State of the banking industry report

Research and outlook for 2023

WIPFLI

Banks build vibrant, thriving communities. In good times and in bad, they help Americans bridge financial gaps, pursue lifelong dreams and build stable futures. And in order to do that, financial institutions need to be in solid, healthy shape for everyone to thrive.

So, how are banks doing? To find out, Wipfli surveyed nearly 250 banks in 39 states. We learned how banks are navigating the economy, facing the national labor shortage and managing digital banking.

Table of contents

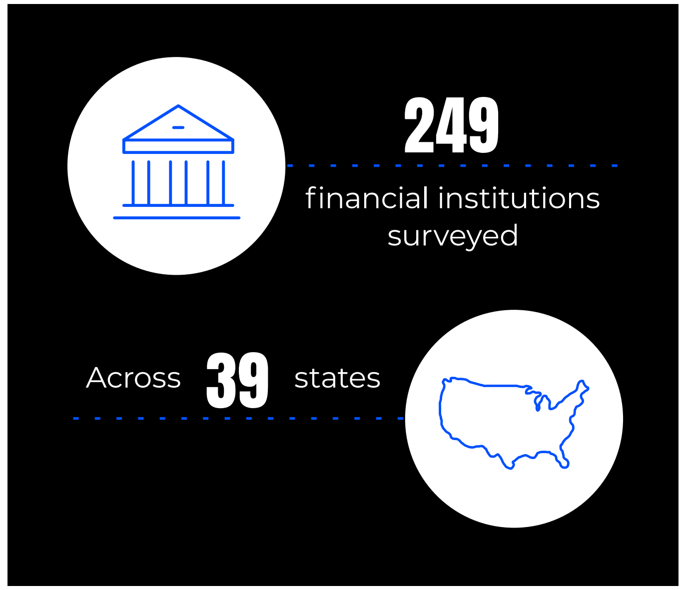
Executive summary

Uncertainty. That's how major, global financial organizations have summarized the past year.

According to the International Monetary Fund, global economic output contracted because of downturns in China and Russia. In the U.S., consumer spending fell below expectations. Inflation rocked the U.S. and major European economies, causing financial conditions to worsen for families and businesses. The Eurozone is heading into a recession, and the U.S. could follow.

Despite this uncertainty, banks are confident in their futures.

Nearly every bank we surveyed for Wipfli's annual State of the Banking Industry report expects to grow in the next 12 months. Seventy-seven percent of banks think they'll grow 5% or more in the next year. Banks with over $3 billion in assets (which we categorize as "regional banks") reported even higher confidence. Ninety-four percent of regional banks expect to grow 5% or more.



What's buoying their financial outlook? Despite dire economic circumstances, banks posted strong financial results. Stimulus money contributed to strong deposit growth, and a low interest rate environment propped up business lending. Many banks used the influx of revenue to fund digital transformation projects, which led to operational efficiencies (more savings) and better customer experiences (more revenue).

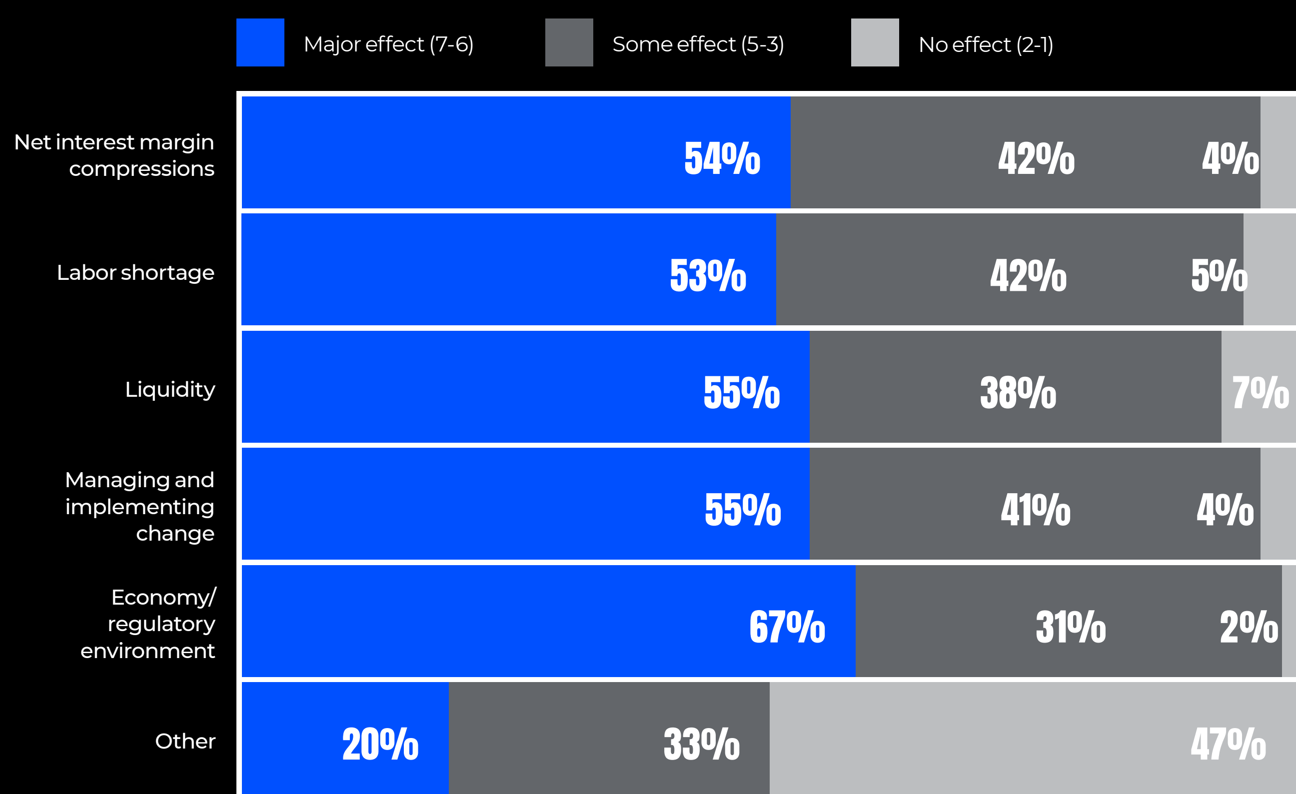
That doesn't mean its smooth sailing into the next fiscal year. Banks are concerned about the continued rising interest rates and a prolonged recession. Two-thirds of banks said the economic and regulatory environment could affect whether they meet their goals. Around half of respondents cited change management, liquidity and net interest margin compression as other significant barriers.

How will they respond? In this report, we explain the most important strategies for banks, according to our research. We surveyed banks across the United States to learn how they will overcome obstacles and serve their communities. This report documents their responses, plus the perspective and advice of our banking specialists.

Together, we can move past the gloom and uncertainty and build a stronger, more prosperous 2023.

What effect do the following factors have on achieving your goals?

Rated on a scale of 1-7, with 1 being "no effect at all" and 7 being a "major effect."



Other responses included items such as culture, coronavirus, competition, data and retention.

Strategic priorities for financial institutions

Banks said the most important strategies for 2023 are:

1. Talent management
2. Digital customer engagement
3. New revenue streams
4. Digital efficiency (labor-replacing and/or staff-augmenting technologies)

Regional banks cited slightly different priorities. After talent management, they are focused on data analytics/AI, embedded banking and cloud adoption.

Priority #1

Managing talent in a record tight labor market

Banks said talent management was their top priority heading into 2023. They need recruitment and retention strategies to help them cope with the tight labor market. That's consistent with wider labor market trends.

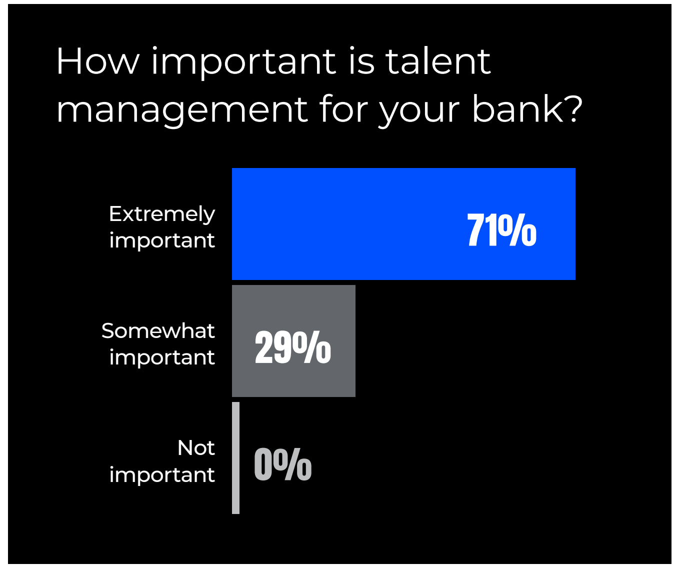
Why is the labor market tight? It's about scarcity. There are only 73 workers available for every 100 open jobs, according to the [U.S. Chamber of Commerce](#).

According to our research, smaller banks are having the hardest time filling front-line, commercial and retail roles, while larger banks are struggling to find digital and IT workers.

To fill the gap, banks are increasing wages, benefits and perks, and creating career paths for existing employees. At regional banks, talent development is focused on leadership roles. Banks are also allowing more flexible work locations and arrangements.

About a third of finance employees are dissatisfied with their pay, according to a survey by eFinancialCareers. The bigger issue is how that makes them feel: unappreciated.

