

Russian Banks

Evidence Lab survey: In mobile we trust

Equities

Russia
Banks

Russia – well-placed to leverage mobile banking

Leveraging the UBS Evidence Lab survey of bank management and consumers in 18 countries, we focus on mobile banking in Russia, which is among the top three most advanced countries in terms of implementing mobile banking strategy. The Russian part of the survey involved 1,100 bank customers as well as a poll of three banks. Russian banks expect mobile banking penetration to double to 55% by 2018 and revenue to potentially grow c8.5% in three years – more bullish than for global peers (c6% revenue upside potential). We estimate the mobile banking ROE enhancement potential for key Russian players: ~1.4 pct pts ROE upside in the case of Sberbank (+0.4 pct pts for VTB) and comparable to South African banks. We think banks that are slow to adapt to shifting consumer preferences might fall victim to FinTech innovators like Qiwi.

Consumer survey: Sberbank and VTB are winning; foreign banks downsizing

Our Evidence Lab consumer survey suggests that 43% of bank customers in Russia use mobile banking applications. In general, mobile clients are somewhat unhappy with the quality of banking services, and surprisingly, Sberbank is the most recommended, while foreign banks lag. While mobile customers are more active and rate/fee sensitive versus non-mobile customers, a quality mobile offering boosts retention, and with less dependence on branch proximity, suggests significant room for branch rationalisation.

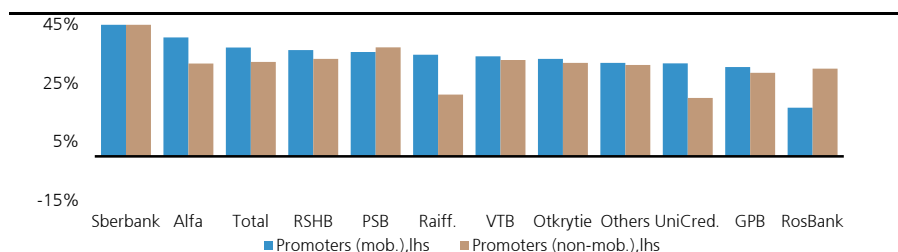
B2B survey: The financial impact is significant

Our B2B survey suggests the Street is underestimating the potential earnings upside, which is expected to be generated by right-sizing branch networks as well as potential revenue increases from higher fees and innovative tools like in-app ads (with a 35% conversion rate). We think Sberbank is best positioned to leverage these trends, given its scale and sizeable branch network, while VTB lags. Please also see our [interactive model](#).

Sberbank: Earlier IT investments are paying off; it could add 1.4pp to 2018 ROE

The merit of Sberbank's accelerated digitalisation push over the past few years is confirmed with our survey showing the bank winning from both a technology and client perspective, suggesting continuing gains in market share as competitors either remain underinvested (other large state banks and private banks) or downsize (foreign banks). Sberbank looks exceptionally strong to us, even in the context of the global scale of the UBS scorecard, coming 26th of 88 emerging market (EM) banks, with mobile banking generating up to 9% upside potential to our 2018 earnings forecast.

Promoters share among mobile and non-mobile banking customers



Source: UBS Evidence Lab, UBS research analysis

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UBS Evidence Lab provides our research analysts with rigorous primary research. The team conducts representative surveys of key sector decision-makers, mines the internet, systematically collects observable data, and pulls information from other innovative sources. They apply a variety of advanced analytic techniques to derive insights from the data collected. This valuable resource supplies UBS analysts with differentiated information to support their forecasts and recommendations – in turn enhancing our ability to serve the needs of our clients.

UBS conducted online studies among banking customers in a B2C study and among bankers responsible for mobile banking strategy in a B2B study spanning 18 countries. The two studies have provided deep insights into current mobile banking practices, the behaviours as well as attitudes of banking customers, and the mobile banking strategy among major banks in these countries. To supplement these studies, UBS Evidence Lab performed an analysis of the rankings and download trends of the mobile banking applications of the Russian banks.

Executive summary

Mobile banking has emerged as the great disruptor in the banking and broader financial services industries, in our opinion. Being a truly global phenomenon, it is affecting both developed markets (DM) and emerging markets (EM). Globally, mobile banking penetration has doubled from 17% two years ago and is expected to rise to 59% over the next three years.

Mobile banking – the great disruptor

Russia, given its huge geographical span over 11 time zones and unevenly populated territories, combined with high internet and growing smartphone penetration, is very well-placed to leverage remote channels and mobile banking specifically.

Russia affords significant mobile banking potential

In this report we try to gain an insight to the perspectives of mobile banking development. We take a look at mobile banking trends from bank management and banking customers' perspectives. The report uses the results of the bank management and consumer studies conducted by UBS Evidence Lab. B2B research spanned 67 banks across 18 countries, including Russia, examining banks' mobile banking strategies, penetration levels and cost-cutting and revenue enhancing opportunities. UBS Evidence Lab consumer survey provides unique opportunity to estimate perspectives of mobile banking development looking at mobile users profiles, behavior and preferences. Both studies allow deep dive into Russia specific data as well as make cross-country comparisons.

