BCG

Report

Creating Value in Banking 2009

# Living with New Realities

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# Contents

# Note to the Reader

The financial crisis has changed many things—including the structure of our seventh annual study of value creation in banking. These reports usually begin with a review of last year's performance. Given the extraordinary events of the last six months, however, simply "reporting the scores" seemed insufficient. So this report concentrates on describing how the crisis is changing the banking industry and what these changes mean for banks as they develop strategies for competing in the postcrisis world.

As usual, we include comprehensive data about the state of the banking industry in 2008. The report covers a large sample of banks representing more than 77 percent of the market capitalization of the global banking industry. We placed the performance data at the back of the report not because we think the results are overly discouraging or irrelevant—in fact, they provide important insights into banking performance in different parts of the world—but because the crisis is likely to change the way banks create value.

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# Preface

The losses suffered by the banking industry are astounding. Since the precrisis peak, the market capitalization of the global banking industry has fallen by $5.5 trillion. This is equivalent to about 10 percent of global GDP. But losses are only half the story. The financial crisis has done more than destroy value and topple banks. It has redefined what financial institutions must do to compete and win. It will prove to be as transformative as it is destructive.

Many banks are eager to move beyond dissecting the causes of the financial crisis and tallying the damage. They want to figure out how to move forward—and not just over the next few months. This is challenging because the future is clouded by uncertainty and a deepening economic downturn. We are likely to see more significant change as governments and regulators pursue measures that are both unconventional and without precedent.

If the financial crisis has made one thing clear, it is that no one knows exactly what lies ahead. But that should not stop banks (or us) from looking past the immediate—and largely defensive—responses to the turmoil, such as the scramble for funding and hurried efforts to cut costs. The crisis will precipitate changes that are more fundamental than actions driven solely by self-preservation.

To begin moving forward, banks must ask, What is the right business model for the postcrisis era? The business model includes the shape of the business portfolio, the bank's operating and governance models, its approach to talent management, and its strategy for establishing competitive advantage.

Several new realities will change the face of the industry in general:

- We expect the much-maligned universal-banking model to reestablish its primacy. The fundamentals of the model are sound. These banks are built on strong customer relationships and funded predominantly from their own deposit base.

- At the same time, banks will become more focused. They will compete where they can win. Large banks will still loom over the landscape, but they are much more likely to be multilocal institutions—repeating a simpler, more standardized business model across fewer countries—rather than wide-ranging, highly complex global titans. Competitive advantage is back in fashion.

- Banks will move forward by returning to the past. They will once again emphasize "old-fashioned" products and practices, where the bias is to lend what gets taken in as deposits. Their business models will reflect a more cautious, more highly regulated, and less risk-oriented environment. There will be a stronger focus on transaction, processing, and fee-based activities.

- This does not mean that banking will be dull or easy. If anything, it will become more demanding as banks get back to the business of focusing on their customers—the emphasis will be on relationships, not products. Branches may need to extend their hours of operation. Advice will need to be more meaningful and relevant, and thus more valuable. Operations will need to become not only more efficient but also more responsive to customers.

The new realities will force many banks to fall back on core businesses and leaner cost structures, reverting to the things they do best and competing only in the markets where they have strong positions. These actions—coupled with better risk management and an up-to-date view of how the crisis is playing out—should do more than just ensure stability. They will position a bank to gain substantial ground in their core markets at the expense of competitors that do not respond quickly and with purpose.

The report begins with an overview of the impact of the financial crisis on the banking industry as a whole. What follows is an in-depth look at the imperatives for five specific businesses: retail banking, corporate banking, investment banking, asset management, and wealth management.

The report concludes with a detailed analysis of the banking industry's performance in 2008, along with rankings of top performers by size and country.

# Navigating a New Landscape

More than a year and a half has passed since we heard the first deep rumblings of the financial crisis. In June of 2007, Bear Stearns informed investors that two of its hedge funds, which were highly leveraged and closely linked to home mortgages, were in trouble. One month later, the funds had lost nearly all of their value. Shortly thereafter, BNP Paribas temporarily suspended withdrawals from three of its investment funds. At the time, the bank explained that the "complete evaporation of liquidity in certain market segments of the U.S. securitization market" had made it impossible to value certain assets. These events marked the beginning of a global crisis of confidence and liquidity.

The impact on the banking industry has been staggering. From the third quarter of 2007 through January 23, 2009, banks lost $5.5 trillion in market capitalization, or 63 percent of their peak market value. (See Exhibit 1.) They have suffered nearly $780 billion in write-downs since the crisis began. Ten companies alone accounted for more than half of this total.

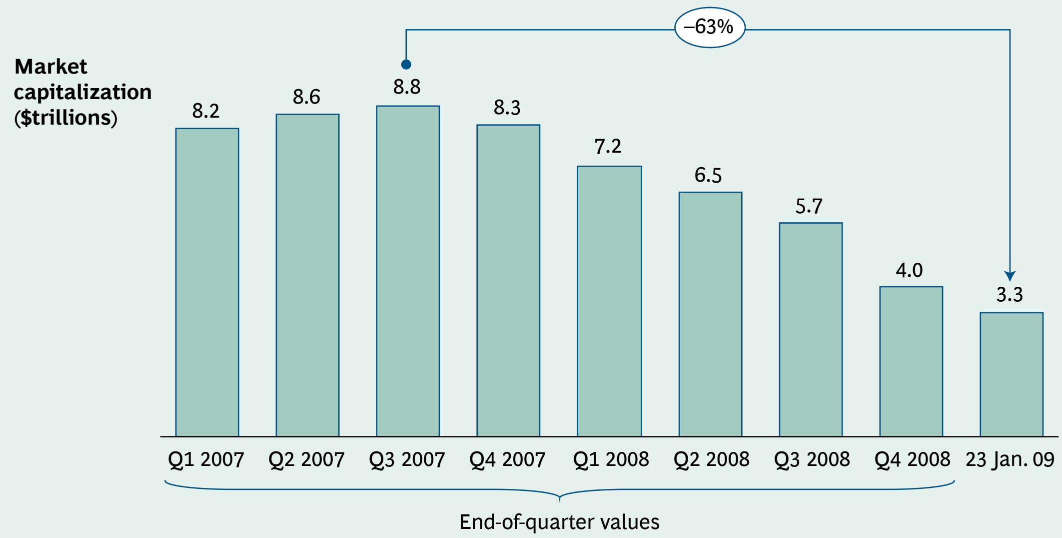
The causes of the financial crisis are now plain to see. They include, among other things, lax lending standards, compensation systems that were not even closely linked to long-term profitability and value creation, watered-down risk management, unrealistically low interest rates, a wall of money seeking enhanced returns, and the proliferation of complex, arcane financial instruments. But determining what the crisis will mean for financial institutions from a strategy perspective has proved to be far more challenging. The situation today is extremely fluid and could change significantly—some banks are planning for the possibility of both hyperinflation *and* persistent deflation. Moreover, governments around the world, stung by the severity of the turmoil, have become much more active. Their interventions are as unprecedented—and potentially game changing—as the crisis itself.

One thing is clear: the financial services landscape is going to change. These changes will go well beyond the inevitable consolidation and stress-induced rationalization of businesses. There is going to be a *new normal*—a more difficult, challenging environment for financial institutions, which will persist for a considerable time. Some financial businesses will eventually return to equilibrium. Others may not return at all. The best institutions will develop a view of how to compete in the post-crisis world and will act now to position themselves for success.

## Defunct Businesses and Not-So-Innocent Bystanders

Between the last economic downturn following the dot-com crash in 2000 and the current crisis, the financial services industry embarked on a path of intense innovation that radically transformed instruments, techniques, and business models. The astonishing rise of the shadow banking system meant that vast swathes of credit were located beyond the scope and interest of regulators. It also allowed banks to deconstruct their value chains on an unprecedented scale and at a breakneck speed. The deconstruction of credit, in particular, resulted in a dangerous gap between the people originating credit and those investing in it. This *originate-to-distribute* model allowed banks (and shadow banks) to generate credit at a phenomenal rate—their ability to lend was unconstrained by any capacity to hold risk.

## Exhibit 1. The Impact of the Crisis on the Banking Industry Has Been Staggering




**Sources:** T.F. Datastream; BCG analysis.
**Note:** All market capitalizations are based on figures in U.S. dollars.

Banks originated loans but were less concerned with the underlying quality of these assets because they could quickly offload them to investors. And in the United States, mortgage brokers poured oil on the flames by originating toxic home loans. None of this could have happened without investors' insatiable desire for instruments with enhanced returns. These investors, in turn, were removed from the origination process and put a great deal of faith in rating agencies. When investors lost faith in the ratings, they lost faith in the assets.

Financial institutions and regulators let these innovations outpace their capacity to manage risk. A false sense of confidence got the better of their judgment. Central banks believed in their ability to outmaneuver or outsmart the business cycle. Financial institutions mistook the sophistication and complexity of their quantitative models for quality and robustness. They exacerbated the situation when they allowed their quantitative models to trump the qualitative judgment of their own experts.

The severity of the crisis has varied among institutions, based on their business models and their exposure to certain risk-taking practices:

- **Defunct or Broken Business Models.** Institutions that concentrated on originate-to-distribute activities or engaged heavily in arbitrage of one kind or another were undone by the crisis. The investment banking industry, as a whole, has been devastated, and the credit monoline is essentially a defunct business model given its reliance on wholesale and capital markets for funding.

- **Not-So-Innocent Bystanders.** Many banks invested their surplus capital in paper generated by other banks' deconstructed value chains. These banks were innocent bystanders, in the sense that they were not responsible for the activities that corrupted the assets, but their unquestioning pursuit of seemingly risk-free investments exposed them to the turmoil.

- **Disconnected but Still Affected Institutions.** Conservative banks with strong balance sheets and good funding positions have fared better. Banks that have focused on transactions and fee-based activities, in particular, have managed to dodge the full brunt of the financial crisis. The total shareholder returns (TSR) of fundamentally sound banks have fallen but have managed to stay above the average TSR of their local markets.

## A Winning Portfolio of Businesses and a New Kind of Titan

As severe as they are, some effects of the crisis are temporary. Credit performance is a cyclical phenomenon, and a rise in default rates goes hand-in-hand with a recession. Eventually, economic growth will resume and, along with it, demand for financial services products. After the crisis subsides, however, financial institutions will face several new realities that will redefine what they must do to compete and win.

Universal banks that have strong brands and a customer-centric offering stand to prosper

- **The Need for a More Focused Business Strategy.** For some banks, diversification was not a business strategy but an overrated insurance policy. It was meant to shield them from a significant disruption in any one market or business. But there are far too many interconnections in the global economy—and in the financial services industry—for simple geographic diversification to provide a reliable defense against a breakdown of business fundamentals. The extreme breadth of some banks' activities made it hard for them to avoid the turmoil and, in some cases, contributed directly to their troubles; flag-planting strategies created unmanageable complexity and led to subscale and disadvantaged positions in many markets.

  Diversification beyond core products and business models also played a role in the crisis. The deconstruction of the credit value chain, for example, gave rise to destabilizing credit risk, which then led to excessive market risk. In addition, the crisis of confidence that began in North America soon spread to Western Europe and then to virtually every banking market in the world. And even the largest banks that boasted widespread customer bases have suffered massive write-downs owing to the downturn in the U.S. housing market. For some banks, there was almost nowhere to hide as diversification led to greater exposure, not greater protection.

  Institutions that expanded prudently—based on a sound, exportable business model—have not been immune to the crisis, but the relative strength of their share prices speaks volumes about the sort of diversification that the market values.

- **The Competition for Deposits and the Primacy of Relationships.** The competition for deposits has intensified, with banks trying hard to strengthen their sources of funding in the midst of a severe liquidity crisis. Some banks that have the greatest need to boost deposits—namely, those that have suffered massive losses—are facing an outflow of funds, as customers move their deposits to safer havens. This has prompted governments to intervene on an unprecedented scale, as policymakers try to stabilize the banking system. At the same time, customer relationships are taking the place of innovative products and risk-taking activities as the centerpiece of banking strategy. Universal banks that have strong brands and a comprehensive, customer-centric offering stand to prosper. Investment banking is likely to focus less on taking risks and more on helping clients transform risk.

- **An Emphasis on "Old-Fashioned" Products and Practices.** Banks will move forward by returning to the past. We do not expect a complete reversion to the originate-to-hold model, but banks will need to develop prudent business models that reflect a more cautious, highly regulated, risk-conscious environment. This does not mean that banking will be dull or easy. If anything, it will become more demanding as banks get back to the business of focusing on their customers. There will be a stronger emphasis on relationship banking, which will encompass transaction, processing, and fee-based activities. Branches may need to extend their hours of operation. Advice will need to be more meaningful and relevant, and thus more valuable. Banking operations will need to become not only more efficient but also more responsive to customers.

  Securitization will not vanish, but it will be more transparent, with collateral subject to much closer scrutiny; and, on the whole, it will involve significantly less leverage. The return to relatively basic offerings will force banks to recalibrate their compensation structures recognizing that capital, rather than the individual, will play a greater role in driving returns. The science underpinning some of the industry's arcane, highly engineered products has been shown to be without merit. The modern financial wizards were no more able to turn lead into gold than the alchemists of old.

- **The Importance of Economies of Scale.** Economies of scale have always been important in banking, but they were often cancelled out by diseconomies of complexity or relative management inefficiency. Taking advantage of economies of scale will become critical as banks gravitate toward simpler business models and begin adapting to an environment where success will depend on capturing a greater share of high-volume, low-margin transaction and processing activities. And as economies of scale become more important, so too will banks' ability to control the costs associated with running large branch networks or high-volume businesses. As ever, banks will need to reduce the costs of IT and operations, which account for a significant share of overall costs.

As a result of these new realities, many financial institutions will rein in their ambitions and concentrate on the businesses they know best, casting off high-risk, complex activities—which were not the high-return businesses many thought them to be—and focusing on their role as financial intermediaries. For a few institutions that have the capabilities and appetite to compete in more complex, risky businesses, the back-to-basics trend could open up significant opportunities for growth once the turmoil subsides.

We believe that these changes will lead to a new world order for banks and the rise of several different business models:

- **Large, Integrated Banks in Developed Markets.** A group of large, vertically integrated banks will carve out top five positions in multiple markets. Their leading positions will help drive scale benefits—they will leverage common IT platforms, for example—and allow them to keep their cost-to-income ratios at or below 45 percent. Their commitment to being a top five competitor will also constrain their geographic reach—they will be careful not to spread themselves too thinly. The majority of their revenues will come from retail and commercial banking—in other words, traditional universal banking.

- **Emerging Market Champions.** A few banks will continue to build meaningful positions in emerging markets, such as the BRIC countries (Brazil, Russia, India, and China) and Central and Eastern Europe. They will be among the top one or two international players in an emerging market, but they will also have strong positions relative to local competitors. Their strategy will be based on a long-term plan (and a suitable risk appetite) for building a competitive presence in these markets. They may even take over the businesses of European banks that stretched too far and are now forced to withdraw from emerging markets.

There is no room for the global titan as it existed before the crisis

- **Global Specialists.** Some banks will develop business portfolios that are deeper than they are wide. In other words, they will focus on a set of core businesses that give them leading positions in markets around the world, rather than spreading themselves across a spectrum of businesses. This approach is particularly relevant to investment banks, private banks, securities servicers, and asset managers, which can rely on innovation and expertise to give them a firm footing in overseas markets.

We have long argued that the banking world would experience global consolidation in much the same way that other industries have consolidated across borders. What we did not have in mind, however, were the flag-planting strategies that would eventually lead to untenable positions for some of the world's largest banks.

There is no room in the new order for the global banking titan as it existed before the crisis. Banks that sought to do just about everything, everywhere have seen their market values plummet and are not likely to survive in the postcrisis landscape. Some titans confused their massive proportions with competitive advantage in individual businesses and countries. They were blinded to the fact that their size was actually a disadvantage—it made them far too complex to manage.

