The future of the Belgian banking industry: the executives’ point of view

Prof. Dr. André Thibeault
Thomas Matthys
Vlerick Centre for Financial Services

Point of contact: thomas.matthys@vlerick.com (+32 9 210 92 16)
CONTENTS

The KPMG – Vlerick Prime Foundation Partnership .................................................. 1
Acknowledgement .............................................................................................................. 3
Executive Summary ........................................................................................................... 5
Introduction ......................................................................................................................... 6
Chapter 1: Methodology and Sample .............................................................................. 7
  Methodology ....................................................................................................................... 7
  Sample ................................................................................................................................. 7
Chapter 2: The value chain ............................................................................................... 8
  Income diversification ......................................................................................................... 9
  Cost management .............................................................................................................. 10
  Distribution channels and relationship banking .............................................................. 16
Chapter 3: Regulatory environment ............................................................................... 19
Chapter 4: Measuring bank performance: future key performance indicators .............. 22
Chapter 5: Global view on the future Belgian banking landscape ................................... 24
References ......................................................................................................................... 26
  Appendix A: Sample and interviewees ........................................................................... 27
  Appendix B: Glossary ........................................................................................................... 28
THE KPMG – VLERICK PRIME FOUNDATION PARTNERSHIP

This survey on the future of the Belgian banking industry is part of a 3-year project conducted in the format of a Prime Foundation Partnership between KPMG and the Vlerick Centre for Financial Services.

The research content of the Prime Foundation Partnership will be filled in as follows:

**Year 1:** Helicopter View – International Scorecard. What is the performance (from many different angles) of the participants in the banking sector in Belgium, and how do they rank under these dimensions?

**Year 2:** Survey – the success factors for the future in the Belgian Banking Industry. How will different business models drive performance? What differentiates these banks? The survey looks at various dimensions, including: distribution channels, business models, asset structure, financial aspects and managerial aspects.

**Year 3:** Based on the information gathered in the first and second years, identify interesting issues to be investigated further. Points of specific research interests raised by KPMG could also be investigated in the course of this part of the research project.
ACKNOWLEDGEMENT

This research project would not have been possible without the support of many people.

The authors would like to extend warm thanks to KPMG for providing the financial resources and access to their network – and especially to Bart Walterus, Partner Financial Services Consulting / KPMG Advisory, who has provided managerial support and extremely helpful professional advice throughout the writing of the report. Furthermore, the authors would like to thank Erik Clinck, Olivier Macq, Stijn Broekx, Vincent Piron, Koen De Loose, Paul Op de Beeck and Ingrid Stoffels for their valuable feedback on a number of occasions throughout the duration of the study. Special thanks also to Manuella Ferreira Pinto De Mendonca for organising the many meetings and conference calls.

We wish to express our sincere appreciation to Maureen O’Hare, Vlerick’s Corporate Development Manager, who has played a major role in the discussions leading to the Prime Foundation Partnership with KPMG. Maureen has also coordinated this project in a very dedicated and professional way.

The authors,

Prof. Dr. André E. Thibeault
Thomas Matthys
EXECUTIVE SUMMARY

The goal of this study is to represent the points of view of financial executives in the Belgian banking sector on the future of their industry. The analysis was conducted through personal interviews with the executives of 15 Belgian banks, who altogether represent 92% of the sector in terms of total assets.

The dimensions considered are: the value chain, the regulatory environment, key performance indicators and an overall view on the future of the sector.

Within these dimensions, we highlight differences between large and small banks, as well as between banks with different business models, without conceding the confidential nature of the interview.

Belgian banks today are operating in a low growth, low interest rate environment, which is increasingly putting pressure on the main value driver for most banks: net interest income. While most banks are trying to offset the erosion of interest margins, many are struggling to do so and about half of the banks in the sample seem to recognize that there will be some suffering on this value driver. The focus on cost management strategies is expected to continue in the future. Making physical branches more cost-effective through increased automation and streamlining of different distribution channels will be one of the top priorities for the larger banks. For both smaller and larger retail and universal banks, the integration of different contact points will allow the bank to create a complete customer experience and additional value to the bank.

On the regulatory side, a vast body of rules is heading for the sector, and banks are now in the process of evaluating and implementing requirements and new compliance procedures. In the report, we specifically draw attention to the expected consequences for the banking industry of the Basel III capital and liquidity requirements. Around 87% of the banks interviewed confirm that the implementation of the Basel III regulatory framework will impact the banks’ profitability and/or the choice of business model in the future.

With new strategies and business models come new ways of measuring performance. There seems to be increased attention to customer-related key performance indicators (KPIs). Customer-centricity, client satisfaction and net promoter score will be the most important KPIs of the future. Concerning the more traditional measures, 71% of the banks are targeting a cost-income ratio lower than 60%, while the average return on equity target is 10%.

To conclude the interview, we asked the executives questions about the general state of the Belgian banking landscape in the coming 5-10 years. About 80% of the banks are convinced that the number of banks will decrease through a further consolidation phase set to start two years from now. Banks will grow larger, and the presence of pan-European players will become inevitable.
INTRODUCTION

Complementary to our first banking report (May 2012), which looked at the historical performance of the Belgian banking sector, this report presents the views of C-level executives of 15 Belgian banks on the future of the Belgian banking sector. To achieve this, we designed a structured interview that provides a top-down approach in assessing bank strategy and performance.

Based on the definition of the value chain in banking developed in the first banking report, the interviews try to assess the future evolution of the business models of the Belgian banks and the impact of these business models on a bank’s value drivers.

Given the diversity of the banking landscape in Belgium, the survey presents the points of view of executives managing full services and very integrated businesses as well as "niche" players. The interviews are strictly confidential, and no reference is made to a specific bank or person unless the interviewee has explicitly agreed to be cited.