UBS Evidence Lab management survey

Key conclusions

UBS Evidence Lab surveyed 67 banks across 18 countries, including three Russian banks (accounting for c45% of total banking assets). The key takeaways are:

- **Mobile banking penetration** in Russia as a percentage of the customer base accessing banking services **is expected to double in three years to 55% from 27.5%.**
- Based on the survey results, our global banking team views **Russia as one of the top three most advanced countries (Spain and Sweden) when it comes to mobile banking strategy development** and capabilities offered to mobile banking customers.
- **Mobile is forecast to drive revenues by 8.5% on average** over the next three years – a top three estimate across 18 countries and above the global average of c6%.
- **Cost saving potential is significant:** All respondents admitted that the increased usage of mobile banking would lead to branch footprint reduction – one of the primary consequences of the development of mobile banking.
- **Transactions via a mobile channel are cheaper**, on average, by 24% relative to traditional channels. Retail banking transaction costs account for an average c32% of total operating expense, with the value varying from 10% to 60% across Russian respondents.

UBS Evidence Lab consumer survey

Key conclusions

UBS Evidence Lab polled 1,100 respondents in Russia with the sample targeted at top-10 bank clients. The key findings are:

- **Mobile banking penetration – 43%** of survey respondents used mobile banking, placing Russia on par with the global average (41%), but below most EM countries in a sample suggesting significant catch-up potential.
- **State banks** (Sberbank, VTB, RSHB) **are most recommended** by customers, while the retail franchise positions of foreign banks (UniCredit, Raiffeisen) appear to be the most vulnerable.
- **Mobile banking (if executed properly) increases client retention**, as evidenced by foreign banks Raiffeisen and Unicredit, where mobile banking customers are much more likely to recommend the bank to friends compared with non-mobile clients. Indeed, the difference in attitude to the primary bank between the two groups of customers at Raiffeisen and UniCredit is reflected in net promoter score (NPS) differences reaching c30 and 31 pt pct., respectively.
- **Mobile banking applications can serve as an advertising platform**, promising to enhance revenue, given a **decent advertising conversion rate of 35%** among customers who saw advertisements for third-party products.

Case study: Russian banking apps – downloads and usability ranking

UBS Evidence Lab studied the iOS ranking of 15 mobile banking applications across our Russian universe. The key findings are:

- Sberbank's leadership is confirmed among the banks with its app securing a top 10 ranking across all iOS apps in Russia and a significant share of the mobile banking apps market.
- The widespread use of Sberbank's app makes it an attractive advertising platform, so enhancing cross-selling capabilities.

Separately, an independent usability survey, conducted by Markwebb Rank & Report and published on 16 July 2015, showed that Tinkoff Bank (not rated) continued to dominate all three mobile platforms (iOS, Android, Windows Phone) with Sberbank showing the biggest improvement in Android (+14 places to #4) and iOS (+5 positions to #3).

Investment implications: what is (and not) priced in?

Mobile banking is not any more a marginal theme, and would gain in importance as a differentiator in terms of client offering as well as the tool to rationalize the costs. While room for cost saving is on the surface (branches & low transaction costs) and to some extent guided by the banks we think in the Russian context it's a bit underestimated given huge territory spin of the country, specifically important for Sberbank.

At the same time, the common theme on both global and Russia level, is the revenues upside both from increased cross-sell and third party products selling via apps as well as room to increase fees, with transfer fees of Brazilian 3x of those of Sberbank.

Together with the UBS global banks team, we identify Sberbank as one of the most attractive mobile banking plays in EM (for methodology details, please see the 7 July 2015 Q-Series® report, *Is a bank in your pocket the next big thing?*). Sberbank's positioning is even better than we thought, such that we see potential 2018 ROE upside of up to c1.4 pct pts to our base case, which is a healthy mix of revenues (+1.2%) and costs upside (6.3%) by 2018, with the latter benefitting from earlier huge investments in IT and implied high cost base given branch footprint. Sberbank current strategy envisages closing around 3k branches, we think mobile banking could increase it by another 850 with lower transaction costs.

VTB is leaner, in our opinion, but likely requires more investment into IT to catch up with Sberbank while inferior scale wise. That said, we estimate incremental potential upside to ROE might reach only 0.4 pct pts in three years.

Costs saving are on the surface, but Russian banks can do even more given geographical spin...