You can't make people care about the work unless you care about them. To reverse the "quiet quitting" trend and build a desirable culture, leaders need coaching and listening skills, as well as empathy. These soft skills have a hard impact on the bottom line when you consider the costs of absenteeism, turnover and disengagement in general. And for many traditional bank leaders, soft skill development has not been a focus, either personally or institutionally.



Gallup recommends transitioning from a culture of "paycheck" to a culture of "purpose." Today's employees are motivated by values, which is manifested in their demand for environmental, social and governance (ESG) data from banks before they'll consider applying or accepting a position. And bank executives recognize that, with 48% citing ESG as extremely important.

In addition, today's workers expect mentorship and coaching, collaborative cultures and flexible work schedules. They want to be recognized for their efforts — but not with more work.

Employees also want to understand where they fit into the organization's longer-term plans. Today's workers don't understand their opportunities for advancement or how to get there.

Assess the roles you have, along with the skills needed to thrive in each position. Make sure there's a path for staff to gain the experiences they need to fill future roles. Then, put the right people in the right seats — and the right support systems around them.

Respondents were asked to rank the top 3 ways they are currently working to address **employee recruitment/retention.**

1. **Increased wages**
2. **Increased benefits, perks**
3. **Career development pathing & leadership development**

Priority #2

Improving customer engagement in a digital world

Many banks pride themselves on customer service and knowing customers by name. But it's proving difficult to build deep relationships with customers they rarely, if ever, see face-to-face.

For service industries such as banking, improving digital customer engagement is paramount to reach audiences that are growing up digital-first. Banks recognize this and named "improving digital customer engagement" their second priority heading into 2023.

Accountholders of all ages use digital banking services, but the greatest opportunity lies with Gen Z (those born between 1997 and 2012). Within the next four years, Gen Z will become the largest consumer group in the country. It already has $44 billion in spending power — and it's significantly underbanked. Less than half of Gen Z has an account with a traditional financial institution.

Gen Zers that have banking accounts have high expectations. They want interactions to be simple and transparent. They want to complete rote transactions autonomously. But when they need help, they expect 24/7/365 service.

To meet their needs, 54% of banks introduced instant payments services over the past three years. Another 47% added automated investing or robo-advisor services, and nearly a third started cryptocurrency solutions.

But financial institutions can't afford to stop there. Mobile banking, for example, is now a standard expectation. In fact, customers say they'll leave a bank if it doesn't have a good mobile app.

The definition of "good" is always changing. To meet new demands and fend of fintechs, financial institutions must create long-range, customer-centric digital roadmaps. Accountholders should be the center of innovation strategies — because digital plans don't matter if they leave users behind.

Aha moments should drive digital engagement strategies. Financial leaders need **awareness** of how technology, economics, social causes, culture and political trends are converging; **humility** to understand that what worked yesterday might not be sufficient for tomorrow; and readiness to take **action** toward a new future.

Priority #3

Exploring new revenue streams in a mature industry

The majority of banks we surveyed were optimistic about their near-term growth potential. So, how do they plan to increase revenue and grow?

Acquisition and service expansion.

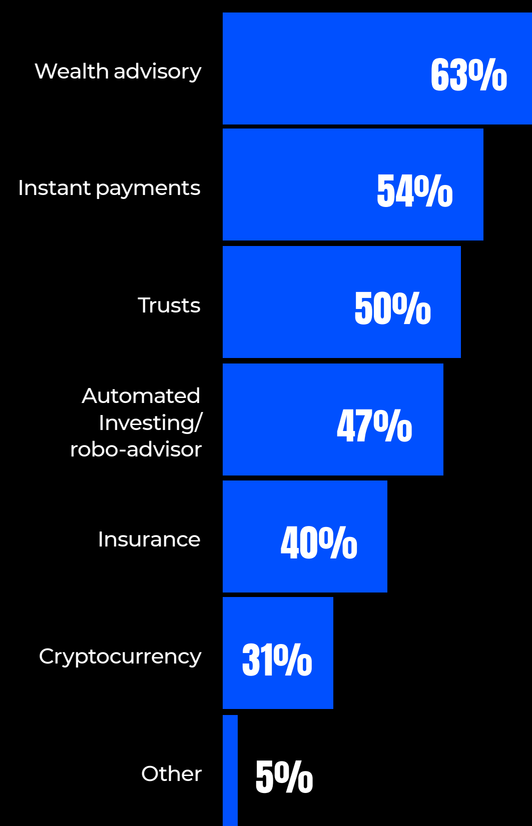
Ninety-one percent of banks that rated M&A as an important strategy said they plan to buy another financial institution. Presumably, they're hoping to take advantage of falling prices and unrealized capital loss.

To generate new revenue streams, banks added services. Nearly two-thirds of banks added wealth advisory services over the past three years. Half of respondents added trusts to their portfolios and 40% started offering insurance. All these were anticipated in earlier industry surveys.

Not mentioned in past research: instant payments. Fifty-four percent of banks and two-thirds of regional banks added instant payments capabilities.

Instant payments systems have been around since the 1970s — so they're not new. What may have been a slow rollout has turned into a blowout. [The Clearing House's] RTP® network processed 45 million transactions in Q3 2022 — and transaction volume is projected to grow through 2026. FedNow℠, the real-time payments network from the Federal Reserve, is slated to be fully operationalized in 2023. That means it's becoming easier for financial institutions of all sizes to offer instant capabilities, which they need to compete with financial giants and fintechs.

Which of the following services have you added in the last 3 years?



Other responses included online account opening, online loans, rewards and various e-banking items.

Ninety-one percent of community banks are planning to buy another financial institution.

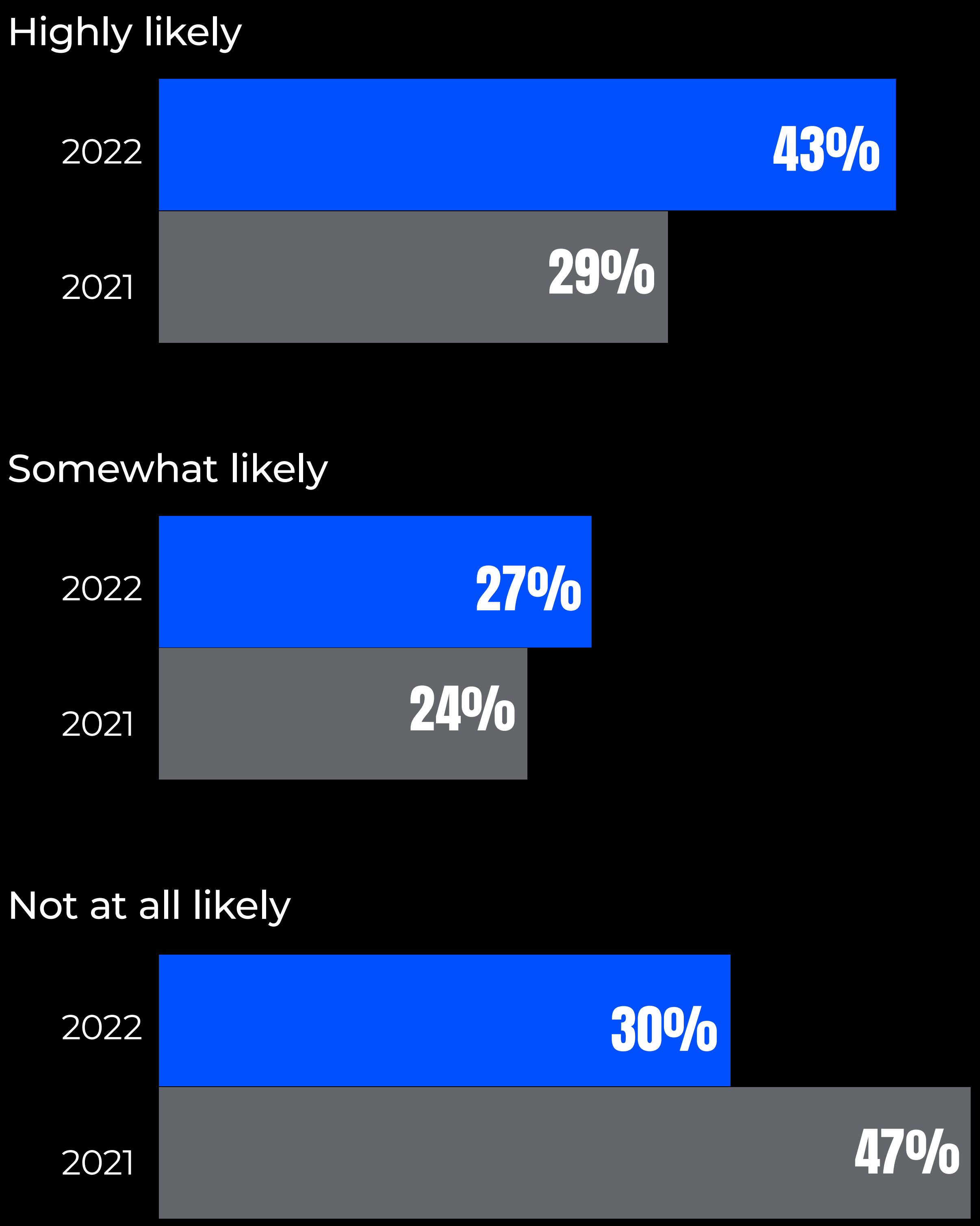
Although recent events have tampered market sentiment, cryptocurrency is another potential revenue stream. About 31% of banks added cryptocurrency services, which is more than projected in our prior survey. Last year, only 29% of respondents were planning to offer digital assets.

Interest in digital currency is rising. In this year's survey, 43% of banks said they are highly likely likely to start offering digital assets in the next 12-18 months. In [last year's survey] of bank executives, only 29% said they were likely.