Thus, the survey addresses some fundamental issues like the conditions for survival of the full services banks as well as of the "niche" banks, the strategies that need to be put in place to manage costs, and which categories of costs are targeted. Executives have also been asked how the post-crisis era, with its flood of new regulations and regulators, might impact their capacity to generate a desirable return.

Here are the main findings, which will be elaborated on (with others) in the report that follows:

- While it is widely believed that “niche” banks will be able to maintain their position in the Belgian market in the coming years, the majority of the respondents believe that only the full services players with some kind of European presence will be able to survive 5 to 10 years from now.

- Concerning the cost strategies of the respondents, most of them believe that they can combine cost-effectiveness and customer intimacy. In fact, banks are making substantial investments to put customer focus and the seamless integration of distribution channels at the centre of their value proposition.

- Similarly, executives identify continuous investment in technology as a survival area. Only a few “niche” players believe that their clients are willing to pay the extra euro to be a prime customer of such a bank.

- Finally, the impact of all the new rules associated with the post-crisis era is felt differently by the big players compared to the smaller ones. The big full services players have already incorporated the new regulations into their organisations. For the smaller players, the costs associated with these new rules are seen as a major burden, primarily due to the fact that these new rules are not stable but change from time to time.
CHAPTER 1: METHODOLOGY AND SAMPLE

METHODOLOGY

The research on the future of the Belgian banking sector was conducted through semi-structured, personal interviews with C-level executives in the sector. Through its network, either KPMG or Vlerick Business School invited banks to participate and comment on how they see the development of the banking sector over the coming years. Items covered during the interviews included: the bank's business model, the regulatory environment and operational topics. All interviews were conducted by Prof. Dr. André Thibeault and Thomas Matthys (Vlerick Business School).

- Top-down approach: both strategic and more technical topics
- The time horizon is 5-10 years

SAMPLE

We interviewed C-level executives of 15 financial institutions that are active on the Belgian market. These 15 banks represent different business models and cover 92% of the entire Belgian market in terms of size (total assets). The heterogeneity of our sample, and the semi-structured type of interview, encouraged the banks to stress those topics they related to more than others. For a complete list of our sample and the interviewees, please see Appendix A.

<table>
<thead>
<tr>
<th>Bank name</th>
<th>Type of bank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argenta Spaarbank -ASPA</td>
<td>Retail Bank</td>
</tr>
<tr>
<td>AXA Bank Belgium</td>
<td>Universal Bank</td>
</tr>
<tr>
<td>Bank Delen NV</td>
<td>Private Bank</td>
</tr>
<tr>
<td>Bank J. Van Breda en Co NV</td>
<td>Retail Bank</td>
</tr>
<tr>
<td>Banque CPH</td>
<td>Retail Bank</td>
</tr>
<tr>
<td>Belfius Bank NV</td>
<td>Universal Bank</td>
</tr>
<tr>
<td>BNP Paribas Fortis</td>
<td>Universal Bank</td>
</tr>
<tr>
<td>BPost Bank</td>
<td>Retail Bank</td>
</tr>
<tr>
<td>Deutsche Bank NV</td>
<td>Universal Bank</td>
</tr>
<tr>
<td>F. Van Lanschet Bankiers België</td>
<td>Private Bank</td>
</tr>
<tr>
<td>ING Belgium NV</td>
<td>Universal Bank</td>
</tr>
<tr>
<td>KBC Bank NV</td>
<td>Universal Bank</td>
</tr>
<tr>
<td>Optima</td>
<td>Private Bank</td>
</tr>
<tr>
<td>Record Bank NV</td>
<td>Retail Bank</td>
</tr>
<tr>
<td>VDK Spaarbank NV</td>
<td>Retail Bank</td>
</tr>
</tbody>
</table>

Table 1: Banks interviewed
CHAPTER 2: THE VALUE CHAIN

In a first stage, we use the value chain of a bank as it is presented in Figure 1. The value chain is broken down into three components on the income side – net interest income, net commissions and financial transactions – and into two blocks on the expenses side – operating expenses and loan losses. This shows the clear interdependency between (off-) balance sheet items and the bank’s income statement and serves as the basic conceptual framework for discussing business model issues as well as income and cost management strategies during the interviews.

Figure 1: The Value Chain
INCOME DIVERSIFICATION

Income from traditional maturity transformation activities has proved to be a major and stable source of income for Belgian banks in recent years. Financial intermediation between debtors and creditors as a key feature of what constitutes a bank has been, and still is, the most important income driver for Belgian banks. The global financial crisis that started six years ago caused central banks to cut key interest rates to record lows in an attempt to alleviate banks’ access to liquid funds and to support recession-hit economies. Although banks today are granted ample access to liquidity, the current macroeconomic environment remains quite challenging.

The National Bank of Belgium (NBB) projects 0% GDP growth in 2013, with growth in 2014 estimated at a mere 1.1% (NBB, 2013). In the July 2013 consumer survey, the NBB found that households are anticipating a slight dip in their financial situation and their savings capacity in the future. The divergence between economic indicators points to a disconnect between the real economy and the financial sphere.

Belgian banks are operating in a low growth, low interest rate environment, which exerts pressure on the primary value driver through reduced deposit margins and the erosion of asset yields. Structural interest margins are gradually worn down, while reinvesting maturing assets in a low interest rate environment embodies a threat to future profitability. So, how are bankers looking at the current business environment and, more importantly, how will they cope with these challenges?

The banks in our sample generally acknowledge the pressure on net interest income and express their concern with regard to low interest rates associated with a persistent accommodative monetary policy. This concern materialised on 4 July 2013, when Mario Draghi, President of the European Central Bank, stated in a speech that he expects “… key ECB interest rates to remain at present (or lower) levels for an extended period of time.”