...but revenue upside is not in price

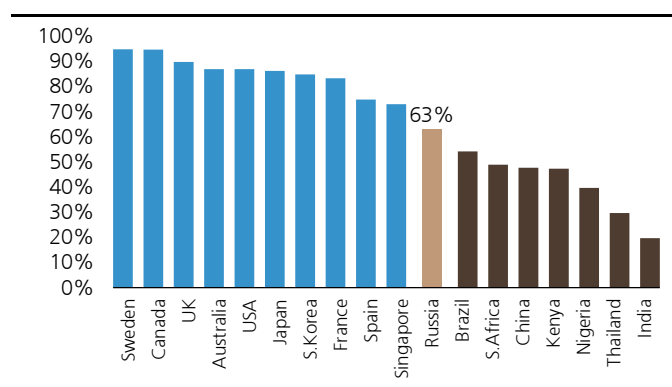
Sberbank offers best leverage with 1.4pp to 2018 ROE

Russian mobile banking in a global context

Russia has been steadily developing internet and mobile usage over the past decade, and currently has one of the highest internet penetration rates among developing countries with 63% of the population using the internet at least once a month – one of the highest rates in the EM EMEA region and close to the rate for developed markets (world average: 42.3%). According to research company Synovate Comcon, around 96% of the population owns a mobile phone, and World Cellular Information Service estimates that 40% of the population had a smartphone in 2014 – above the eastern European and Americas averages (33%), though still below the levels for the developed economies of Western Europe and North America (58% and 66%, respectively).

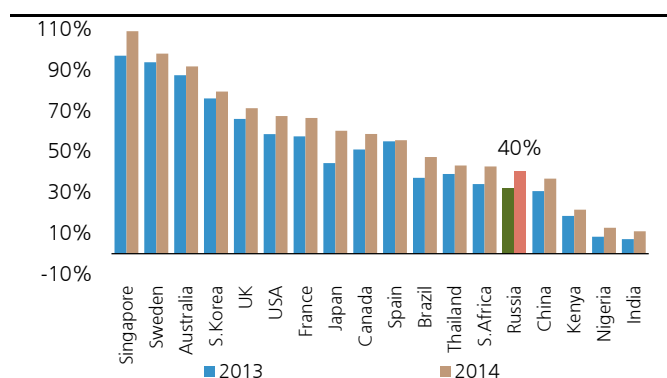
63% of Russians use the internet at least once a month – one of the highest rates in the EM EMEA region

Figure 1: Internet penetration



Source: <http://www.internetworldstats.com>. Note: Data is at December 2013; Canada, India, Nigeria as at mid-2014; US as at March 2014; Russia, China as at December 2014

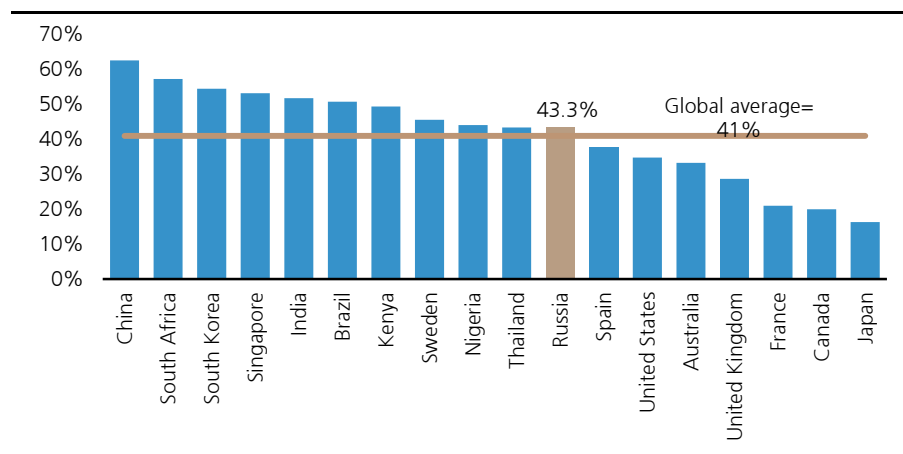
Figure 2: Smartphone penetration



Source: World Cellular Information Service

Remote banking channels are in gaining popularity: according to our Evidence Lab consumer survey, 43% of respondents in Russia used a mobile banking application on a smartphone, while 85% used the internet to access banking services via a desktop computer or laptop – a notch above branch visits (83%). Mobile banking penetration in Russia stands above that of global and large developed markets, but is still lower than in EM EMEA countries.