Most of the holdouts — the institutions that have no or little interest in crypto — said they're concerned about regulation, compliance and risk. They don't see enough demand to stand up infrastructure, staff and expertise for crypto. They see too much risk, with too little reward. No doubt, FTX's sudden and spectacular failure added fuel to those fears.

Whether they pursue crypto or not, banks need new ways to bring in money. For a long time, interest rates squeezed margins. And now, inflation is shrinking revenue. They cannot count on "business as usual" to keep them afloat.

How likely are you to start offering **digital assets, such as cryptocurrency?**



Priority #4

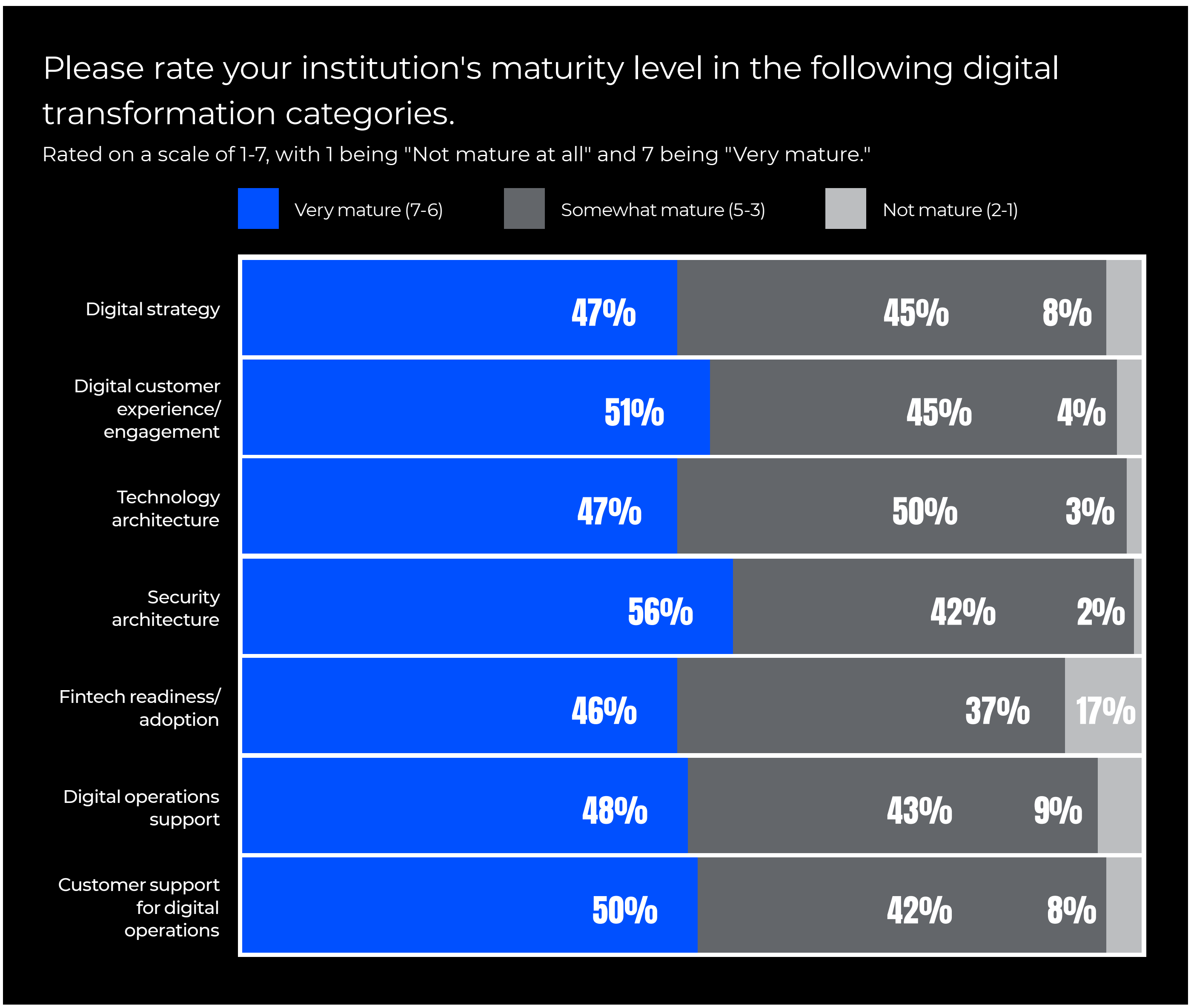
Creating digital efficiencies in a process-heavy business

Banks need to drive revenue and cut costs. Digital transformation is a factor in both and can impact both sides of the balance sheet.

Labor is one of the biggest expenditures, and it's both expensive and scarce. Banks need to find new and more effective ways to work. That's why adopting technologies to replace or augment labor was a top priority.

The banks we surveyed are pursuing digital transformation foremost to speed up processes. They're also using technology to improve digital customer engagement and payments business. Regional banks said they're exploring virtual branch models, too.

What are the options for banks looking to drive digital efficiency? They are plentiful, but artificial intelligence (AI) and machine learning (ML) are ubiquitous.

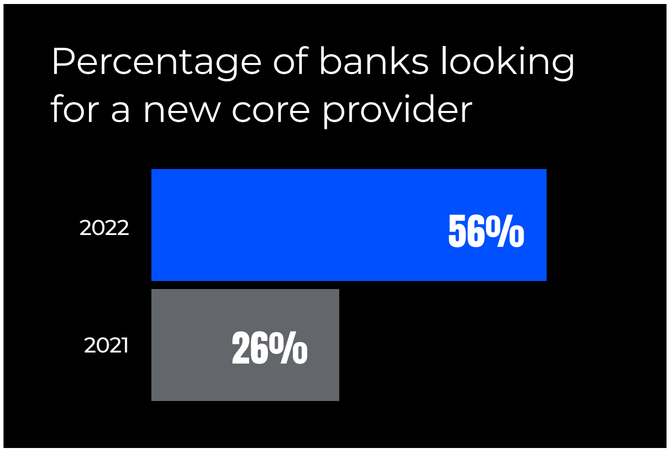


Banks can use [AI](#) and ML to automate manual and time-consuming processes, reduce operating costs, increase customer satisfaction and lower fraud. And the list goes on. Plus, when supported by modern tools, staff can focus their time and energy on the most rewarding parts of their jobs.

Sound too good to be true? It's not. But for most financial institutions, it means wading into unfamiliar territory. However, solutions available in the market today require less technical prowess than many banks may assume.

When it comes to digital transformation strategy, banks believe they have a handle on security, customer experience and customer support. They weren't as confident in fintech adoption or digital strategies. They need help creating roadmaps and processes for the digital world.

For many banks, support comes from their core provider. However, many are starting to revisit those relationships. Last year, about a quarter of respondents were looking for a new core provider. This year, 56% of banks said they're exploring new options. Of those, 20% are considering an open platform.



For banks, **digital transformation** means:

1. **Faster loan approvals and account-opening processes**
2. **Engaging with customers digitally**
3. **Payment transactions**

Rising concerns

Overcoming uncertainty takes preparation. Financial institutions have to plan for many possible risks, threats and outcomes. This is the nature of the business.

What are banks worried about?

Same as last year's survey, banks are most concerned about cybersecurity. Meeting customer needs, recruiting and retaining employees, and holding onto market share also made the list.

Financial services firms may experience 300 times more cyberattacks per year than other firms. On top of that, financial institutions are managing more channels. Faster transactions. And more complex services. The push for remote work, staff vacancies and turnover all increase vulnerability, too.

To protect a wide attack surface, the banks we surveyed are taking a layered approach to security. Half of respondents have taken six or more actions to protect their network, including adding 24/7 monitoring services, tightening internal controls and investing in network upgrades. Nearly 60% of financial institutions have conducted a cyber risk assessment and over half conducted security testing.

Executives also cited ESG as another rising concern, and not only because public disclosures are required for publicly traded institutions. In some sectors and demographics, growing acceptance of ESG has implications on talent, customer affinity, financial performance and risk management, to name a few.

Many employees are seeking a culture of purpose and want to work for good global citizens. Clear and strong ESG practices can help financial institutions attract top talent, and especially younger talent, as well as like-minded customers, vendors and investors.

Despite its importance, more than half of survey respondents find the environmental components of ESG the most difficult to quantify. They don't have systems in place to calculate the impact of operational decisions.

Banks need to add ESG to their strategic planning, customer journey mapping and decision-making processes so it becomes part of the organization's culture and financial plans. But ESG covers a wide range of issues, so where — and how — should organizations begin?

Like all other organizational changes, ESG has to start at the top. It needs sponsorship and buy-in from executive leaders to build momentum. From there, the organization can pick a few influential issues. The issues could have materiality to the business (like cost savings) or be relevant to stakeholders (like social justice causes). Once ESG priorities are established, leaders can pursue goals, benchmarks and action plans.

Bank's reported top concerns

1	2	3	4
Cybersecurity	Meeting customer needs	Employee recruitment/ retention	Retaining market share

Thoughts on the future

Optimism is good. But it needs a plan.

To achieve their growth ambitions in the current economic and regulatory environment, banks need to address four burning issues: talent, digital transformation, agility and ESG.

Talent

The labor issue will not resolve itself. In fact, respondents expect the labor shortage to increase over the next five years as more workers retire. When that happens, critical institutional knowledge could be walking out the door.

Create a plan to build and protect people skills and capabilities, as you would any other business asset. Make sure the right people are in the right roles, and cultivate high-performing teams (not one or two high-performing individuals). Invest in coaching and culture now, before it's too late.