There will still be large banks looming over the landscape. But they will be multilocal rather than global titans. They will concentrate on a smaller set of activities and probably a more limited number of markets. They will compete where they can win. If they venture outside their home markets, it will be for sound strategic reasons—namely, because a particular market suits their strengths. As a result, their business models will be consistent from country to country, and they will gather strength from being a top five bank in individual markets.

Some of the new global titans will follow the T-shaped model. They will be formidable competitors in a limited number of markets, but they will have wider reach in areas that are truly global, such as payments and trade-related businesses.

## The Logic and Limits of Consolidation

Consolidation has intensified among domestic banks, which are searching for ways to ramp up deposits or achieve economies of scale. Mergers have also been driven by banks' efforts to restructure their businesses—some are retreating from foreign markets, whereas others are exiting lines of business—or avoid dissolution. In less troubled times, some of these combinations might have been prohibited for the sake of keeping markets competitive.

Mergers and acquisitions (M&A) activity will continue, but it will be driven more by long-term strategy and less by do-or-die scenarios or hurried efforts to slash costs. The rise of the integrated model and the growing importance of high-volume transaction and processing activities will spur banks to pursue deals that allow them to build business-specific scale. We may see more utility-style pooling of scale-intensive, non-capital-consuming businesses, such as payment processing, securities clearing, and settlement.

In a survey conducted by BCG and UBS Investment Bank from September through November 2008, 67 percent of banks believed that transformational deals are likely in the industry.[1] All banks believed that there will be more restructuring deals, leading to a rise in the number of spinoffs, carve-outs, and closures of individual businesses. High-profile restructuring deals include JPMorgan Chase's acquisition of Bear Stearns and Washington Mutual, Bank of America's takeover of Merrill

1. For more information on the survey, see *M&A: Down but Not Out: A Survey of European Companies' Merger and Acquisition Plans for 2009,* BCG white paper, December 2008.

### The New Regulatory Regime

As much as the crisis has altered the chemistry of the banking industry, more changes are in store as regulators take measures to prevent a similar meltdown.

The mandate for a new regulatory regime is overwhelming. Governments have provided guarantees and direct injections of capital to support weakened banks and reassure investors and consumers. They have a vested interest in the stability of the industry, along with an unusual amount of leverage to impose new rules and regulations. Moreover, the crisis has proved that a serious risk event in one corner of the world can have catastrophic consequences for the global financial system. It is not surprising, therefore, to hear calls for international supervision, but global rules are difficult to define and harder to enforce. Even if a global regime does not take root, we believe banks in many markets will see similar efforts to strengthen regulations.

- **A Broad Mission.** Regulators will be charged with protecting the stability of the financial sector as a whole. Their ambit will expand to cover activities and actors that contributed to the crisis. A significant share of wholesale financial activity is beyond the scope of regulators. The most obvious areas include the over-the-counter derivatives markets and many alternative investors, but there are also market participants, such as mortgage brokers, whose potential to affect the financial system is not matched with a commensurate level of oversight.
- **Capital Requirements.** Basel I and II were designed to prevent crises, but they were based largely on historical, rather than theoretical, events. They did not cover some of the key drivers of the crisis, most notably liquidity risk. We expect capital requirements to become more stringent. Regulators might also encourage banks to hold an additional capital buffer, building it up when market conditions are favorable. In addition, minimum standards could be set for liquidity management, subject to the same level of scrutiny as capital.
- **Certification Requirements.** Regulators may put in place certification mechanisms to ensure that, within any bank, the necessary level of competence either exists or is brought in to understand and monitor the business. Such mechanisms are already in place for a number of financial professionals, including traders and financial advisors.
- **Governance Requirements.** Regulators could ensure that banks' governance reflects the importance of risk. They might stipulate, for example, that the chief risk officer is a member of the highest operational governance body of the bank, and that the bank establishes a board-level risk committee.

Lynch, Wells Fargo's acquisition of Wachovia, and Lloyds TSB's merger with HBOS.

The crisis could also spark a limited increase in cross-border M&A, as the new titans search for targets that will complement their business models and provide a leading position in a foreign market. In addition, banks in countries that have been less affected by the turmoil could find opportunities to acquire distressed or weakened banks. But it remains to be seen how governments will react to foreign takeovers of domestic banks. We are likely to see increased regulation of entities operating across borders and a rolling back of global businesses. (For more on potential regulatory changes, see the sidebar "The New Regulatory Regime" on page 11.) Governments may make an exception for deals that pave the way for greater integration of payment systems and exchanges, which would facilitate regulation and oversight.

A further limit to consolidation lies in an emerging (but hopefully temporary) sense of financial protectionism. The press in many countries has reported on the public's discomfort with the significant losses that national banks have incurred by lending to foreign consumers and companies.

Although increased M&A activity could lead to the reemergence of the *national champion model*—a strong bank that builds a seemingly unassailable national position—regulators may seek to limit the size of banks. As the crisis deepened, some governments took steps to rescue banks deemed "too big to fail." The concern now is that a bank may become too big to save. Its collapse, which would be almost impossible to prevent, would undermine a country's entire banking industry.

## Moving Beyond the Turmoil

Although a sense of austerity will shape banks' immediate responses to the turmoil, the crisis will trigger changes that are far more fundamental. Banks need to combine stabilizing the business with preparing for the new normal—they cannot afford to neglect long-term strategy. To move forward, banks should take the following steps:

**Develop the right business model for the postcrisis era.** Some banks are already challenging the strategic fit of businesses once considered untouchable. All options are on the table. Having a more focused, coherent portfolio of core businesses will make it easier for banks to control costs and improve performance. They will be doing fewer things, but they will be doing them very well. Competitive advantage is back in fashion.

**Strengthen risk management.** Regulators and investors will insist on seeing tangible evidence that banks have taken steps to improve risk management, and banks' plans for growth will hinge on having an empowered but business-oriented risk function. Risk management is not simply about reducing risk, nor is it about smothering opportunities. In fact, when done well, risk management can unlock new opportunities for growth. Banks will be able to move forward with confidence—and with the support of regulators and investors. (See the sidebar "A Stronger Risk Regime" on page 13.)

**Understand how consolidation will reshape your market.** In many markets, it is a question of when, not if, consolidation will change the playing field. Banks need to understand which of their competitors might engage in M&A and what those combinations will mean for their businesses.

**Look for opportunities.** Although many banks are likely to fall back on leaner cost structures and core businesses, these actions—when coupled with stronger risk management and an up-to-date view of how the crisis is playing out—could allow the best banks to gain ground, even as the crisis continues to trouble markets. As some banks retreat from certain regions, businesses, or customer segments, other banks may find viable ways to fill the void.

## A Stronger Risk Regime

A sense of overconfidence or complacency contributed to banks' inability to address the risk factors that preceded this crisis. There was no shortage of warning signs, even beyond the sharp downturn in the U.S. housing market and the deterioration of assets tied to subprime mortgages.

A high level of liquidity in the markets, driven by increased savings in Asia and excess cash in the oil states, boosted demand for complex investment instruments. This demand grew stronger as interest rates fell and investors hunted for any opportunity to increase returns. At the same time, a seemingly benign risk environment led to widespread mispricing of credit risk, as evidenced by the prevailing conditions in the subprime market, particularly in the United States. The apparent cost of risk on subprime loans from 2004 to 2006, as measured by the delinquency rate, was the lowest in a decade, at 5 percent. (This covers loans that were 60 days past due through to foreclosure.) Compounding the problem were incentives that rewarded excessive risk taking and encouraged people to focus on short-term profits, not long-term consequences.

In addition, banks tended to use past events to inform their thinking about future crises. One institution used a model that did not allow for any potential drop in real estate prices. There was also a lack of visibility of the risk function at the board level and, as a consequence, a lack of empowerment of this function. Finally, the blind-faith acceptance of external ratings—by both financial institutions and investors—had devastating consequences.

Although the actions necessary to improve risk management may seem obvious, even banal, they are still nowhere near to being universally practiced. Such actions include the following steps:

- **Foster a risk culture throughout the business.** Risk is too important to be left to risk managers alone. The first responsibility for managing risk should sit with the trader or banker who structures or books an operation. The board of a bank should also take an interest in the bank's overall risk position. In addition, every bank should have a board-level risk committee, which meets frequently to monitor the risk portfolio. Senior executives and front office staff should also be encouraged, or even required, to spend time in a risk position during their careers.
- **Redesign incentive schemes.** Incentive schemes should ensure that remuneration is tied to realized profit, as opposed to mark-to-market gains; is adjusted for risk; and accounts for the liquidity-adjusted cost of funding. Some incentive schemes should specify a period over which the actions of an individual will play out (and thus be measured). Finally, incentive schemes should be disclosed for independent assessment.
- **Restore the role of business sense.** VaR, economic capital, and other mathematical constructs should be seen as tools to inform—not supplant—the judgment of executives and senior risk managers as they seek to embrace, rather than avoid, the bank's risks. The aim is not simply to reduce risk, but to ensure that the risk portfolio, in aggregate, suits the bank's risk appetite.
- **Change risk measures and capital adequacy ratios.** Banks need robust liquidity management systems that include daily cash-flow analysis, a liquidity transfer price system, a contingency funding plan, timely liquidity risk reporting, and stress tests that gauge the impact of other risk categories on liquidity risk. They also need to understand and account for the balance sheet dynamics arising from the interdependencies between market, credit, and liquidity risk.
- **Anticipate the worst.** Financial institutions should convene an emergency risk team and appoint a senior leader as a *crisis czar*—someone whose sole task is to monitor the situation and divine what the latest developments mean for the company. This is critical for banks in the most affected markets, which face an overwhelming number of issues and thus might not see the forest for the trees. The crisis team should have the profile and longevity to deal with the turmoil and its aftermath. It could become something akin to a think tank, playing out scenarios, crafting responses, and keeping the executive group informed as the crisis unfolds and competitors and governments respond.
- **Empower the risk function.** The risk function should be independent of the business lines, but still integrated enough to be knowledgeable about the business and involved in the product development process. Interfaces between the business and risk must be well defined, and the internal audit function needs to be capable of policing risks. The risk function must have ultimate responsibility for and authority over all risk-related issues.
- **Build a better information infrastructure.** Banks need to upgrade their information infrastructure so they have a view of the risk-adjusted performance of the portfolio. They also need to provide clear reports to senior management detailing their exposure to the most salient risks. New insights can be generated by integrating risk information with finance and business information.

# What the Crisis Means for Different Businesses

For the financial services sector as a whole, several imperatives are now clear: financial institutions need to bolster their risk management capabilities, reshape their portfolios, attack costs with deep and transformative measures, and stabilize their sources of funding. In many sectors, financial institutions need to move away from a product-focused model to a more prudent customer-centric approach. Beyond these broad-based actions, the crisis has had different consequences for the major businesses:

- **Retail Banking.** The evaporation of high-growth credit businesses has hit retail business models. The battle for deposits may determine the fate of entire financial institutions.
- **Corporate Banking.** A steep increase in loan losses is just one of several challenges facing corporate banks. By focusing on fundamentals such as pricing and relationship manager productivity, corporate banks can still achieve strong performance.
- **Investment Banking.** Substantially weaker economics and the end of favorable trends will force investment banks to redefine their business portfolios. Many will gravitate toward a model based on facilitating trades.
- **Asset Management.** Asset managers are contending with a massive withdrawal of funds and mounting pressure on fees. Two of their most pressing imperatives are to cut costs and rebuild trust.
- **Wealth Management.** Wealth managers have avoided the most severe effects of the crisis but face challenges stemming from the bleak economic outlook and damage to brands and trust.

Given the extent of change required in most of these businesses, financial institutions must not shy away from asking a hard question: Is portfolio simplification really avoidable? We expect that many will discover that the answer is no and will find good reason to pare down their businesses—perhaps aggressively—to zero in on the activities they do best. Few companies will stumble onto a path out of the crisis. They will need to make calculated decisions about which businesses correspond to their core strengths and will be relevant in a postcrisis world.

## Retail Banking: Renewing the Focus on Quality Assets, Deposits, and Branches

Retail-oriented banks have fared better than their wholesale-oriented and credit-monoline competitors, and we expect them to emerge from the crisis in a stronger position than most other banking businesses. Nevertheless, the crisis has created material challenges for retail banks:

- **Higher Priced, Rationed Credit.** Retail banks are rationing the supply of credit and raising prices to better account for risk. As a result, loan acceptance rates are sharply down—globally, they fell from about 60 percent to about 25 percent in the second half of 2008—and the volume of retail loans will continue to shrink over the short term. In the second half of last year, mortgage transactions fell by anywhere from 40 to 80 percent, depending on the country.
- **Lack of Funding and Liquidity.** Wholesale funding dried up during the crisis, as concerns about the sta-

bility of financial institutions—and about hidden exposure to toxic assets—kept banks from lending to one another. The problem was acute for banks that focused on mortgages and consumer credit while relying on cheap wholesale funding rather than customer deposits.

- **Pressure on Profits.** In the short term, the performance of retail banks will suffer dramatically, with gross operating profit expected to decline by anywhere from 5 to 30 percent, depending on the prominence of credit in a given market. Deposit volumes are likely to remain strong, but margins will shrink. Credit revenues will remain relatively stable, as higher margins offset weak growth in volume.

In the near future, retail banks face serious funding and profit challenges. To confront these problems, they must get back to the basics of the business: assets, deposits, and branches. (See Exhibit 2.)

**Generate high-quality assets.** Increased margins on credit products provide an opportunity to offset lower margins on deposits, but banks need to be much more discerning about the assets they generate, particularly in an environment where competitors are shedding low-value customers. They need excellent underwriting and pricing skills, supported by thorough information about their customers. Face-to-face interactions are often essential, and long-standing customer relationships are invaluable.

**Win the competition for deposits and local market share.** In the absence of wholesale funding, a dependable base of deposits has become a prerequisite for generating assets. As a result, the battle for deposits has intensified and will, to a large extent, determine the winners and losers in many markets.

When it comes to winning and retaining deposits, there is no substitute for a physical presence. Branches are essential to building a foundation of "sticky" (and less expensive) deposits. They also facilitate the kinds of customer interactions and relationships that are critical to generating high-quality assets. In the postcrisis world, banks need to know their customers well.

The importance of deposits and branches should lead banks to focus more intently on building strong, defendable positions at a local level—leveraging their branches

**Exhibit 2. Retail Banks Must Focus on the Basics: Assets, Deposits, and Branches**

| Business | Impact: Client demand | Impact: Risk and funding | Impact: Competitors | Implications: Retail banks should recognize that ... |
|---|---|---|---|---|
| Deposits | ◇ Flight to quality and major risk aversion | ◇ Advantage for higher-quality names or banks with government guarantees | ◇ Exit of many marginal players<br>– Direct models being squeezed<br>– Weak asset generation and poor underwriting have been punished | ◇ ... the battle for deposits is just beginning; switching activity will intensify in the short term<br>◇ ... branches are essential to building a foundation of "sticky" (and less expensive) deposits |
| Checking accounts | ◇ Unchanged | ◇ Interest-bearing offers are increasing<br>◇ Sharp rise in overdraft charges | | |
| Unsecured credit (cards and loans) | ◇ Dampened by economic slowdown but still significant | ◇ Asset prices are increasing<br>◇ Acceptance rates fell from about 60 percent to about 25 percent | ◇ Credit will be scarce<br>◇ Increased competition for high-quality assets<br>◇ Monolines are closing | ◇ ... they can capture a greater share of wallet and reprice asset books<br>◇ ... they need to be discerning; focus on high-quality assets |
| Mortgages | ◇ Transactions down between 40 percent and 80 percent (varies by country) | ◇ Prime prices have been significantly rebased<br>◇ Subprime, lo/no doc, and buy-to-let products have been decimated | ◇ Significant reduction in competition<br>◇ Brokers and specialists will be most affected | ◇ ... they need to return to branch-based relationships<br>◇ ... they must focus on high-quality assets |

**Source:** BCG analysis.

and developing a base of loyal customers—rather than spreading themselves thin across too many markets. Local positions will be anchored by branch networks, but banks should also recognize that consumers have come to expect consistent service across channels.

