EUROPEAN BANKING:

Striking the right balance between risk and return

By Walter Sinn, Rocco D'Acunto and Andrea Oldrini

BAIN & COMPANY

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European banking: Striking the right balance between risk and return

Now that risk figures so prominently in European banking, it's time to raise the profile of a metric that has played a minor role to date.

This benchmark—the rate of return on risk-weighted assets, or RoRWA—reliably integrates a balance-sheet-management perspective with the revenue and cost side of the business. Based on a comprehensive analysis of 121 banks across Europe by Bain & Company, RoRWA clearly emerges as the single most practical measure to help senior bank executives manage their companies' performance and make savvy risk-reward decisions.

Our analysis shows how and where the quality of management plays a major role in determining performance. That's especially true in the core European countries, where banks can't rely on economic growth to lift their fortunes.

Why does RoRWA deserve more respect now? Five years since the global financial crisis, bankers across Europe still find themselves waging battle on many fronts. Low interest rates, a loss of customers' trust, stiff new target capital requirements and regulatory mandates have compounded the difficulty of operating in weak eurozone economies. On the cost side, moreover, banks are reconfiguring their distribution networks and streamlining operations. Yet even as revenue growth flattens and new digital technologies push up capital investments, banks are not making much headway on reining in costs.

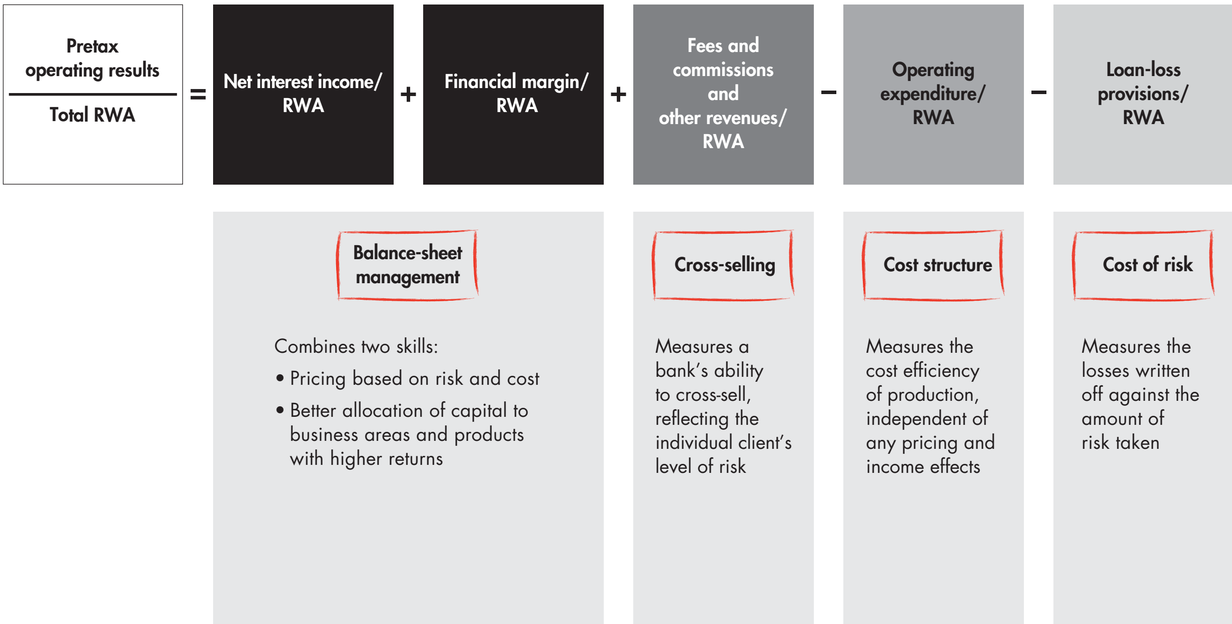
Indeed, the banking industry is going through a major restructuring, and only the fittest will survive this Darwinian process. The traditional tools that bankers have used to chart their competitive courses provide an inadequate map for navigating treacherous new terrain. With capital adequacy, asset quality and broad macroeconomic trends playing more prominent roles in shaping a bank's financial performance, it is the balance sheet, not the profit-and-loss statement, which better captures the bank's overall health and points to the areas that most need improvement. Today's environment of disruptive change calls for a holistic yet simple view of the returns that banks generate on every unit of capital they commit to their businesses, on a risk-adjusted basis.

RoRWA fits the bill. Other measures may be more precise in understanding risk theoretically, but they're impractical to use in managing the enterprise. RoRWA's strength lies in using a well-understood measure—risk-weighted assets—as a denominator, making it a good proxy for risk.

For business leaders, RoRWA and the analysis of key components can provide practical guidance to optimize bank performance across four dimensions:

- First, RoRWA tracks how well a bank manages its balance sheet and appetite for risk. Managers can see whether they are properly pricing offerings to reflect their risk and cost, and how well they are allocating capital to business areas and products that generate higher returns.
- Second, the benchmark guides decisions on how a bank factors in risk to its cross-selling opportunities that bring in fees, commissions and other revenues.
- Third, on the cost side, a RoRWA approach reveals the cost efficiency per unit of risk for the volume of business a bank generates.
- Fourth, RoRWA shines a light on the cost of risk by disclosing how well a bank is able to minimize its loan-loss provisions on a risk-adjusted basis.

RoRWA reflects performance across four key dimensions



Source: Bain analysis

Beyond its value as a guide for bringing risk and capital to the forefront in managing a bank's internal performance, RoRWA also can serve as a powerful tool for external communications. Executives, regulators and investors can see in a single number (supported by a few key components) how a bank stacks up against its direct competitors across different regions.

Based on the RoRWA metric, Bain undertook a comprehensive analysis of conditions influencing risk-weighted returns across Europe. Our analysis spans 12 core EU countries and the four fast-growing markets of the Commonwealth of Independent States (CIS), Poland, South Africa and Turkey from the onset of the global economic crisis in 2008 through the end of 2012. We conducted an in-depth examination of 121 banks, ranging from the largest globe-spanning institutions headquartered in Europe and other large banks that operate subsidiaries beyond their home countries to smaller local or regional banks. Together, the institutions we evaluated cover at least 70% of their respective markets.

The charts on the following pages highlight three major findings.

Economic growth counts, but management effectiveness plays a critical role. Overall, RoRWA correlated strongly with GDP growth trends in the markets we examined. Our analysis revealed a dramatic gap between the general underperformance of banks in the core European countries—whose economies have largely stagnated or remained mired in recession—and the stronger risk-weighted returns posted by banks based in markets that experienced more rapidly expanding GDP.

Yet analysis of bank-level data also showed a wide variance in the performance of institutions competing within individual markets. For example, in the slow-growth, mostly core European markets, where GDP ranged from negative 10% to 5% over the five-year period, RoRWA by bank varied widely in every year. Clearly, for these markets, the quality of an individual bank's management plays a major role in determining performance.

