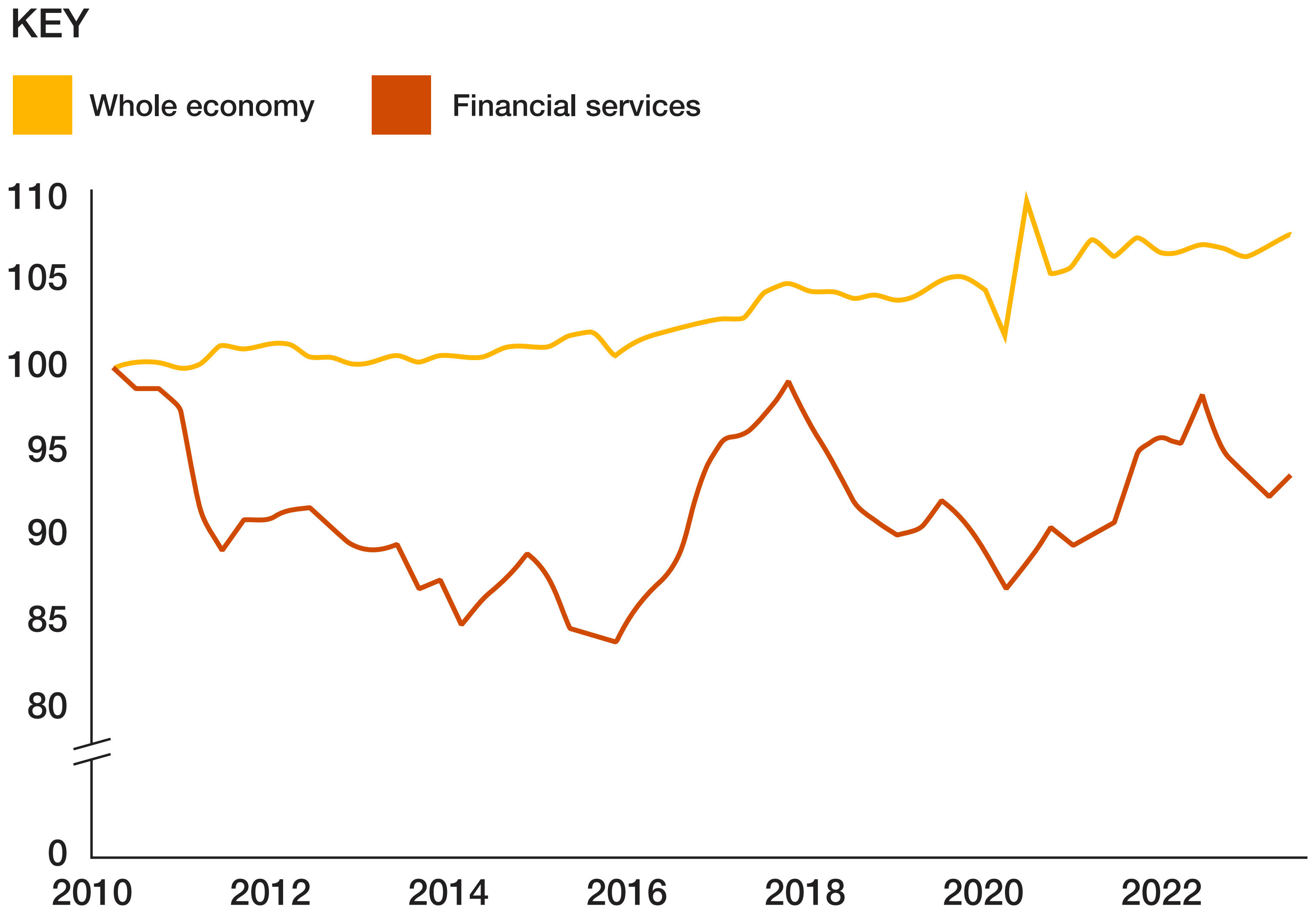
As interest income begins to fall, the short-term pressure on performance may be exacerbated by the relatively limited progress that's been made in tackling the underlying key fundamentals, such as cost and diversification of revenues:

Cost: For the major banks, the total 'expense to loans' ratio remained flat at 1.1% between 2020 to 2023, with high inflation offsetting efficiency initiatives. In addition, across the FS sector, overall productivity growth (economic output per employee) has underperformed the wider economy despite significant investment, see Exhibit 3.