A multichannel strategy can complement the branch network and bolster a bank's local market share. In our experience, it can boost new account growth by 10 to 15 percent, improve cross-selling by 2 to 5 percent, and reduce attrition by about the same percentage. The right multichannel strategy can also lower a bank's cost-to-serve by 10 to 20 percent. Most important, it does not require significant investments in technology. Many off-the-shelf solutions are available, and small steps can make a big difference. A bank can address some of the key barriers to a seamless multichannel experience by focusing on organizational alignment, not just technology solutions. By restructuring its incentives, for example, it can begin to change how the business uses different channels.

These measures will help retail banks move beyond the turmoil. Even then, however, their ability to expand will continue to be tested by the frailty of traditional growth engines such as mortgages and consumer credit. These products have been hobbled by the scarcity of capital and the depth of the economic downturn. What is more, as the crisis begins to subside, customers are bound to search for better ways to grow their assets, particularly if low interest rates persist.

To overcome these challenges to long-term growth, retail banks need to abandon the mindset that growth is linked to products. Banks are only going to grow as fast as their physical footprint—it all comes back to the branch. More broadly, retail banks should recognize the value of having a customer-centric, rather than product-driven, business model. In many markets, banks have been shifting to a customer focus over the past five or ten years, but only gradually. The financial crisis has added a sense of urgency to this transformation.

There are several ways banks can translate a customer-centric philosophy into practice, beyond building more or better branches. They can enhance their pricing capabilities to capture a full view of the customer's banking portfolio and reinforce long-standing relationships. In addition, operations can be revamped not simply to improve efficiency but also to make the bank more responsive to customers.

## Corporate Banking: Preparing for a Surge of Loan Losses

The financial crisis has led to a striking reversal of fortune for corporate banks. Revenues from this sector's growth engines—such as structured finance and leveraged buyouts—have declined more than 70 percent from their peak levels. Many of these businesses may recover in time, but they will not be the potent sources of growth they once were owing to the industry's more cautious approach to leverage and funding costs, as well as the increased risk aversion of investors. At the same time, corporate loan losses have risen steeply. (See Exhibit 3.) And these are far from the only challenges that corporate banks face.

- **Economic Profit.** Even during the "good times"—the period of unusually low loan losses that preceded the crisis—many corporate banks had trouble sustaining strong performance. From 2005 through 2007, 39 percent of the corporate banks in a BCG benchmarking survey had shrinking economic profit. This clearly reflects both an underlying failure to price appropriately and the power wielded by corporate customers. With loan losses on the rise, many corporate banks will be tested.[2]

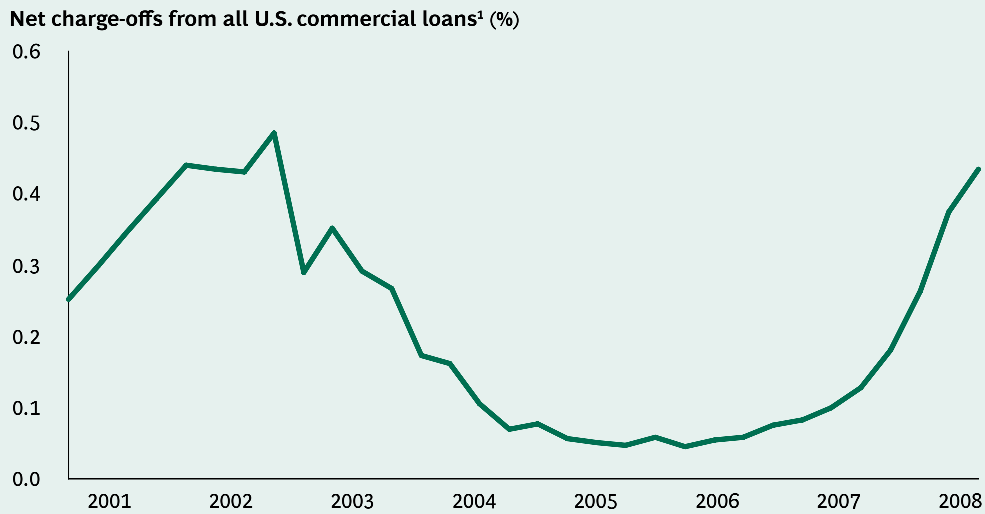
- **Funding.** The low funding costs of 2006 and early 2007 are unlikely to recur, and there is likely to be greater differentiation between risky and less risky banks. Within banks, capital will be more difficult and costly to obtain. Some corporate banks may face capital constraints that limit their growth in key sectors and products.

- **Competition.** Banks are renewing their focus on the core products and segments they neglected during the boom years. Corporate banks can expect to find more players trying harder to win the same clients.

Many corporate banks have already made defensive moves in response to the crisis. For the most part, how-

2. For more information on corporate banks, see the BCG report *Thriving in the New Normal: Corporate Banking 2008/2009,* BCG report, December 2008.

**Exhibit 3. Corporate Banks Are Confronting an Extraordinary Rise in Loan Losses**




**Sources:** FDIC; BCG analysis.
[1] Seasonally adjusted owing to above-average growth rates in fourth quarters.

ever, these moves have been typical responses to market turbulence, rather than strategic, forward-looking adjustments made in preparation for the new normal—a world of slower economic growth, higher loan losses, scarce liquidity, and more realistic pricing of risk. To achieve strong performance in this altered landscape, corporate banks will need to focus on six fundamental drivers.

**Create a value-driven mix of revenue.** Strong performers pay attention to the quality—not just the size—of their revenue streams, and they make an effort to look beyond credit products. They rely on valuable deposit revenue, for example, or products that have high fees but low capital requirements such as domestic transaction-banking and international payments. A long-term commitment is necessary to create such models, but banks can produce immediate results by identifying segments of clients that have a preference for noncredit products.

**Redesign distribution models and improve sales force productivity.** Well-designed distribution models and productive sales forces can have a tremendous impact on performance. Our recent benchmarking analysis found banks that generated 3.6 times more revenue per sales resource than some of their peers.

**Improve pricing capabilities.** The key elements of pricing are tied to risk and capital management, but top-performing banks define their pricing approach by assessing their capabilities and practices along three dimensions:

- **Pricing Strategy.** Does the bank think strategically about its pricing options? What are the target client segments and how price sensitive are they? How does price sensitivity differ across the bank's products and discrete customer segments?

- **Pricing Model Inputs.** Is pricing based on economic or regulatory capital? Do pricing tools reflect Basel II capital requirements? When customers' circumstances change, are key parameters such as their probability of default, exposure at default, and loss given default updated?

- **Pricing Execution.** Is the bank's discounting policy clearly defined and understood by the sales force? Are the objectives of discounting being achieved across the sales force—that is, does discounting drive cross-selling or the acquisition of new client relationships? How much is given away by relationship managers providing "round number" discounts?

**Strengthen risk management.** In our experience, credit processes vary widely in terms of data quality, risk ratings, and analytical rigor, and banks dedicate vastly different amounts of time and attention to their biggest and riskiest loans. This suggests that many banks have significant room to improve their credit-decision processes. Banks may also find ways to improve their monitoring and collections activities. Some have early-warning systems that monitor customers and spot signs of potential trouble. Combined with a proactive and well-organized collections team, this approach can dramatically reduce loss rates.

**Fundamentally change cost management.** Banks must address cost reduction opportunities along the entire value chain. Reducing the sales force may provide short-term benefits, but investing in the sales force can improve productivity. Successful banks focus more on controlling costs in the back office and support functions. To help streamline their back-office processes, they differentiate between standard and nonstandard credit products; standard products lend themselves to more efficient, industrialized processes. And banks need to carefully check that nonstandard products are profitable on a fully costed basis.

**Overhaul capital management.** The practice of managing economic capital is going to become more pivotal, given the lessons of the credit crisis. Leading banks are striving to ensure that their sales forces understand and take ownership of risk management. To this end, banks must spread capital management capabilities across the organization and break down long-standing barriers between "risk" and "the business." They need to transform what has historically been an esoteric topic into a broad framework that everyone, including sales teams and product groups, can use as they plan, execute, and track their strategies.

## Investment Banking: Moving from Risk Taker to Trade Facilitator

The crisis has devastated the investment banking industry. Beyond its immediate impact on earnings and TSR, the upheaval has set in motion several changes that will have long-lasting consequences:

- **The Demise of Major Independent Investment Banks.** The collapse of Bear Stearns was not widely regarded as a harbinger of the end of an era, but the systemic problems that felled the bank have continued to intensify. The crisis has caused some of the surviving independents to embrace retail deposit businesses, mainly as a way to access cheap liquidity.

- **The End of Favorable Macroeconomic Trends.** Before the crisis, banks benefited not only from deregulation and the convergence of lines of business but also from booming economies, rising house prices, and the insatiable appetite for the securities that investment banks created from the boom. Growth was also fueled by the rise of structured finance and blind faith in collateralized instruments, along with a steady fall in both interest rates and the cost of capital. Increased regulatory constraints are now inevitable, as is slower, less radical product innovation and the rigorous scrutiny of underlying collateral.

- **Weaker Economics.** Consolidation among nonfinancial companies will pick up, but these transactions will have lower price premiums and will involve less leverage than precrisis deals driven by financial sponsors. In addition, weak equity markets and illiquid credit markets will constrain corporate activity in routine debt and equity capital markets. Even when markets thaw, a pervasive sense of risk aversion will freeze out all but the highest-quality issuers for some time. (It would be rash to predict a permanent change: after all, the lessons from the junk bond crisis of the 1980s eventually seemed to fade.)

To succeed in this challenging environment, investment banks will need to stabilize the business. Liquidity is on offer from central banks, but banks need to cultivate stable sources of financing to prepare for a time when this crutch is not as available. Investment banks will also need to lower their costs to keep pace with the sharp fall in return on equity (ROE), which has been undermined by a less profitable business mix and reduced leverage. The average ROE of investment banks is expected to fall to single digits this year. (See Exhibit 4.) To restore ROE to double digits, investment banks will need to substantially reduce costs—they could need well in excess of $100 million in cost reduction for every $100 billion in balance sheet assets (assuming that leverage does not fall even further). To do this, banks will need to pull traditional cost levers, but they will also need to make structural changes to compensation.

At a more fundamental level, investment banks need to recast their businesses. Some are already reassessing their portfolios and exiting businesses where they lack strong capabilities or see lower prospects for growth. Investment banks that fail to realign their business portfolios risk losing substantial market share to competitors that have made deliberate, sometimes difficult choices about where they can best compete. They will also miss important opportunities to lower costs by concentrating on a smaller business portfolio.

A crisis of this magnitude creates an imperative for major structural changes that are otherwise impossible to achieve. Instead of focusing on aggressively growing revenue, for example, the industry can concentrate on managing risk-adjusted profitability. Instead of trying to be all things to all people, it can stop supporting unprofitable businesses, products, and clients. Instead of viewing risk management as a support function, it can look at it as a competitive differentiator.

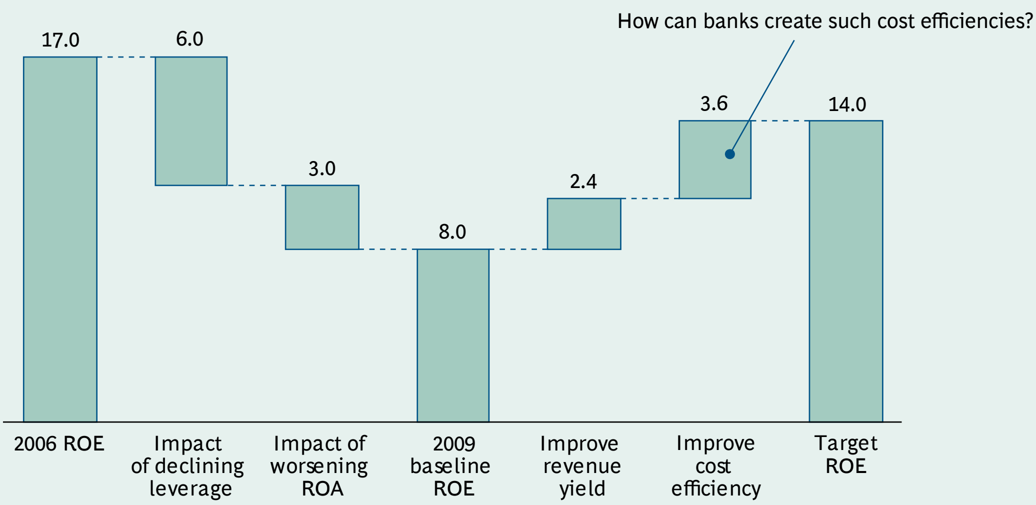
The new business model can be stronger than the precrisis model—and not just because a weakened banking system has created a larger role for capital markets. Investment banks have opportunities to reverse-engineer the most complex products—namely structured finance—into their basic elements, putting the emphasis back on the underlying collateral. They can also take part in the significant repricing of credit risk, participate in the growth of capital markets in countries such as China and India, and arrange investments for the massive infrastructure and green initiatives being launched around the world. And as companies in other industries craft their plans for competing in the postcrisis world, there will be a resurgence of strategic M&A activity.

To help frame the new business model, investment banks should assess their strengths in relation to three clusters of businesses.

- **High-Growth, Specialized Businesses.** This includes businesses that could see strong growth and profitability over the next few years, such as prime brokerage and equity derivatives. Many of these businesses require scale and technology.

**Exhibit 4. Investment Banks Must Transform Themselves in Order to Restore ROE**

**Impact of the crisis on a typical investment bank, ROE (%)**




**Investment banks will need at least $100 million in cost reduction for every $100 billion in balance sheet assets**

**Sources:** SNL database; BCG analysis.

- **Low-Return, Commoditized Businesses.** Mature businesses like equities and rates trading constitute the core product offering for practically all investment banks, but they produce relatively low return on assets and may be insufficient to drive profitability in a world of falling leverage. Business scale and operating efficiency will be critical to success.

- **High-Return, Cyclical Businesses.** These businesses, particularly the advisory business, require special expertise and strong relationships. Some banks might use credit products as a way to drive client activity in these businesses, but many will find this hard to do, given their own balance-sheet constraints.

We expect the bulk of demand to center on low-return, commoditized businesses. As a result, most investment banks will gravitate toward the *trade facilitator* model. A strong aversion to risk will prompt them to focus on facilitating client transactions in mature products. This overcrowding could weaken the economics of businesses that already have a low return on assets. Banks will need to create scale and operating efficiency in these factory-like businesses. Trade volumes will become concentrated among a handful of leaders in each business.

A smaller number of investment banks will align their business models around different sets of capabilities. *Risk takers* will use their expertise and risk appetite to compete in profitable, higher-growth businesses that are based on the acquisition and distribution of risk. They will come to resemble, and may even converge with, alternative investment managers. As most banks pare back their total risk exposure, sophisticated risk takers will exploit superior risk premiums to drive returns, but they will also need to keep some of the risk on their balance sheets. *Experienced bankers* will focus on the advisory business, which remains a viable, albeit highly cyclical, model. Large institutions will play significant roles, but the market will become fragmented as experienced advisors leave to create their own niche firms.

## Asset Management: Restructuring Costs and Rebuilding Trust

After years of steady growth, the value of professionally managed assets under management (AuM) dropped by about 15 percent in 2008. (See Exhibit 5.) It was the first decline in AuM since 2002.[3]

Despite the drop in AuM, several trends will help propel asset managers out of the crisis. Aging populations still need help managing their retirement funds, for example, and institutional investors will continue outsourcing the management of their assets. In addition, wealth will resume its strong growth in emerging markets, and investors will eventually steer their assets back into actively managed investments.

In the near future, however, four factors will lead to lower—and also more volatile—fees for asset managers: a bear market will slash regular and performance-based fees, a preference for low-margin products will dampen revenues, margins will also be compressed by increased investor skepticism and negotiating power, and the share of performance-based fees will rise.