Digital transformation

JPMorgan has a branch in the metaverse. The Federal Reserve is testing its own digital currency. Nonbanks run the leading peer-to-peer payments systems. Digital transformation is not a nebulous idea that banks can continue to avoid.

Does this mean you need a virtual branch? Or that tellers should be donning VR headsets? It could.

But it also means opening the door to capturing new customers and becoming an innovative leader, which will be core to survival because the threats are only going to increase.

You can't let cybercriminals become savvier than your security team. You can't let nonbanks issue loans faster and easier than you do. Fintechs shouldn't have deeper relationships with customers you've served for their entire lives.

So yes, some things will have to change — and change completely. Digital transformation should transform the way you operate, not just digitize paper processes.

Every business is different, which is why there's more than one digital transformation path. Once you set the priorities, there's certain to be a smarter way to get work done. And you'll probably delight customers, staff and other stakeholders in the process.

Agility

As you innovate and digitally transform, strive to be an open-tech institution and to maintain control over your data. Institutional and customer data should drive your tech destiny — not vendors or legacy systems.

Technologies should be quick to develop and deploy so you're ready to meet new customer demands. Think API-driven, data-driven, vendor-agnostic and cloud.

Give technology partners the freedom to experiment and innovate, especially if they can automate processes or increase customer knowledge. Banks of every size can create better customer interactions and deeper relationships through digital experiences.

Companies that innovate and invest in digital readiness will outperform their peers in all economic cycles. Use technology and innovation to stay agile and create more opportunities for growth.

ESG

ESG is not a fad, and you can't fake it. Employees, customers and stakeholders see right through "greenwashing."

Here's our advice: Embrace it — including the environmental aspect which the majority of banks say is the toughest to quantify.

Of course, there's a moral imperative to do the right thing. But ESG also plays into due diligence and fiduciary responsibility. Leaders need to understand all the risks associated with an investment, including environmental and social factors. Investments and strategies that aren't in sync with the market won't perform well. ESG can steer financial institutions toward better, long-term decisions.

Make ESG part of your business mindset and processes, so every major decision is reviewed through an ESG lens. You might be surprised how quickly your impact adds up once ESG is embedded in company culture.

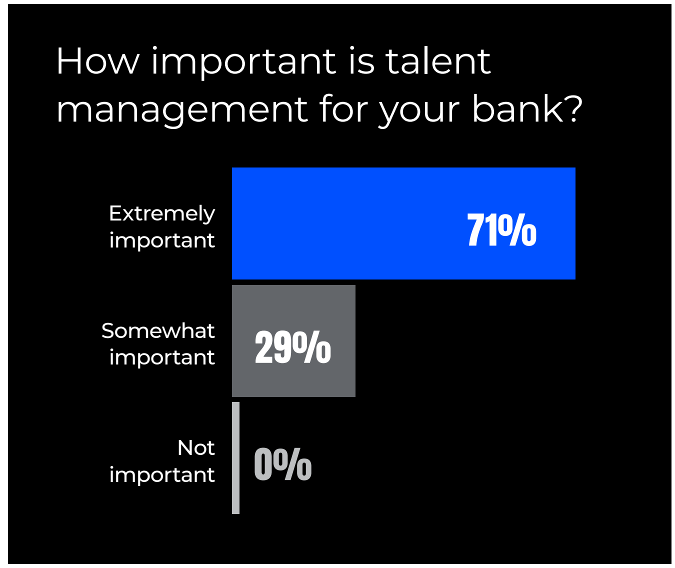
Keep in mind, a lot of impact happens downstream — such as the products and services you deliver. In many ways, ESG has always been part of community banking. Your financial services have positive, widespread effects across the entire community. ESG recognizes that. Documents it. And encourages expansion into more and new impact areas.

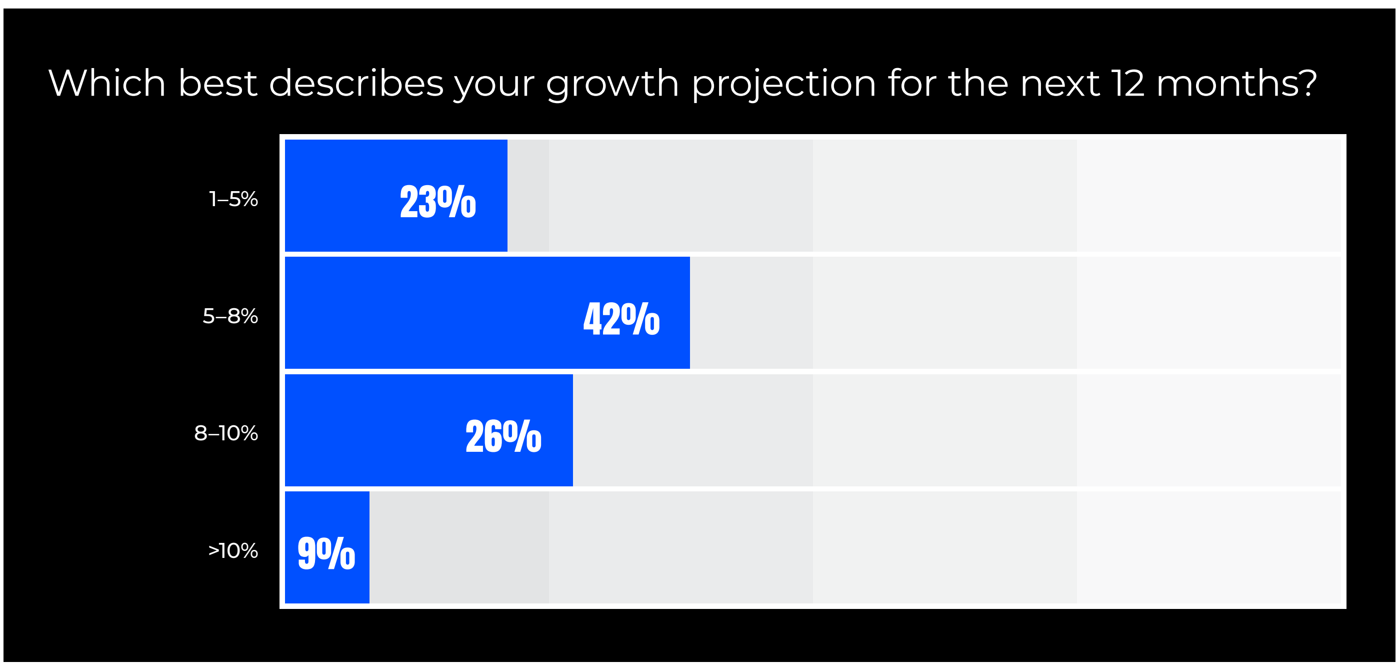
Anna M. Kooi
National Financial Services Industry Leader
Partner
Wipfli LLP