In the survey, three smaller retail banks commented that changes in regulation and competition are also likely to affect the net interest margin. They argue that the introduction of the Liquidity Coverage Ratio, along with foreign banks attempting to penetrate the attractive Belgian deposit market, might increase competition for deposits and, hence, drive up deposit rates, negatively affecting the net interest margin.

The retail banks, and some of the universal banks, which rely most on the net interest income driver, see two remedies for this threat to their business model:

- One is to increase their commercial margin in long-term lending, a trend that has already been taking place over the past few years. The banks acknowledge that there is more prudence in the overall credit function; this trend is expected to continue should the macroeconomic environment remain precarious. Despite increased competition and
shop-around client behaviour, a broad majority of banks indicate that profitability will receive increased attention relative to market share in the loan market. However, competition is strong in the corporate mid-markets and, as a consequence, increasing risk costs are not necessarily covered by margins on credits.

- The other remedy is to diversify the income base by evolving to a more commission-based business model, although executives realise this will not be straightforward either in the current environment. Opportunities in the fee business are restricted by the overall shape of the customer and the power of incumbent market players. Diversifying the income base towards financial transactions is no longer relevant in the current environment.

These are the direct courses of action that can be taken to offset the external stress on the main income driver for retail banks and some of the universal banks. We must note, however, that about half of the banks that discussed the net interest income issue seem to recognise that there will be some suffering on this value driver. Instead, financial institutions have found leeway in different cost management strategies, a trend that will probably continue in the industry for quite some years to come.

**COST MANAGEMENT**

With limited potential on the income side, Belgian financial institutions are focusing on cost management strategies and rethinking preferred distribution channel processes. As a natural starting point for this discussion, we let the executives identify the most important operational costs for their organisation today.

**Current cost drivers**

Not surprisingly, information technology (IT) and staff expenses are mentioned most frequently. However, it’s hard to disentangle the two, as information technology developments require expensive human capital. During the interviews, we did not distinguish between FTE costs and the costs of IT developments and the infrastructure.

---

**WHAT ARE YOUR MAJOR COST DRIVERS AT THE MOMENT?**

<table>
<thead>
<tr>
<th>Cost Driver</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>IT</td>
<td>14</td>
</tr>
<tr>
<td>Staff</td>
<td>14</td>
</tr>
<tr>
<td>Premises</td>
<td>2</td>
</tr>
<tr>
<td>Taxes</td>
<td>1</td>
</tr>
<tr>
<td>Marketing</td>
<td>1</td>
</tr>
</tbody>
</table>

*Chart 1: Current major cost drivers for banks. Figures represent the number of times the cost category was mentioned. Respondents were allowed to name more than one cost driver.*
Both of the current major cost drivers for Belgian banks relate (at least partly) to the choice of distribution channel:

- New digital channels are rapidly being deployed to serve changing client needs. There are approximately 6 million online channel subscriptions in Belgium, and banks have started rolling out mobile banking applications to further encourage customers to carry out their own banking activities. Notably, the smaller banks in our sample stress that IT investments are a heavy burden.

- The physical presence of Belgian banks is still very dense when compared with neighbouring countries. There are about 720 branches per million inhabitants in Belgium, compared to 480 and 450 in France and Germany, respectively. Although physical network costs have been reduced with the closing of about 10,000 branches over the past 20 years, in most cases the front-office personnel are still the most prevalent cost driver. The core question pertains to how banks will deal with their desire for operational efficiency and relationship banking.

Drivers of IT expenses

Capital planning, risk measurement and reporting requirements are just a few of the many areas that emphasise the need for an integrated information technology system. Heightened regulatory and compliance pressure and evolving customer demands have made continuous technology investments a source of strategic advantage. Banks increasingly make use of digital channels (such as home- and mobile-banking) as well as social media to interact with their clients and enhance the overall customer experience. Indeed, 12 of the 15 banks point to these reasons when rationalising IT expenses. Citing the lasting nature of the aforementioned drivers, 71% of the banks expect IT spending to rise further in the coming years.

Cost flexibility practices that have emerged in the past are expected to be maintained in the future. One of these is executing a project in sequential phases, where the completion of each phase produces a standalone solution. Thus, when revenues dip, the bank is able to trim its costs and cope with unexpected events without aborting the entire project. This approach has been adopted at four banks in our sample.

However, IT development doesn’t only involve complying with regulatory standards or meeting the needs of customers. One third of the banks indicate necessary adjustments to the business model and product offering decisions as underlying grounds for future IT costs. These banks recognise the need for a simpler product offering to be more operationally efficient. Determining what products to put on the shelf, and which product offerings to abandon, requires data management systems and a methodological framework. In addition, IT serves as a way to automate business processes and optimise a bank’s cost structure. Thus, information technology has a very strategic aspect, and, despite the heavy
burden it places on them, smaller banks especially are convinced of the competitive edge it can bring to the organisation.

Regulatory requirements have forced banks all over the world to assess and redesign IT systems, data and management reporting tools. Regulatory proposals initiated by different governing bodies do not tend to be cohesive, and so individual banks are stuck with the integration. Two of the Big 4 banks, and three smaller retail banks, stated that investing in the latest technology for risk management and compliance can give banks a competitive advantage. They are keen on increasing the quality of information and metrics used to set and measure risk appetite to provide forward-looking risk assessments, especially in the field of liquidity risk. Retail banks have a more pronounced intention to assess more precisely their capacity to take risk.