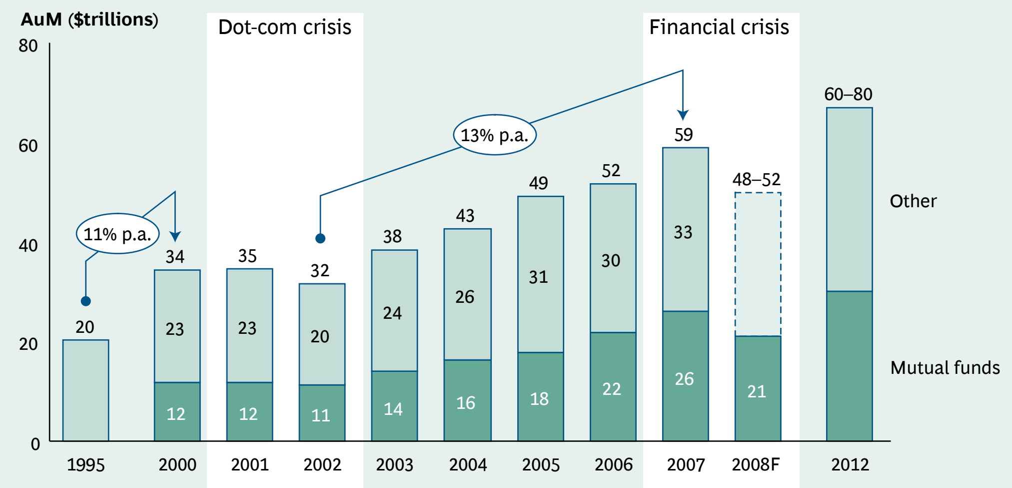
To mitigate the effects of the crisis, asset managers should focus on containing costs, protecting revenues, and enhancing risk management, but they should also view the crisis as an opportunity to review their portfolios and explore new ways to grow.

**Fundamentally restructure costs.** Asset managers will need to go beyond simple (and often temporary) measures to squeeze costs, such as postponing projects or freezing salaries. Cost savings of more than 10 percent can be achieved only by making fundamental changes to the operating and business models. Such changes include reengineering the product development process to reduce time-to-market, simplifying the product portfolio and closing or merging funds, focusing on the most profitable channels, and improving the link between performance and compensation.

**Rebuild client trust to safeguard revenues.** Rebuilding client trust is one of the most important levers to protect revenues, both immediately—to stop or at least limit asset outflows—and over the long term. All too often, clients have been sold a product before really understanding it or without having had a chance to sufficiently explain their investment objectives. To improve their focus on client needs, asset managers should provide their distributors with the right sales tools, such as wealth management platforms, to guarantee that they

3. For more information on asset managers, see *Winning Strategies in Uncertain Times: Global Asset Management 2008*, BCG report, November 2008.

**Exhibit 5. Asset Managers Experienced the First Decline in AuM Since 2002**




**Sources:** BCG Global Asset Management database; Investment Company Institute; European Fund and Asset Management Association; BCG analysis.
**Note:** Only professionally managed assets were included. The analysis includes 32 countries. The forecast for 2008 was based on data from January through November 2008 for the United States, Japan, and Europe.

truly address client needs. In addition, asset managers should ensure that their products are relevant in a post-crisis world. Demands for transparency have risen dramatically, generating new requirements both in terms of product and solution design and in terms of risk management.

**Enhance risk management.** Many funds did not have the risk profiles that asset managers thought they had. Clearly, asset managers need to bring risk management to the forefront, in both their organizations and their interactions with customers. In an environment characterized by uncertainty and fear, asset managers could use their advanced risk-management capabilities as a way to market their funds. When designing a new risk organization, asset managers need to pursue three key initiatives:

- **Build a strong and independent risk function.** A properly resourced risk function should be kept separate from the investment management function and should report directly to senior executives who understand risk.

- **Upgrade skills and infrastructure.** Asset managers need to enhance their understanding and measurement of derivative products, leverage, and the concentration of risk in the portfolio construction process.

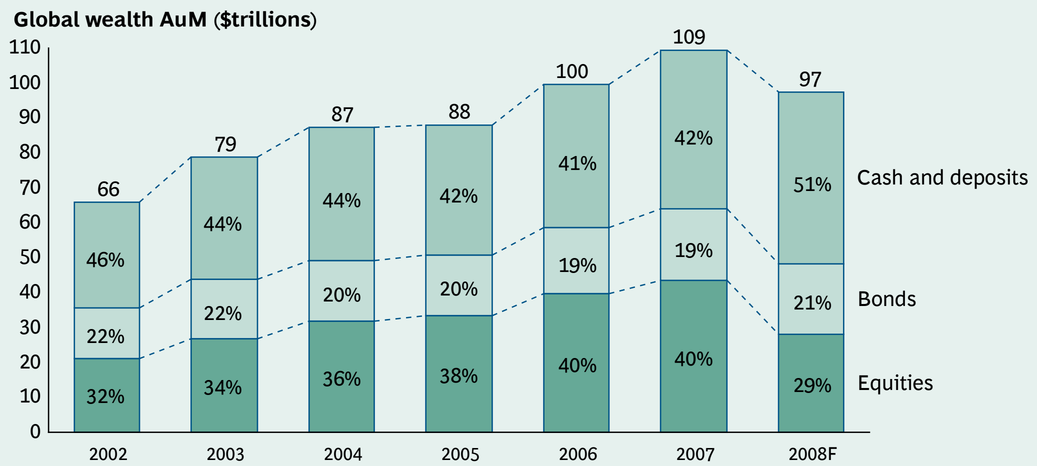
- **Develop a strong risk culture throughout the business.** Recent scandals have devastated investors around the world, underscoring the financial industry's grave exposure to operational risk. In asset management, the risk team's assessment must take priority over the business's desire to launch an innovative product.

**Reorient the business and explore new growth opportunities.** Large asset managers, which are often a mixed bag of small businesses, must take a hard look at their overall business and de-average it by product, client, channel, and region. They need to identify key areas of expertise and competitive advantage, exiting areas where they are subscale or lack advantage. Asset managers with sufficient financial strength should look for opportunities as other financial institutions review their portfolios and dispose of noncore businesses.

## Wealth Management: Reestablishing Credibility with Clients and Advisors

Wealth managers have avoided the most severe effects of the crisis. And although the high growth rates and

**Exhibit 6. As It Eroded Wealth, the Crisis Triggered a Shift to Cash and Deposits**




**Sources:** BCG Global Wealth Market-Sizing database, 2008; Economist Intelligence Unit (EIU).
**Note:** Forecasts were revised on October 8, 2008. AuM projections are based on projections of currency exchange rates from the EIU. Global wealth is measured in AuM across all households.

stellar returns of the precrisis era are unlikely to reappear anytime soon, there is a tremendous amount of wealth sitting on the sidelines. Once investor confidence returns, wealth managers will find that clients are eager to make up for lost time (and wealth). Until then, however, wealth managers face a variety of challenges, most of which stem from the bleak outlook for economic growth.

- **Declining Revenues and Margins.** In addition to eroding wealth, the crisis led many investors to reorient their AuM towards less risky products, which generally provide lower fees and margins. More than half of the world's wealth was held in cash or deposits in 2008, up from 42 percent in 2007.[4] (See Exhibit 6.) Equities accounted for 29 percent of global wealth, down from 40 percent in 2007.

- **Brand Damage and the Loss of Trust Among Clients and Advisors.** Wealth managers that are part of larger financial institutions have seen their reputations damaged by huge losses in other business lines. Additionally, some products that had been marketed as relatively safe investments proved to be anything but risk free. High losses quickly undermined both advisor and client trust, leading to greater attrition in both groups.

- **Reduced Net New Assets.** Damaged brands and weak economies have taken a heavy toll on net new assets. Clients are directing their funds elsewhere.

- **Deteriorating Cost-to-Income Ratios.** A troubling combination of decreasing asset levels, lower margins, and relatively inflexible cost bases is straining wealth managers' cost-to-income ratios. This, in turn, is constricting their ability to invest in initiatives to counter the crisis.

- **Pressure on Offshore Wealth.** For some wealth managers, increased regulatory pressure on offshore centers poses a substantial barrier to long-term growth. If closer scrutiny and tighter restrictions diminish the attractiveness of offshore centers, some wealth managers are likely to see further reductions in net new assets.

Before they do anything else to respond to these challenges, wealth managers must rebuild trust among clients and advisors. They can then turn their attention to more fundamental improvements to the business.

4. For more information on wealth managers, see *A Wealth of Opportunities in Turbulent Times: Global Wealth 2008*, BCG report, September 2008.

- **Regain client trust.** Wealth managers need to clean up and strengthen their balance sheets and protect their fundamentals. Then they need to reach out to their clients to talk about the impact of the crisis. Well-prepared, detailed, and honest performance discussions are an excellent way to rebuild credibility and trust. But this is easier said than done—many advisors are reluctant to call clients when they have bad news to deliver. Wealth managers, in general, will need to move away from a product-push model and instead focus on an advisory model.

- **Reestablish credibility with client advisors.** Wealth managers should not underestimate the importance of rebuilding credibility with the front line. Client advisors need frequent and honest communication from firm's leadership, explaining what is being done to deal with the crisis. Many advisors have also seen a significant reduction in the value of their long-term compensation. Wealth managers may need to develop new and creative incentive programs to enhance advisor retention.

- **Align client risk profiles and investment strategies.** The performance of products once seen as low risk or even "risk free" has highlighted serious mismatches between client risk profiles and their investment strategies. Wealth managers need to address this issue by conducting detailed, individualized performance reviews with their clients. Such reviews present an opportunity to have frank discussions about the effects of the crisis and to begin managing client expectations against the backdrop of a far more challenging investment environment.

- **Strengthen product and service innovation.** Clients want high-quality products that are simple, transparent, and low risk. They are increasingly dubious of bank-specific products and tend to be more interested in the best-in-class formula of multimanager investment approaches. Wealth managers therefore need to strengthen their product and service innovation, with a focus on conservative, transparent, lower-risk products. They should also consider whether such products are best provided in-house or through third-party providers.

- **Adjust capacity and reduce costs.** Intense economic pressures have made cost reduction imperative for wealth managers, but they have also given wealth managers the impetus to make tough decisions that are easy to avoid during better times. Small clients should be priced up or migrated to lower-cost service models (or simply encouraged to leave). Low-performing advisors and product specialists should be rationalized to bring capacity in line with new client and asset levels, and compensation schemes may need to be restructured. Marginal products should be reviewed to reduce costs and complexity in the front and back offices. Management delayering can dramatically improve spans and layers and reduce management costs by 20 to 25 percent.

# The State of the Banking Industry in 2008

The crisis more than halved the industry's market value in 2008, effectively wiping out all of the gains made since 2003. (See Exhibit 7.) Other crisis-induced losses occurred as far back as the third quarter of 2007, when the crisis was beginning to spread, and as recently as the first month of 2009. (In the first 23 days of this year, banks lost an additional $700 billion in market value.)

The crisis took a particularly heavy toll in the second half of 2008. The banking industry's market value fell by a staggering $2.5 trillion in the space of six months. In September, a series of events made it clear that the crisis was going to be extraordinary and transformational. The month began with the government bailout of Fannie Mae and Freddie Mac, which was followed by the sale of Merrill Lynch to Bank of America, the bankruptcy of Lehman Brothers, the government rescue of AIG, the transformation of Goldman Sachs and Morgan Stanley into bank holding companies, and the collapse of Washington Mutual—the largest bank failure in U.S. history.

The industry's TSR, which includes capital gains and free-cash-flow yields, fell to –53.6 percent in 2008. (See Exhibit 8.) It was nearly 80 percentage points lower than it had been in 2006, before the onset of the crisis. The average TSR of all industries, including banking, fell from 15.2 percent in 2007 to –43.3 percent in 2008.

The banking industry's TSR was far below the low-water mark set during the last economic slump. Banking TSRs were –11.7 percent and –10.6 percent in 2001 and 2002, respectively. Throughout that downturn, the average banking TSR managed to stay above the all-industry average and eventually bounced back to an extraordinary high of nearly 45 percent in 2003. The situation now is quite different, with banks leading—rather than resisting—the downturn.

Any hope that the crisis might be contained to certain countries was dashed in 2008. Average banking TSRs were steeply negative in all markets. In Western Europe, the average banking TSR fell by nearly 58 percentage points, to –60.5 percent. Among the BRIC countries, the average banking TSR plunged by more than 100 percentage points, to –54.4 percent.

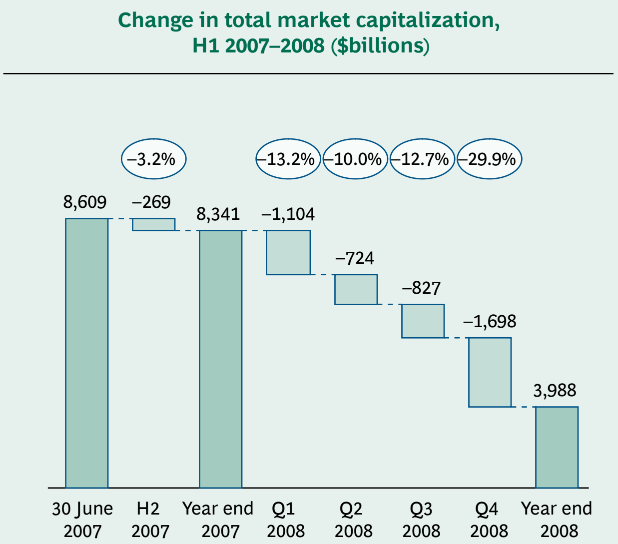
The dramatic swing in performance underscores the global nature of the crisis, but it also masks important differences in how the turmoil has affected certain markets. In the BRIC countries, in general, the decline in banking TSRs owed more to a significant revaluation of companies—which extended beyond the banking sector—rather than to any direct exposure to corrupt assets or high-risk activities on the part of banks. In three of the four BRIC countries, average banking TSRs beat the all-industry average; Russia was the exception. (See the sidebar "Down but Not Out: Banking Industries in Emerging Markets" on page 28.)

The crisis has devastated most industries. The five-year TSR for all industries was only 1.6 percent in 2008, down from 21.4 percent in 2007. (See Exhibit 9.) All but four of the industries in our study saw their one-year TSRs decline by at least 50 percentage points in 2008.

## Country Performance

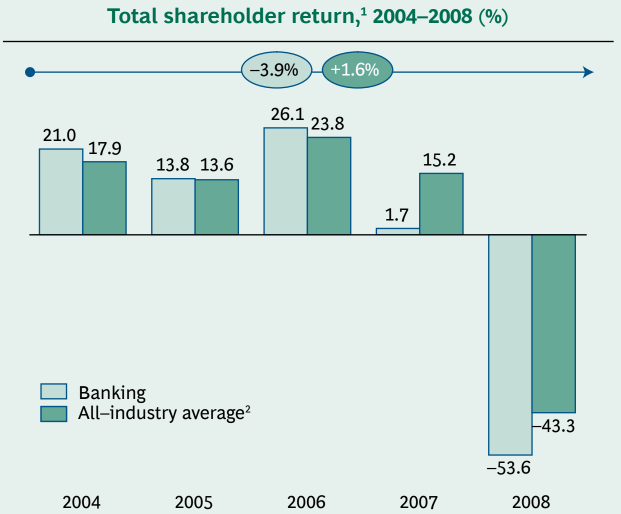
The banking industry in the United States, despite being the epicenter of the crisis, had neither the lowest TSR nor the largest decline in TSR among the ten major banking markets. (See Exhibit 10.) This is a surprising

## Exhibit 7. The Crisis Has Wiped Out All the Gains Made in the Banking Industry Since 2003


**Sources:** T.F. Datastream; BCG analysis.
**Note:** Percentage changes in market capitalization were calculated using complete, not rounded, figures for market capitalization.
[1] Compound annual growth rate.

