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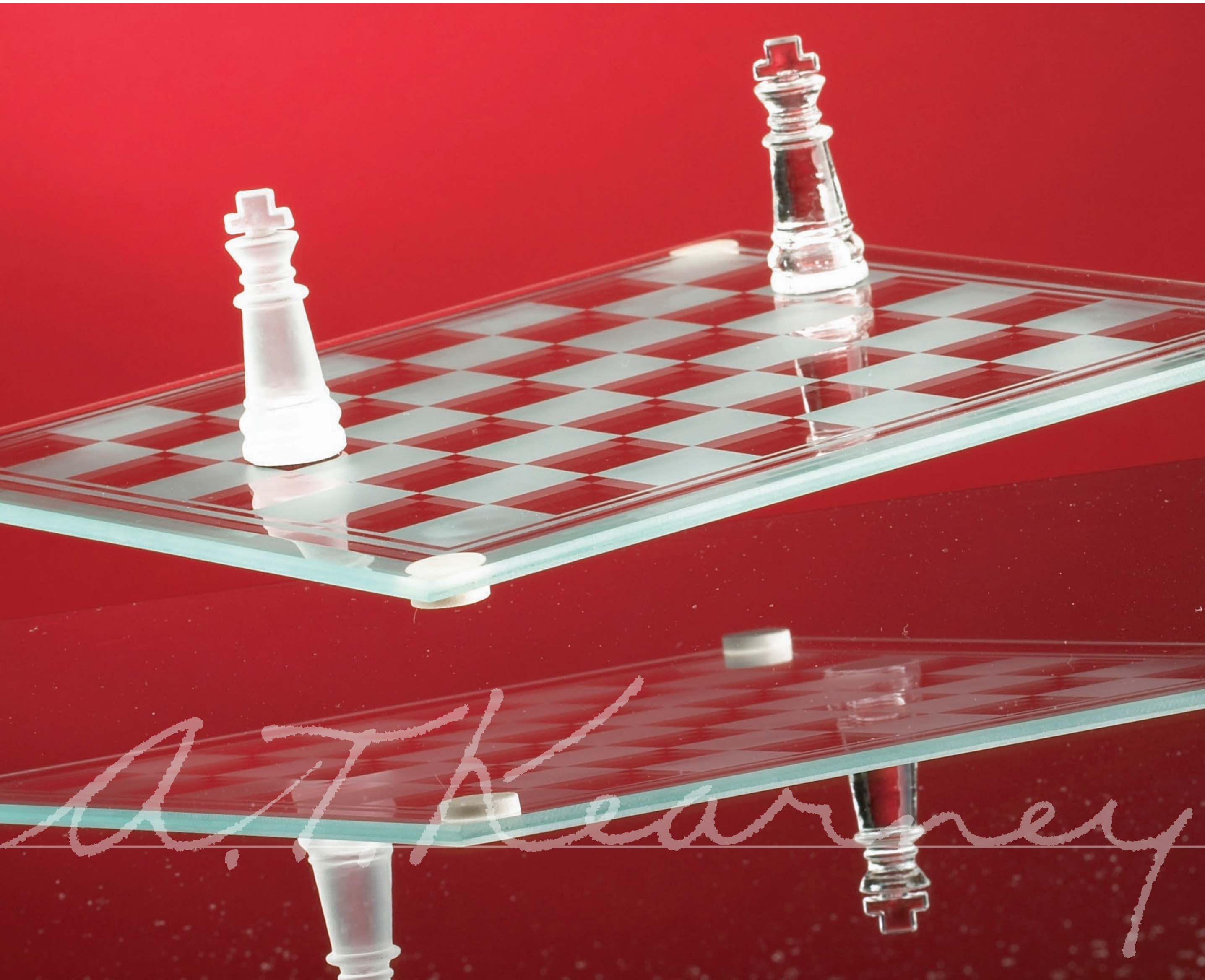
# A Chessboard Strategy for Russia's Banking Market

Russia is home to well over 1,000 licensed credit institutions. But that's not to say Russia's banking market is fully served—or that inroads can't be made if the right strategy is applied.