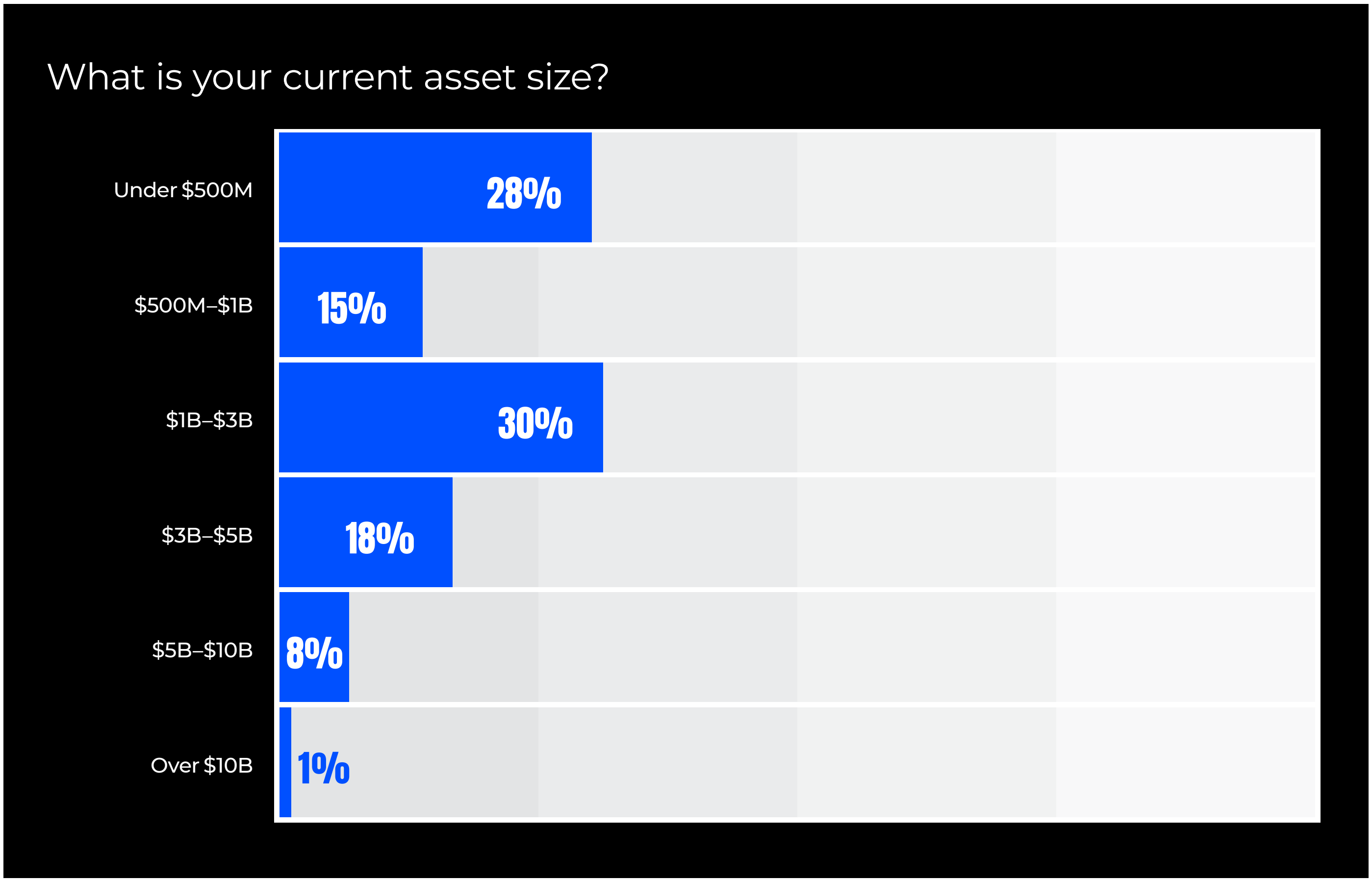
Appendix: The raw data

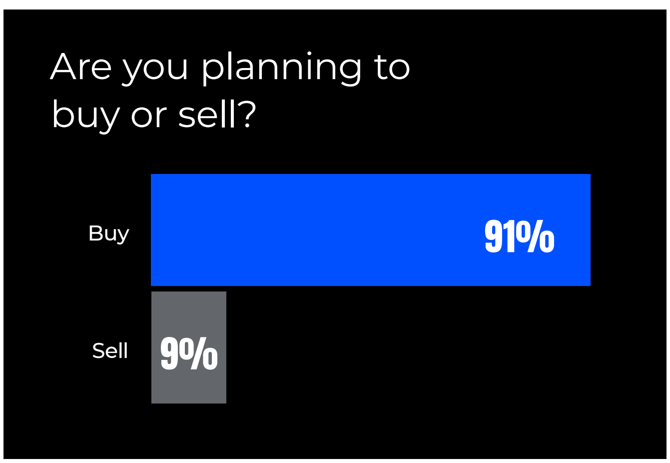
Wipfli received survey response from 249 bank leaders in 39 states.

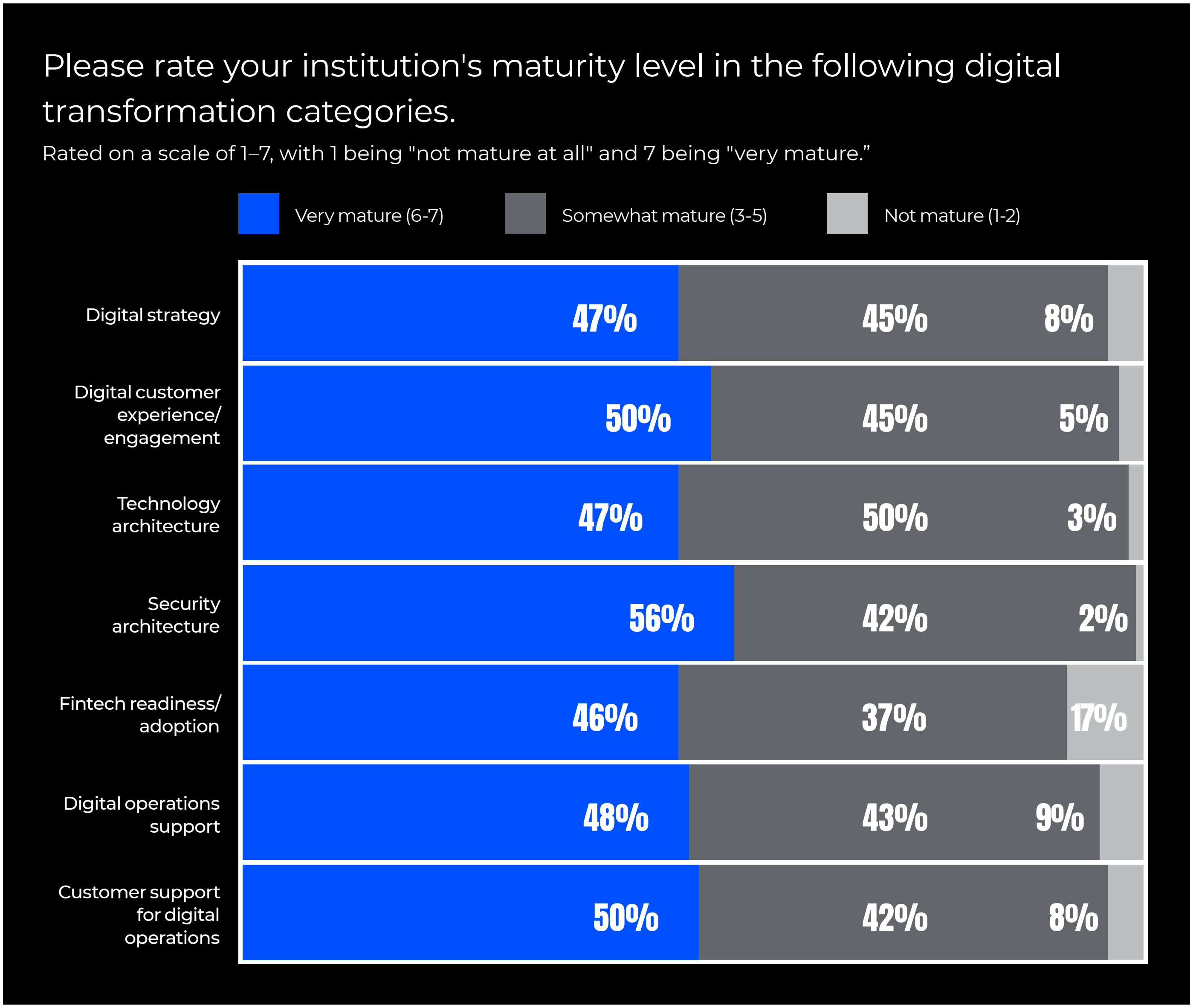
The survey was emailed and the answers were collected in November 2022. All responses were confidential and anonymous.





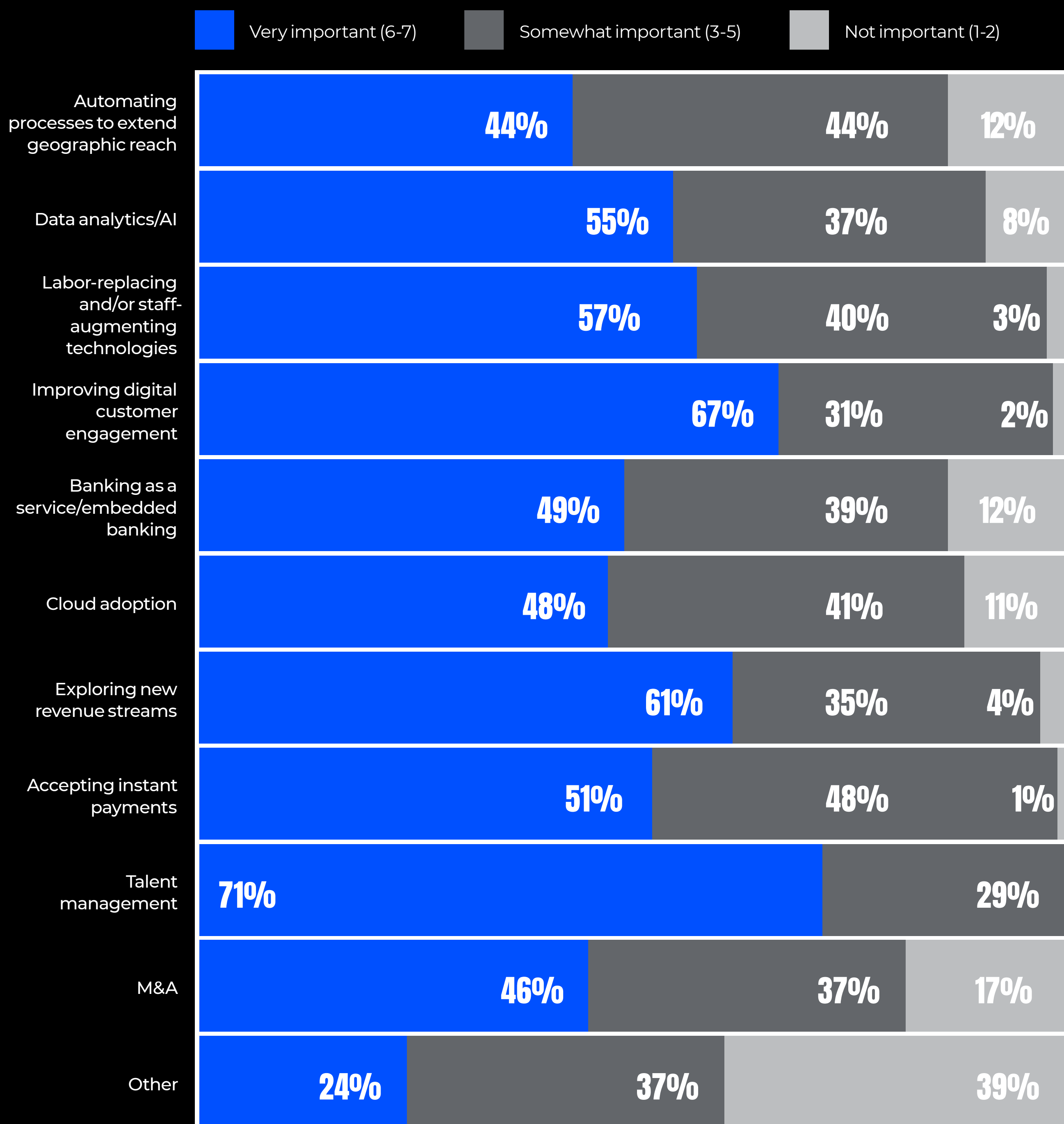

What is your current asset size?
Under $500M
28%
$500M–$1B
15%
$1B–$3B
30%
$3B–$5B
18%
$5B–$10B
8%
Over $10B
1%


Are you planning to buy or sell?
Buy
91%
Sell
9%


Please rate your institution's maturity level in the following digital transformation categories.
Rated on a scale of 1–7, with 1 being "not mature at all" and 7 being "very mature."
Very mature (6-7)
Somewhat mature (3-5)
Not mature (1-2)
Digital strategy
47%
45%
8%
Digital customer experience/ engagement
50%
45%
5%
Technology architecture
47%
50%
3%
Security architecture
56%
42%
2%
Fintech readiness/ adoption
46%
37%
17%
Digital operations support
48%
43%
9%
Customer support for digital operations
50%
42%
8%

Of the following strategies, which are the most important for your bank in 2023?