In markets where GDP growth exceeded 5%, by contrast, we found considerably less variation in bank-level RoRWA performance. As the rising tide lifted all banks, management's role in shaping returns appears to have been more circumscribed.

Most banks fail to earn their cost of capital. Bain determined that the RoRWA required for banks to cover their cost of capital fell within a range of 1.6% to 2.1%, depending on a bank's size and the country in which it is based. The RoRWA of most banks has failed to clear that cost-of-capital hurdle, on average, in any year since 2008, falling well short in every year except 2010. Once again, however, we found a wide variation between the bank performance in the core European countries, where RoRWA was consistently below the cost of capital, and that in the high-growth countries, where RoRWA easily cleared the capital-cost bar.

Looking at the banks' underlying strengths and weaknesses by market, we identified several major pain points that pinched banks' RoRWAs in the core European countries.

The need to shed debt and rely on higher-cost equity to strengthen their balance sheets reduced these banks' total risk-weighted assets by nearly 8% between 2008 and 2012. Meanwhile, their cost of risk increased sharply, as stagnant or shrinking economies forced them to boost their loan-loss provisions in the face of steeper write-offs of bad credit. Interest margins that remained at low levels, shrinking fee incomes and higher operating costs also added downward pressure to banks' RoRWAs.

Size matters. Within core Europe, the 10 biggest pan-European banks (by total assets and market capitalization) fared best overall. Helped by large increases in net interest income and strong improvements in financial margins, their RoRWAs came closest to earning their cost of capital.

Other large European banks with subsidiaries outside their home countries reduced their operating costs, partially offsetting declines in risk-weighted fee income and higher loan-loss provisions. But the RoRWAs for these banks still failed to clear their cost-of-capital hurdle.

Local banks in core Europe struggled, weighed down by nonperforming loans and flat revenues. Their RoRWAs were negative in both 2008 and 2012 and did not come close to covering their cost of capital.

Turning to country differences, the four high-growth countries on the fringe of Europe, the Middle East and Africa have the wind at their backs. Turkey ranked first in RoRWA for 2012, and it has jockeyed for top billing with Poland and South Africa over the past five years.

Countries in core Europe's northern tier occupied the middle ranks of the national league tables, with the Nordic and Austrian banks showing the most consistent performance since 2008. Dutch, Belgian and German banks have been on an upswing since the financial crisis hit. UK and French banks have been treading water, although Standard Chartered Bank and HSBC in the UK and BNP Paribas in France all ranked among the top 15 banks in core European countries.

Not surprisingly, banks in Italy, Portugal, Spain and Ireland—all feeling the sting of the sovereign debt crisis and deep economic recessions—have turned in the weakest RoRWAs.

Illuminating the road ahead

While most European banks are moving in the right direction to meet Basel III requirements, they could benefit from using RoRWA to better anticipate and navigate the road ruts that lie ahead.

Devising sustainable business models and bringing profitability back to attractive levels—meaning above the cost of capital—will not be easy. In the current market environment, we expect continued pressure on interest as well as on fee income. For most banks, managing the cost of risk will also be a challenge, as stagnant economies tend to drive up this cost.

Getting a better grip on operating cost, therefore, will lead the agenda for most banks. Structural costs can be addressed using several means: adopting new digital technologies and modernizing IT platforms, optimizing processes from end to end through such approaches as outsourcing and offshoring, and expanding global procurement initiatives.

Local banks in core European countries face perhaps the stiffest challenges, as restructuring will continue in the face of stagnant economies and a higher cost of risk. We expect to see further consolidation in this group. For the surviving institutions, higher performance will hinge on better management of the deleveraging process, containment of the cost of raising new capital and more accurate factoring of risk into their price structures.

High-growth countries still offer the most promising opportunities for the 10 biggest and other large pan-European players that aim to diversify their portfolios. The best performers will be those banks that keep tight control of the reins as they ride these booming economies.

Regardless of a bank's home country, asset size or loan portfolio, RoRWA analysis illuminates the ruts and holes on the road ahead. With just a few metrics, senior managers can understand how their bank compares with its peers and which factors to work on in order to create value—a highly pragmatic means of improving the bank's risk-return profile.

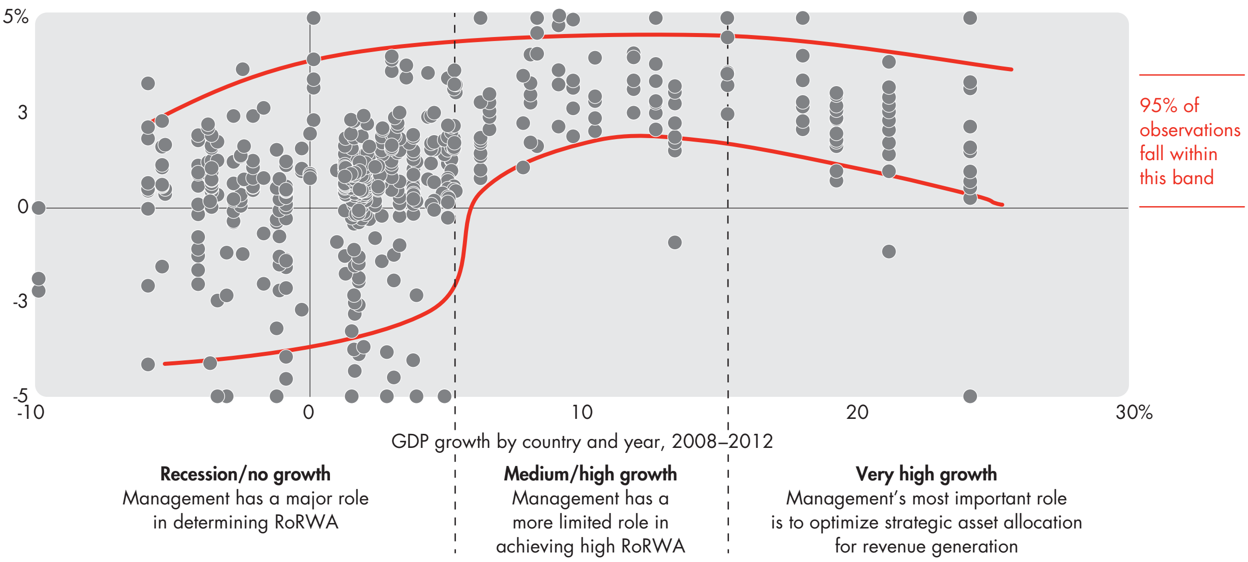
1.