**Chart 2: Projected direction of IT expenses in the coming 5-10 years**
Cost management strategies

Seven of the 15 interviewed banks will thoroughly rethink their branch network over the coming years. Banks with a larger branch network comment that the sheer number of branches that they’ve maintained in the past is not sustainable, and most of them are in the process of reshaping their branch network. Reshaping does not necessarily mean closing down local branches, but rather changing the format of the smaller ones to remain easily accessible to clients at a lower cost than today. The distribution cost in Chart 3 refers to the commission the bank pays its independent agents. Although strongly convinced of the benefits of working with agents, three banks stated that the commission they’ve been paying for this distribution channel has become too high. So, rightsizing the remuneration that was set when more favourable macroeconomic conditions prevailed will be one of the key priorities in the coming years.

Three banks are comfortable with their cost structure as it is today – so they do not plan to implement any cost management strategies.

What will be the main focus for reducing costs in the coming years?

Chart 3: Cost reduction areas

Automation

Ten banks see automating business processes as a potentially valid way to manage costs. According to the input we received, automation means:

- Using direct distribution channels, in which the clients’ personal interaction with the bank is strictly reserved for the most important transactions.
- Processing customer transactions, processes and activities in a streamlined fashion.

Therefore, automation serves to cut back to an absolute minimum the human input required to execute processes and activities. Although self-service channels are widely used nowadays, the question remains: how quickly should banks move into a strictly automated interaction with the client? Belgian customers tend to appreciate the interaction with their bank and see the branch network as a physical and psychological connection to it.
Back-office automation and streamlining customer transaction processes will receive profound attention as long-term sustainable cost-reduction measures. For small and large players alike, document processing for regulatory or customer purposes constitutes an opportunity to reduce costs significantly.

Further streamlining the online sales channel and the physical branch network (in the account opening process, for example) are a couple of ways to increase efficiencies and cost-effectiveness. Moreover, faster handling speed is likely to affect both customer and employee experience in a positive way. In addition, private banks point to the benefits of automating – or standardising – products that appear to be tailor-made in the front-office.

Branch network

Banks – especially those with a large branch network – are experiencing the need to alter their physical presence to contain costs, and they can do so in two ways: (i) close branches or (ii) adjust the format of the network. Currently, the latter option is preferred – and executives from different banks generally have the same concepts in mind when describing how they will redesign their branch network. The branch of the future tends to be smaller, more open and has an outlet-like feel, making it an accommodating contact point for clients. It is aimed at seamlessly linking clients’ experiences in the branch with services provided via the internet and other mobile banking applications. Reducing the branch network, or rethinking the format of a branch, directly affects personnel costs, one of the two major cost drivers in banks today. The smaller players – whose physical branch network is much smaller to start with – are also keen on integrating physical presence with internet and mobile banking, but with the prime objective of being physically close to the customer.

Outsourcing

Banks are divided on the role of outsourcing in containing costs, with conflicting opinions concentrating on whether or not to outsource IT development. On the one hand, we see bankers who are convinced that outsourcing IT activities is beneficial for their organisation – they point to cost savings and the ability to focus on more strategic issues. On the other hand, we also see bankers who regard their IT infrastructure as a core engine of the organisation – and so they are reluctant to let go of it. In addition, larger banks find custom-made packages and updates to the system to be more expensive when done by an external company. Confronted with these conflicting opinions, some executives conjecture that executives who ‘know’ IT, or have a background in IT, are more likely to keep it in-house, because they understand better what kinds of resources are required for successful development and implementation.

Charts 4 and 5 below indicate that the majority of the Belgian banks will leave the extent to which they outsource unchanged. Three banks will increase outsourcing, and one bank will decrease outsourcing activities. However, the view of banks on the use of outsourcing in the entire industry is different: 6 banks are convinced the industry as a whole will

Reasons to keep IT development within the organisation include:

- the strategic nature of IT
- cost of custom-made solutions
- differentiation towards the client
- negative outsourcing experiences in the past
increase its reliance on outsourcing, and they cite the increased regulatory burden for small banks as the main reason for this.

A large majority of our sample share the same view concerning outsourcing of business activities other than those related to IT. In most banks, services like catering, transportation and press relationships currently lie with outside suppliers, and we are not able to identify a future trend in the outsourcing of these activities. About 50% of the banks we interviewed share back-offices, but again for less strategic and less important business activities. Compliance and risk management regulations are in place with principles to increase the empowerment and control of the company that decides to outsource. But the more important reason for not outsourcing is that most banks do not see outsourcing as a sustainable, long-term cost reduction strategy.

**Other avenues**

A clear decision regarding the service model and product offering impacts the cost base significantly. Small- and medium-sized banks, in particular, realise that having a large menu to choose from does not always add value for the customer, while it requires resources that can be used more effectively in other parts of the bank. Nearly half of the small- and medium-sized banks believe a more pure model will support growth in a niche market, because it offers a qualitatively sound and transparent proposal to the client. Limited in their ability to offer a bit of everything, these banks prefer a simple and clean product offering that is comprehensible to the personnel and the client. Finally, some of the small subsidiaries intend to leverage their position within a larger financial group to make use of shared services centres and manage costs this way. The choice of service model pertains to private banks who provide discretionary and/or advisory services to their clients. In an attempt to optimise their cost structure, private banks foresee a shift towards either offering a strictly discretionary service or introducing an additional premium for the advisory services they offer.
This sub-section builds on the most important cost management strategies set out previously. We now explicitly address the banks’ views on the distribution channel and its potential implications for customer intimacy and customer experience. ‘Customer intimacy’ involves moving beyond transactional relationships into long-term customer relationships through a better understanding of customer needs. ‘Customer experience’ focuses on creating differentiated experiences at touch points that customers choose to interact with the bank.