Revenue diversification: Whilst banks benefited from the base rate increases, they have made limited progress in diversifying income streams. At around £40 billion, mortgage lending is still by far the biggest source of income for UK banks contributing around 65% of their income. Non-NII income made up less than 15% of total revenue in 2023, down from around 30% in 2017, and is largely limited to interchange fees, cash held at the central bank and a small amount of subscription fees for value-add services. In comparison, non-NII income accounts for around 35-40% of revenues in US and EU banks, primarily from interchange and account fees.

Exhibit 3 Limited progress on productivity

Output per hour worked in financial services vs. UK economy
Q1'10- Q3'23, Indexed (Q1'10=100)



Long term performance: Looking further ahead, long term market development and shifts in demand could put further pressure on traditional value pools e.g.

Mortgages

Competition is expected to continue to place pressure on mortgage margins and overall demand may fall over the longer term as it becomes more and more difficult to get on the housing ladder and preferences for home ownership shift.

Current Accounts

This key source of low-cost funding is likely to decline as consumers increasingly shift to more valuable alternatives, such as feature-rich or higher-yield accounts. Alternative options, like e-money wallets, which are prevalent in markets such as Singapore and Thailand, could gain similar traction in the UK.

Credit cards

Value pools may further shrink as the shift to embedded finance continues and interchange income comes under pressure.

Vehicle financing

Demand and revenues may decline as the shift to subscription models gathers pace and the structure of the industry is reshaped by the move to electric vehicles.

FX

Cross-border payments are likely to become more commoditised as competition proliferates. Beyond that, technology and infrastructure innovation could further reduce banks' access to this value pool (e.g. crypto, connected real time payment systems).

3.3 The changing competitive landscape

The competitive landscape is being transformed by the disruptive impact of innovative entrants on one side, and consolidation of traditional players on the other.

There was a surge of new entrants in the years following the Global Financial Crisis – around 300 e-money firms and 66 banks have been authorised since 2013. Big tech firms are also making inroads into the market through their wallet offerings in the UK. Internationally they have expanded into credit cards, remittances, bill management and e-money wallets.

New entrants have so far had a limited impact on the market share of the major banks in their core lending value pools in the UK. In fact, in some areas the market share of the major banks has in fact increased, see Exhibit 4. However, new entrants have carved out new and expanding value pools in areas such as FX and Payments.

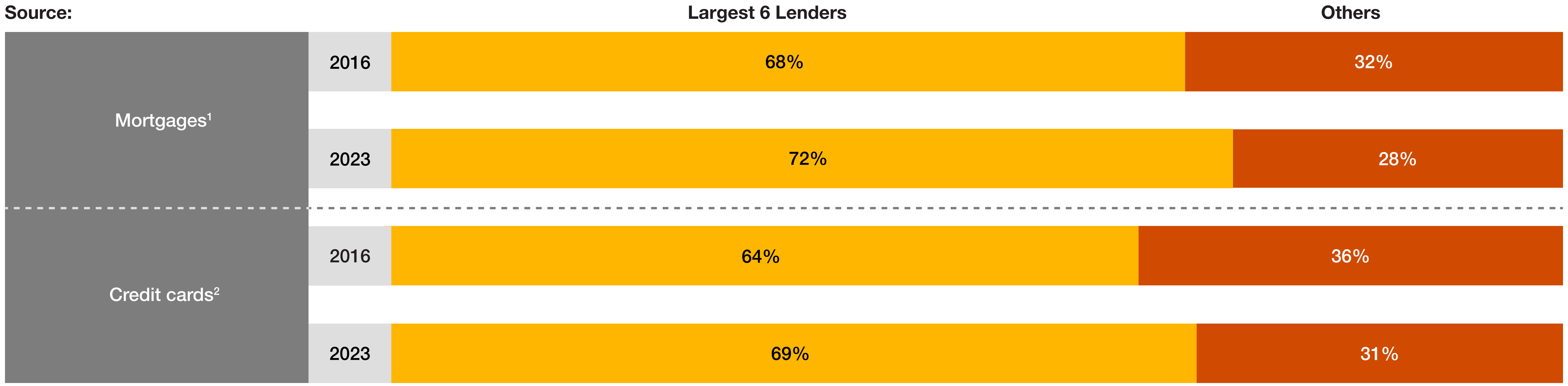
Crucially, they have also shifted customer expectations around customer service and experience. Monzo and Starling now typically top the ratings for overall quality of service in both retail and business banking and have captured significant customer bases for transactional current accounts.

In contrast, the traditional challengers have largely struggled to build up the scale or differentiated consumer propositions that many expected in the mid-2010s, contributing to the recent wave of consolidation in the sector.