Five years of RoRWA in Europe: A bumpy landscape

- European banks' return on risk recovered from the 2008 financial crisis, peaking in 2010 with an average 1.3% RoRWA. Since then, however, RoRWA has declined to 0.5% on average. This translates to a level of profitability below the cost of capital, which means banks are destroying value.
- Looking beneath the average, European banks' RoRWAs correlated closely with economic growth over the past five years. Banks in countries that saw strong GDP growth, like Turkey, posted dramatically higher performance and growth in both assets and risk-weighted assets (RWA) than those in the core European countries.
- Banks in high-growth countries also consistently exceeded their cost of capital, whereas banks in core Europe have not covered their cost of capital, only coming close to that bar in 2010. Core Europe experienced a major amount of deleveraging despite extraordinary initiatives such as the European Central Bank's long-term refinancing operation (LTRO).
- The quality of management plays a major role in individual bank performance, particularly in the slow-growth countries. There was a wide range of RoRWAs among banks in those markets for each of the five years.
- In 2012, the biggest factors determining significant value destruction were cost of risk, as loan-loss provisions rose, and increased operating cost, which trended up as a percent of risk-weighted assets. More active management of the balance sheet helped raise revenues, but fees and commissions progressively declined.
- The larger the bank, the better its performance, on average. The 10 biggest banks used their improvements in financial margins and lower risk costs to come close to earning their cost of capital.
- Other large regional banks managed to keep operating costs lower than the 10 biggest, but still fell well short of their capital hurdle. Smaller local banks fared the worst, posting a negative RoRWA in 2012. They have been forced to undertake a major deleveraging of their balance sheets.

Although RoRWA correlates with economic growth, there is still substantial variation among banks

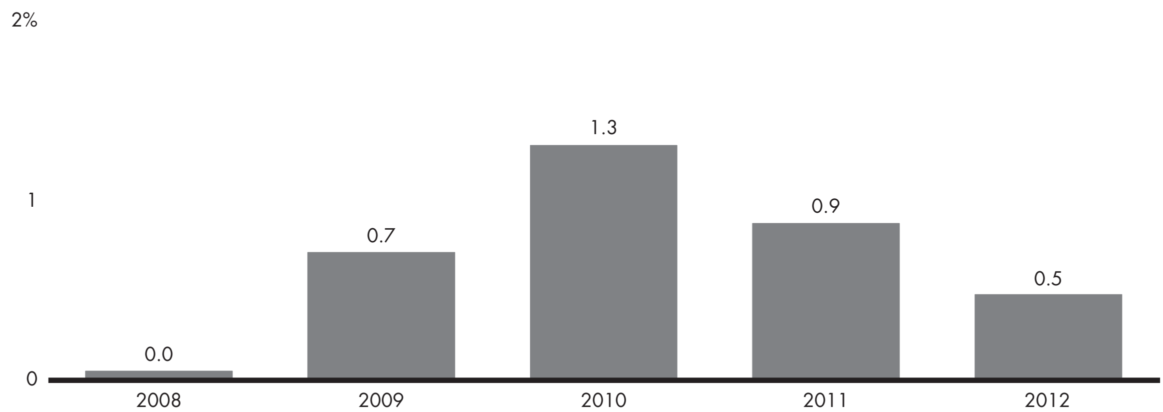
RoRWA per bank and year, 2008–2012



Note: Each observation is composed of a bank's RoRWA in a given year and the respective country's year-over-year GDP growth rate in that year.
Sources: Banks' financial statements 2008–2012, n=605; Bureau van Dijk; Bain analysis

Bank profitability has eroded since the post-crisis peak of 2010

European-wide RoRWA

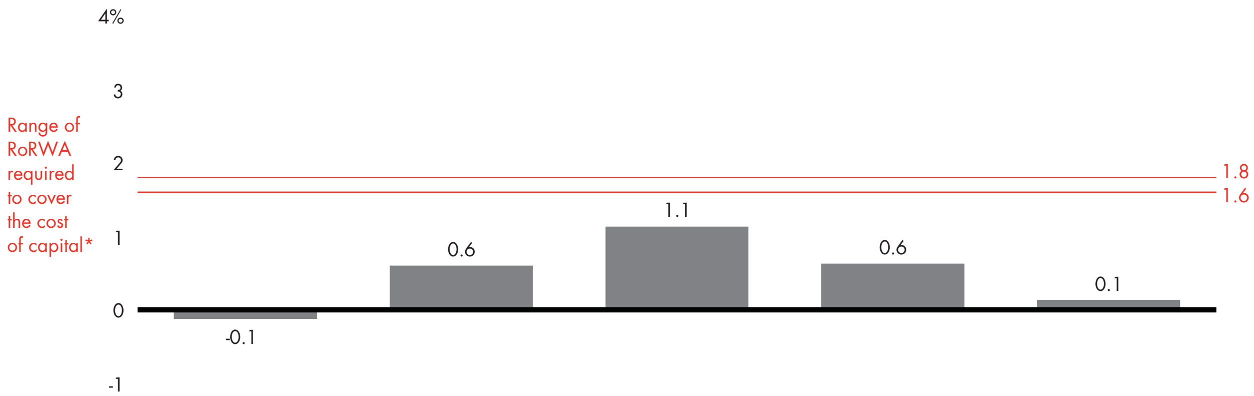


	2008	2009	2010	2011	2012
Total assets (€B):	33,576	30,229	31,770	33,528	33,028
ROE (%)*:	0.8	6.4	10.4	7.5	4.9
RWA (€B):	11,690	11,555	11,726	11,986	11,207
Annual GDP growth (%):	4.4	-3.2	5.2	5.3	2.9

*Return on equity (ROE) = Pretax profit/average shareholders' equity
Sources: Banks' financial statements 2008–2012, n=121; Bureau van Dijk; Bain analysis

Banks in core Europe have not covered their cost of capital over the past five years…

RoRWA, weighted average

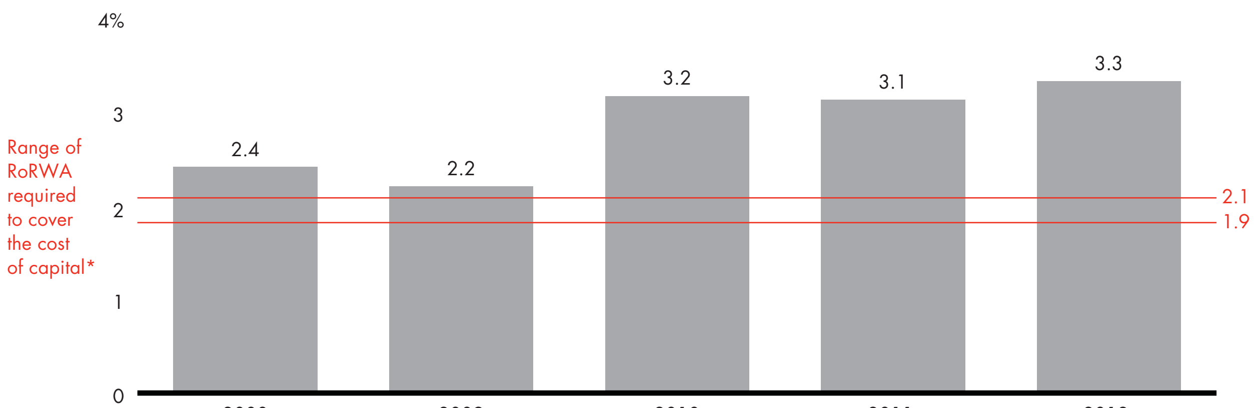


	2008	2009	2010	2011	2012
Total assets (€B):	32,373	29,129	30,366	31,957	31,219
ROE (%):	-1.5	5.1	8.8	5.3	2.2
RWA (€B):	10,899	10,846	10,785	10,869	10,047