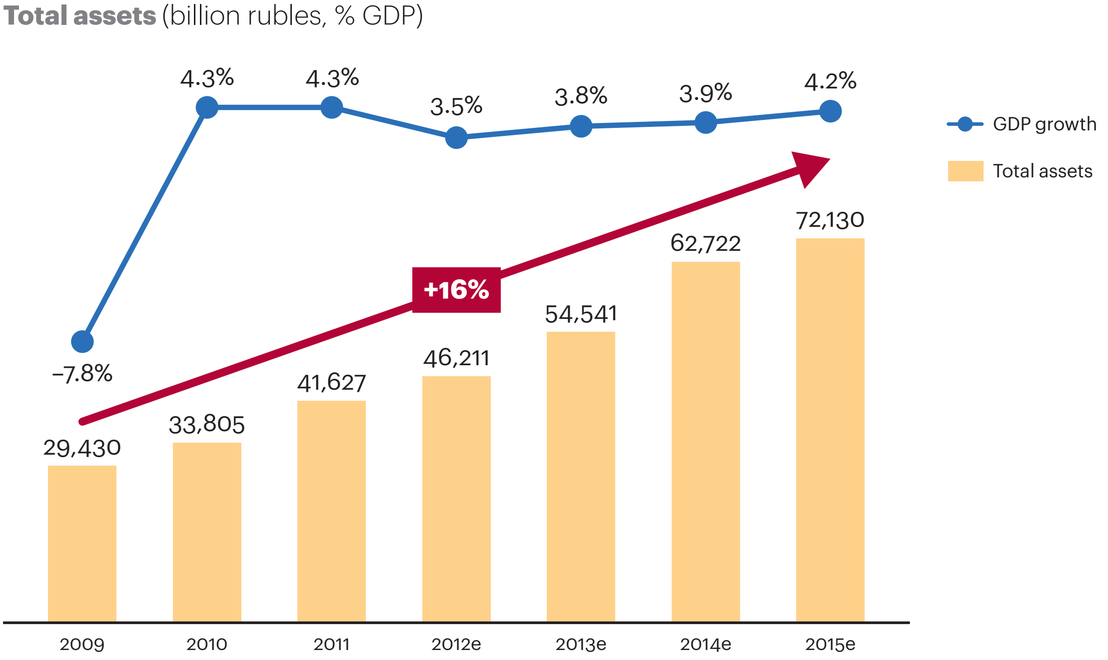


The Russian banking market can be described in two words: consolidation and adrenalin. Over the past six years, consolidation has resulted in some 300 banks being taken over by large state-owned or international institutions. But there's also a kind of frenetic, thrill-seeker side to the Russian banking market, most apparent in very little transparency, lots of governmental involvement, fluid regulatory environment, and capital flight. In short, this is not a market for the timid—it is dynamic and changing rapidly. Banks seeking success in Russia need not only a well-thought-out game plan, but also the flexibility to adapt to unforeseen events.

As background, Russia's banking market has experienced significant growth compared with those of other developing European countries. Indeed, the market's 27 percent compound annual growth rate from 2005 to 2010 was more than double that of its closest competitors, Turkey and Poland, both of which registered 13 percent CAGR over that time span. Clearly, there is room for even more growth, as banking-sector assets represent only 75 percent of gross domestic product (GDP), compared with developed economies, in which banking assets typically exceed 100 percent of GDP. Other room-for-growth indicators include a stabilizing macroeconomic scenario, strong resource prices, and solid demand levels. We expect Russia's well-capitalized banking industry to grow at a rate of 16 percent into 2015 (see figure 1).

Russian banks did not go unscathed during the global economic recession. Between 2007 and 2010, the sector had a combined return on equity (ROE) of 12.4 percent, which was fairly healthy but lagged well behind two other strong emerging countries, Brazil and Turkey, both of which boasted ROEs of about 17 percent. In short, statistics show that even in the depths of the crisis, Russia's banking sector remained profitable and in 2011 bounced back to exceed pre-crisis profitability levels fueled mainly by the recovery of (parts of) provisions and significant increases in interest income.