However, with the recent M&A activity in the UK (Nationwide-Virgin, Barclays-Tesco, Coventry-Coop etc.) the total availability of remaining retail and SME lending portfolios outside of the largest six banks in the UK market is quickly declining, with ~£130bn of total banking assets being consolidated into the larger organisations in the period March 2023 to October 2024. Further consolidation may therefore be more targeted at growing non-interest bearing products or acquiring distinctive capabilities.

Exhibit 4 UK Lending market share

Source:



1. UK finance
2. Mintel

3.4 Technology

A combination of advanced new technologies, digital engagement and service delivery are accelerating industry reinvention. The impact includes a sharp decline in the cost of sharing data and integrating ecosystem partners to support internal operations or develop compelling propositions.

At the same time the costs of new technology deployment are falling, which is opening up opportunities for transformative innovation. We can already see banks are opening up their APIs to access the best technologies and deliver more differentiated propositions for customers.

04

The new archetypes: Focusing on differentiated value drivers

What's the way forward? As the changes we have explored in this paper continue to materialise, we expect the structure of the industry to change and a range of new and evolved banking archetypes to emerge in the coming years.

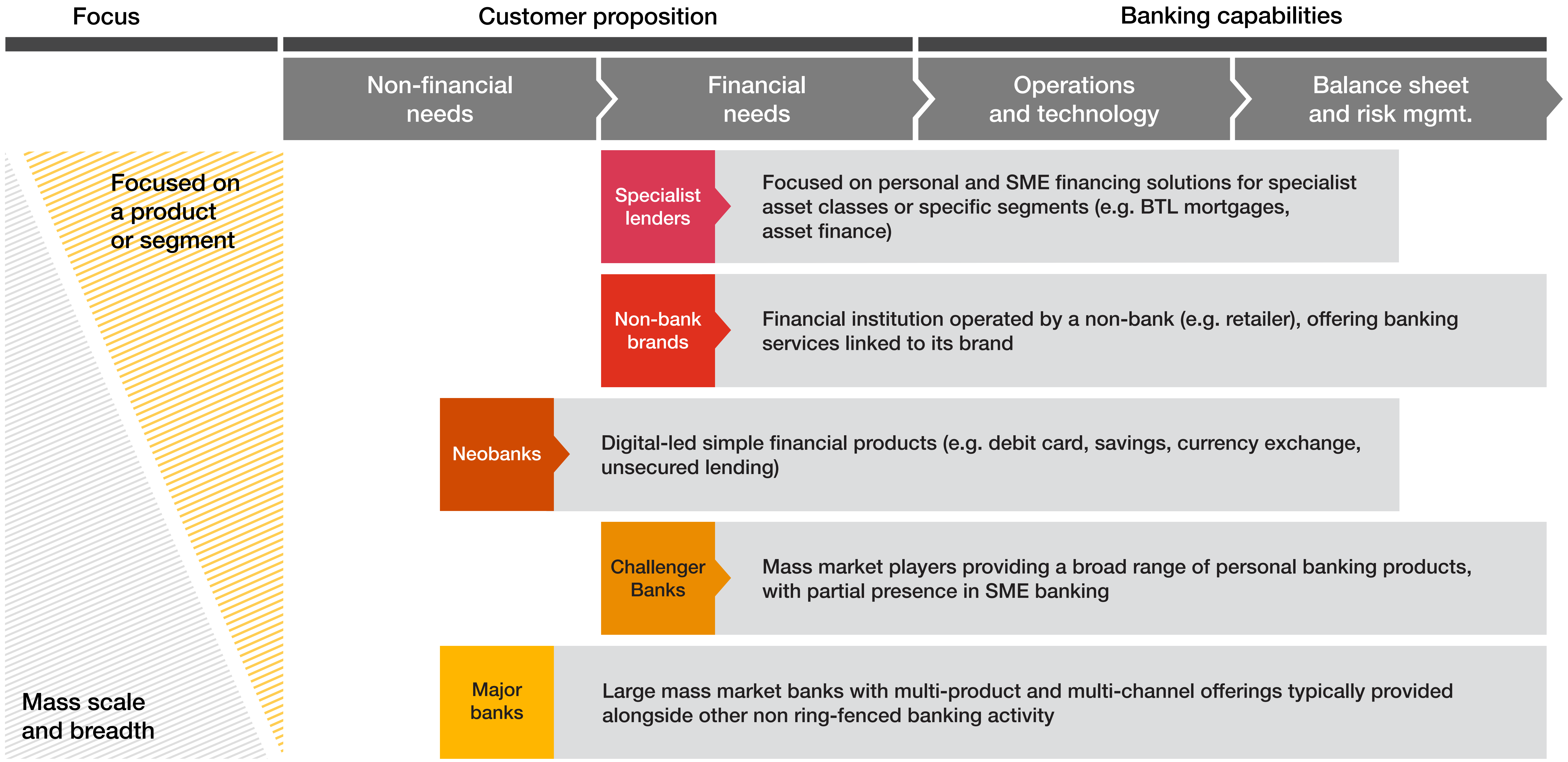
The industry structure that emerged in the decade following the financial crisis (see Exhibit 5) is already beginning to change. The recent uptick in M&A activity in UK retail banking is evidence that that this change is acelerating, with the consolidation of non-bank brands (e.g. Tesco Bank, Virgin Money) and the acquisition of specialists by the Major Banks (e.g. Kensington)