*The range represents the level of RoRWA required to cover the banks' cost of capital and varies by bank size and country; analysis of 88 banks based in Austria, Belgium, France, Germany, Ireland, Italy, the Netherlands, the Nordics, Portugal, Spain, Switzerland and the UK.
Sources: Banks' financial statements 2008–2012; Bain analysis

…while banks in high-growth countries consistently exceeded their cost of capital

RoRWA, weighted average



	2008	2009	2010	2011	2012
Total assets (€B):	1,203	1,100	1,404	1,571	1,810
ROE (%):	22.6	20.6	25.0	26.7	24.7
RWA (€B):	791	708	941	1,117	1,160

*The range represents the level of RoRWA required to cover the banks' cost of capital and varies by bank size and country; analysis of 33 banks based in the Commonwealth of Independent States (CIS), Poland, South Africa and Turkey.
Sources: Banks' financial statements 2008–2012; Bain analysis

Higher operating expenditure and cost of risk caused banks' value destruction in 2012

Main components in European-wide RoRWA	2008	2009	2010	2011	2012	Major trends
RoRWA (%)	0.0	0.7	1.3	0.9	0.5	
Total assets (€B)	33,576	30,229	31,770	33,528*	33,028*	**Partial deleveraging of assets**
Tier 1 capital (€B)	1,079	1,261	1,363	1,426	1,510	**Strengthening of capital**
RWA/total assets (%)	35	38	37	36	34	**Fairly constant risk profile despite deleveraging of assets**
Net interest income/RWA (%)	3.1	3.4	3.5	3.5	3.6	**Overall margin from balance-sheet management increasing**
Financial margin/RWA (%)	-0.7	0.9	1.0	0.5	0.9	
Fees and commissions + other revenues/RWA (%)	2.2	1.7	1.7	2.0	1.7	**Continuous pressure on fees and commissions**
Operating expenditure/RWA (%)	3.6	3.5	3.7	4.0	4.3	**Inability to reduce costs in proportion to deleveraging**
Loan-loss provisions/RWA (%)	1.1	1.8	1.2	1.2	1.5	**Rising cost of credit**

*Long-term refinancing operations (LTRO) 2011 ~€500 billion; LTRO 2012 ~€750 billion (including repayment), corresponding to 2011 total assets of ~€33.0 trillion and 2012 total assets of ~€32.2 trillion.
Sources: Banks' financial statements 2008–2012, n=121; Bain analysis

In core Europe, banks increased capital ratios and revenues, but did not optimize costs

	Components	2008	2009	2010	2011	2012	Change 2008–2012
Asset leverage	**Total RWA (€B)**	10,899	10,846	10,785	10,869	10,047	**-7.8%**
	Total assets (€B)	32,373	29,129	30,366	31,957	31,219	-3.6%
	RWA/total assets (%)	34	37	36	34	32	-2% pts
	Tier 1 ratio (%)	9.0	10.7	11.4	11.8	13.3	+4.3% pts
	Total Tier 1 (€B)	981	1,159	1,230	1,280	1,336	+36%
Balance-sheet management	**Net interest income/RWA (%)**	2.9	3.2	3.3	3.3	3.4	**+0.5% pts**
	Financial margin/RWA (%)	-0.7	0.9	1.0	0.5	0.9	**+1.6% pts**
	Net interest income/total assets (%)	1.0	1.2	1.2	1.1	1.1	+0.1% pts
	Financial margin/total assets (%)	-0.2	0.3	0.4	0.2	0.3	+0.5% pts
	Net interest income + financial margin/RWA (%)	2.2	4.1	4.3	3.9	4.3	+2.1% pts
Cross-selling	**Fees + other revenues/RWA (%)**	2.2	1.7	1.6	1.9	1.6	**-0.6% pts**
Cost structure	**Opex/RWA (%)**	3.5	3.5	3.7	4.0	4.3	**+0.7% pts**
	Cost/income (%)	80	61	62	68	70	-10% pts
	Opex/total assets (%)	1.2	1.3	1.3	1.4	1.4	+0.2% pts
Cost of risk	**Loan-loss provisions/RWA (%)**	1.0	1.7	1.2	1.2	1.5	**+0.5% pts**
	Nonperforming loan ratio (%)	2.5	4.0	4.6	4.7	5.5	+3.0% pts
	Coverage ratio (%)	61	54	50	51	49	-12% pts

Notes: **Components in bold** are direct components of the RoRWA calculation; changes in red are negative trends
Sources: Banks' financial statements 2008–2012, n=88; Bain analysis

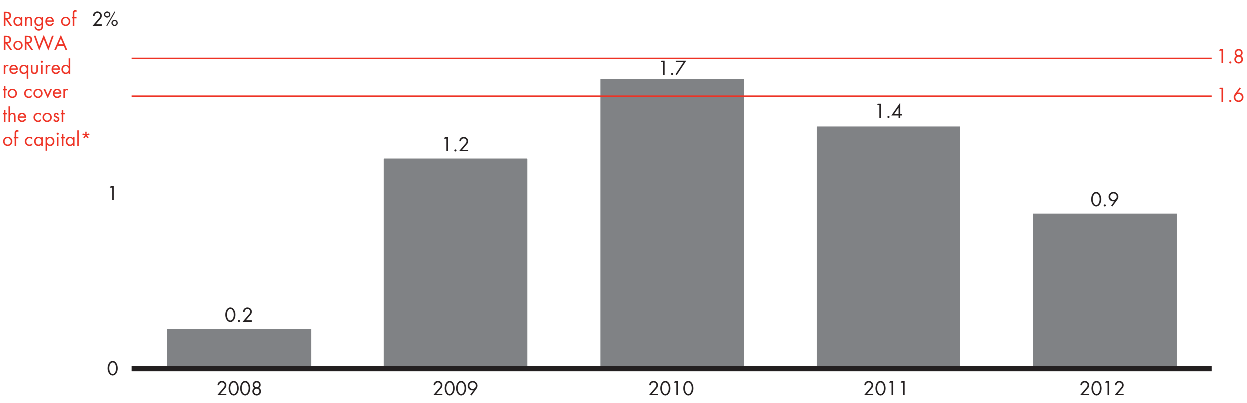
In high-growth countries, higher financial margins offset lower fees, and relatively high nonperforming loans affected cost of risk

