

VoxEU: The bank business model in the post-Covid-19 world

This article presents a report by the IESE Business School and CEPR which shows how the current crisis will shape the future of banking, **writes Elena Carletti, Stijn Claessens, Antonio Fatás, Xavier Vives for VoxEU**



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Low profitability was already a problem before the Covid-19 crisis

Forecasts for 2020 suggest a drop in global GDP of 6% with a record number of countries growing at negative rates (OECD 2020). Advanced economies will suffer a much larger drop in GDP, of a size not seen since the Great Depression. No doubt, banks will come under stress as large-scale insolvencies among firms will arise and a wave of bankruptcies among households may follow. In addition, while banks entered the crisis better capitalised and more liquid, the size of the crisis will likely strain them to a degree exceeding that envisioned in many stress tests conducted so far (ECB 2020).

The crisis comes on top of the combination over the past decade of several trends that have meant increased competitive pressure on banks and that, in particular in some regions, have lowered their profitability. In the second report in CEPR/IESE series on The Future of Banking

(Claessens et al. 2020), we argue that the global pandemic is likely to prolong, if not accelerate, many of these trends – digitalisation in particular. While the economic crisis has triggered policy responses to stimulate lending to the real economy while assuring the stability of the banking sector that provides breathing space in the short run, deep restructuring of many banking systems will be needed in the medium-term.

A key quote from the article:

In the short run, banks may enjoy a revitalisation as they continue lending to their customers during the crisis, notably as soft information can be more valuable today than hard information. They also enjoy the protection of the safety net and access to deposit financing. Nevertheless, Covid-19 will likely accelerate the digitalisation and the shift over the medium term of activities away from the sector. Medium-sized banks will likely be suffering the most since reaping cost efficiencies with large IT investments, crucial in a persistently low-interest environment, will be out of reach.

As a result, the banking sector will need deep restructuring; winding up banks and consolidating the remaining ones will be preferred. Whether in the post-Covid-19 world, political obstacles to cross-border mergers will prevent, as states become more protective of their national banking champions, is a major policy question. BigTech companies have many of the ingredients to get ahead in the post-Covid world. They are digital natives; they have the technology, customer base and brand recognition, as well as vast amounts of data and deep pockets.

Banking may thus move from the traditional oligopoly to a system with a few dominant platforms that control access to a fragmented customer base, with a few BigTech firms, together with some platform-transformed incumbents, monopolising the interface with customers. In this scenario, ensuring customer data ownership and portability for individuals, and data interoperability between platforms will be key to keeping switching costs for customers low and the market sufficiently competitive.

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