About 93% of the bankers interviewed are convinced that their bank’s online channel will gain importance as a distribution and client interaction channel. The figure is lower (73%) when we inquire about the use of the online channel for the entire industry – essentially asking executives what weight they think competitors will attach to this development. Thus, three banks (20%) who indicated the online channel will receive increasing attention within their bank believe competitors will attach less importance to this channel. As smartphone and tablet applications are currently being rolled out at an increasing pace, it is expected they will continue to relieve the stress on the physical branch network. However, a growing adoption rate of online banking in general does not predict the end of multi-channel banking. Almost every bank is convinced that branches are important as a physical and psychological connection to the Belgian client – and so they do not believe in branchless banking for the time being.

There are, however, two differing views on the online channel, as exemplified by the fact that 75% of the largest banks in Belgium are convinced that the online channel will be of very significant importance to their business model, compared to 18% of the smaller- and medium-sized players. We believe that the discrepancy is due to the current business model of the smaller- and medium-sized banks, which include players serving a specific market segment as well as private banks. Larger, universal banks tend to have higher potential benefits to reap by supporting and administering the self-service channel. The promotion of the online channel has the following ramifications for the physical branch network:

- Larger banks seem to be steering towards redesigning these branches into sales and advice outlets – essentially, high-tech, flexible “stores” that are geared towards the client. Retaining the accessibility and the advice function of banks, while lowering the distribution costs, is the core idea behind this move.

- Small- and medium-sized banks are convinced that there is – and always will be – a market for banks like them. They judge themselves to be closer to the customer and more embedded in the local community than the larger banks.

Implications for future customer experience

Both groups will need to focus on integrating contact points and providing a complete customer experience. In fact, all of the banks that use both digitised channels and a physical branch network see great challenges in streamlining a multi-channel network where different contact points can be used interchangeably. Developing a seamless multi-channel approach requires banks to monitor changing channel usage patterns and carefully interpret client information data. Despite the high penetration of online channels, the physical branch network still dominates when it comes to actually selling a product. As the channels blend into each other, and clients feel more and more at ease, 5 banks – mostly larger players – see great untapped potential for online cross-selling and up-selling.
However, the incentive for smaller- and medium-sized retail banks to shift to more online versus physical distribution is less pronounced, because they have a smaller physical network to start with. The need to integrate channels is less pressing for the private banks, which typically have a very limited number of offices (<10) and meet their clients an average of twice a year.

Successful relationships with customers in the digital world are high-trust relationships. But do clients still trust the banking industry? An April 2013 study by Febelfin – the Belgian Financial Sector Federation – showed that banks are having a hard time regaining consumer trust following bail-out procedures and controversy over remuneration policies. However, we should also note that the same study revealed that 88% of the clients are ‘satisfied’ to ‘very satisfied’ with the service their bank offers. According to the majority of the banks in our sample, building high-trust relationships by integrating all channels and having multiple contact points is the way forward.

**Implications for customer intimacy**

Nearly 75% of the banks deem client relationships ‘very important’ (Chart 8). It seems that banks today still appreciate the value of being close to the customer. Maintaining close ties with the community and a strong local presence are historical characteristics of the Belgian banking landscape, but they also entail a view on the future. Evolving customer preferences, combined with impaired trust in the banking sector, promote a clear customer focus as a driver for future profitability and value creation. From the banks with a neutral stance on the importance of customer relationships, we received the comment that, although a lot of banks say they believe customer relationships are important, it is not operationally efficient – and thus not feasible – to cater to the smaller customer’s every need.

The view on customer intimacy versus operational excellence is a strategic issue. Some bankers – following Treacy and Wiersema (1995), who first coined the terms – feel that these generic strategies are mutually exclusive. However, the majority of the Belgian bankers are convinced that these concepts should be viewed in a symbiotic way. More complex transactions with the client need to be handled with care, and although taking the time to listen to a small client’s needs may
seem costly and inefficient, intensively standardising back-office operational efficiency can make the relationship profitable. In addition, this enables the bank to identify changing consumer behaviour trends. According to 70% of the banks, face-to-face communication is not the only way to build client relationships: making the product offering easily available in a digitised form, and fully integrating digital channels in the business model, will – through an enhanced customer experience – contribute to a customer-intimate relationship.

**How important is customer intimacy for your bank?**

<table>
<thead>
<tr>
<th>Importance</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very important</td>
<td>7%</td>
</tr>
<tr>
<td>Important</td>
<td>20%</td>
</tr>
<tr>
<td>Neutral</td>
<td>73%</td>
</tr>
</tbody>
</table>

**Can relationship banking be used to obtain a unique selling proposition?**

<table>
<thead>
<tr>
<th>Response</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>33%</td>
</tr>
<tr>
<td>No</td>
<td>67%</td>
</tr>
</tbody>
</table>

Chart 8: Customer relationship importance (bank)  
Chart 9: Customer relationship as a unique selling proposition.

Two large banks and one medium-sized retail bank note that, besides offering the client a wide variety of efficiently managed contact points, customer analytics will help strike the balance between customer intimacy and operational performance. Attempts to increase cross-selling and up-selling via online channels will prove to be more successful using customer behaviour analysis – which leads these banks to predict that customer analytics will constitute a success factor in the Belgian banking landscape.

“All banks that use both digitised channels and a physical branch network see great challenges in streamlining a multi-channel network where different contact points can be used interchangeably”
CHAPTER 3: REGULATORY ENVIRONMENT

In the years before the global financial crisis, bank business models were changed and perilous activities set up, mainly by large, international financial institutions. While the increase in leverage and complexity and the lack of transparency made these players more vulnerable to adverse shocks, regulatory action in this matter remained subdued.

The global financial crisis revealed these deficiencies and failures of the regulatory framework, thus setting the wheels of financial reform in motion. The detrimental effects on the macroeconomic environment of the financial sector’s collapse, and the approval of state aid packages for the larger banks, reinforced public support for more regulation. The goal of putting banks in a regulatory straitjacket is clear: to build a responsible and resilient banking sector for the future.