## Exhibit 8. Banking TSR Was Dismal Across All Regions





**Sources:** T.F. Datastream; BCG analysis.
**Note:** All TSRs were calculated after conversion to U.S. dollars.
[1] TSR consists of capital gains and free-cash-flow yields.
[2] Weighted by market capitalization.
[3] Consists of 32 countries.
[4] United States and Canada.
[5] Brazil, Russia, India, and China.
[6] Benelux countries, Denmark, Finland, France, Germany, Italy, Norway, Spain, Sweden, Switzerland, and the United Kingdom.

result, perhaps, but U.S. banks absorbed a number of hits in 2007, and some of the weakest banks completely disappeared.

Four countries were clustered at the bottom of the ranking of five-year TSR: the United States, Germany, France, and the United Kingdom. Germany's banking industry lost the most ground in the ranking of five-year TSR, dropping from first place in 2007 to eighth place in 2008. Its one-year TSR, at –61.9 percent, was the lowest among the ten countries.

In 2007, German bank valuations were inflated by expectations of consolidation among some of the country's largest exchange-listed banks. In 2008, the growing crisis led to a massive revaluation of bank stocks and a steep decline in TSR.

France's banking industry had the second-lowest TSR in 2008, at –61.5 percent, as well as one of the lowest five-year TSRs. French banks had sound retail businesses, but their TSRs were weighed down by their significant corporate- and investment-banking activities. The problem was acute for banking groups that were partially listed and for which the listed company was focused largely on corporate or investment banking.

Banking TSRs in the United Kingdom were weakened by the lackluster shape of the economy—households there are saddled by high levels of debt—as well as the collapse of Northern Rock. The share price of RBS was pulled down by its acquisition of parts of ABN Amro and its transfer into majority public ownership. Another big bank, HBOS, ran into trouble because of its exposure to the U.K. property and construction market, its exposure to leveraged finance, and an overreliance on wholesale funding, which led to an emergency merger with Lloyds TSB.

Australia and Canada had the only positive five-year TSRs among the ten countries, at 2.7 percent and 2.4 percent, respectively. In the years leading up to the crisis, Australian banks had achieved strong productivity and credit-driven growth, supported by a favorable economic climate. The industry's ability to generate shareholder value remained relatively strong, but the impact of the financial crisis became apparent in 2008. Both countries also had the highest one-year TSRs in 2008, but they were well into negative territory.

Spain's five-year TSR was only marginally negative at –0.6 percent. Italy's was –3.5 percent. Despite its low TSR in 2008, Italy's banking industry has been less affected by the crisis than other European markets. Many Italian banks have conformed to more traditional, retail-oriented business models while eschewing riskier activities associated with capital markets. As a result, these banks enjoy good margins and have more conservative (and resilient) balance sheets and higher quality assets.

## Performance by Market Capitalization

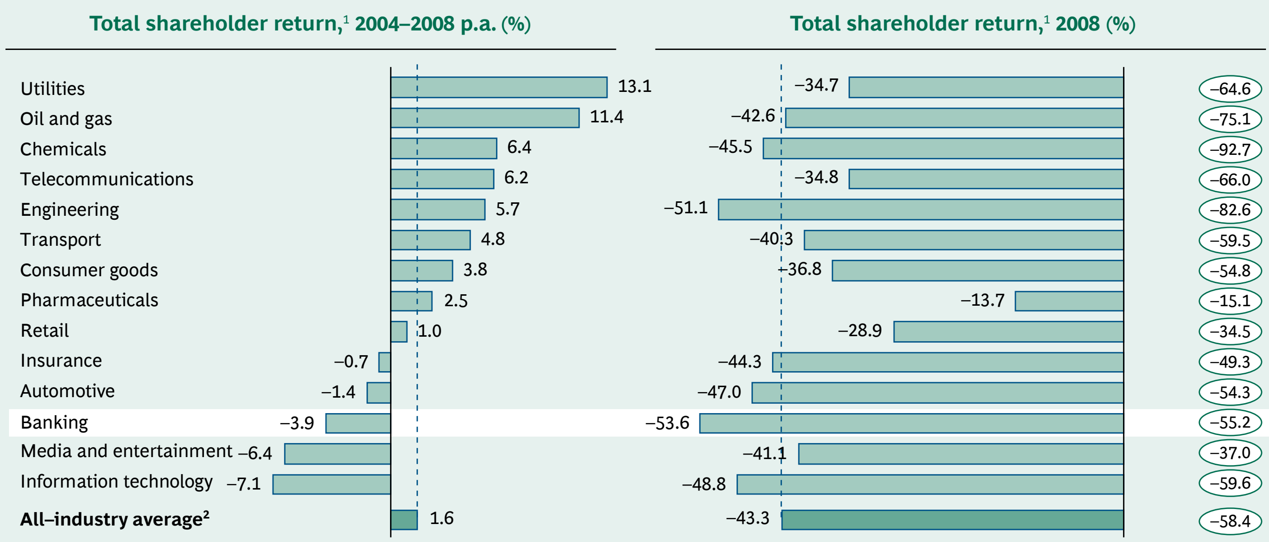
The total market value of the 30 largest banks dropped from $3.2 trillion in 2007 to $1.7 trillion in 2008—a decline of about 47 percent. Every bank in the top 30 lost market capitalization last year. The losses ranged from 75 percent (Citigroup) to 3 percent (Wells Fargo).

At the end of 2008, only four banks had market values greater than $100 billion: ICBC, China Construction Bank, JPMorgan Chase, and HSBC. (See Exhibit 11.) At the end of 2007, by comparison, 11 banks had market values greater than $100 billion. ICBC remained the largest bank in the world, measured by market capitalization; but its market value fell by nearly half, from about $339 billion in 2007 to about $174 billion in 2008.

Six banks entered the top 30 in 2008: Bank of New York Mellon, Mizuho Financial Group, Sumitomo Mitsui Financial Group, The Toronto-Dominion Bank, U.S. Bancorp, and Westpac Banking Corporation. All achieved double-digit gains in the ranking of banks by market value. Some managed to lose less value than other banks because they were active across a range of banking segments or had limited exposure to the U.S. mortgage market. Others gained ground through M&A.

Westpac had the biggest jump among the top 30 banks. It moved up 28 places, largely because of its acquisition of St George Bank but also because of its focus on customer-based universal banking—it is active in retail and corporate banking, as well as in wealth management—and its distance from the U.S. mortgage market. U.S. Bancorp made a similar jump, moving up 25 places. Like Westpac, it benefited from a customer-oriented banking model, which encompasses asset management, retail banking, insurance and investments, and wholesale and international banking. It also made a series of acquisitions.

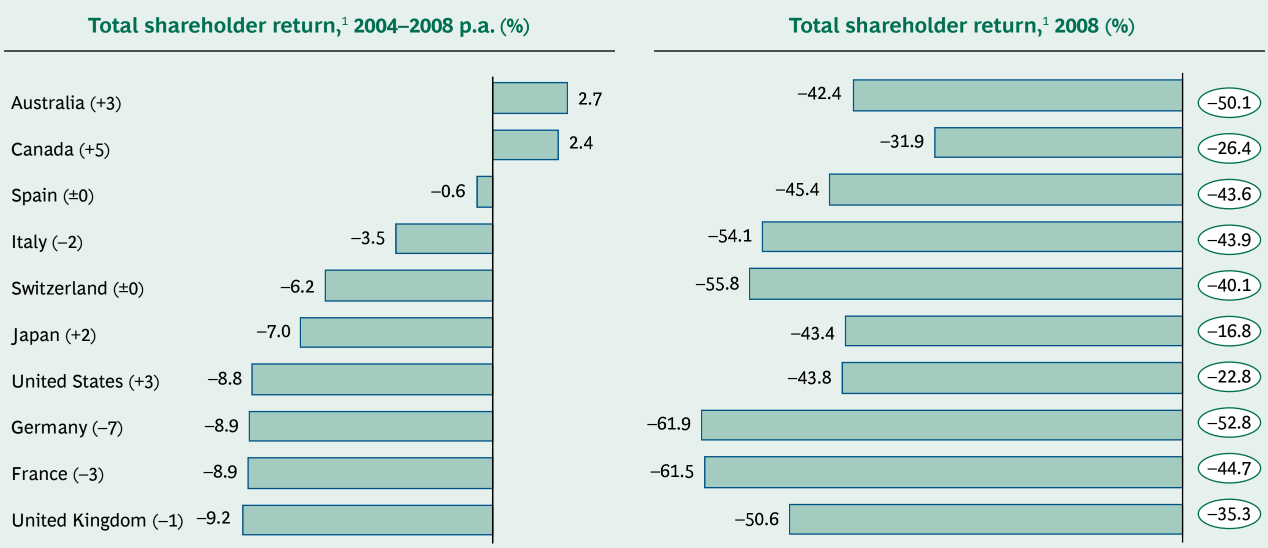
## Exhibit 9. The Crisis Has Devastated Most Industries




**Sources:** T.F. Datastream; BCG analysis.
**Note:** All TSRs were calculated after conversion to U.S. dollars.
[1] TSR consists of capital gains and free-cash-flow yields.
[2] Weighted by market capitalization.

Change, in percentage points, from 2007 TSR

## Exhibit 10. The Banking Industry in the United States Was Not the Hardest Hit




**Sources:** T.F. Datastream; BCG analysis.
**Notes:** All TSRs were calculated in local currency. Numbers in parentheses indicate change in rank from end of 2007.
[1] TSR consists of capital gains and free-cash-flow yields.

Change, in percentage points, from 2007 TSR

## Down but Not Out: Banking Industries in Emerging Markets

The world is flat. That's the metaphor that author and columnist Thomas L. Friedman used to describe the leveling of the global competitive playing field. The world has become far more interconnected to the benefit, in particular, of developing markets. And although the crisis did eventually spread to developing markets—that is the downside of flatness—there are several reasons why banks in these markets may bounce back faster than others.

First, the impact of the crisis on banks in the BRIC countries had less to do with underlying problems in their financial sectors, such as direct exposure to U.S. subprime mortgages, and more to do with an adjustment to extremely high market values. (Nonbank industries in the BRIC countries had also experienced extraordinary growth in market value.)

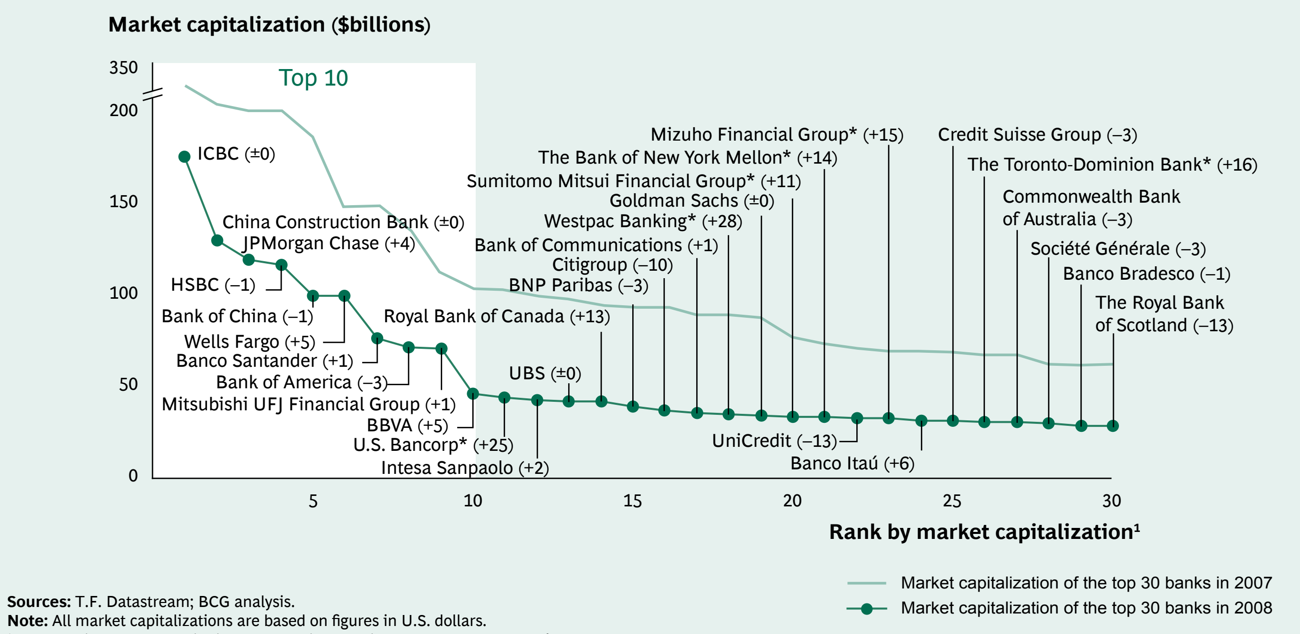
Second, banks in the BRIC countries will draw strength from the conservative leanings of both their business models, which are balance-sheet based and typically funded by deposits, and their local environments. Regulatory regimes tend to be more conservative in developing markets, and consumer debt in the BRIC countries is generally much lower compared with debt levels in developed markets, whereas savings rates are higher. Moreover, the conservative nature of consumers represents significant untapped potential for banks. Once growth resumes, banks will have opportunities to convert "unbanked" consumers, while cross-selling a broad range of products to their existing customers.

Third, banks in the BRIC countries have done more than ride the coattails of surging economic growth. Many have developed competitive capabilities and practices. Six of the ten best large-cap performers, measured by RTSR from 2004 to 2008, were from the BRIC countries—one each from Russia, India, and China; and three from Brazil. Brazil's banking industry has benefited from investments in technology (inflation taught banks to invest early in clearing), remote channels (the use of Internet banking is relatively high, based on the country's per capita GDP), and state-of-the-art risk management (it was essential, given the market's volatility). Chinese banks boast strong capital ratios, which range from 8 percent to 20 percent, and strong liquidity positions (banking regulations cap loan-to-deposit ratios at 75 percent). In addition, Chinese banks had limited exposure to asset-backed securities, and most of the country's large commercial banks tend to provide credit mainly to larger, lower-risk companies.

Fourth, several macroeconomic trends should reemerge once the crisis subsides, propelling the economic growth in the BRIC countries well beyond that of developed markets. From 2008 through 2012, the OECD forecasts real GDP to grow at an average annual rate of 9.8 percent in China, 7.7 percent in India, 6.0 percent in Russia, and 4.2 percent in Brazil. The IMF's forecasts for near-term growth are lower. From 2008 through 2010, it expects real GDP to grow at an annualized rate of 7.9 percent in China, 6.3 percent in India, 2.2 percent in Russia, and 3.7 percent in Brazil.

Certain sectors, such as wealth and asset management, had strong runs of growth prior the crisis and could return to form. From 2001 through 2006, household wealth grew faster in China and Brazil than anywhere else in the world, at 23.4 percent and 22.4 percent, respectively. In addition, deregulation will continue opening up opportunities for domestic and foreign banks in these markets.

**Exhibit 11. Every Bank in the Top 30 Lost Market Capitalization Last Year**




**Sources:** T.F. Datastream; BCG analysis.
**Note:** All market capitalizations are based on figures in U.S. dollars.
[1] Numbers in parentheses indicate change in rank since 31 December 2007; * represents a new entry.