Whilst we can't be certain what these new business models will look like, we expect much clearer differentiation in the roles different banks and non-banks play in the value chain and the segments they serve. The results would enable a bank to concentrate on a smaller number of areas where it can make the most of its differentiating capabilities.

How the bank creates value for itself and its customers varies by archetype, as does the combination of capabilities, skills and cultures needed to be successful. Operating with more than one archetype is possible, though banks risk spreading themselves too thinly if they adopt too many. This multi-pronged approach could also make it difficult to invest in all the capabilities needed to support the models simultaneously.

Exhibit 5 Today's UK banking archetypes

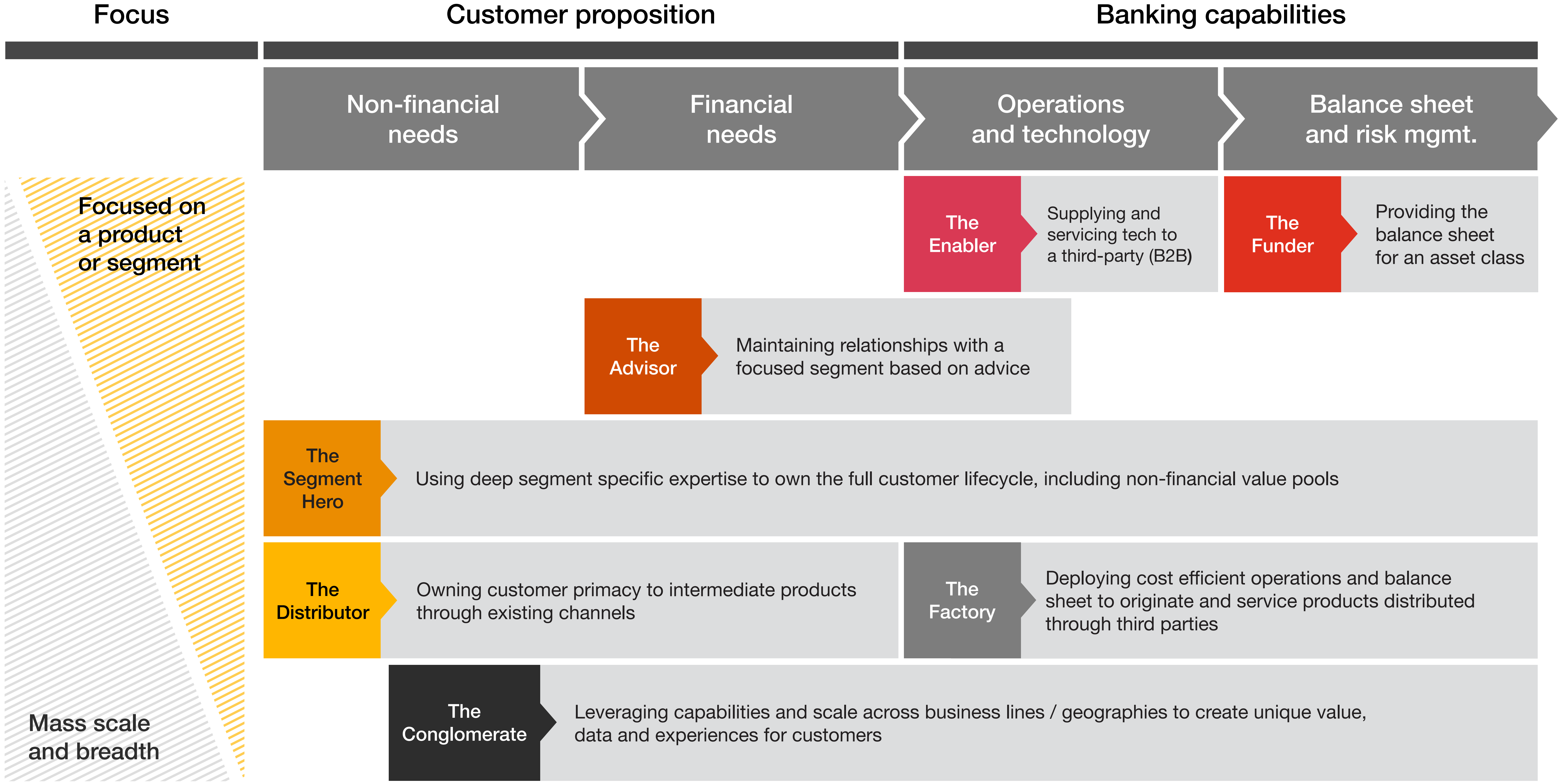
Banking business models of the 2010s



Specialist lenders	Focused on personal and SME financing solutions for specialist asset classes or specific segments (e.g. BTL mortgages, asset finance)
Non-bank brands	Financial institution operated by a non-bank (e.g. retailer), offering banking services linked to its brand
Neobanks	Digital-led simple financial products (e.g. debit card, savings, currency exchange, unsecured lending)
Challenger Banks	Mass market players providing a broad range of personal banking products, with partial presence in SME banking
Major banks	Large mass market banks with multi-product and multi-channel offerings typically provided alongside other non ring-fenced banking activity

Exhibit 6 The seven archetypes of the future

Potential banking business models of the future



Focus

Customer proposition

Banking capabilities

Non-financial needs

Financial needs

Operations and technology

Balance sheet and risk mgmt.

Focused on a product or segment

Mass scale and breadth

The Enabler Supplying and servicing tech to a third-party (B2B)

The Funder Providing the balance sheet for an asset class

The Advisor Maintaining relationships with a focused segment based on advice

The Segment Hero Using deep segment specific expertise to own the full customer lifecycle, including non-financial value pools

The Distributor Owning customer primacy to intermediate products through existing channels

The Factory Deploying cost efficient operations and balance sheet to originate and service products distributed through third parties

The Conglomerate Leveraging capabilities and scale across business lines / geographies to create unique value, data and experiences for customers

The seven archetypes of the future

	Archetype	Description	Income model	Differentiating capability	Key difference to today