Regulatory initiatives that are under way, or already close to implementation, include:

- capital and liquidity requirements
- supervision and governance frameworks
- remuneration practices
- customer treatment practices
- wholesale market risk

With this vast body of rules heading for the sector, banks are now in the process of evaluating the implications of the reforms on their business models, structures and operations.

In the survey, we focus on the Basel III international regulatory framework for financial institutions, because the framework is reasonably complete1 in its design and is one of the initiatives closest to implementation in EU legislation. In addition, KPMG’s Regulatory Pressure Index, which sets out an assessment of the scale of the challenge posed by key areas of financial sector reform, confirms that the Basel III requirements are still the main challenge for all banks globally. Thirteen of the fifteen executives confirm that the implementation of the Basel III regulatory framework will have an impact on their bank’s profitability and/or choice of business model in the future. It seems that, overall, banks are less worried about the framework for liquidity risk measurements than they are about the capital requirements of the accord.

---

1 As for the international framework for liquidity risk measurements, standards and monitoring, the Basel Committee issued the full text of the revised Liquidity Coverage Ratio (LCR) following endorsement on 6 January 2013 by its governing body – the Group of Central Bank Governors and Heads of Supervision (GHOS). The Net Stable Funding Ratio (NSFR) is currently under revision.
The new layer of capital rules has forced banks to monitor their capital and leverage ratios closely to bring them in line with the minimum requirements. Raising new capital in the current environment is deemed difficult, and so retaining earnings has been, and will remain, an important way to increase the capital buffer (the macroeconomic environment permitting). De-leveraging by selling assets and reducing lending is seen as a more direct and manageable process. A number of banks are contemplating jettisoning or shrinking some of the business lines that are under pressure following the Basel framework, with investment banking divisions as an apparent target. Increased risk charges for bank trading books will make investment banking very costly in terms of capital allocation. Because of the time-consuming nature of the de-leveraging process, Belgian banks are now improving the performance of existing internal assessment methodologies to ensure the development of a successful capital strategy and to navigate the environment carefully. Nine banks feel that the capital rules presented by Basel III will have a significant but manageable (medium) impact on their organisation’s profitability and/or shift in business model. Two banks foresee an impact on the business that is very significant and difficult to manage (high).

**WHAT WILL BE THE IMPACT OF Basel III CAPITAL RULES ON YOUR FUTURE PROFITABILITY AND/OR BUSINESS MODEL?**

<table>
<thead>
<tr>
<th>Impact Level</th>
<th>Number of Banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>1</td>
</tr>
<tr>
<td>Medium</td>
<td>10</td>
</tr>
<tr>
<td>High</td>
<td>2</td>
</tr>
</tbody>
</table>

**WHAT WILL BE THE IMPACT OF Basel III LIQUIDITY RULES ON YOUR FUTURE PROFITABILITY AND/OR BUSINESS MODEL?**

<table>
<thead>
<tr>
<th>Impact Level</th>
<th>Number of Banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>4</td>
</tr>
<tr>
<td>Medium</td>
<td>6</td>
</tr>
<tr>
<td>High</td>
<td>3</td>
</tr>
</tbody>
</table>

*Chart 10: Basel III capital rules impact (bank)*

*Chart 11: Basel III liquidity rules impact (bank)*

The introduction of two minimum standards for funding liquidity – Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) – will require banks to hold significantly more liquid, low-yielding assets, thereby negatively impacting profitability. Some executives even warn of unwanted incentives – such as excessive risk taking in other areas – to compensate for the low-yielding assets. Moreover, they criticise the rules for overshooting entirely the classic maturity transformation role banks fulfil; a change in the funding profile of banks is imminent due to the regulator’s focus on more longer-term funding. Private banks object to the fact that deposits larger than €1 million are treated as wholesale funding – and thus considered high liquidity risk. More often than not, a trust relationship is established with these depositors, making it a very stable source of funding in practice.

Those bankers who expressed discontent over regulatory requirements argue that the Basel III framework is business model-neutral, and that it does not always take into account the specific economics of products. Consequently, different business models display different sensitivities to the capital and liquidity requirements. In addition, some of the small- and medium-sized banks feel that it is unfair that they be thrown into this regulatory upheaval while they were not involved in causing the financial crisis. Indeed, these were not the highly leveraged banks, nor were they trading or distributing complicated structured products on a large scale. For example, the deposit
tax does not take into account the soundness of the balance sheet, affecting strong retail banks equally. Other banks deem the involvement of regulatory bodies essential to the safety of the financial system and to the protection of clients and taxpayers. John Heller, Argenta Spaarbank: “The Liikanen Report is right: there are different ball games, and splitting the relationship between banking and deal-making is the way forward.”

Aside from the direct impact on the asset mix and the funding profile decisions, there is a large operational cost attached to the regulatory environment. Updating databases and strengthening IT infrastructures to develop appropriate risk-managing tools and increasing reporting requirements will continue to take up a large part of the bank’s resources. However, according to two large banks (one medium-sized retail bank and one small retail bank), dealing with the regulatory environment and making proactive decisions will prove to be a key success factor for the future.

**Lack of coherence**

With different sets of regulations, banks need to respond to the combined impact of regulatory reforms. It is expected that a bank’s profitability will be undercut by the compilation of costs this regulatory knot brings about. The executives in our sample have the impression that, in their attempt to create a stable and resilient banking sector, different regulatory bodies act from their own point of view. There is no question that the protection of deposits and the facilitation of the banking transformation model are vitally important to restoring trust and confidence in the sector. The issue banks face today, however, is an uncoordinated set of rules. Dealing with them is expected to be a challenge for the future.