## Top-Performing Banks

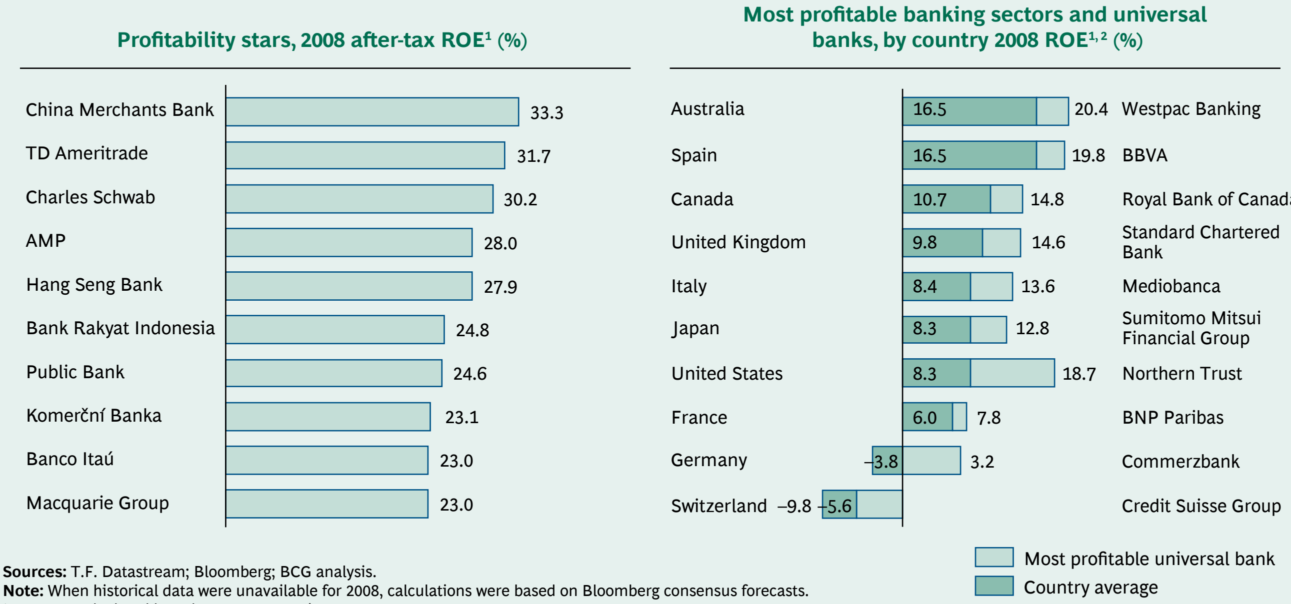
Profitability stars were impressive, if somewhat less dazzling than they were before the crisis deepened. In 2008, the ten best ROEs ranged from 23 percent to about 33 percent. (See Exhibit 12.) In 2007, by comparison, the ten highest ROEs ranged from 30 percent to about 55 percent.

Nearly every corner of the globe provided a top-performing bank in 2008; these banks were spread across Asia-Pacific, Europe, and North and South America. Two models were prevalent among this group: branch-based retail banks focused on emerging markets and capital-light wealth managers or brokerages. Three institutions stayed in the group of top performers from 2007 to 2008, in part because they had a strong customer focus or a broad base of retail customers.

- TD Ameritrade's ROE declined slightly, to 31.7 percent, but ranked second overall. The company benefited from its focus on retail investors, its product and service capabilities, and its industry-leading operating margins.
- Charles Schwab had the best ROE in 2007, at 55.1 percent, and the third-best ROE in 2008, at 30.2 percent. It managed to deliver strong performance in a difficult market largely because of its relentless focus on client service, operating discipline, and capital strength. It has emerged as a trusted brand, which is invaluable during times of volatility, and has helped attract new client assets.
- Hang Seng Bank had the fourth-best ROE in 2007, at 35.2 percent, and the fifth-best ROE in 2008, at 27.9 percent. It focuses on retail and commercial banking in Hong Kong and has a growing presence in China. Its strong base of retail banking customers provides access to low-cost funding and facilitates the distribution of fee-based products, which has contributed to the bank's high ROE.

Half of the top ten performers came from developing markets. Brazil's Banco Itaú made a splash in 2007, when it posted a record profit for a Brazilian bank, and again in 2008, when it agreed to a merger with Unibanco. The combined entity would be the biggest bank in Latin America and among the largest in the Americas. Bank Rakyat Indonesia is one of the world's leading pro-

## Exhibit 12. Top-Performing Banks Were Scattered Around the World




**Sources:** T.F. Datastream; Bloomberg; BCG analysis.
**Note:** When historical data were unavailable for 2008, calculations were based on Bloomberg consensus forecasts.
[1] ROE was calculated based on average equity.
[2] Ranking of individual players includes only universal banks in the ten major developed markets with market capitalizations above $5 billion.

viders of microfinance. It operates in a market where net interest margin has hovered around 10 percent for nearly a decade. Malaysia's Public Bank is a highly focused, disciplined retail bank. It has had an outstanding cost-to-income ratio and has been rewarded with a high market-to-book ratio.

**Country Banking Sectors.** Our analysis of ROE focused on ten large banking sectors in developed markets. Australia, Spain, and Canada again had the top banking sectors. Banks in Spain and Australia, in particular, had outstanding performance. Both sectors achieved average ROEs of 16.5 percent—well above the others.

Among the ten markets, Switzerland's banking sector had the most steeply negative TSR. Before the crisis, Swiss banks achieved above-average value creation and TSRs because of high asset inflows, strong market performance, and solid demand for high-margin investment products. In the second half of 2007, massive write-downs at UBS were followed by declining share prices among banks—even those that had little exposure to the crisis or limited investment-banking activities. The declines were the result of weaker economics and the loss of confidence in future growth. Revenue and profit pools were affected by reduced asset volumes, lower asset inflows, a shift to low-risk and low-margin investment products, increased regulatory scrutiny, and damage to Switzerland's reputation as a financial center.

**Large-Cap Banks.** Relative total shareholder return (RTSR) adjusts TSR for local market influences. In 2008, six of the ten best large-cap performers, measured by average RTSR from 2004 through 2008, were from the BRIC countries—one each from Russia (Sberbank), India (State Bank of India), and China (China Merchants Bank), and three from Brazil (Unibanco, Banco Bradesco, and Banco Itaú). (See Exhibit 13.) The rest were based in the United States.

Several of these banks had extremely high one-year alphas in 2008, indicating that their investors received strong returns relative to the risks they took for the particular company. Alpha signifies individual risk-adjusted performance relative to the market. If the value is positive, the stock is earning a return in excess of its own risk profile, while a small or negative alpha indicates underperformance relative to a stock's own risk profile. (See the Appendix for a description of RTSR and alpha.)

Despite bearing the brunt of the crisis, the United States had five of the top-performing banks in 2008, measured by one-year RTSR. HSBC was the only European bank in the top ten. Still, it was hard to maintain strong performance in the midst of a global financial crisis. Only two banks stayed in the top ten ranking of one-year RTSR from 2007 to 2008: State Bank of India and Hang Seng Bank.

**Mid-Cap Banks.** Indonesia and Turkey had two of the best mid-cap performers from 2004 to 2008: Bank Central Asia and Türkiye Garanti Bankasi. (See Exhibit 14.) Four of the ten best performers were from the United States, and the rest were from Asia.

Mid-cap banks experienced a massive turnover of top performers in 2008. No top performers from 2007 remained in the top ten. And like large-cap banks, the top mid-cap banks performed at a much higher level. In 2007, the tenth-highest mid-cap RTSR was –2.2 percent. In 2008, it was 21.3 percent. (For large caps, the tenth-highest RTSR in 2007 was 3.6 percent. In 2008, it was 19.2 percent.)

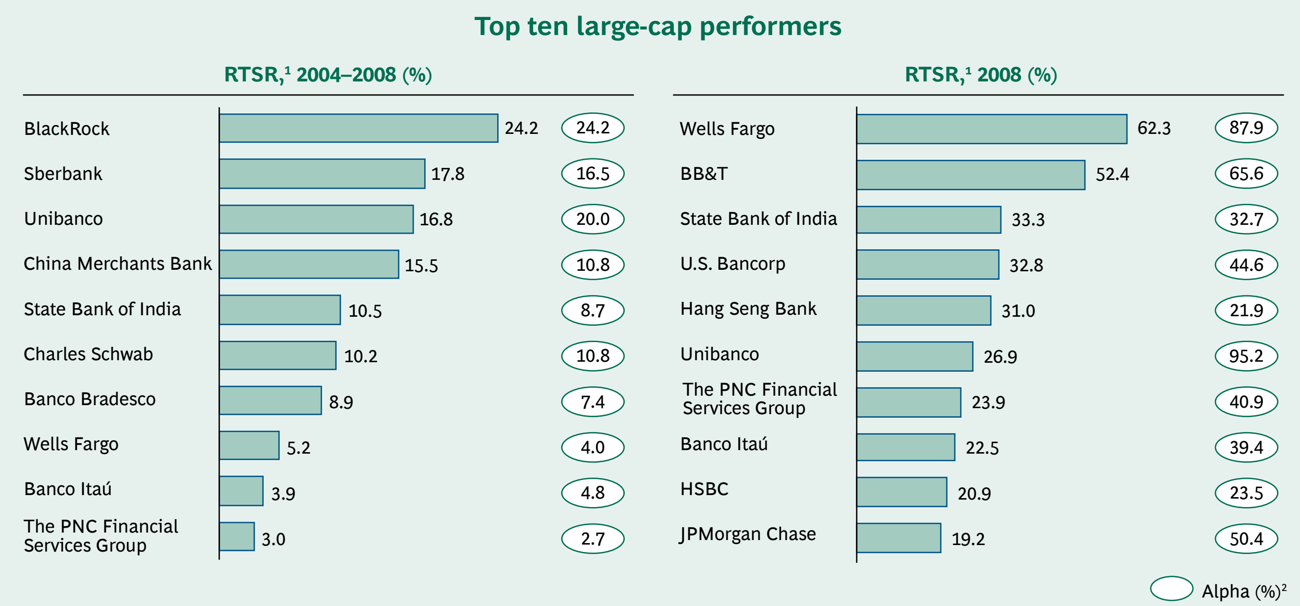
## Drivers of Performance

The banking industry's profitability, measured by ROE, plummeted from 14.2 percent in 2007 to 6.5 percent in 2008. (See Exhibit 15.)

At the same time, the industry's cost of equity (COE) rose to 14.7 percent, mainly because betas for large banks increased. (Higher betas reflect the increasing risk associated with bank stocks relative to local markets.) As a result, the profitability spread—the difference between ROE and COE—plunged into negative territory. It marked a profound shift in banking value creation and underscored the parlous state of the industry. Even during the depths of the last downturn in 2001 and 2002, banks managed to maintain positive spreads above their cost of equity.

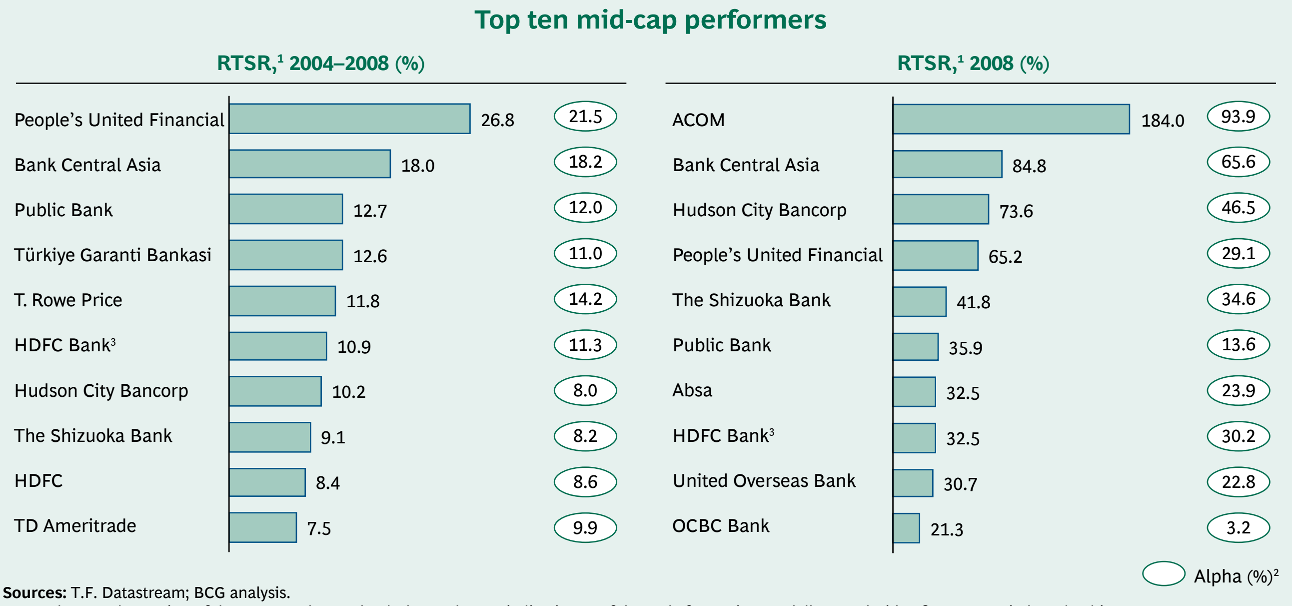
Although the industry's equity rose slightly in 2008, to $3.3 trillion, the negative profitability spread led to a massive drop in after-tax profits, from $423 billion in 2007 to $213 billion in 2008. The banking industry's after-tax profits fell below where they were in 2004.

**Exhibit 13. Among Large Caps, Six of the Ten Best Performers over the Long Term Were from BRIC Countries**



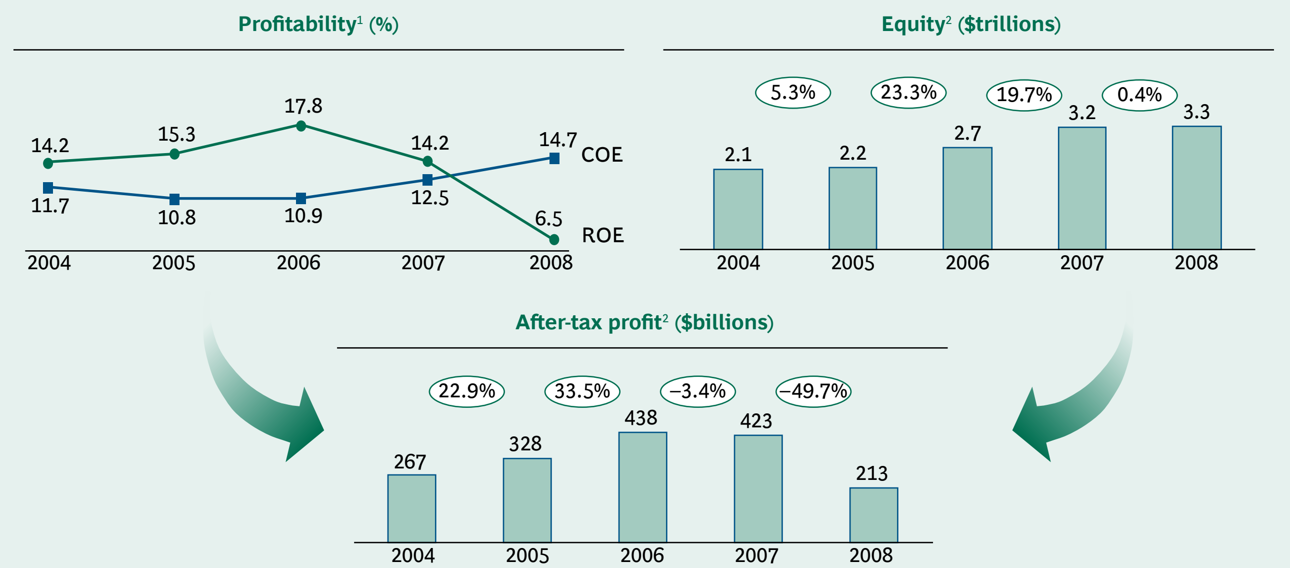

**Sources:** T.F. Datastream; BCG analysis.
**Note:** The sample consists of the 50 largest banks by market capitalization as of the end of 2008, in U.S. dollars, and with a five-year capital market history.
[1] For further explanation of this measure, see the appendix.
[2] Alpha is the risk-adjusted excess return on an investment above what would be predicted by the market. For further explanation, see the appendix.

## Exhibit 14. Banks from Emerging Markets Were Prevalent in the Ranking of Mid-Cap Performers




**Sources:** T.F. Datastream; BCG analysis.
**Note:** The sample consists of the 51 to 100 largest banks by market capitalization as of the end of 2008, in U.S. dollars, and with a five-year capital market history.
[1] For further explanation of this measure, see the appendix.
[2] Alpha is the risk-adjusted excess return on an investment above what would be predicted by the market. For further explanation, see the appendix.
[3] HDFC Bank was created by the Housing Development Finance Corporation (HDFC) as a separate entity.