1	**The Factory**	The factory harnesses cost-efficient operations and balance sheet strength to build and service products which are distributed through third-parties. This model will be most likely for banks that can run products at a consistently lower cost to serve either due to their scale or their differentiating capabilities. Cost, reliability and flexibility are key differentiators. This is because products are sold through distributors such as brokers or aggregators, who will have their choice of factories.	Net interest margin from low-cost, mass production of financial products	• Capital, liquidity and balance sheet management • End-to-end process management • Lean, productive operations • Risk and controls management • Partnership management • Credit risk	Does not distribute products or own the end customer relationship
2	**The Distributor**	Drawing on customer data and experience design, the distributor understands what customers want and develops appropriate solutions by partnering with factories and enablers. The distributor is a viable model for banks and non-banks as it doesn't create and manage the underlying products. Instead, it generates fees as an intermediary. Its key differentiators are customer insight, proposition development and experience management.	Fee income from product manufacturers for distributing products and services	• Customer data, analytics and insights management • Channel management (for origination and servicing) – digital and/or physical • Partnership management and contracting • External integration • Customer experience • Brand management and marketing	Does not build and run the banking products and services
3	**The Segment Hero**	The segment hero focuses on sector expertise and superior customer experiences as it manages both financial and non-financial demands in its specialist area. Potential examples include adding property management to a buy-to-let mortgage offering, industry-specific value added services alongside merchant acquiring, or equipment management and disposal services alongside asset finance.	Premium interest and fee income from servicing end to end customer needs (e.g. non financial needs)	• Segment expertise, including customer and regulatory • Proposition management • Customer experience design • Origination and distribution • Partnership management • Brand management and marketing	Does not have propositions beyond chosen segments
4	**The Advisor**	The advisor offers tailored solutions and insights. The differentiators don't just include expertise, but also relationships, impartiality and trust. Technology can help to strengthen customer engagement, understanding and experience, while helping advisors to compete against traditional distributors such as brokers.	Fee income from tailored advice (from customer or bank)	• Customer data management • Customer analytics and insights generation • Third-party integrations • Segment expertise, including customer and regulatory • Brand management and marketing	Does not provide underlying banking products and drives volumes to third-parties