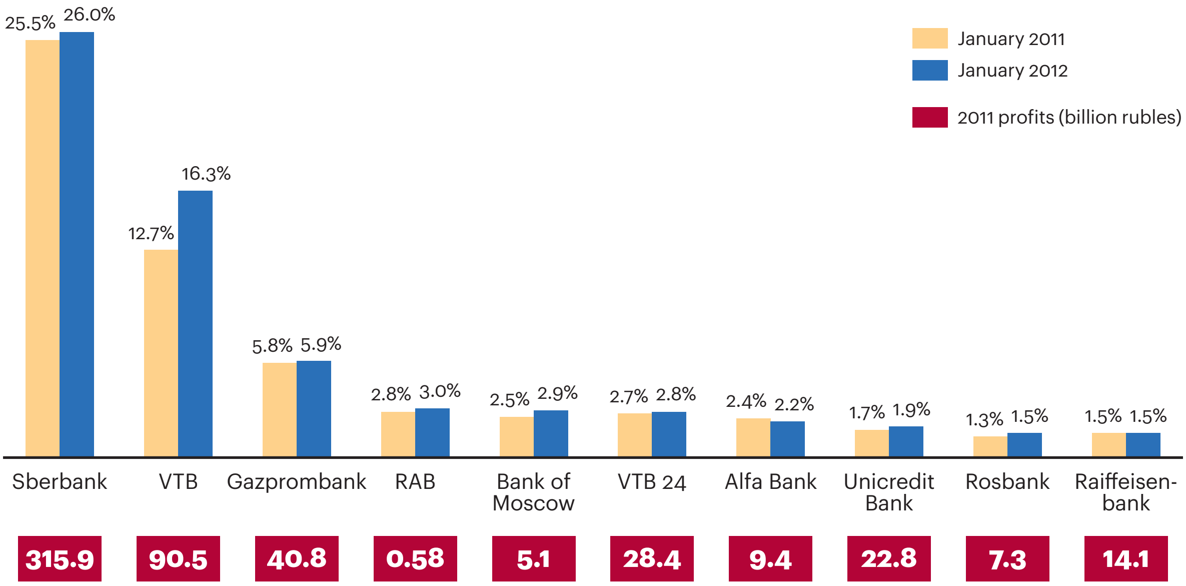
Figure 1
**Russia's banking industry is projected to grow 16 percent by 2015**




Sources: Central Bank of Russia, Business Monitor International, Economist Intelligence Unit; A.T. Kearney analysis

Figure 2

**Market share of major banks in Russia**




Sources: Annual reports, RosBusinessConsulting (RBC); A.T. Kearney analysis

Amid all this optimism, however, there remains some underlying risk in the area of non-performing loans. Although there was a noticeable improvement in portfolio quality in 2010, credit risk remained relatively high. And although the percentage of problematic loans decreased in 2011, it was a small decrease, leading us to believe that such loans could be an issue that banks will need to confront to keep their books in the black.

The state-owned Sberbank and VTB dominate the Russian banking sector, with institutions such as Unicredit, VTB 24, AlfaBank, RAB, Bank of Moscow, and Gazprombank among the leading competitors. This means that other banks must work hard to find their own sweet spots in the market. A comparison of the levels of concentration from 2010 to 2011 reveals that the trend is toward greater concentration by the largest banks, both state- and privately owned (see figure 2).

## Future Scenarios

From a scenario-based assessment of the Russian banking market, we project two potential futures: continued dominance by state-owned banks, with minor banks playing a minor role; or dominance by many large state-owned and private banks, with niche and smaller banks making up a second level.[1]

Which of these potential futures emerges depends largely on what approach the new government takes toward the banking sector specifically and economic liberalization in general. Three things are certain to happen. Concentration—a natural phenomenon in maturing markets—will

[1] For more on A.T. Kearney's approach to forecasting, see *Scenario-Based Strategic Planning: A Dynamic Alternative to Conventional Forecasting in Uncertain Times*, at www.atkearney.com.

continue as weaker banks disappear. Niche banks (auto banks, wealth services, home credit) will remain with the only question being how large a role they will play. Banks that innovate (mobile and direct banking) will carve out profitable market segments.