## Exhibit 15. After-Tax Profits Plunged by Almost 50 Percent in 2008




**Sources:** T.F. Datastream; Bloomberg; BCG analysis.
**Note:** When historical data were unavailable for 2008, calculations were based on Bloomberg consensus forecasts. To meet the data requirements of this performance analysis, a subset of the full market sample was used—367 banks instead of 583.
[1] ROE: after-tax return on average equity; COE: cost of equity.
[2] Percentage changes are based on complete, not rounded, figures.

# Rankings of Top Performers

Rankings were performed by assessing all the banks for which a five-year RTSR could be calculated. Therefore, banks with public offerings after January 1, 2004, were excluded from this analysis; excluded banks include, for example, ICBC and China Construction Bank. Banks were then ranked by market capitalization and segmented into two groups: the largest 50 banking companies were designated "large-cap," and the companies ranked 51 to 100 were designated "mid-cap."

# Large-Cap Banking Companies

| RTSR rank 2004–2008 | RTSR rank 2008 | Company: Name | Company: Country | Company: Segment | Company: M' cap '08 ($billions) | Performance 2004–2008: RTSR p.a. | TSR | Market | Alpha p.a. | Risk | TSR p.a. | Rank |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1 | 18 | BlackRock | USA | AM | 15.9 | 24.2% | ++++ | – – | 24.2% | – – | 22.2% | 6 |
| 2 | 40 | Sberbank | RUS | UB | 16.0 | 17.8% | ++++ | + | 16.5% | – | 24.3% | 4 |
| 3 | 6 | Unibanco | BRA | UB | 15.8 | 16.8% | ++++ | ++++ | 20.0% | + | 42.4% | 1 |
| 4 | 26 | China Merchants Bank | CHN | UB | 26.4 | 15.5% | ++++ | ++ | 10.8% | + | 23.4% | 5 |
| 5 | 3 | State Bank of India | IND | UB | 16.8 | 10.5% | ++++ | ++ | 8.7% | – | 21.0% | 7 |
| 6 | 16 | Charles Schwab | USA | IB | 18.7 | 10.2% | ++ | – – | 10.8% | – – | 8.4% | 8 |
| 7 | 14 | Banco Bradesco | BRA | UB | 28.0 | 8.9% | ++++ | ++++ | 7.4% | – | 32.7% | 2 |
| 8 | 1 | Wells Fargo | USA | UB | 98.0 | 5.2% | + | – – | 4.0% | ++ | 3.5% | 15 |
| 9 | 8 | Banco Itaú | BRA | UB | 30.8 | 3.9% | ++++ | ++++ | 4.8% | + | 26.6% | 3 |
| 10 | 7 | The PNC Financial Services Group | USA | UB | 17.1 | 3.0% | + | – – | 2.7% | + | 1.4% | 19 |
| 11 | 4 | U.S. Bancorp | USA | UB | 43.6 | 2.9% | + | – – | 1.6% | ++ | 1.3% | 20 |
| 12 | 12 | Resona Holdings | JPN | UB | 16.9 | 2.6% | + | – | 4.1% | – – – | 3.5% | 16 |
| 13 | 13 | Royal Bank of Canada | CAN | UB | 40.9 | 2.0% | ++ | + | 2.8% | ++ | 7.7% | 9 |
| 14 | 10 | JPMorgan Chase | USA | UB | 117.7 | 2.0% | + | – – | 2.2% | – | 0.4% | 24 |
| 15 | 23 | Intesa Sanpaolo | ITA | UB | 41.8 | 1.9% | + | – | 2.4% | – – | 2.8% | 17 |
| 16 | 31 | Standard Chartered Bank | GBR | UB | 23.8 | 1.2% | + | – – | 3.4% | – – | 0.1% | 26 |
| 17 | 22 | The Bank of New York Mellon | USA | AM | 32.5 | –0.1% | – | – – | –1.2% | ++ | –1.7% | 28 |
| 18 | 25 | Nordea | SWE | UB | 18.0 | –0.2% | + | – | –0.2% | – | 2.4% | 18 |
| 19 | 15 | Westpac Banking | AUS | UB | 34.1 | –0.2% | + | + | –0.1% | + | 4.7% | 11 |
| 20 | 39 | The Goldman Sachs Group | USA | IB | 33.4 | –0.7% | – | – – | 2.9% | – – – | –2.2% | 29 |
| 21 | 5 | Hang Seng Bank | HKG | UB | 25.1 | –0.7% | ++ | + | –0.1% | ++ | 5.0% | 10 |
| 22 | 2 | BB&T | USA | UB | 15.2 | –0.8% | – | – – | –2.7% | ++ | –2.4% | 30 |
| 23 | 17 | The Bank of Nova Scotia | CAN | UB | 27.2 | –0.9% | + | + | –0.2% | ++ | 4.6% | 12 |
| 24 | 29 | Mizuho Financial Group | JPN | UB | 31.8 | –1.1% | – | – | 1.4% | – – – – | –0.3% | 27 |
| 25 | 28 | Commonwealth Bank of Australia | AUS | UB | 29.6 | –1.2% | + | + | –1.0% | + | 3.6% | 14 |
| 26 | 21 | The Toronto-Dominion Bank | CAN | UB | 29.8 | –1.5% | + | + | –1.0% | ++ | 4.0% | 13 |
| 27 | 32 | State Street | USA | AM | 17.0 | –2.6% | – | – – | –2.0% | – | –4.1% | 35 |
| 28 | 9 | HSBC | GBR | UB | 115.2 | –3.9% | – – | – – | –5.2% | ++ | –5.0% | 37 |
| 29 | 19 | Australia and New Zealand Banking Group | AUS | UB | 23.0 | –4.0% | + | + | –3.8% | + | 0.7% | 21 |
| 30 | 33 | Sumitomo Mitsui Financial Group | JPN | UB | 32.7 | –4.9% | – | – | –3.4% | – – – | –4.1% | 34 |
| 31 | 11 | Canadian Imperial Bank of Commerce | CAN | UB | 15.8 | –5.0% | + | + | –4.4% | ++ | 0.4% | 23 |
| 32 | 24 | Mitsubishi UFJ Financial Group | JPN | UB | 70.1 | –5.0% | – | – | –3.9% | – – | –4.2% | 36 |
| 33 | 27 | BBVA | ESP | UB | 45.1 | –6.9% | + | ++ | –7.9% | – | 0.6% | 22 |
| 34 | 30 | Banco Santander | ESP | UB | 75.0 | –7.3% | + | ++ | –8.8% | – – | 0.2% | 25 |
| 35 | 20 | National Australia Bank | AUS | UB | 27.2 | –7.8% | – | + | –7.9% | + | –3.3% | 31 |
| 36 | 34 | BNP Paribas | FRA | UB | 38.3 | –8.0% | – | + | –8.1% | + | –3.9% | 33 |
| 37 | 38 | Credit Suisse Group | CHE | UB | 30.4 | –9.2% | – | + | –10.7% | – – | –3.4% | 32 |
| 38 | 37 | Société Générale | FRA | UB | 29.1 | –10.1% | – – | + | –11.1% | – – | –6.1% | 38 |
| 39 | 41 | UniCredit | ITA | UB | 32.4 | –11.8% | – – – | – | –12.0% | – – | –11.0% | 41 |
| 40 | 35 | Crédit Agricole | FRA | UB | 24.8 | –12.6% | – – | + | –13.6% | – | –8.7% | 39 |
| 41 | 43 | American Express | USA | CF | 21.5 | –12.9% | – – – | – – | –12.7% | – – | –14.3% | 44 |
| 42 | 36 | Nomura Holdings | JPN | IB | 15.8 | –13.0% | – – – | – | –12.5% | – – | –12.3% | 42 |
| 43 | 42 | Bank of America | USA | UB | 70.6 | –13.4% | – – – | – – | –12.9% | – – | –14.8% | 45 |
| 44 | 44 | Deutsche Bank | DEU | UB | 22.3 | –15.9% | – – – | + | –18.6% | – – | –11.0% | 40 |
| 45 | 45 | Morgan Stanley | USA | IB | 17.0 | –16.7% | – – – – | – – | –12.9% | – – – – | –18.0% | 46 |
| 46 | 47 | UBS | CHE | UB | 40.9 | –17.7% | – – – | + | –20.9% | – – | –12.5% | 43 |
| 47 | 46 | Barclays Bank | GBR | UB | 18.5 | –19.0% | – – – – | – – | –19.4% | – – | –19.9% | 47 |
| 48 | 48 | Lloyds TSB Group | GBR | UB | 15.5 | –19.0% | – – – – | – – | –20.3% | – | –19.9% | 48 |
| 49 | 49 | Citigroup | USA | UB | 36.6 | –28.7% | – – – – | – – | –30.5% | – – | –29.8% | 49 |
| 50 | 50 | The Royal Bank of Scotland | GBR | UB | 28.0 | –35.2% | – – – – | – – | –39.9% | – – – | –35.9% | 50 |

**Largest increase**

| From ('03–'07) | To ('04–'08) | Positions gained | Company |
|---|---|---|---|
| 39 | 8 | 31 | Wells Fargo |
| 50 | 22 | 28 | BB&T |
| 43 | 21 | 22 | Hang Seng Bank |
| 34 | 13 | 21 | Royal Bank of Canada |
| 48 | 31 | 17 | Canadian Imperial Bank of Commerce |

**Largest decline**

| From ('03–'07) | To ('04–'08) | Positions lost | Company |
|---|---|---|---|
| 15 | 37 | –22 | Credit Suisse Group |
| 4 | 24 | –20 | Mizuho Financial Group |
| 12 | 30 | –18 | Sumitomo Mitsui Financial Group |
| 30 | 45 | –15 | Morgan Stanley |
| 22 | 36 | –14 | BNP Paribas |

AM Asset managers
CF Consumer finance
IB Investment banks
MF Mortgage finance
UB Universal banks

RTSR: Relative total shareholder return
TSR: Total shareholder return – – – – (++++) strongly negative (positive)
Risk: Volatility of returns compared to domestic market (β) – – – – (++++) very high (low)
Market: Stock-specific impact of overall market – – – – (++++) strongly negative (positive)

## Mid-Cap Banking Companies

| RTSR rank | | Company | | | | Performance 2004–2008 | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 2004–2008 | 2008 | Name | Country | Segment | M' cap '08 ($billions) | RTSR p.a. | TSR | Market | Alpha p.a. | Risk | TSR p.a. | Rank |
| 1 | 4 | People's United Financial | USA | UB | 6.2 | 26.8% | ++++ | – – | 21.5% | +++ | 24.8% | 2 |
| 2 | 2 | Bank Central Asia | IDN | UB | 7.3 | 18.0% | ++++ | ++ | 18.2% | ++ | 29.9% | 1 |
| 3 | 6 | Public Bank | MYS | UB | 9.0 | 12.7% | ++++ | ++ | 12.0% | – | 21.1% | 4 |
| 4 | 41 | Türkiye Garanti Bankasi | TUR | UB | 7.1 | 12.6% | ++++ | ++ | 11.0% | – – | 20.5% | 5 |
| 5 | 29 | T. Rowe Price | USA | AM | 9.2 | 11.8% | +++ | – – | 14.2% | – – – | 10.0% | 14 |
| 6 | 8 | HDFC Bank | IND | UB | 8.7 | 10.9% | ++++ | ++ | 11.3% | + | 21.4% | 3 |
| 7 | 3 | Hudson City Bancorp | USA | UB | 8.3 | 10.2% | ++ | – – | 8.0% | ++ | 8.5% | 18 |
| 8 | 5 | The Shizuoka Bank | JPN | UB | 8.1 | 9.1% | +++ | – | 8.2% | ++ | 10.0% | 13 |
| 9 | 11 | HDFC | IND | MF | 8.7 | 8.4% | ++++ | ++ | 8.6% | + | 18.7% | 6 |
| 10 | 16 | TD Ameritrade | USA | IB | 8.4 | 7.5% | ++ | – – | 9.9% | – – | 5.8% | 25 |
| 11 | 33 | Franklin Templeton Investments | USA | AM | 14.8 | 7.1% | ++ | – – | 9.2% | – – | 5.4% | 26 |
| 12 | 7 | Absa | ZAF | UB | 8.0 | 6.7% | ++++ | ++ | 7.0% | + | 17.8% | 7 |
| 13 | 22 | Northern Trust | USA | UB | 11.6 | 5.8% | + | – – | 7.9% | – – | 4.2% | 27 |
| 14 | 15 | The Bank of Yokohama | JPN | UB | 7.9 | 4.9% | ++ | – | 4.9% | – | 5.8% | 24 |
| 15 | 37 | Bumiputra-Commerce Holdings | MYS | UB | 6.0 | 4.6% | +++ | ++ | 3.7% | – – | 12.4% | 10 |
| 16 | 30 | Shinhan Bank | KOR | UB | 9.3 | 3.0% | ++ | ++ | 3.3% | + | 10.0% | 15 |
| 17 | 17 | Akbank | TUR | UB | 9.3 | 2.8% | +++ | ++ | 1.7% | – – | 10.1% | 12 |
| 18 | 18 | The Standard Bank of South Africa | ZAF | UB | 13.7 | 2.0% | +++ | ++ | 2.0% | + | 12.6% | 9 |
| 19 | 28 | Mediobanca | ITA | UB | 8.2 | 1.9% | + | – | 1.3% | ++ | 2.8% | 28 |
| 20 | 21 | IGM Financial | CAN | AM | 7.5 | 1.8% | ++ | + | 2.2% | + | 7.5% | 20 |
| 21 | 44 | National Bank of Greece | GRC | UB | 9.1 | 1.7% | + | – | 2.2% | – | 2.5% | 29 |
| 22 | 24 | Banco Sabadell | ESP | UB | 8.3 | 1.2% | ++ | ++ | 2.5% | ++ | 9.4% | 16 |
| 23 | 9 | United Overseas Bank | SGP | UB | 13.7 | 1.0% | ++ | ++ | 1.6% | ++ | 7.6% | 19 |
| 24 | 20 | FirstRand | ZAF | UB | 9.8 | 0.7% | +++ | ++ | 0.8% | + | 11.1% | 11 |
| 25 | 26 | Bank Polska Kasa Opieki | POL | UB | 11.1 | 0.5% | +++ | +++ | –0.4% | – | 12.7% | 8 |
| 26 | 45 | Julius Baer Group | CHE | IB | 7.9 | 0.5% | ++ | + | –1.1% | – – | 6.8% | 21 |
| 27 | 12 | Sumitomo Trust & Banking | JPN | UB | 9.5 | 0.2% | + | – | 2.0% | – – – | 1.1% | 30 |
| 28 | 10 | OCBC Bank | SGP | UB | 10.8 | 0.2% | ++ | ++ | 0.5% | + | 6.8% | 23 |
| 29 | 38 | ICICI Bank | IND | UB | 10.2 | –0.2% | ++ | ++ | –1.2% | – | 9.2% | 17 |
| 30 | 14 | Türkiye Iş Bankasi | TUR | UB | 7.3 | –0.3% | ++ | ++ | –0.8% | – | 6.8% | 22 |
| 31 | 1 | ACOM | JPN | CF | 6.6 | –0.4% | + | – | –1.9% | ++++ | 0.5% | 32 |
| 32 | 27 | Banca Monte dei Paschi di Siena | ITA | UB | 11.7 | –0.6% | + | – | –1.0% | + | 0.4% | 33 |
| 33 | 25 | UBI Banca | ITA | UB | 9.1 | –1.3% | – | – | –1.9% | ++ | –0.3% | 34 |
| 34 | 34 | Daiwa Securities Group | JPN | IB | 8.2 | –1.8% | – | – | –0.5% | – – | –1.0% | 36 |
| 35 | 23 | Svenska Handelsbanken | SWE | UB | 9.7 | –3.1% | – | – | –3.3% | ++ | –0.6% | 35 |
| 36 | 31 | Malayan Banking | MYS | UB | 7.2 | –6.5% | + | ++ | –6.1% | + | 0.5% | 31 |
| 37 | 47 | KBC | BEL | UB | 10.6 | –6.5% | – – | – | –6.2% | – | –6.2% | 43 |
| 38 | 13 | M&T Bank | USA | UB | 6.3 | –6.7% | – – | – – | –8.8% | +++ | –8.1% | 44 |
| 39 | 32 | Mizuho Trust & Banking | JPN | UB | 6.2 | –6.9% | – – | – | –5.7% | – – – | –6.2% | 42 |
| 40 | 40 | Erste Bank | AUT | UB | 7.1 | –7.4% | – | – | –7.7% | – | –4.7% | 39 |
| 41 | 19 | Capital One | USA | CF | 12.5 | –10.1% | – – – | – – | –9.4% | – – | –11.5% | 45 |
| 42 | 39 | Bank of China (Hong Kong) | HKG | UB | 12.0 | –10.3% | – – | + | –10.9% | – | –5.1% | 40 |
| 43 | 42 | KB Financial Group | KOR | UB | 9.5 | –10.6% | – | ++ | –11.6% | – | –4.6% | 38 |
| 44 | 35 | Bank of Montreal | CAN | UB | 13.7 | –10.8% | – – | + | –10.4% | +++ | –5.8% | 41 |
| 45 | 36 | Grupo Banco Popular | ESP | UB | 10.3 | –10.9% | – | ++ | –11.1% | + | –3.6% | 37 |
| 46 | 43 | SunTrust Banks | USA | UB | 10.5 | –11.6% | – – – | – – | –11.8% | – | –13.0% | 48 |
| 47 | 46 | Danske Bank | DNK | UB | 6.8 | –16.0% | – – – | + | –17.3% | + | –12.5% | 47 |
| 48 | 49 | Commerzbank | DEU | UB | 6.8 | –16.9% | – – – | + | –19.8% | – – | –12.0% | 46 |
| 49 | 48 | DBS Group | SGP | UB | 13.3 | –19.8% | – – – | ++ | –22.7% | – – | –14.5% | 49 |
| 50 | 50 | HBOS | GBR | UB | 12.8 | –36.4% | – – – – | – – | –41.9% | – – | –37.1% | 50 |