The seven archetypes of the future

	Archetype	Description	Income model	Differentiating capability	Key difference to today
5	**The Enabler**	The enabler develops and supplies technology or operations solutions to third-parties. The enabler doesn't carry out regulated banking activities or interact with end-consumers. Key differentiators include interoperable, scalable and secure solutions.	Transaction-based fee income from third-parties	• Interoperable, scalable and secure technology • Technology delivery • End to end process management • Partnership management and contracting • Partner technical support	Does not perform regulated banking activities or interact with end consumers
6	**The Funder**	The funder provides the balance sheet for an asset class, often in a niche, specialised or high-risk area. This model focuses on funding for lending, such as via a forward flow or strategic funding arrangement, without providing the technology and operations to originate or service the product. This may be a viable additional archetype for a major bank to adopt alongside other archetypes to deploy spare capital. Key differentiators include capital, liquidity and asset class expertise.	Net interest margin from higher risk / niche asset class	• Capital, liquidity and balance sheet management • Asset class knowledge [and underwriting expertise] • Controls management • Credit risk	Does not provide sales, technology or operations to originate, distribute or service the product
7	**The Conglomerate**	The conglomerate draws on its scale, breadth and data-enabled insights from across business lines to create unique value for its customers – whether in the form of lower prices, unique propositions or superior service. Like the factory, this model is only likely to be viable for larger banks due to the necessity for scale. But the connectivity of the conglomerate across brand and product areas marks a shift from the business models employed by major banks today. The conglomerate model may include several other archetypes within it. We expect the more successful conglomerates to reconfigure their business unit and functional structures, with each unit anchored on a clear purpose and value proposition underpinned by combinations of common differentiating assets, capabilities and ecosystem relationships.	Interest and fee income, leveraging volume and data to create scale efficiency	• Pan-bank data management and integration • Customer life-cycle management (managing customers across business lines) • Proposition design and management • End to end process management • Lean, productive operations • Risk and controls management	Step-change in internal connectivity and use of data to drive differentiated experiences for customers across business lines

05

Four foundations for successful reinvention

So how can your bank lead the change and capitalise on the potential?

To make the transition to this new set of archetypes you need both strategic clarity and solid operational foundations. You also need to be equipped for continuous transformation as you look to keep pace as shifts in both customer expectations and competitive dynamics continue. Four priorities stand out:

Decide on your archetype

Judge where to invest and divest

Create a strategic operating model to support the chosen archetype

Take your people with you

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Decide on your archetype

The starting point is assessing how the marketplace is likely to evolve and judging where and how you can deliver the most value.

One key consideration is your current positioning – capabilities, market share and brand resonance are clearly important parts of this. You can then assess how competitors are likely to evolve, how this affects the potential value pool in particular segments and what capabilities would help you to stand out.