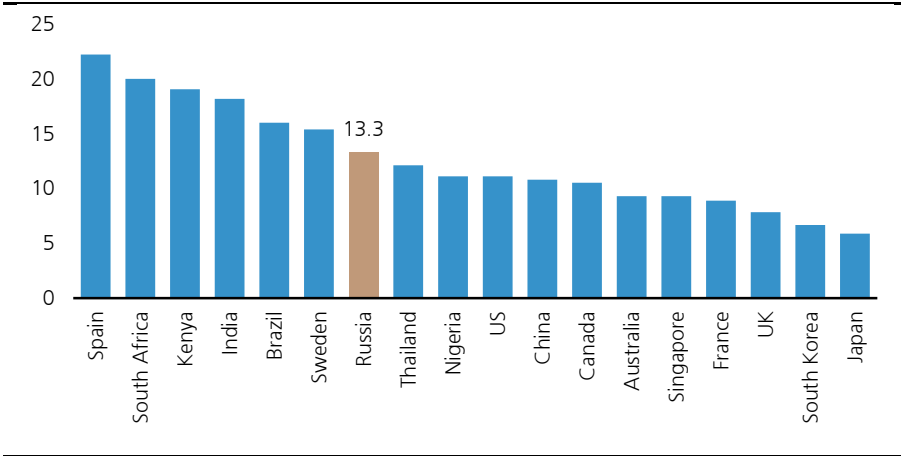
Figure 3: Mobile banking penetration by country



Source: UBS Evidence Lab, UBS research analysis

The UBS global banking research team has developed and constructed the 'Market growth' scorecard, using the results of the Evidence Lab bank management survey. Russia scored 7/18 implying that Russia affords good potential for the further growth and development of mobile banking.

Figure 4: Market growth score by country



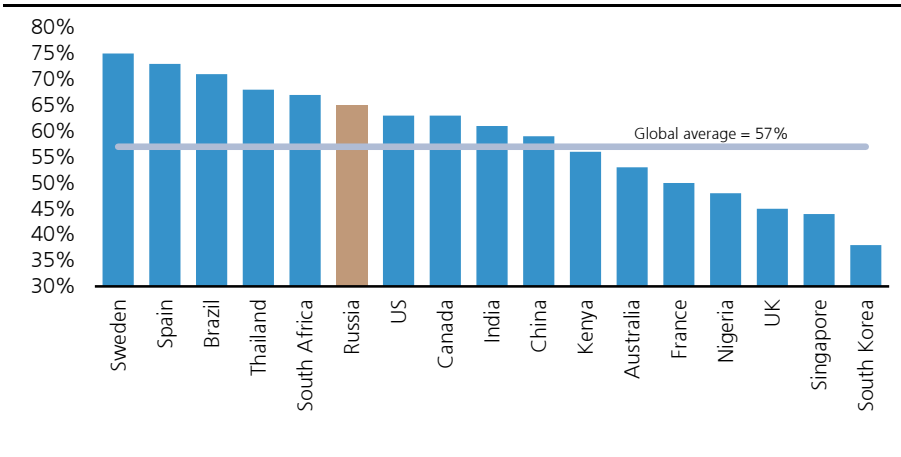
Russia affords good potential for the further development and growth of mobile banking

Source: UBS Evidence Lab, UBS research analysis. Note: Score is calculated as (100/average rank), so that higher is better

Mobile banking applications have room for capability improvements

Attempting to gain an insight into the attractiveness of Russian mobile banking, the Evidence Lab bank management survey assessed the capabilities of the banks' mobile applications (e.g., current account (CA) balance check, transfers to other accounts). Our global banking team views Russia as one of the top three most advanced countries (Spain and Sweden) by mobile banking strategy development and capabilities offered to mobile banking customers. Consequently, we suggest that Russian banks have further room to develop the capabilities of their mobile applications, including revenue-enhancing ones.

Figure 5: Regional mobile banking application capabilities (score)



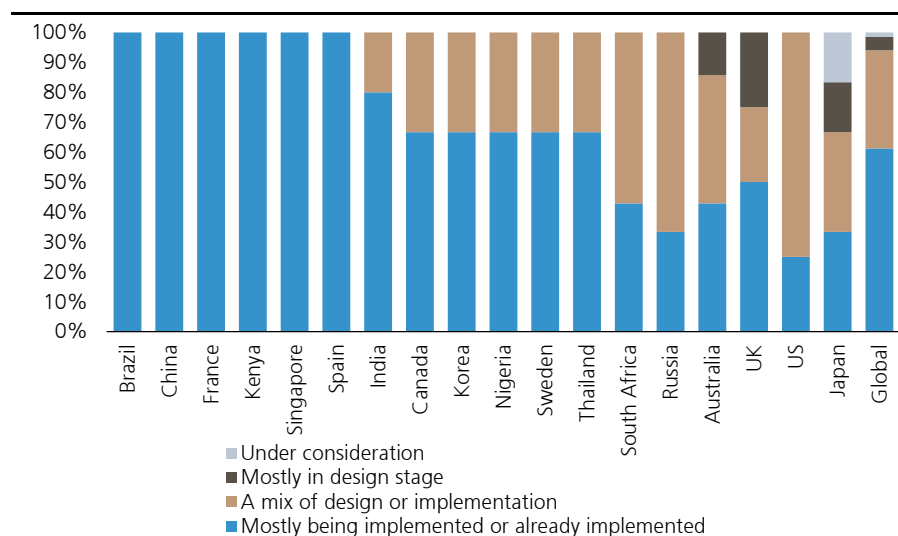
Source: UBS Evidence Lab, UBS research analysis

Looking at the current snapshot of mobile banking application functionality (see Figure 7), Russian banks look more advanced than global peers, offering core (e.g., current account/credit card balance check, bills payments) and advance services (e.g., cheque recognition functionality, card photo scans). That notwithstanding, it seems to us that Russian banks are lagging Brazilian peers in leveraging

Russian banks look more advanced than global peers in terms of mobile banking application functionality

revenue/funds flow generating services, such as 'taking out loans', 'external transfers', 'setting up a new personal/business payee' as well as 'investment account management' and 'making deposits'.