| Largest increase | | | |
|---|---|---|---|
| From ('03–'07) | To ('04–'08) | Positions gained | Company |
| 34 | 8 | 26 | The Shizuoka Bank |
| 45 | 23 | 22 | United Overseas Bank |
| 23 | 2 | 21 | Bank Central Asia |
| 50 | 31 | 19 | ACOM |
| 24 | 6 | 18 | HDFC Bank |

| Largest decline | | | |
|---|---|---|---|
| From ('03–'07) | To ('04–'08) | Positions lost | Company |
| 1 | 39 | –38 | Mizuho Trust & Banking |
| 14 | 48 | –34 | Commerzbank |
| 10 | 37 | –27 | KBC |
| 8 | 26 | –18 | Julius Baer Group |
| 15 | 29 | –14 | ICICI Bank |

AM Asset managers
CF Consumer finance
IB Investment banks
MF Mortgage finance
UB Universal banks

RTSR: Relative total shareholder return
TSR: Total shareholder return – – – – (++++) strongly negative (positive)
Risk: Volatility of returns compared to domestic market (β) – – – – (++++) very high (low)
Market: Stock-specific impact of overall market – – – – (++++) strongly negative (positive)

## Ranking by Country

| Country | Company: Name | Company: Segment | Company: M' cap '08 ($billions) | TSR '04–'08: Rank | TSR '04–'08: TSR p.a. |
|---|---|---|---|---|---|
| Australia  | Westpac Banking | UB | 34.1 | 1 | 4.7% |
| | Commonwealth Bank of Australia | UB | 29.6 | 2 | 3.6% |
| | Australia and New Zealand Banking Group | UB | 23.0 | 3 | 0.7% |
| | Suncorp-Metway | UB | 5.9 | 4 | –2.3% |
| | National Australia Bank | UB | 27.2 | 5 | –3.3% |
| Canada  | Royal Bank of Canada | UB | 40.9 | 1 | 7.7% |
| | The Bank of Nova Scotia | UB | 27.2 | 2 | 4.6% |
| | The Toronto-Dominion Bank | UB | 29.8 | 3 | 4.0% |
| | Canadian Imperial Bank of Commerce | UB | 15.8 | 4 | 0.4% |
| | Bank of Montreal | UB | 13.7 | 5 | –5.8% |
| France  | BNP Paribas | UB | 38.3 | 1 | –3.9% |
| | Société Générale | UB | 29.1 | 2 | –6.1% |
| | Crédit Agricole | UB | 24.8 | 3 | –8.7% |
| | Crédit Agricole d'Ile de France | UB | 0.5 | 4 | –11.3% |
| | Natixis | UB | 5.1 | 5 | –22.2% |
| Germany  | DVB Bank | AM | 1.7 | 1 | 30.8% |
| | Deutsche Bank | UB | 22.3 | 2 | –11.0% |
| | Commerzbank | UB | 6.8 | 3 | –12.0% |
| | Aareal Bank | MF | 0.3 | 4 | –22.5% |
| | Hypo Real Estate Holding | MF | 0.9 | 5 | –28.8% |
| Italy  | Mediobanca | UB | 8.2 | 1 | 2.8% |
| | Intesa Sanpaolo | UB | 41.8 | 2 | 2.8% |
| | Banca Monte dei Paschi di Siena | UB | 11.7 | 3 | 0.4% |
| | UBI Banca | UB | 9.1 | 4 | –0.3% |
| | UniCredit | UB | 32.4 | 5 | –11.0% |
| Japan  | Resona Holdings | UB | 16.9 | 1 | 3.5% |
| | Mizuho Financial Group | UB | 31.8 | 2 | –0.3% |
| | Sumitomo Mitsui Financial Group | UB | 32.7 | 3 | –4.1% |
| | Mitsubishi UFJ Financial Group | UB | 70.1 | 4 | –4.2% |
| | Nomura Holdings | IB | 15.8 | 5 | –12.3% |
| Spain  | Banco de Valencia | UB | 4.9 | 1 | 21.4% |
| | Banco Sabadell | UB | 8.3 | 2 | 9.4% |
| | BBVA | UB | 45.1 | 3 | 0.6% |
| | Banco Santander | UB | 75.0 | 4 | 0.2% |
| | Grupo Banco Popular | UB | 10.3 | 5 | –3.6% |
| Switzerland  | Banque Cantonale Vaudoise | UB | 2.6 | 1 | 26.1% |
| | Valiant | UB | 3.1 | 2 | 22.3% |
| | Julius Baer Group | IB | 7.9 | 3 | 6.8% |
| | Credit Suisse Group | UB | 30.4 | 4 | –3.4% |
| | UBS | UB | 40.9 | 5 | –12.5% |
| United Kingdom  | Standard Chartered Bank | UB | 23.8 | 1 | 0.1% |
| | HSBC Holdings | UB | 115.2 | 2 | –5.0% |
| | Barclays Bank | UB | 18.5 | 3 | –19.9% |
| | Lloyds TSB Group | UB | 15.5 | 4 | –19.9% |
| | The Royal Bank of Scotland | UB | 28.0 | 5 | –35.9% |
| United States  | BlackRock | AM | 15.9 | 1 | 22.2% |
| | Charles Schwab | IB | 18.7 | 2 | 8.4% |
| | Franklin Templeton Investments | AM | 14.8 | 3 | 5.4% |
| | Wells Fargo | UB | 98.0 | 4 | 3.5% |
| | The PNC Financial Services Group | UB | 17.1 | 5 | 1.4% |
| | U.S. Bancorp | UB | 43.6 | 6 | 1.3% |
| | JPMorgan Chase | UB | 117.7 | 7 | 0.4% |
| | The Bank of New York Mellon | AM | 32.5 | 8 | –1.7% |
| | The Goldman Sachs Group | IB | 33.4 | 9 | –2.2% |
| | BB&T | UB | 15.2 | 10 | –2.4% |
| | State Street | AM | 17.0 | 11 | –4.1% |
| | American Express | CF | 21.5 | 12 | –14.3% |
| | Bank of America | UB | 70.6 | 13 | –14.8% |
| | Morgan Stanley | IB | 17.0 | 14 | –18.0% |
| | Citigroup | UB | 36.6 | 15 | –29.8% |

AM Asset managers    CF Consumer finance    IB Investment banks    MF Mortgage finance    UB Universal banks

For each country the five largest banks, by market capitalization, are listed, except for the United States where the 15 largest banks are listed.

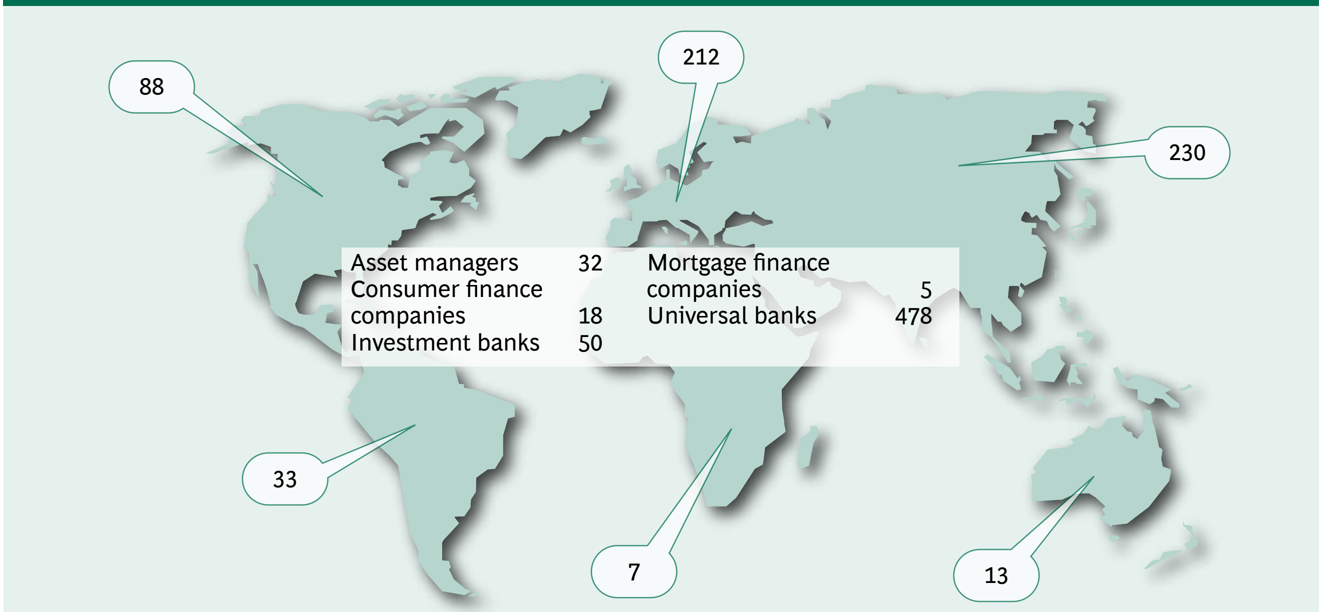
# Appendix: Sample and Methodology

The analyses in this report are based on a sample of 583 stock-market-listed universal and specialized companies in the banking industry. The companies include all major banking players and represent more than 77 percent of the industry's total market capitalization as of January 2009.

Five segments are distinguished in the sample: universal and diversified banks with a broad business portfolio; investment banks (providers of capital markets services and corporate-finance services); asset managers (providers of retail broker services and money management, including investments, budgeting, banking, and taxes); consumer finance businesses (credit card companies and providers of personal financial services); and mortgage finance companies (providers of mortgages and mortgage insurance). Companies were categorized in these segments according to their dominant business focus.

Most of the historical capital-market and fundamental data for the sample were acquired from Thomson Financial Datastream. Bloomberg consensus forecasts, if available, were used to fill gaps in data for 2008, with estimated data as of January 21, 2009.

**The Sample Includes 583 Companies in Different Regions and Segments**




**Sources:** T.F. Datastream; BCG analysis.

The report uses several different measures to gauge value creation.

**Total shareholder return (TSR).** TSR measures the change in a company's stock price and/or gains from reinvesting dividends paid in a particular period. It is the percentage change of the return index on a given stock. To measure the true capital market performance of a company, TSR was adjusted for two elements: the impact of local stock market performance and the impact of risk.

**Relative total shareholder return (RTSR).** Like TSR, RTSR measures shareholder returns based on capital gains and free-cash-flow yield, but it adjusts a company's TSR to account for the impact of the local stock market. This is important when drawing comparisons among companies in different countries. For example, one company's performance could be buoyed by a bull market, whereas another company's performance could be dampened by a bear market.

**Alpha.** This measure adjusts a company's excess return for the volatility of stock relative to the local market. Alpha accounts for the expectation that companies that take on greater risks will have greater returns. This adjustment makes it easier to compare, for example, the performance of a diversified universal bank (which has relatively low risk) with the performance of an investment bank (which has relatively high risk).

These two dimensions reveal how and why a company's true capital market performance might vary from its TSR. When converted to RTSR, for example, a company's TSR will be adjusted upward, if it posted strong gains despite a poorly performing local market. Alpha adjusts the company's excess return downward, if the business involves greater underlying risk. If a company has a high RTSR and a low or negative alpha, it means that although the stock outperformed the local market, the return was not high enough to compensate for the risk taken by the investors.

The formal definition of *RTSR* for stock *S* in local market *M* is as follows:

$$RTSR(S,M) = (1 + TSR(S)) / (1 + TSR(M)) - 1$$

The formal definition of alpha for stock *S* in local market *M* is as follows:

$$\alpha = r_i(S) - (r_f + (\mu_m - r_f) \bullet \beta(S))$$

where alpha is the excess return of stock *S*, calculated by the difference of the realized return of the stock $r_i(S)$ above what would be predicted by the capital asset pricing model (CAPM). The CAPM predicts the expected return of stock *S*. It includes:

- The risk-free rate r*f*.
- The excess return of the market $(\mu_m - r_f) \bullet \beta(S)$, derived from the average return of the domestic market *M*, $\mu_m$, over $r_f$, and $\beta$, which is the volatility of stock *S* compared to the domestic market *M*; alpha directly measures the percentage excess return of the stock.

# For Further Reading

The Boston Consulting Group publishes other reports and articles that may be of interest to senior financial executives. Recent examples include:

**Collateral Damage Part 4: Preparing for a Tough Year Ahead: The Outlook, the Crisis in Perspective, and Lessons from the Early Movers**
A white paper by The Boston Consulting Group, December 17, 2008

**Thriving in the New Normal: Corporate Banking 2008/2009**
A report by The Boston Consulting Group, December 2008

**M&A: Down but Not Out: A Survey of European Companies' Merger and Acquisition Plans for 2009**
A white paper by The Boston Consulting Group, December 2008

**Collateral Damage Part 3: Asia, Advantage and Action**
A white paper by The Boston Consulting Group, November 14, 2008

**Winning Strategies in Uncertain Times: Global Asset Management 2008**
A report by The Boston Consulting Group, November 2008

**Collateral Damage Part 2: Taking Robust Action in the Face of the Growing Crisis**
A white paper by The Boston Consulting Group, October 24, 2008

**Collateral Damage Part 1: What the Crisis in the Credit Markets Means for Everyone Else**
A white paper by The Boston Consulting Group, October 7, 2008

**Missing Link: Focusing Corporate Strategy on Value Creation: The 2008 BCG Value Creators Report**
A report by The Boston Consulting Group, September 2008

**Venturing Abroad: Chinese Banks and Cross-Border M&A**
A report by The Boston Consulting Group, September 2008

**A Wealth of Opportunities in Turbulent Times: Global Wealth 2008**
A report by The Boston Consulting Group, September 2008

**A Principled Look at Cost Cutting**
Opportunities for Action in Financial Institutions, June 2008

**The Return of the Strategist: Creating Value with M&A in Downturns**
A report by The Boston Consulting Group, May 2008

**Managing Shareholder Value in Turbulent Times: Creating Value in Banking 2008**
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**Banking on Lean Advantage**
Opportunities for Action in Financial Services, January 2008

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