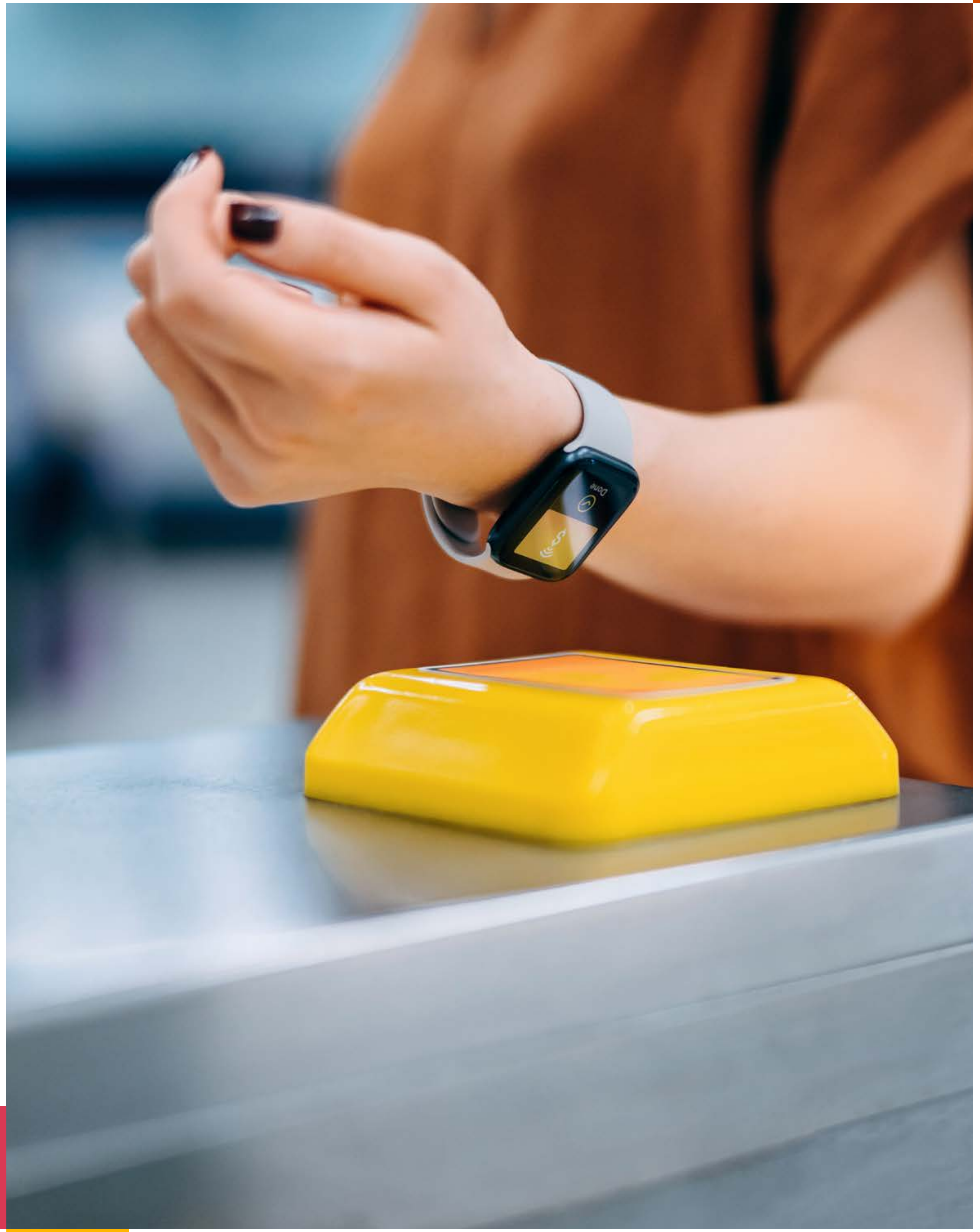
You won't necessarily need to choose a single archetype. But driving towards one or two will help clarify investment decisions and instil coherence in your organisation. It will also allow you to exit less viable and profitable activities.

Judge where to invest and divest

Having determined the most viable archetype for your business, you can assess your portfolio to judge what's aligned, which areas need further investment and which are no longer core and can be divested.

The starting point is gauging how your choice of archetype affects the customers and segments you should focus on, as well as the kind of products and services you should be offering.

It's clearly important to be sure that your innovation and investment strategies are aligned with changing customer demands. Equally important is ensuring that you have the organisational appetite and capability for your shift in strategic focus.