	Components	2008	2009	2010	2011	2012	Change 2008–2012
Asset leverage	**Total RWA (€B)**	791	708	941	1,117	1,160	**+47%**
	Total assets (€B)	1,203	1,100	1,404	1,571	1,810	+50%
	RWA/total assets (%)	66	64	67	71	64	-2% pts
	Tier 1 ratio (%)	12.3	14.4	14.1	13.1	15.0	+2.7% pts
	Total Tier 1 (€B)	97	102	133	147	174	+78%
Balance-sheet management	**Net interest income/RWA (%)**	5.8	6.7	5.5	5.0	5.7	**-0.1% pts**
	Financial margin/RWA (%)	0.0	0.8	0.5	0.3	0.5	**+0.5% pts**
	Net interest income/total assets (%)	3.8	4.3	3.7	3.5	3.6	-0.2% pts
	Financial margin/total assets (%)	0.0	0.5	0.4	0.2	0.4	+0.4% pts
	Net interest income + financial margin/RWA (%)	5.8	7.5	6.0	5.3	6.2	+0.5% pts
Cross-selling	**Fees + other revenues/RWA (%)**	2.7	2.7	2.7	2.4	2.5	**-0.2% pts**
Cost structure	**Opex/RWA (%)**	4.2	4.3	4.1	3.8	4.3	**+0.1% pts**
	Cost/income (%)	47	39	43	45	45	-2% pts
	Opex/total assets (%)	2.8	2.8	2.8	2.7	2.7	-0.1% pts
Cost of risk	**Loan-loss provisions/RWA (%)**	1.8	3.6	1.5	0.8	1.1	**-0.7% pts**
	Nonperforming loan ratio (%)	3.7	8.2	6.9	5.5	4.9	+1.2% pts
	Coverage ratio (%)	59	57	63	64	64	+5% pts

Notes: **Components in bold** are direct components of the RoRWA calculation; changes in red are negative trends
Sources: Banks' financial statements 2008–2012, n=33; Bain analysis

Europe's 10 biggest banks come closest to earning their cost of capital

RoRWA, weighted average



	2008	2009	2010	2011	2012
Total assets (€B):	13,409	11,336	12,395	13,239	13,385
ROE (%):	2.2	9.4	12.3	10.7	5.9
RWA (€B):	3,514	3,474	3,698	3,765	3,639

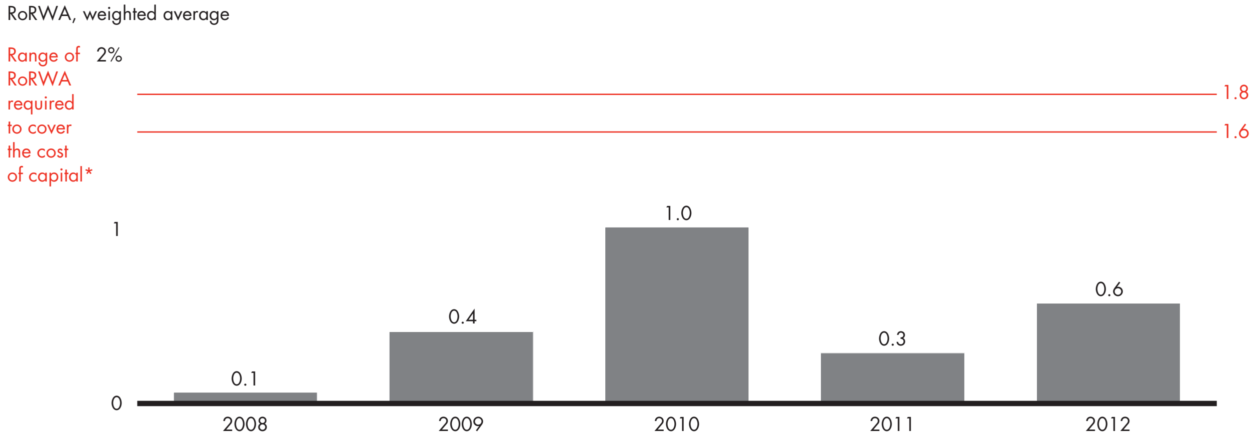
*The range represents the level of RoRWA required to cover the banks' cost of capital and varies by bank size and country. Analysis of the 10 largest Europe-headquartered banks by market capitalization, with a pan-European presence, a universal bank business model and assets of at least €650 billion (Barclays, BNP Paribas, Crédit Agricole, Credit Suisse, Deutsche Bank, HSBC, Nordea, Santander, UBS and UniCredit).
Sources: Banks' financial statements 2008–2012; Bain analysis

Among the 10 biggest banks, lower risk costs and improved margins offset high Opex

	Components	2008	2009	2010	2011	2012	Change 2008–2012
Asset leverage	**Total RWA (€B)**	3,514	3,474	3,698	3,765	3,639	**+3.6%**
	Total assets (€B)	13,409	11,336	12,395	13,239	13,385	-0.2%
	RWA/total assets (%)	26	31	30	28	27	+1% pts
	Tier 1 ratio (%)	8.5	11.0	11.5	11.6	13.1	+4.6% pts
	Total Tier 1 (€B)	299	380	426	437	477	+60%
Balance-sheet management	**Net interest income/RWA (%)**	3.3	3.7	3.7	3.8	3.8	**+0.5% pts**
	Financial margin/RWA (%)	-0.7	1.4	1.4	0.9	1.0	**+1.8% pts**
	Net interest income/total assets (%)	0.9	1.1	1.1	1.1	1.0	+0.2% pts
	Financial margin/total assets (%)	-0.2	0.4	0.4	0.3	0.3	+0.5% pts
	Net interest income + financial margin/RWA (%)	2.6	5.1	5.1	4.7	4.9	+2.3% pts
Cross-selling	**Fees + other revenues/RWA (%)**	3.0	2.2	2.3	2.6	2.4	**-0.6% pts**
Cost structure	**Opex/RWA (%)**	4.3	4.4	4.6	4.8	5.2	**+0.9% pts**
	Cost/income (%)	77	60	62	65	71	-6% pts
	Opex/total assets (%)	1.1	1.3	1.4	1.4	1.4	+0.3% pts
Cost of risk	**Loan-loss provisions/RWA (%)**	1.1	1.7	1.1	1.1	1.2	**+0.1% pts**
	Nonperforming loan ratio (%)	2.4	3.5	4.6	4.4	4.5	+2.1% pts
	Coverage ratio (%)	78	71	52	53	54	-24% pts

Notes: **Components in bold** are direct components of the RoRWA calculation; changes in red are negative trends
Sources: Banks' financial statements 2008–2012, n=10; Bain analysis

Other large European banks have fallen well short of earning their cost of capital



	2008	2009	2010	2011	2012
Total assets (€B):	8,616	8,222	8,509	8,674	8,886
ROE (%):	0.7	3.7	7.8	2.2	4.0
RWA (€B):	3,188	3,468	3,339	3,214	3,115