Figure 6: Mobile banking implementation progress



Source: UBS Evidence Lab, UBS research analysis

Figure 7: Capabilities of Russian banks' mobile applications

	Russia	Global	Brazil
Recharge pre-paid mobile	100%	49%	100%
Check credit card balance and limits	100%	69%	100%
Payment of utility bills – existing payees	100%	84%	100%
Other bills or fees to existing payee	100%	85%	100%
Transferring money between customer's own accounts	100%	96%	100%
Current account balance check	100%	99%	100%
Barcodes and bills photo recognition	67%	31%	100%
Taking out loans	67%	36%	100%
Make deposit	67%	49%	33%
External transfers/wire transfers (e.g.to friends)	67%	90%	100%
Use the camera on the phone to "deposit" cheques	33%	16%	0%
In-store contactless payment	33%	31%	0%
Manage overdraft	33%	37%	100%
Set up a new personal/business payee	33%	63%	0%
Other	33%	16%	0%
Investment accounts management	0%	61%	100%

Source: UBS Evidence Lab, UBS research analysis

Bank management survey

Implications of mobile banking strategy for market players

The UBS Evidence Lab bank management survey has been developed to try and gain insight into: (1) how bank management positions their mobile banking strategy; and (2) what are the targets and the current implementation status of mobile banking. In total, the survey covered 67 banks from 18 countries. In Russia, three banks responded to the survey, together accounting for around 45% of total sector assets.

Mobile banking is key to banking strategies

Banks globally have come to understand that mobile and internet banking, and the larger concept of 'big data' are now an integral part of financial services development, capable of changing the whole banking landscape. Banks have started to realise that mobile banking enables them to potentially extract additional opportunities from the 'contextualization' and 'personalization' of services.

The results of the UBS Evidence Lab bank management survey confirm the trends towards banking digitalisation in Russia:

- Digital banking (internet and mobile) has become an integral part of banks' strategies. Most banks state that their mobile banking strategy is already fully integrated into their usual business.
- Key objectives banks pursue in developing mobile banking strategies include developing an alternative banking channel for existing customers, better interacting with customers, and gathering data for analysing habits and expectations. In addition, banks see mobile banking as a way to reduce churn rates, lower transaction costs for customers, and educate customers.
- Banks' top management and board members are very supportive of developing mobile banking, while the regulatory environment is seen by most respondents as 'neutral'. Viewed from the perspective of mobile banking fuelling increased competition, banks see the threat largely coming from internet payment systems (like PayPal, Qiwi).

This provides potential upside for extracting revenue and cost benefits as a result of mobile banking, as both consumers and regulators adjust to new banking technologies.

Are there opportunities for revenue generation?

Yes. As more people increasingly undertake online/mobile operations, we calculate the volume of operations made via remote channels might almost double. In our opinion, this is a win-win outcome: banks are able to reduce operating costs as well as use 'big data' to differentiate customers and offer contextual products, both banking and non-banking from third parties. Customers, in turn, enjoy banking services of higher quality any time, any place.

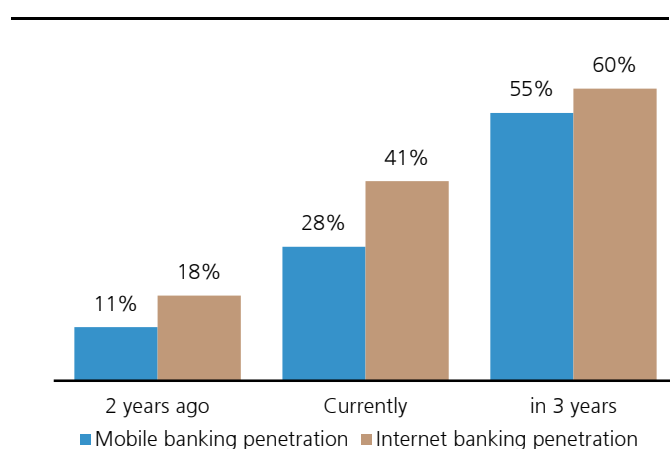
Yes; both banks and customers are set to benefit from the growth in mobile banking

Mobile penetration is expected to almost double in three years

Russian banks participating in the survey estimate that mobile penetration (the share of the customer base using the mobile banking channel) will double in the next three years to reach c55% (estimate across 18 countries up from the current 35% to 59%), while internet banking penetration will likely grow from 41% at present to 60% of the customer base (from 42% to 55% on a cross-country basis). Naturally, as mobile and internet penetration increases, the share of transactions via both platforms should grow. On a cross-country basis, over the next three years, 46% of all banking transactions are expected to be mobile related – up from 25% today and 13% two years earlier. In Russia, one bank estimated that mobile banking transactions will grow from the current 25% to 50% – close to the global trend.