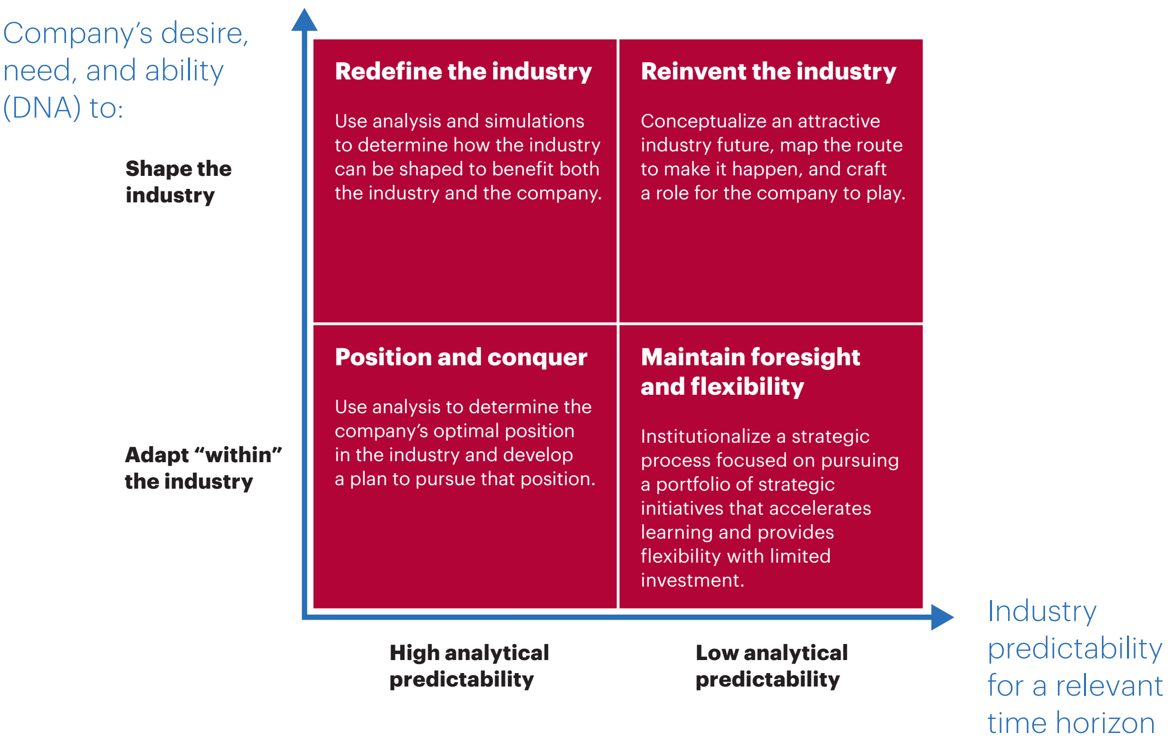
## The Chessboard Approach

To capitalize on Russia's market potential will require deploying the appropriate strategies at the right time. Which strategy makes the most sense and when can be determined with a "strategy chessboard." The chessboard features four strategic possibilities shaped by two basic factors: a company's needs and abilities (in essence, its DNA) and the level of sector predictability over a relevant time horizon. For the latter factor, it is interesting to note that the choice of time horizon can impact the level of predictability. In other words, an industry may be predictable over a 30-year horizon but not predictable in the short term—or vice versa—so selection of the time horizon is critical (see figure 3).

Since Russia will have a relatively high level of analytic predictability over the next few years, banks should focus on either a *Redefine the industry* or *Position and conquer* strategy. Those that want to shape the industry will use the former. Larger banks may pursue a global endgame consolidation approach by taking advantage of the relative strength of their current balance sheets and acquiring assets domestically, in Europe, or even elsewhere. Other players can pursue game-changing strategies by redefining the value chain, changing industry conduct, or converging (or slicing up) the industry. An example of redefining the value chain is centralizing certain services and either outsourcing them or spinning them off and selling them to others.