*The range represents the level of RoRWA required to cover the banks' cost of capital and varies by bank size and country. Analysis of 13 banks with assets of at least €200 billion, a universal bank business model and small to medium-sized subsidiaries outside their core geography (ABN AMRO Group, BBVA, Commerzbank, Danske Bank, Erste, ING, Intesa Sanpaolo, KBC, Lloyds, Rabobank, RBS, Société Générale and Standard Chartered).
Sources: Banks' financial statements 2008–2012; Bain analysis

Other large European banks had Opex lower than the big 10, which offset pressure on fee income and higher cost of risk

	Components	2008	2009	2010	2011	2012	Change 2008–2012
Asset leverage	**Total RWA (€B)**	3,188	3,468	3,339	3,214	3,115	**-2.3%**
	Total assets (€B)	8,616	8,222	8,509	8,674	8,886	+3.1%
	RWA/total assets (%)	37	42	39	37	35	-1.9% pts
	Tier 1 ratio (%)	9.0	10.2	11.4	11.9	12.9	+3.9% pts
	Total Tier 1 (€B)	287	353	382	382	402	+40%
Balance-sheet management	**Net interest income/RWA (%)**	3.1	3.1	3.4	3.5	3.5	**+0.4% pts**
	Financial margin/RWA (%)	-0.5	1.0	1.1	0.3	1.2	**+1.7% pts**
	Net interest income/total assets (%)	1.2	1.3	1.3	1.3	1.2	+0.1% pts
	Financial margin/total assets (%)	-0.2	0.4	0.4	0.1	0.4	+0.6% pts
	Net interest income + financial margin/RWA (%)	2.6	4.1	4.5	3.8	4.7	+2.1% pts
Cross-selling	**Fees + other revenues/RWA (%)**	2.1	1.5	1.2	1.7	1.2	**-0.9% pts**
Cost structure	**Opex/RWA (%)**	3.7	3.2	3.3	3.9	3.9	**+0.2% pts**
	Cost/income (%)	78	58	57	70	66	-12% pts
	Opex/total assets (%)	1.4	1.4	1.3	1.4	1.4	No change
Cost of risk	**Loan-loss provisions/RWA (%)**	1.0	1.9	1.4	1.4	1.4	**+0.4% pts**
	Nonperforming loan ratio (%)	3.4	5.0	5.4	5.7	5.6	+2.2% pts
	Coverage ratio (%)	47	46	48	48	50	+3% pts

Notes: **Components in bold** are direct components of the RoRWA calculation; changes in red are negative trends
Sources: Banks' financial statements 2008–2012, n=13; Bain analysis

Local banks have seen their RoRWA sharply deteriorate in recent years

	2008	2009	2010	2011	2012
Total assets (€B):	10,347	9,571	9,462	10,044	8,948
ROE (%):	-6.8	2.0	5.9	2.0	-4.2
RWA (€B):	4,198	3,904	3,748	3,890	3,293

*The range represents the level of RoRWA required to cover the banks' cost of capital and varies by bank size and country; analysis of 65 banks operating exclusively within a single national or regional market.
Sources: Banks' financial statements 2008–2012; Bain analysis

Local banks have experienced sharp deleveraging, higher cost of risk, more nonperforming loans and flat revenues

	Components	2008	2009	2010	2011	2012	Change 2008–2012
Asset leverage	**Total RWA (€B)**	4,198	3,904	3,748	3,890	3,293	**-21.5%**
	Total assets (€B)	10,347	9,571	9,462	10,044	8,948	-13.5%
	RWA/total assets (%)	41	41	40	39	37	-3.8% pts
	Tier 1 ratio (%)	9.4	10.9	11.3	11.8	13.9	+4.4% pts
	Total Tier 1 (€B)	396	426	422	461	457	+15%
Balance-sheet management	**Net interest income/RWA (%)**	2.5	2.8	2.8	2.8	2.8	**+0.3% pts**
	Financial margin/RWA (%)	-0.9	0.4	0.5	0.3	0.6	**+1.4% pts**
	Net interest income/total assets (%)	1.0	1.1	1.1	1.1	1.0	No change
	Financial margin/total assets (%)	-0.4	0.2	0.2	0.1	0.2	+0.6% pts
	Net interest income + financial margin/RWA (%)	1.6	3.2	3.3	3.1	3.4	+1.7% pts
Cross-selling	**Fees + other revenues/RWA (%)**	1.6	1.4	1.4	1.5	1.1	**-0.5% pts**
Cost control	**Opex/RWA (%)**	2.8	3.0	3.0	3.2	3.5	**+0.8% pts**
	Cost/income (%)	87	65	65	69	71	-17% pts
	Opex/total assets (%)	1.1	1.2	1.2	1.3	1.3	+0.2% pts
Cost of risk	**Loan-loss provisions/RWA (%)**	1.0	1.4	0.9	1.2	2.0	**+1% pts**
	Nonperforming loan ratio (%)	2.0	3.6	4.0	4.3	6.4	+4.4% pts
	Coverage ratio (%)	64	51	52	51	46	-18% pts

Notes: **Components in bold** are direct components of the RoRWA calculation; changes in red are negative trends
Sources: Banks' financial statements 2008–2012, n=65; Bain analysis

2.

Country and cluster league tables

- Countries with strong economic growth led the 2012 RoRWA rankings. Turkey took pole position with a 4.9% RoRWA. In core Europe, the Nordic countries posed the strongest performance with a 1.9% RoRWA, followed by Austria and the Netherlands. The largest economies of Germany, the UK and France trailed behind.
- Banks in Italy, Portugal, Spain and Ireland, which have been mired in the sovereign debt crisis and deep economic recessions, turned in the weakest RoRWA performances.
- Among the core European countries, changes in RoRWAs from 2008 to 2012 stemmed mainly from changes in three components: net interest income, financial margin and loan-loss provisions.
- Countries that posted large positive changes—including Germany, the Netherlands, the Nordic countries and the UK—benefited from higher financial margins, more control of operating expenditure and lower cost of risk. Countries with large drops in RoRWAs were hurt by inflexible cost structures, which prevented them from shrinking their production costs, and a cost of risk that was almost double the average.
- Northern Europe dominated the league tables, whether one looks at the 2012 leaders or the most improved banks. For example, the RoRWA leaders among both local and the 10 biggest banks included banks in the Nordic countries, followed by those in the UK, France, Austria and the Netherlands.
- In the most improved group, banks in Switzerland, the Netherlands and Germany made a strong showing.
- In high-growth countries, Turkey and the Commonwealth of Independent States (CIS) took leading positions for the most improved banks and Turkey for the 2012 leaders.