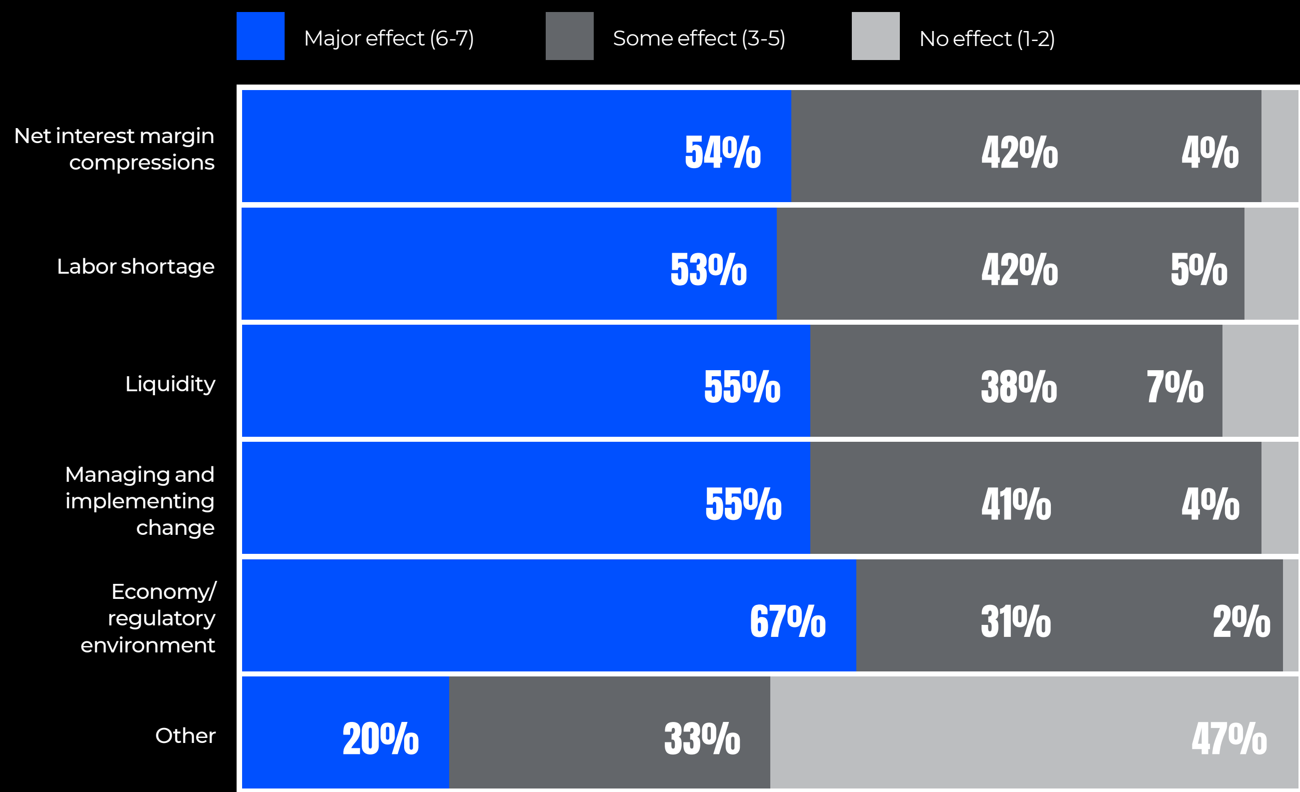
Rated on a scale of 1–7, with 1 being "not important at all" and 7 being "very important."



Other responses included items such as business lending, customer satisfaction, post M&A integration and trust accounts.

What effect do the following factors have on achieving your goals?

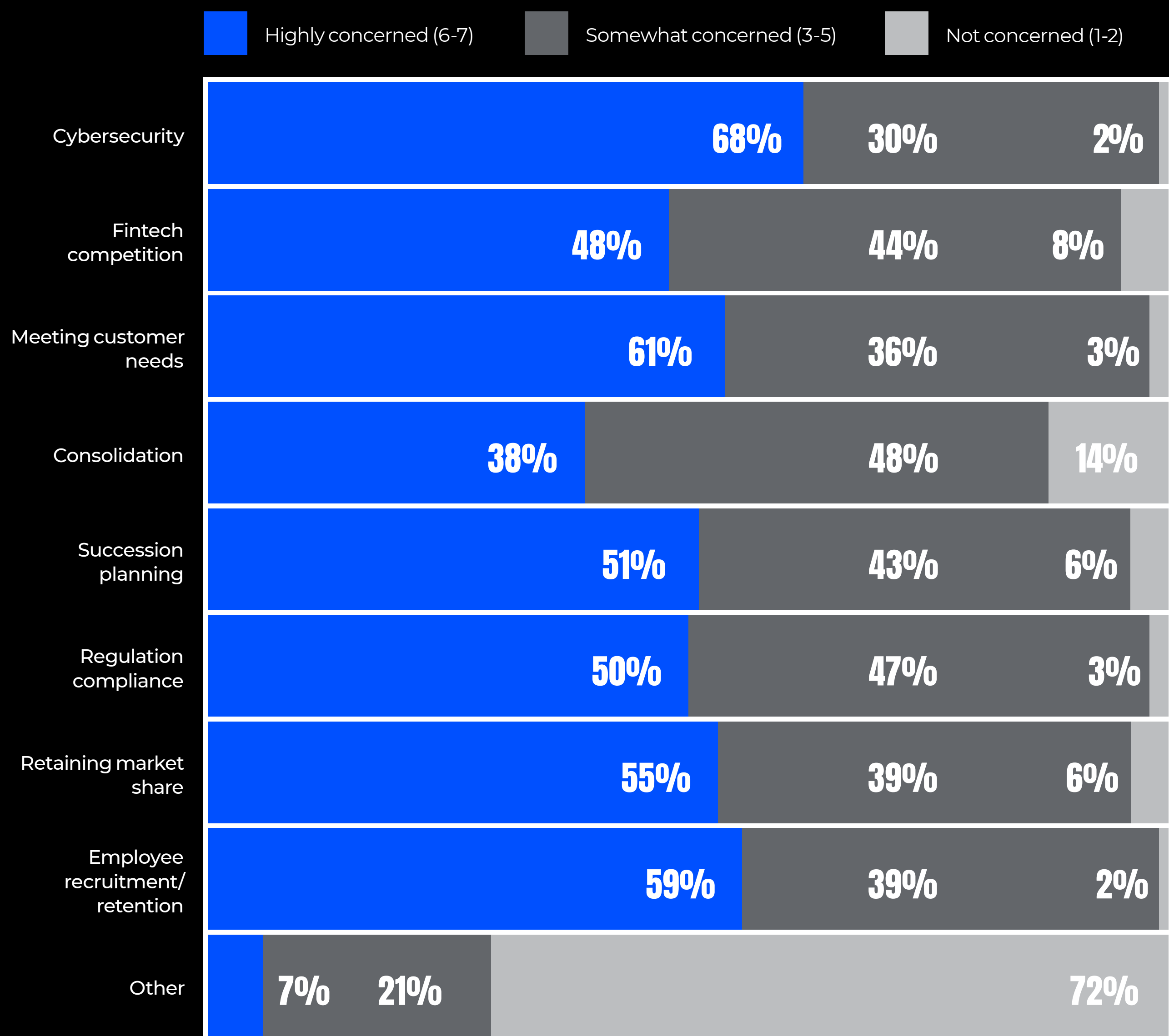
Rated on a scale of 1–7, with 1 being "no effect at all" and 7 being a "major effect."



Other responses included items such as culture, coronavirus, competition, data and retention.

How concerned are you about the following?