Figure 3

**The chessboard approach features four strategic possibilities**




Source: A.T. Kearney analysis

Industry conduct can be changed via new offerings, such as branchless banks using only the Internet and phones as transaction channels. Convergence can be pursued by both banks and non-traditional bank players; banks might offer non-traditional products, such as insurance or payroll services, and non-bank players might slice up the industry by providing sections of services such as fast-cash access at retail outlets or electronic wallets.

For smaller banks that want to adapt within the industry, it makes sense to focus on the *Position and conquer* quadrant, which has four more options. For example, one option for smaller banks is to build competitive advantage by excelling at some part or parts of the value chain, such as quicker loan processing. Another is to redefine a product or market mix by focusing on or withdrawing from certain business lines. Indeed, we have already seen this approach in Russia with the withdrawal of some banks from the retail space. A third option is to compete head-to-head and deploy battle strategies on potentially lucrative segments such as credit cards or mortgages. Finally, there is an option to develop a flexible strategy, which provides time to identify and adapt to emerging or unexpected profit patterns. This last approach requires either participating in beneficial parts of the value chain, chasing high-value market segments such as payday lending, or pursuing vertical strategies to dominate a chosen industry.

Armed with a better understanding of corporate DNA and industry predictability, the decision is then made based on which of the four quadrants is most appropriate to meet a bank's needs. This is the essence of the strategy chessboard (see figure 4).

Figure 4
**Which of the four quadrants is most appropriate to meet your needs?**

Company's desire, need, and ability (DNA) to:

**Portfolio strategy** (Ansoff, GE, various consultants)

| | | | | |
|---|---|---|---|---|
| **Shape the industry** | **Pursue global industry endgame consolidation** (Kröger) | **Converge or slice industry** (Pennings and Puranam; Stieglitz; Lind; Christensen; Rosenberg) | **Create "Blue Ocean" opportunities** (Kim and Mauborgne; Christensen; Schumpeter; von Hippel) | **Create and pursue "preferred future"** (Hamel, Prahalad, Kratzert) |
| | **Reconfigure industry value chains** (Porter; Aurik and Willen; J. Moore; Christensen) | **Change industry conduct** (von Neumann, Morgenstern; Ghemawat; Chussil; Oriesek and Schwarz; Pfeffer, Salancik) | **Cross the "chasm" with innovative products** (Moore; Arthur) | **Think big and lateral** (Schmitt; de Bono) |
| **Adapt "within" the industry** | **Position to build competitive advantage** (Porter) | **Grow in core, adjacent business, and step out** (Andrew; Wernerfelt; Zook; Viguerie et al.; Deans, Kröger et al.) | **Pursue dynamic strategies** (Doz et al.; Carpenter et al.; Lindblom; Quinn; Markides) | **Prepare for multiple scenarios** (Kahn; de Geus, Wack; Wilkinson) |
| | **Identify and adapt to profit patterns** (Slywotzky) | **Deploy battle strategies** (Sun Tzu; Clausewitz; Welch; McNeilly, El-Kadi) | **Deploy real options-based strategies** (Myers; Schwarz; Luehrman; Arms) | **Implement an evolutionary strategic process** (Arthur et al.; Beinhocker; Holland; Gell-Mann) |
| | **High analytical predictability** | | **Low analytical predictability** | |

Industry predictability for a relevant time horizon

Source: A.T. Kearney analysis

## Tailored Strategies for Success

There is no one-size-fits-all approach to strategy, as different models are appropriate in different situations. The Russian banking sector is dynamic, growing, and fast-changing, and only those banks that adopt the right strategy will succeed. A strategy chessboard can be the differentiator between success and disappearing into history.

### Authors


**John Winkler,** partner, Moscow
john.winkler@atkearney.com

**Jiri Steif,** partner, Prague
jiri.steif@atkearney.com

**Thomas Kratzert,** partner, Stockholm
thomas.kratzert@atkearney.com

**Ettore Pastore,** partner, Milan
ettore.pastore@atkearney.com

**Michael Broquist,** principal, Stockholm
michael.broquist@atkearney.com

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