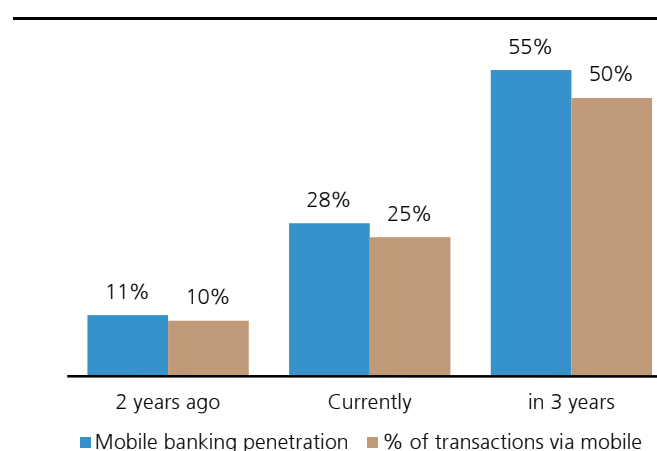
Mobile penetration could double in the next three years to reach c55% with internet banking penetration up to 60% from 41%

Figure 8: Mobile banking penetration in Russia



Source: UBS Evidence Lab, UBS research analysis

Figure 9: Mobile banking penetration vs % of transactions via mobile in Russia



Source: UBS Evidence Lab, UBS research analysis. Note: Percentage of transactions via mobile, based on estimates provided by only one bank respondent.

At the same time, the percentage of in-branch transactions is expected to decline globally from 35% to 25% in the next three years. Again, one Russian bank participant made an even more extreme estimate of in-branch transaction decline of 10% from the current 15%. However, we do not assume that the actual number of branch transactions would fall by the same amount, as we think that mobile banking could trigger the growth of the total transaction volume.

In-branch transactions should decline globally from 35% to 25% in the next three years

Russian banks are more bullish on revenue upside opportunities

All the banks surveyed agree that mobile banking is an incremental revenue-generating channel while also representing a good advertising platform. Most participating Russian banks estimate the annual incremental revenue generated by mobile banking could reach more than 10% (average estimate for Russia 8.5% versus 6.2% in Brazil). The view of the UBS global banking team is that Russian banks seem to be more upbeat than global peers (6% incremental revenue estimate; weighted average, based on count of respondents).

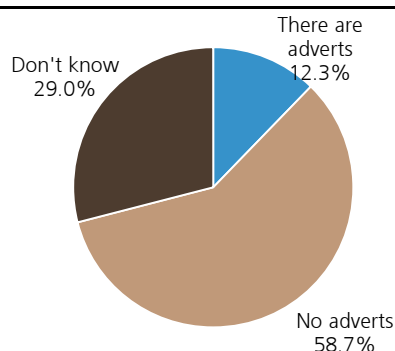
Russian banks estimate the annual incremental revenue generated by mobile banking could reach more than 10%

Advertising conversion set to yield revenue

Though more than 10% revenue upside potential might look bullish, we think the potential upside might come from the advertising platform, as shown by our Evidence Lab consumer survey. Bank customers were asked whether they received adverts for non-banking products via their bank's mobile banking app, and 12.3%

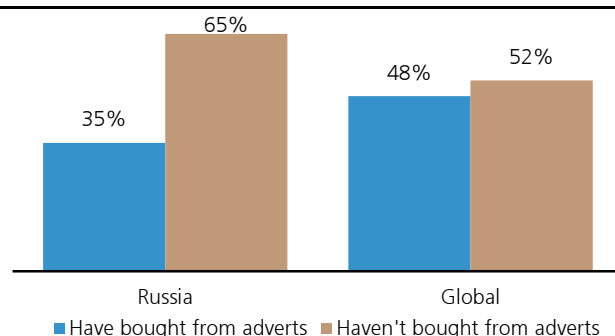
of respondents confirmed they did. Moreover, we were surprised by how many mobile banking customers availed of these offers: **35%** of those who saw the adverts for third-party products answered that they had actually bought those products (versus 48% across 18 countries). And the huge dispersion between the Russian banks' conversion rates (highest – 75% at FC Otkrytie, and lowest – 0-10% at VTB, RSHB, Sberbank) testifies to the improvements in advertising content.