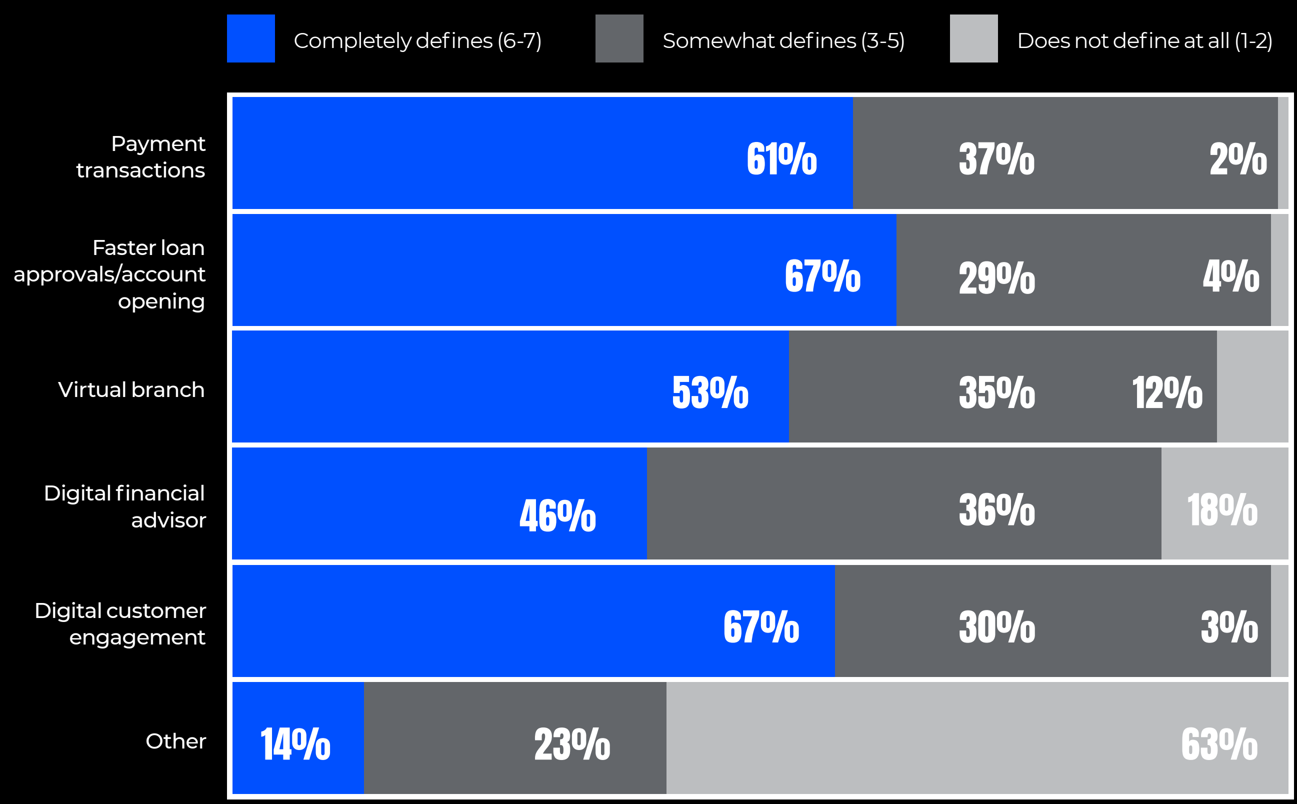
Rated on a scale of 1–7, with 1 being "not concerned" and 7 being "highly concerned."



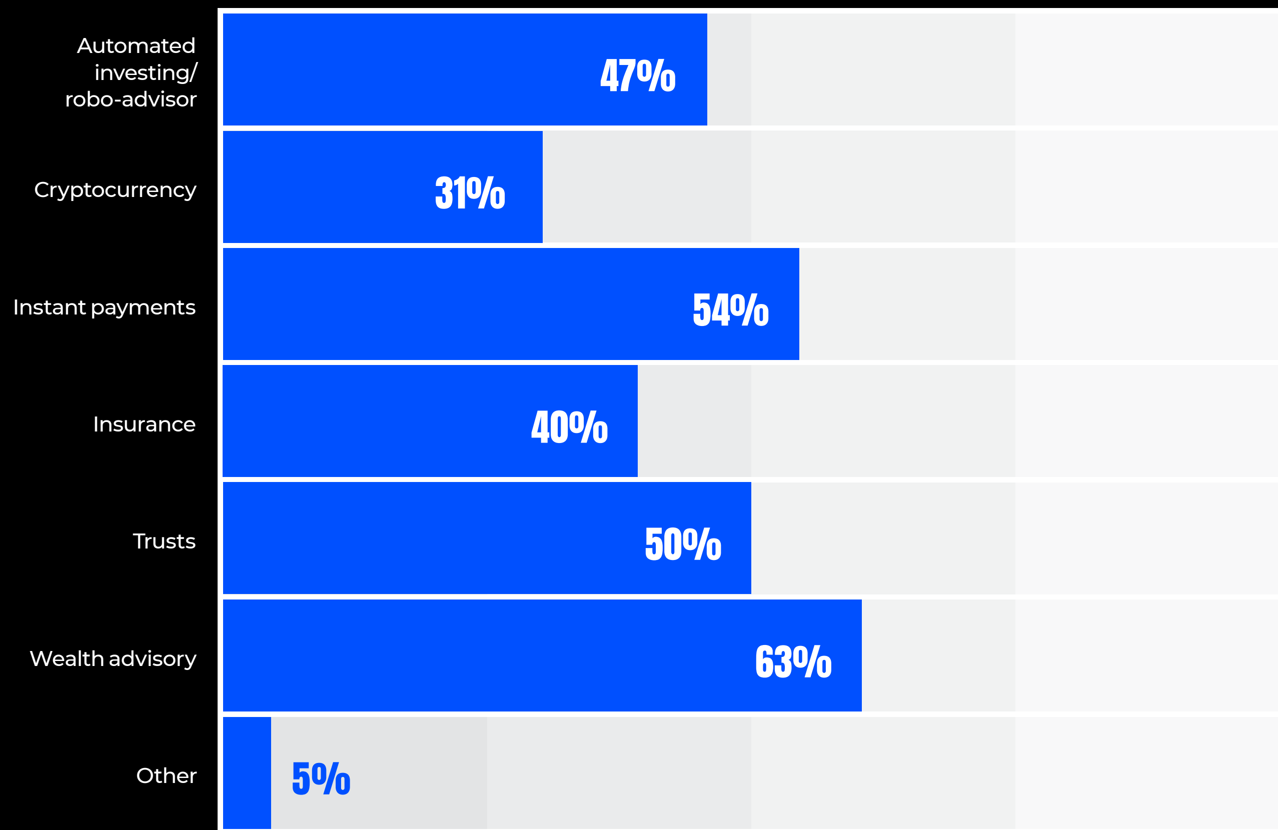
Other responses included concerns about culture, customer complaints, data, fraud, regulations, CECL and COVID-19.

An uncertain economy, fintech competition and growing customer needs require banks to be more and more nimble and forward thinking. Of the following, which most closely defines digital transformation to you?

Rated on a scale of 1-7, with 1 being "does not define at all" and 7 being "completely defines."



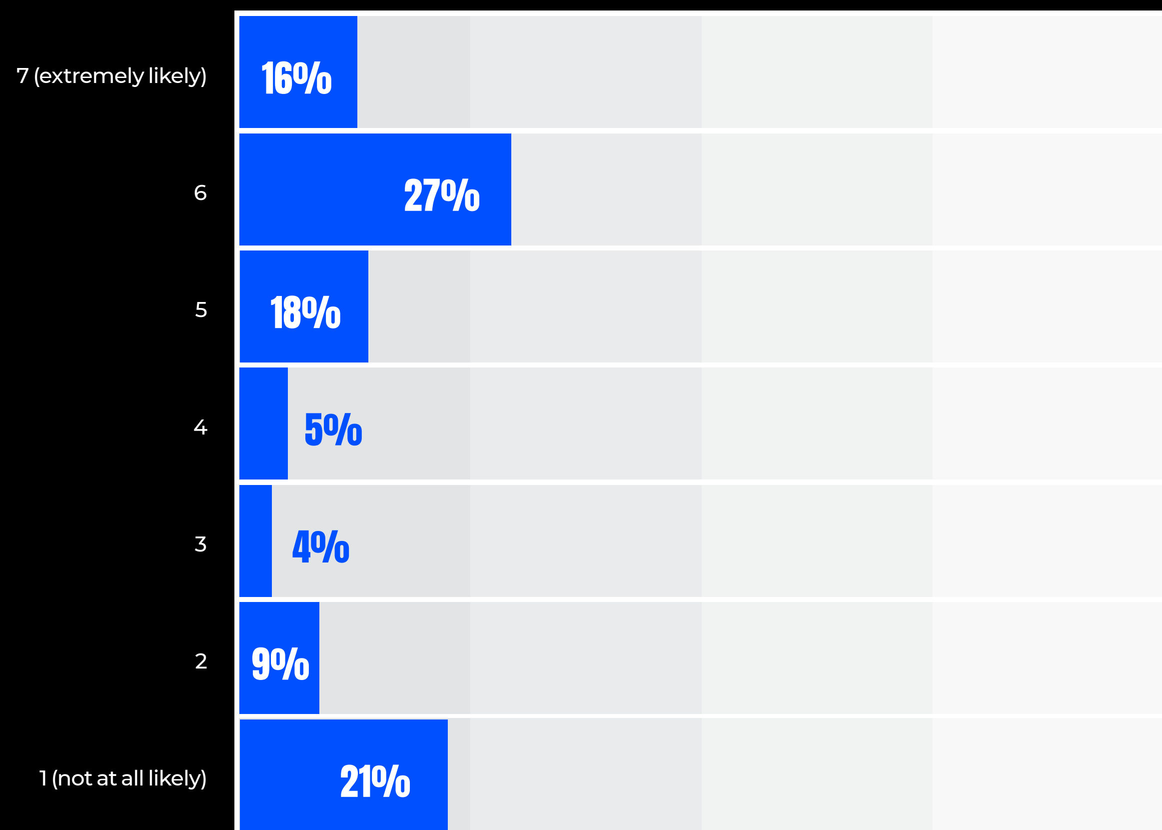
Which of the following services have you added in the last 3 years?