John Heller, Argenta Spaarbank: “The Liikanen Report is right: there are different ball games, and splitting the relationship between banking and deal-making is the way forward.”

Another issue causing banks dissatisfaction relates to the unstable political environment. The fickleness of governmental bodies, in particular, has triggered unnecessary costs, with the introduction and quick abolishment of the withholding tax as a prime example. Leen Van den Neste, VDK Spaarbank: “The banking industry needs a stable governmental environment... It’s already challenging enough for a bank to survive in the current financial environment without the government rethinking our business model.” It is clear that the regulator is not providing a clear guideline that covers all of the regulations and sets out the steps to take. The banks themselves will need to pick up the gauntlet and identify the interrelationships between different regulatory initiatives.
CHAPTER 4: MEASURING BANK PERFORMANCE: FUTURE KEY PERFORMANCE INDICATORS

The developments outlined in Chapters 2 and 3 characterise fundamental changes to business processes in banking. There is an increasing emphasis on cost management strategies due to constraints on revenue growth. Regulatory parameters and the development of new, integrated channels call for a revision of measuring systems and key performance indicators (KPIs). Banks tie their set of KPIs closely to the strategy they plan to pursue. Given the importance of cost management strategies and profitability, we first take a look at the cost-income ratio and return on equity (ROE) targets for the coming 5 to 10 years.

Ten of the banks we interviewed have a target cost-income ratio and, although individual targets will not be disclosed, seven banks were willing to communicate their target to us. The average target cost-income ratio for these banks is 59%, whereas the average cost-income ratio for our sample in 2012 stood at 72%. Belgian financial institutions that found themselves still in a restructuring process deliberately chose not to set a target, while some of the executives have no target because they don’t want to regard their cost management strategy as minimising a percentage. Fostering a mind-set of optimising daily operations throughout the organisation is found to be a more natural and stimulating approach to implementing and monitoring cost management strategies.

Return on equity as a classic performance measure is still widely used, but the variations on it – such as RAROC, RARORAC and ROC – are decreasing in popularity. Executives feel that shareholders are again concentrating on pure ROE measures rather than seeking more advanced gauges. Although capital adequacy is widely monitored, the majority of the banks in our sample does not couple this to returns generated. Nine banks have a target ROE, and eight of them were willing to disclose their target to us. The average target is 10%, although a number of banks do not see double-digit returns materialising for the Belgian financial sector as a whole in the near future (2015-2016). The weak macroeconomic environment and regulatory pressure are the most important reasons for this pessimistic view.

![Chart 13: Target cost-income ratio](image)

![Chart 14: Target return on equity ratio](image)
The starting point for choosing the KPIs that would fit a particular bank should be to choose those that allow management to quantify progress against defined strategies. Identifying future key performance indicators is closely linked to the findings in Chapters 2 and 3 as depicted in Chart 15 below.

Belgian banks realise that enhancing customer experience through the seamless integration of multiple contact points facilitates building a customer-intimate relationship and capitalising on cross- and up-selling via online channels. Three measures related to a customer focus – client satisfaction, customer centricity and net promoter score – were mentioned in about 40-50% of the interviews.

In line with the multi-channel approach and the growing technological nature of banking, the level of IT integration is a KPI in 36% of the banks we interviewed. This measure quantifies the extent to which the IT infrastructure leverages existing databases, connects to external services, and delivers new customer experiences.

Margin targets (29%) tend to be favoured over volume targets (7%) – which confirms the banks’ strategy of choosing profitability over market share in the credit function. The loan-to-deposit ratio (21%) as an indicator of reshaping the business portfolio to fit assets and risk appetite seems to be central to the discussion regarding strengthening balance sheets and liquidity positions. This is a non-exhaustive list of the KPIs that were mentioned during the interviews. For the purposes of brevity, other KPIs, which are not depicted in Chart 15, include: capital intensity, liquidity and capital ratios, profit before tax, number of clients and number of large clients.

In May 2012, Vlerick Business School and KPMG issued a report that develops a scorecard for bank performance in the Belgian banking industry – the KPIs outlined in that scorecard can be extrapolated to the KPIs presented here. The findings of the 2012 report are in line with the Dutch Central Bank study on the same topic (Bos et al., 2006).

What key performance indicators will you start using more consciously?

![Chart 15: Future key performance indicators](chart15.png)
CHAPTER 5: GLOBAL VIEW ON THE FUTURE BELGIAN BANKING LANDSCAPE

In a concluding note, we asked Belgian banks about their view on the future of the Belgian financial landscape. Aside from general market conditions – the shape of the customer and trading activities – threats to the banks’ current business model include regulatory pressure and low interest rates with a flat term structure. These factors will continue to shape business models in the coming years.

About 80% of our sample are convinced that the number of banks in the Belgian landscape will decrease in the coming years. This next consolidation phase is expected to start two years from now. The bankers feel that, currently, there is insufficient cash to engage in such ventures and that the regulator is not likely to look favourably on reduced competition just yet. Risk appetite has also been subdued following the financial crisis shock. However, after this transition period, and if the macroeconomic outlook becomes clearer, merger and acquisition (M&A) activity is likely to rise again. Small banks will be able to continue to serve their niche markets and remain profitable, but medium-sized banks are considered to be somewhere in between: they have a large customer base compared to the small banks but lack economies of scale. For this reason, they may become an acquisition target in the future. In a country with 11 million inhabitants, the presence of four large banks is thought to be unworkable in the longer run.

Bankers are highly divided regarding how large Belgian financial institutions will be in the future compared to today. Indeed, there are two drivers that will determine the banks’ size: on the one hand, there is the regulatory obligation to deleverage and decrease the banks’ balance sheet; on the other hand, we have the degree of consolidation – by definition, increased M&A activity on the Belgian market results in larger banks. Financial sector executives predict that the number of Belgian banks will decrease further. The financial crisis marked a period of reduced Belgian ownership, especially in the case of large banks. A pan-European banking network is expected to develop in the near future, through which some of our banks will become part of a larger group.