Figure 10: Russian consumers' recognition of advertisements within mobile banking applications



Source: UBS Evidence Lab, UBS research analysis

Figure 11: Consumers who have bought from advertisements within a mobile banking application



Source: UBS Evidence Lab, UBS research analysis

Bill/fee payments and transfers are the main revenue-generating activities in Russian mobile banking

The UBS Evidence Lab consumer survey illustrates the most common mobile banking activities. As one might expect, most banking customers who own smartphones use them to get alerts from their banks (64%) or check their current account balance (61%). The most popular revenue-generating banking activities among smartphone users are: (1) to recharge pre-paid mobiles or buy voice/data bundles (58%); (2) to make airtime purchases (46%); (3) to pay (non-utility) bills (40%); and (4) to make money transfers to friends or relatives (33.5%).

Figure 12: Most common mobile banking activities in Russia (revenue-generating activities highlighted)

	Total	Sber-bank	VTB	GPB	RSHB	Alfa	Otkrytie	Uni Cred.	PSB	Ros Bank	Raiff.	Others
Receive alerts (e.g. SMS, e-mails) from bank	63.5%	61.4%	64.7%	58.3%	61.5%	58.9%	61.4%	74.4%	67.6%	64.9%	68.5%	65.1%
Current account balance enquiries	60.7%	57.9%	60.0%	56.9%	65.4%	62.7%	54.5%	74.4%	56.8%	62.2%	66.1%	55.6%
Recharge pre-paid mobile or buy voice or data bundles	57.9%	53.1%	64.0%	50.0%	50.0%	61.4%	63.6%	51.2%	59.5%	67.6%	61.4%	46.0%
Check credit card balance and limits	49.5%	52.4%	52.7%	41.7%	53.8%	49.4%	50.0%	55.8%	47.3%	40.5%	54.3%	38.1%
Buy airtime	45.5%	47.6%	44.7%	45.8%	34.6%	50.0%	59.1%	55.8%	36.5%	37.8%	45.7%	33.3%
Transfer money between accounts	41.6%	50.3%	43.3%	34.7%	38.5%	46.2%	47.7%	51.2%	25.7%	43.2%	39.4%	27.0%
Payment of non-utility bills or fees	40.2%	46.9%	42.0%	40.3%	42.3%	38.0%	50.0%	44.2%	35.1%	43.2%	36.2%	28.6%
Transfer money externally to friends or relatives	33.5%	46.2%	32.0%	34.7%	19.2%	36.1%	38.6%	27.9%	20.3%	29.7%	34.6%	22.2%
Purchase products by contactless payment using bank account bank/credit linked service or app	28.0%	26.9%	28.0%	25.0%	19.2%	33.5%	29.5%	30.2%	24.3%	16.2%	34.6%	19.0%
Payment of utility bills	27.7%	31.7%	28.0%	26.4%	38.5%	31.6%	27.3%	27.9%	18.9%	24.3%	26.0%	22.2%
Purchase products in store by contactless payment using third-party app or "wallet"	23.4%	29.7%	28.0%	19.4%	19.2%	21.5%	31.8%	25.6%	14.9%	10.8%	27.6%	12.7%
Make deposit into savings account	13.4%	14.5%	10.7%	16.7%	11.5%	13.9%	11.4%	20.9%	10.8%	10.8%	15.0%	9.5%
Check investments (time deposit, mutual funds, shares), increase investments or make investment redemption	11.6%	15.9%	15.3%	9.7%	19.2%	10.8%	6.8%	20.9%	5.4%	10.8%	9.4%	3.2%
Other	7.0%	9.0%	6.0%	2.8%	15.4%	2.5%	2.3%	4.7%	13.5%	5.4%	5.5%	15.9%
Paying-in cheques	6.5%	6.2%	6.7%	6.9%	3.8%	6.3%	2.3%	16.3%	4.1%	2.7%	9.4%	3.2%
Taking out loans	4.1%	4.8%	5.3%	8.3%	3.8%	5.1%	4.5%	4.7%	1.4%	0.0%	2.4%	1.6%

Source: UBS Evidence Lab, UBS research analysis

We believe banks have the opportunity to enhance revenue from the mobile banking channel by making money transfer/payment transactions more customized, and by making it easier for customers to take out loans. For example, only 4.1% of customers cited 'taking out loans' as a mobile banking activity, yet when respondents were asked what kind of banking activities they would like to conduct on their mobile phones, 18.7% said they would like to take out loans. This indicates a lack of supply of crediting options from mobile banking applications rather than a lack of demand for loans via mobile banking apps.