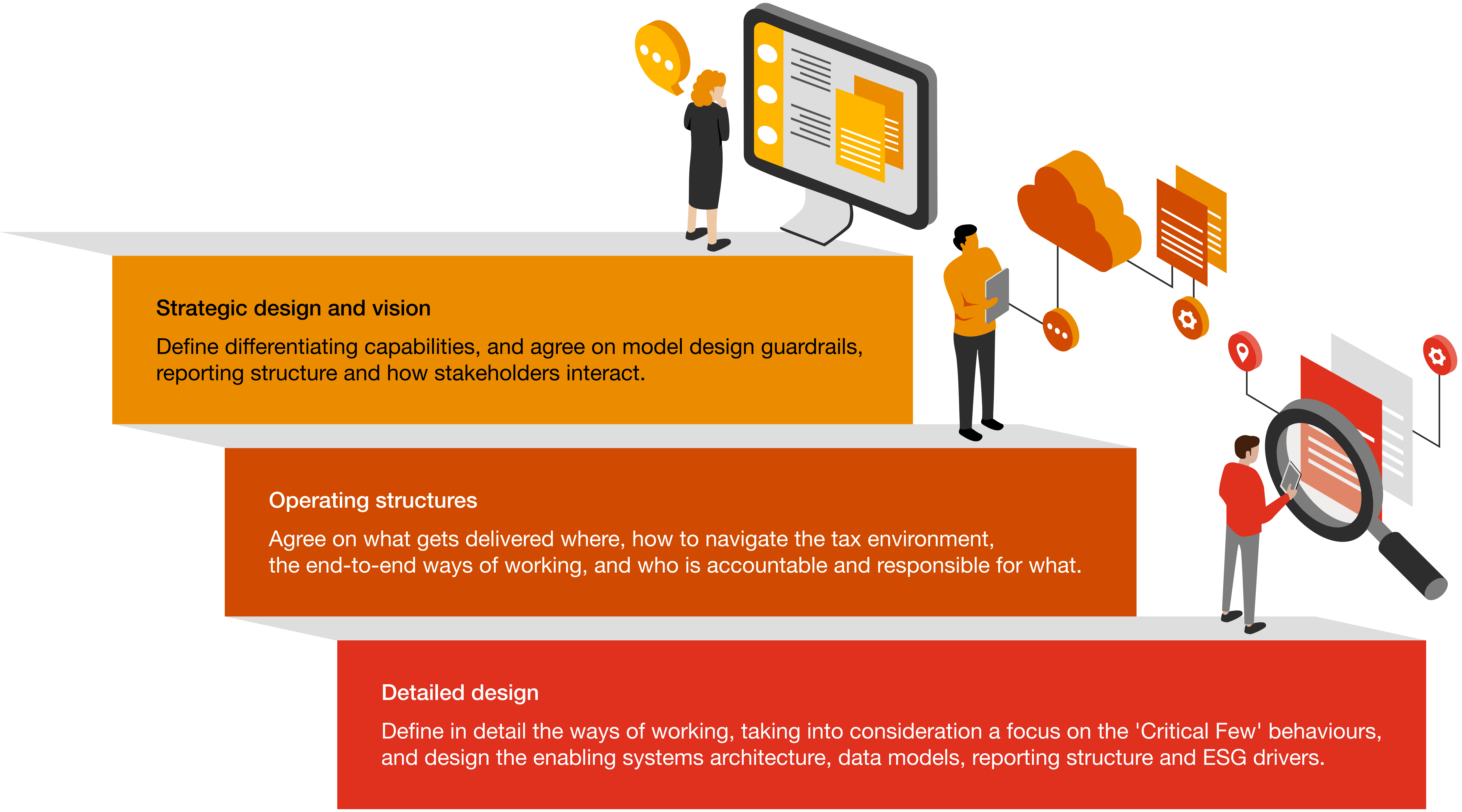
Create a strategic operating model to support the chosen archetype

Strategic clarity is not enough on its own. Equally critical is an operating model capable of executing your strategy. Across all archetypes, key priorities include being agile, customer-centric and building your workforce capabilities and data optimisation. These aspects will not only drive change, but also differentiate your offering and underpin your 'right to win' in your chosen archetype.

Trying to develop all of the necessary capabilities in-house will slow you down and put you on the back foot competitively – just as you're ready, the market may already have moved on. The need to access talent and technology at pace will make third-party partnership more important than ever.

Outsourcing and M&A are going to be key accelerators for transition and gaining access to specialist capabilities. This underlines the need for both third-party management and fast-paced niche acquisition as core capabilities. Equally important are change management skills as you pursue continuous transformation.

Exhibit 7 Strategic operating model components



Strategic design and vision

Define differentiating capabilities, and agree on model design guardrails, reporting structure and how stakeholders interact.

Operating structures

Agree on what gets delivered where, how to navigate the tax environment, the end-to-end ways of working, and who is accountable and responsible for what.

Detailed design

Define in detail the ways of working, taking into consideration a focus on the 'Critical Few' behaviours, and design the enabling systems architecture, data models, reporting structure and ESG drivers.

Take your people with you

Transforming your business model calls for a significant shift in workforce capabilities, ways of working and behaviours. You'll need to get buy-in from your people and make sure they have the skills and motivations to succeed. You'll need to empower your workforce and encourage a healthy level of discussion and challenge — only 38% of workers in FS feel able to do this today. This should be front and centre of your transformation journey.

By empowering employees with the tools and training they need, you can build a workforce that's not only proficient in traditional banking operations, but also adept at navigating the complexities of a digital-first, customer-centric landscape. This workforce transformation will be instrumental in driving innovation, improving customer experiences, and achieving strategic objectives in line with your target archetype.

Many employees will be wary of change. For people who form the core of your new archetype, it's important to stress the opportunities to create more value and enhance their long-term prospects. For people in teams earmarked for divestment, you can highlight the chance to join a new business where their capabilities will be core rather than at the fringes of the organisation.

Sharpening relevance and returns

Each of these archetypes offers an exciting opportunity for banks to sharpen their focus and increase relevance for customers. If delivered effectively, this could create a clearer and more compelling value case for stakeholders

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