High-growth countries led the RoRWA rankings in 2012

Rank	Country	2012 total assets (€B)	2012 RoRWA (%)	2008 RoRWA (%)
1	Turkey	480	4.9	3.3
2	Poland	167	4.7	4.1
3	South Africa	340	3.1	3.5
4	CIS	826	2.7	1.0
5	Nordics	2,357	1.9	1.3
6	Austria	334	1.2	1.9
7	Netherlands	2,186	1.0	-2.0
8	Belgium	911	0.8	-2.5
9	Germany	5,514	0.7	-1.4
10	UK	7,062	0.5	0.0
11	France	6,320	0.3	0.8
12	Switzerland	1,812	0.1	-7.6
13	Italy	2,127	-0.6	0.7
14	Portugal	426	-0.8	1.0
15	Spain	2,917	-1.7	1.9
16	Ireland	312	-4.8	1.0

Note: For CIS, the Netherlands, Belgium, Germany, UK, France, Portugal and Spain, one or two Tier-3 banks had not reported 2012 data by time of publication, so the analysis used 2011 data for those few banks.
Sources: Banks' financial statements 2008–2012, n=121; Bain analysis

In core European countries, RoRWA changes from 2008 to 2012…

Note: Averages are weighted for the total size of the respective components in each country.
Sources: Banks' financial statements 2008–2012, n=71; Bain analysis

…were spurred mainly by net interest income, financial margin and loan-loss provisions

	UK 2008	UK 2012	France 2008	France 2012	Germany 2008	Germany 2012	Spain 2008	Spain 2012	Nordics 2008	Nordics 2012	Italy 2008	Italy 2012	Netherlands 2008	Netherlands 2012	Average 2008	Average 2012
Total assets (€B)	7,751	7,039	5,857	5,715	6,054	5,419	1,976	2,917	1,960	2,357	1,990	2,127	2,263	2,054	2,071	3,947
Total RWA (€B)	2,474	2,467	1,532	1,327	1,534	1,317	1,068	1,315	790	735	1,266	1,139	729	656	928	1,279
Net interest income/RWA (%)	3.1	3.0	2.6	3.8	2.6	3.2	3.6	4.3	2.7	3.2	3.2	2.8	2.9	4.1	3.0	3.4
Financial margin/RWA (%)	-0.2	1.2	-0.3	1.6	-1.9	0.7	0.6	0.6	-0.2	1.2	0.1	0.4	-1.7	0.6	-0.5	1.0
Fees and commissions + other revenues/RWA (%)	2.6	1.5	3.0	1.3	1.4	1.7	1.7	1.0	1.7	1.0	1.8	1.8	1.5	1.0	1.7	1.4
Opex/RWA (%)	4.1	4.2	4.0	5.4	2.7	4.3	2.7	3.5	2.4	2.8	3.3	3.5	3.9	3.8	3.2	4.1
Loan-loss provisions/RWA (%)	1.4	1.0	0.5	1.0	0.8	0.6	1.3	4.1	0.5	0.5	1.0	2.2	0.9	0.9	0.8	1.5

2008 ■ 2012

Note: Averages are weighted for the total sizes of the respective indicators in each country.
Sources: Banks' financial statements 2008-2012, n=71; Bain analysis

These banks are the 2012 RoRWA leaders of their geographic cluster

	Rank	Bank	Country	2012 RoRWA (%)	2008 RoRWA (%)
10 biggest	1	Nordea	Nordics	1.9	1.6
	2	HSBC	UK	1.8	0.8
	3	BNP Paribas	France	1.6	0.6
Other large European	1	Standard Chartered	UK	2.3	2.4
	2	Erste	Austria	1.7	1.9
	3	ING	Netherlands	1.6	0.2
Local	1	Swedbank	Nordics	4.0	2.0
	2	Sparebank 1 Group	Nordics	3.9	N/A
	3	Handelsbanken	Nordics	3.6	2.1
High-growth countries	1	Ziraat Bankasi	Turkey	15.8	19.3
	2	Akbank	Turkey	13.2	10.6
	3	Türkiye Halk	Turkey	4.8	3.8

Sources: Banks' financial statements 2008–2012; Bain analysis

These banks showed the biggest improvements in RoRWA over the past five years

	Rank	Bank	Country	2008–2012 change (% points)	2008 RoRWA (%)
10 biggest	1	UBS	Switzerland	+8.3	-9.2
	2	Credit Suisse	Switzerland	+6.8	-5.8
	3	Deutsche Bank	Germany	+2.1	-1.9
Other large European	1	KBC	Belgium	+2.9	-1.9
	2	RBS	UK	+2.6	-3.7
	3	ING	Netherlands	+1.4	0.2
Local	1	RBS Holdings NV	Netherlands	+6.4	-9.1
	2	BNP Paribas Fortis	Belgium	+5.0	-4.5
	3	Bayerische Landesbank	Germany	+3.3	-2.6
High-growth countries	1	Gazprombank	CIS	+7.1	-5.6
	2	Akbank	Turkey	+2.6	10.6
	3	VTB 24	CIS	+1.3	0.5

Sources: Banks' financial statements 2008–2012; Bain analysis

3.

Strategic perspectives and implications for management

- Europe's environment continues to be volatile, and investors are seeking better information about a bank's stability, asset quality and key factors that generate value. RoRWA plays a useful role here by focusing on the balance sheet—which enables comparison between a bank and its peers—and by identifying the factors influencing bank performance.
- Banks still need to address challenges along each dimension of RoRWA, in order to lift their profitability levels above the cost of capital. In recent years, the profitability of lending assets has been sustained mainly by the financial components, including a boost from LTRO. To raise asset profitability, banks will have to better manage their capital allocations and risk profiles.
- The pressure on fee income will continue. To offset that trend, banks should turn to their close client relationships for new sources of revenues.
- Lowering operating costs is the dimension that warrants management's attention at any bank, regardless of size or location. Initiatives that have the greatest potential for tackling structural costs include adopting digital technologies and modernizing IT platforms; optimizing processes from end to end through outsourcing, offshoring and other means; and expanding global procurement. Such initiatives are essential for survival in an industry going through discontinuous change.
- Deleveraging the loan portfolio for riskier clients is a pressing issue, which still poses significant threats for local banks. In countries with a higher cost of risk and stagnant or negative GDP growth rates, local banks may face further painful restructuring.
- Astute management of the cost of risk, including taking a portfolio perspective, offers opportunities for most banks—in part to meet the new requirements of Basel III and reassure rating agencies.
- Further consolidation of the local and other large banks over the coming years will likely benefit the 10 biggest banks and those in high-growth countries. These high-growth countries offer the greatest opportunities for RoRWA growth for large and pan-European players looking to diversify their portfolios.