Other responses included online account opening, online loans, rewards and various e-banking items.

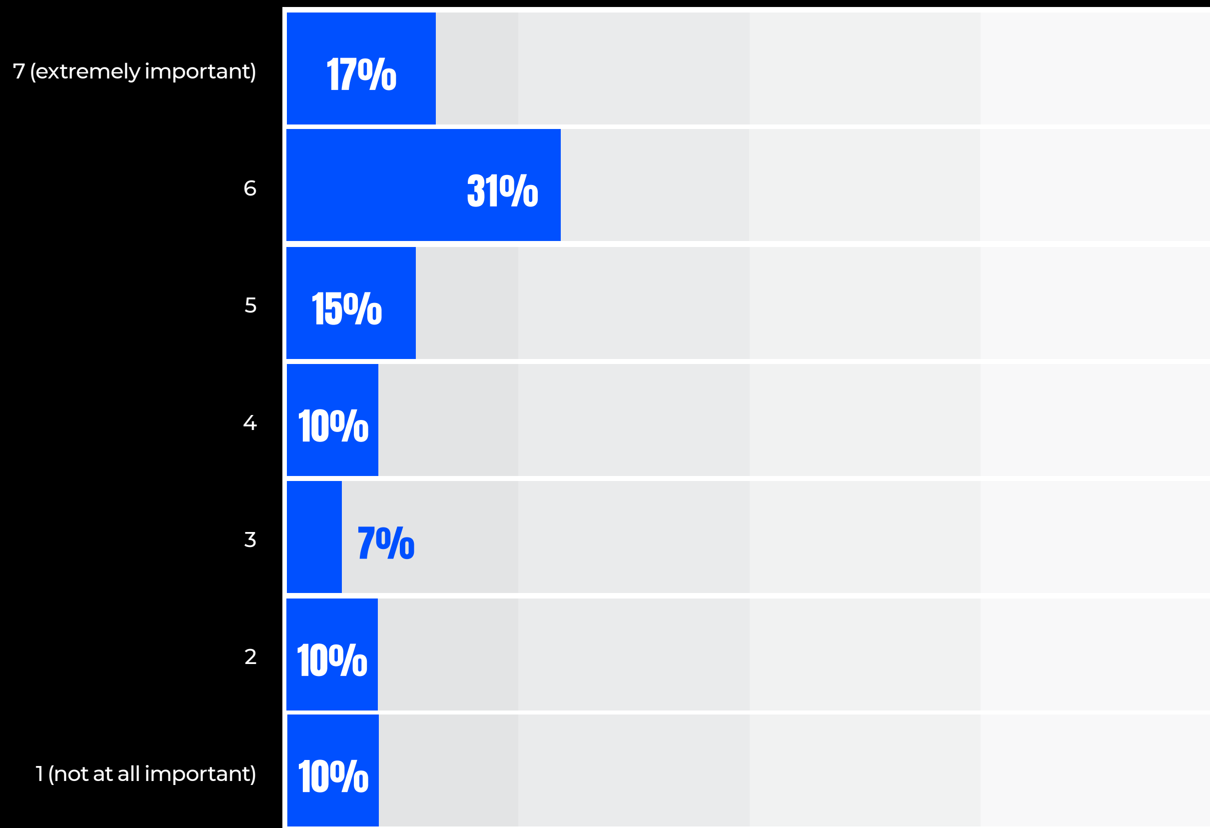
What is the likelihood that you will be offering digital assets (e.g., cryptocurrency, bitcoin, etc.) or related services (e.g., credit, custody or conversion) to your customers in the next 12 to 18 months?

Rated on a scale of 1-7 with 7 being "extremely" likely and 1 being "not at all" likely.

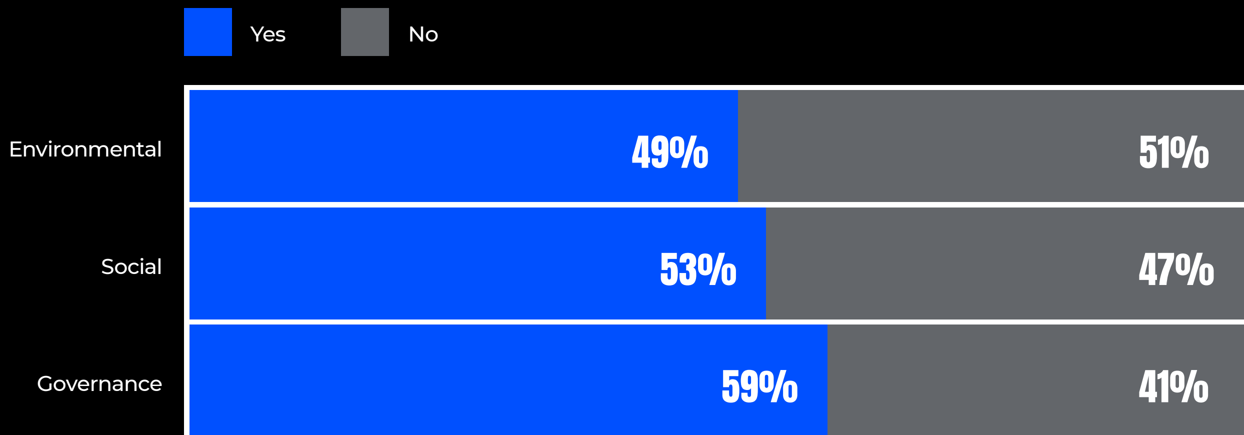


How important is ESG (environmental, social and corporate governance) reporting to your bank?

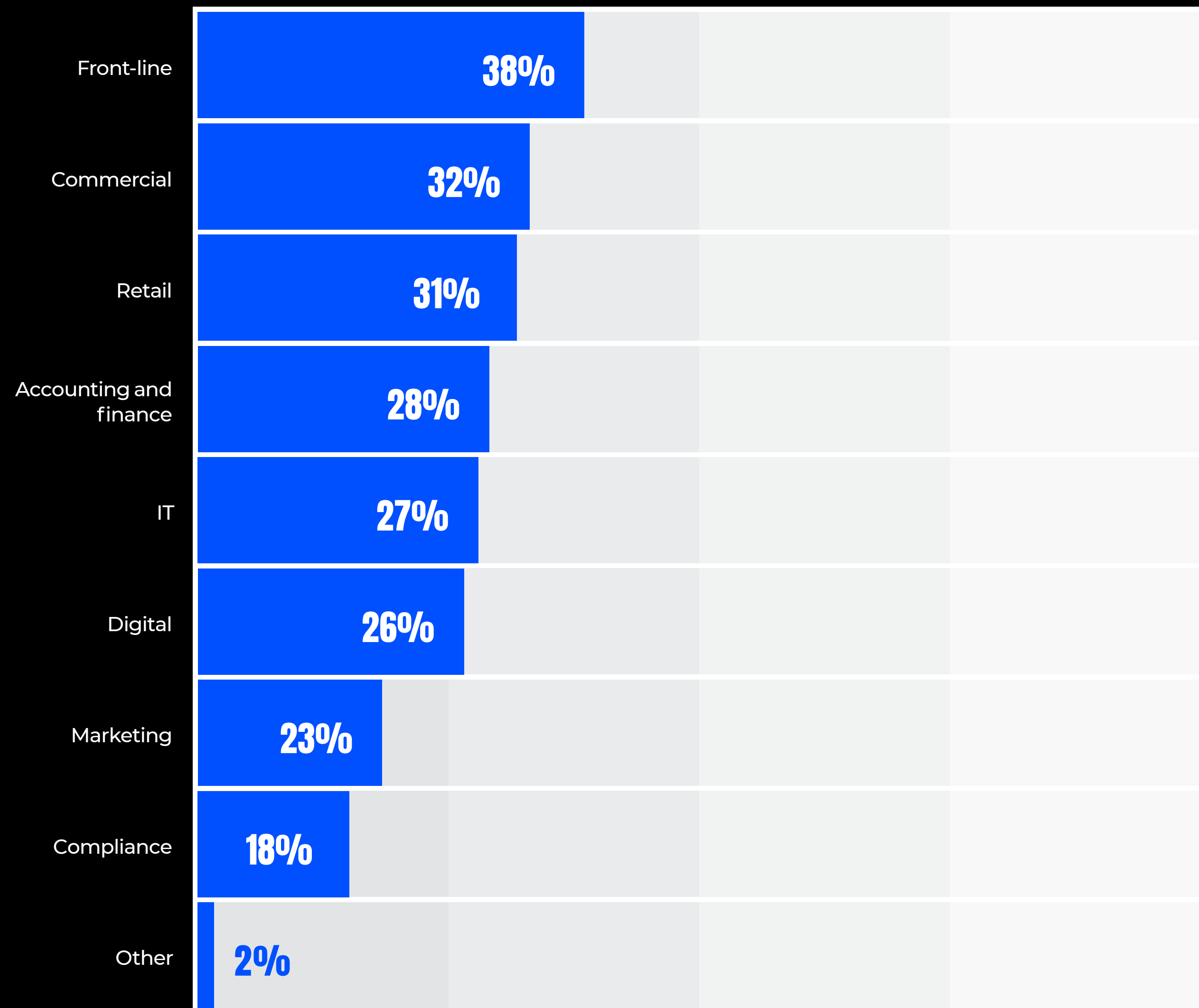
Rated on a scale of 1-7 with 7 being "extremely" important and 1 being "not at all" important.



Are you having difficulty quantifying any of the following ESG components at your bank?



For which positions are you experiencing a labor shortage?



Other responses include positions such as wealth, credit and loan support