As we have already highlighted a number of times in this study, the banks’ growing technological nature is a game-changer. It is not unthinkable that technological companies will start to offer banking services on a large scale. Google, Facebook and Apple are just a few companies that can quickly set up payment service networks in an attempt to capture a large part of the traditional banking market. Moreover, these brands are popular – and their reputation for good customer experience is crucial for the trust relationship that financial services firms need to create. Two bankers foresee a shifting paradigm in which giant, multinational, technology-based companies enter the Belgian market, wielding only digitised channels and using the vast amount of information they already have to expand customer advocacy even further. If this scenario materialises, the pure retail banking business will be severely impacted. Although habits and mentalities may change over time, the incumbent banks should not underestimate the current nature of the Belgian client, who is reassured by physical proximity.

Most banks operating in Belgium will be:

- larger in size
- smaller in number
- operating on a pan-European scale
Chart 16: Global overview on the future Belgian banking landscape
REFERENCES


NBB, 2013. Economic projections for Belgium, spring 2013, economic review June 2013


## APPENDICES
### APPENDIX A: SAMPLE AND INTERVIEWEES

<table>
<thead>
<tr>
<th>Bank name</th>
<th>Person interviewed</th>
<th>Position at time of interview</th>
<th>In this position since</th>
</tr>
</thead>
<tbody>
<tr>
<td>AXA Bank Europe</td>
<td>Sabine De Rycker</td>
<td>CEO</td>
<td>Jan 2012</td>
</tr>
<tr>
<td>Bank J. Van Breda en Co NV</td>
<td>Carlo Henriksen, Dirk Wouters</td>
<td>CEO, CFO</td>
<td>N/A, N/A</td>
</tr>
<tr>
<td>BPost Bank</td>
<td>Eric Pulinx</td>
<td>CFO</td>
<td>June 2009</td>
</tr>
<tr>
<td>Banque Delen NV</td>
<td>Jacques Delen</td>
<td>CEO</td>
<td>1975</td>
</tr>
<tr>
<td>Belfius Bank NV</td>
<td>Jos Clijsters</td>
<td>CEO</td>
<td>September 2011</td>
</tr>
<tr>
<td>Banque CPH</td>
<td>Alain Declercq</td>
<td>CEO</td>
<td>N/A</td>
</tr>
<tr>
<td>Deutsche Bank NV</td>
<td>Michael Point</td>
<td>CFRO</td>
<td>N/A</td>
</tr>
<tr>
<td>F. Van Lanschot Bankiers België</td>
<td>Rob van Oostveen</td>
<td>CEO</td>
<td>May 2012</td>
</tr>
<tr>
<td>BNP Paribas Fortis</td>
<td>Filip Dierckx</td>
<td>COO</td>
<td>N/A</td>
</tr>
<tr>
<td>ING Belgium NV</td>
<td>Guy Beniada</td>
<td>CFO</td>
<td>February 2007</td>
</tr>
<tr>
<td>KBC Bank NV</td>
<td>Luc Popelier, Christine Van Rijseghem</td>
<td>CFO, Senior General Manager</td>
<td>May 2011, N/A</td>
</tr>
<tr>
<td>Optima</td>
<td>Philip De Hulsters</td>
<td>CCO</td>
<td>January 2010</td>
</tr>
<tr>
<td>Record Bank NV</td>
<td>Yvan Peeters</td>
<td>CFO</td>
<td>N/A</td>
</tr>
<tr>
<td>VDK Spaarbank NV</td>
<td>Leen Van den Neste</td>
<td>CEO</td>
<td>April 2012</td>
</tr>
</tbody>
</table>
## APPENDIX B: GLOSSARY

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Client satisfaction</strong></td>
<td>The degree to which the service and the products provided meet or surpass customer expectation.</td>
</tr>
<tr>
<td><strong>Customer centricity</strong></td>
<td>Customer centricity relates to placing the customer at the centre of the organisation. A customer-centric organisation has a deep understanding of its customers’ needs and delivers an integrated customer experience across all contact points.</td>
</tr>
<tr>
<td><strong>Customer experience</strong></td>
<td>Creating differentiated experiences at touch points that customers choose in order to interact with the company.</td>
</tr>
<tr>
<td><strong>Customer intimacy</strong></td>
<td>Moving beyond transactional relationships into long-term customer relationships through a better understanding of customer needs.</td>
</tr>
<tr>
<td><strong>Level of IT integration</strong></td>
<td>The extent to which the IT infrastructure leverages existing databases, connects to external services, and delivers new customer experiences.</td>
</tr>
<tr>
<td><strong>Net income</strong></td>
<td>The bank's total earnings, reflecting revenues adjusted for costs of doing business, depreciation, interest and other expenses.</td>
</tr>
<tr>
<td><strong>Net income after tax</strong></td>
<td>The bank's total earnings, reflecting revenues adjusted for costs of doing business, depreciation, interest, taxes and other expenses.</td>
</tr>
<tr>
<td><strong>Net Promoter Score (NPS)</strong></td>
<td>Loyalty metric that tracks how customers represent a company to their friends, associates, etc. It is constructed by asking customers the following question: &quot;How likely are you to recommend (our company) to a colleague or friend?&quot;</td>
</tr>
<tr>
<td><strong>Online channel</strong></td>
<td>In this paper, we use the term online channel to describe self-service channels that make use of the internet. These include, for example, home-banking and banking via smartphone or tablet applications.</td>
</tr>
</tbody>
</table>