Significant restructuring is warranted for all banks, but the nature of the challenge varies by geography

	Strategic issue	10 biggest	Other large European	Local	High-growth countries
Balance-sheet management	**Profitability** of the asset portfolio has been sustained mainly by the financial component. Deleveraging of the loan portfolio for riskier clients has been only partially successful, and the **risk profile of the portfolio** still has a long way to go	Threat		Major threat	
Cross-selling	To **counter pressure on fees**, banks should work systematically on cross-selling opportunities through initiatives like client-focused service models and CRM support	Threat		Major threat	
Cost structure	To **further reduce costs**, banks should pursue new digital technologies, optimized processes through such means as outsourcing and offshoring, modernized IT platforms and global procurement initiatives	Major threat	Threat	Major threat	Threat
Cost of risk	Active management of cost of risk demands **more systematic solutions**	Major opportunity	Opportunity	Major threat	Opportunity
	• NPL and LLP trends are threatening the stability of the overall system, and not only in individual countries such as Greece				
	• Management of risky clients has become a core business and capability			Major threat	Threat
	• Managing costs of risk demands an integrated portfolio approach	Major opportunity	Opportunity		Opportunity

○ Major opportunity ● Opportunity ● Threat ● Major threat

Source: Bain analysis

List of banks analyzed, by country and assets
10 biggest, other large, local

Country	Bank	Assets (€B)	Cluster
Austria	Erste (AT)	213.8	Other large
	Raiffeisen Bank (AT)	120.2	Local
Belgium	BNP Paribas Fortis	272.3	Local
	KBC	256.9	Other large
	Belfius Banque	212.9	Local
	ING Belgium SA/NV*	169.1	Local
France	Crédit Agricole Groupe	1,793.0	10 biggest
	BNP Paribas	1,543.9	10 biggest
	Groupe Société Générale	1,230.7	Other large
	Groupe BPCE	1,147.5	Local
	Crédit Mutuel*	605.1	Local
Germany	Deutsche Bank	2,012.3	10 biggest
	Commerzbank AG	635.9	Other large
	KfW	511.6	Local
	DZ Bank AG	407.2	Local
	UniCredit Bank AG	348.3	Local
	Landesbank Baden-Württemberg	336.3	Local
	Bayerische Landesbank	286.8	Local
	NORD/LB	225.6	Local
	Helaba	199.3	Local
	HSH Nordbank	130.6	Local
	DekaBank	129.7	Local
	Landesbank Berlin Holding	118.3	Local
	Santander Consumer Bank*	40.3	Local
	Hamburger Sparkasse	39.6	Local
	Deutsche Apotheker - und Ärztebank	37.9	Local
	Sparkasse KölnBonn*	29.9	Local
	Kreissparkasse Köln*	24.8	Local
Ireland	Bank of Ireland	148.1	Other large
	Allied Irish Banks	122.5	10 biggest
	permanent tsb Group Hldgs Plc	40.9	Local
Italy	Intesa Sanpaolo	673.5	Other large
	Unicredit Group	463.9	10 biggest
	Monte dei Paschi di Siena	218.9	Local
	UBI Banca Group	132.4	Local
	Banco Popolare	131.9	Local
	BNL	91.2	Local
	Banca Popolare dell'Emilia Romagna	61.6	Local
	Banca Popolare di Milano	52.5	Local
	Gruppo Banca Carige	49.3	Local
	Cariparma	49.3	Local
	Banca Popolare di Vicenza	46.7	Local
	Veneto Banca	40.2	Local
	Bca Pop.di Sondrio	32.2	Local
	Credito Emiliano	30.7	Local
	Credito Valtellinese	29.9	Local
	Banca delle Marche	22.7	Local

*2011 assets

List of banks analyzed, by country and assets
10 biggest, other large, local—*continued*

Country	Bank	Assets (€B)	Cluster
Netherlands	ING	836.1	Other large
	Rabobank Group	752.4	Other large
	ABN AMRO Group	394.4	Other large
	SNS Reaal*	132.2	Local
	RBS Holdings NV	71.0	Local
Nordics	Nordea	677.4	10 biggest
	Danske Bank	468.2	Other large
	DNB	302.8	Local
	SEB	281.8	Local
	Handelsbanken	274.2	Local
	Swedbank	212.1	Local
	Pohjola Bank	99.8	Local
	Jyske Bank	34.7	Local
	Sparebank 1 Group	6.2	Local
Portugal	Caixa Geral de Depositos	116.9	Local
	Millenium BCP	89.7	Local
	Banco Espírito Santo	83.7	Local
	Banco BPI	44.6	Local
	Santander Totta SGPS	41.4	Local
	Caixa Económica Montepio Geral*	21.5	Local
	Crédito Agrícola Mútuo*	14.2	Local
	BANIF	14.0	Local
Spain	Santander	1,228.2	10 biggest
	BBVA	637.8	Other large
	la Caixa	359.1	Local
	Banco Financiero y de Ahorros	309.2	Local
	Banco Sabadell SA	161.5	Local
	Banco Popular	157.6	Local
	Banco Mare Nostrum	63.4	Local
Switzerland	UBS	1,044.8	10 biggest
	Credit Suisse	766.9	10 biggest
UK	HSBC	2,093.9	10 biggest
	Barclays	1,760.3	10 biggest
	Royal Bank of Scotland	1,152.1	Other large
	Lloyds Banking Group	1,139.5	Other large
	Standard Chartered	495.0	Other large
	Nationwide Building Society	241.7	Local
	Co-operative Bank	61.1	Local
	Clydesdale Bank	54.5	Local
	Yorkshire Building Society	41.3	Local
	Virgin Money*	22.3	Local

*2011 assets

List of banks analyzed, by country and assets
High-growth countries

Country	Bank	Assets (€B)
CIS	Sberbank	378.1
	VTB 24	185.7
	Gazprombank	71.2
	Russian Agricultural Bank	35.8
	Alfa-Bank	35.7
	Nomos-Bank	22.5
	UniCredit Bank Russia	21.8
	AKB Rosbank	20.0
	Promsvyazbank	17.3
	ZAO Raiffeisenbank	16.0
	URALSIB Bank	11.3
	Russian Standard Bank	7.4
	AKB Probusinessbank*	3.5
Poland	PKO BP	46.3
	Bank Pekao	36.1
	BRE Bank	24.4
	ING Bank Slaski	18.7
	Bank Zachodni WBK + Kredyt Bank	14.3
	Getin NobleBank	14.1
	Bank Millennium	12.6
South Africa	Standard Bank	92.8
	Absa	76.6
	FirstRand	72.9
	Nedbank	64.7
	Investec	33.0
Turkey	Türkiye İş Bankası	86.9
	Türkiye Garanti	77.7
	Ziraat Bankasi	70.8
	Akbank	70.6
	Yapı ve Kredi	56.8
	Türkiye Halk Bankasi	47.1
	Türkiye Vakıflar	46.7
	Finansbank	23.9

*2011 assets

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Acknowledgments

The authors would like to thank the following Bain colleagues for their valuable support in producing this report: Sonal Chawla, Christian Duus, François Fastrez, Farsan Ghassim and Shikha Mahato.

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