In order to gauge the size of fees charged by Russian banks, we compared them to those charged by Brazilian banks. Both countries are sizeable markets, having comparable GDP per ca (USD c11,600 in Brazil and USD c12,700 in Russia) and export-oriented economies, dependent on raw and intermediate products. In both markets, transactions via electronic channels are cheaper than in-house. In Russia, banks charge a percentage fee (usually no more than 1%) per transaction, setting minimum and maximum charging amounts (e.g., for transferring money to other banks the minimum charge is around RUB 20, or around USD 0.35; the maximum is up to RUB 1000, or around USD 17). In Brazil, banks charge a fixed amount per transfer regardless of the value of transaction, the market average being BRL 7.8, or around USD 2.5.

We also compared fees charged by Russian and Brazilian banks for transferring money to other banks (benchmark transactions), assuming an average amount equivalent to USD 100. We found that Russian banks effectively charge at least three times less than Brazilian banks (note: we did not take into account loyalty programmes or service packages which offer lower fees). Even though the difference is large, we still think that Russian banks have room for fees and commissions (F&C) increase in medium term, especially given the net interest margin downward trend which makes F&C revenue stream enhancement a priority target.

Within the Russian banking universe, fee charges also vary greatly from bank to bank, with Tinkoff bank (online retail monoliner) charging zero for transfers to accounts at other banks. Sberbank, on the other hand, charges one of the highest rates (1%) for benchmark transactions and thus has limited scope to increase pricing in the near term.

At the same time P2P card-to-card transfers could provide most upside, as banks charge higher fees for this kind of operation (no less than 1%, and a minimum RUB 30, or around USD 0.52).

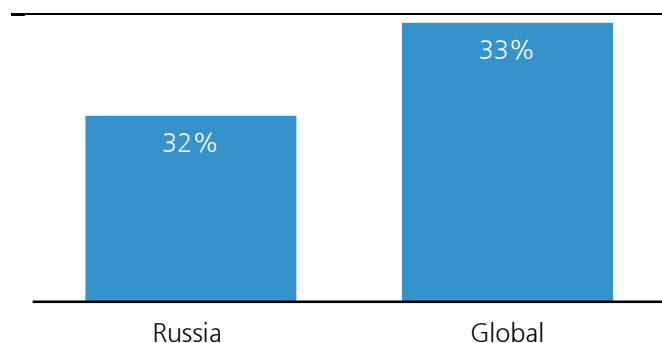
Bottom line: There is scope for further mobile banking penetration and leveraging mobile banking platform with revenue-generating services, as well as opportunities for the advertisement revenue stream.

We see potential for further leveraging mobile banking to revenue-generating services

Significant cost-cutting potential

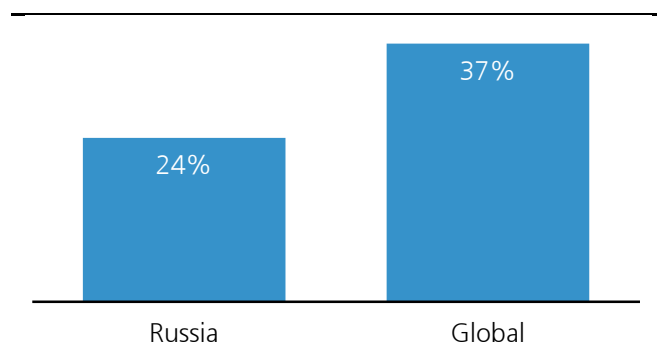
Quite expectedly, mobile banking can generate benefits on the cost side – by replacing more expensive in-house transactions and by branch closures. Banks that participated in the UBS Evidence Lab management survey were asked to estimate the extent to which mobile banking might contribute to cutting operating expenses. While one bank in the Russian sample found it hard to quantify the impact, others gave estimates ranging between 1-4% and 10-19% reduction of operating expense base in the next three years. The average estimate among banks across 18 countries suggests 10% cost-reduction potential. Since costs related to retail transactions account for c32% of total operating expenses, a mobile banking strategy seems to represent a promising cost-saving opportunity.

Figure 13: Estimate of retail transaction cost share in total operating expenses



Source: UBS Evidence Lab, UBS research analysis

Figure 14: Estimated cost savings from customers' migration from in-branch to mobile banking transactions



Source: UBS Evidence Lab, UBS research analysis

The most obvious cost-cutting opportunity lies in a **reduction in the number of branches**, and given the vast territory of Russia, the impact of remote channels should be more pronounced in the country. While the majority of survey respondents in Russia could not provide a guesstimate on the scale of branch reduction as a consequence of mobile strategy implementation on a three-year horizon, globally, banks expected a 5.6% reduction in the number of branches. Trying to assess the number of branches to be cut can be challenging, given the ongoing process of operation de-scaling (especially among foreign banks) and large-scale cost optimisation, which makes it difficult to evaluate the contribution of mobile banking to branch network contraction.

At the same time, Russian banks estimate that, on average, **mobile banking transactions are c24% cheaper** than in-branch transactions, lower than the cross-country estimate of 37%. We see a big incentive for banks to further optimise their branch network.

Interactive mobile banking earnings upside exercise

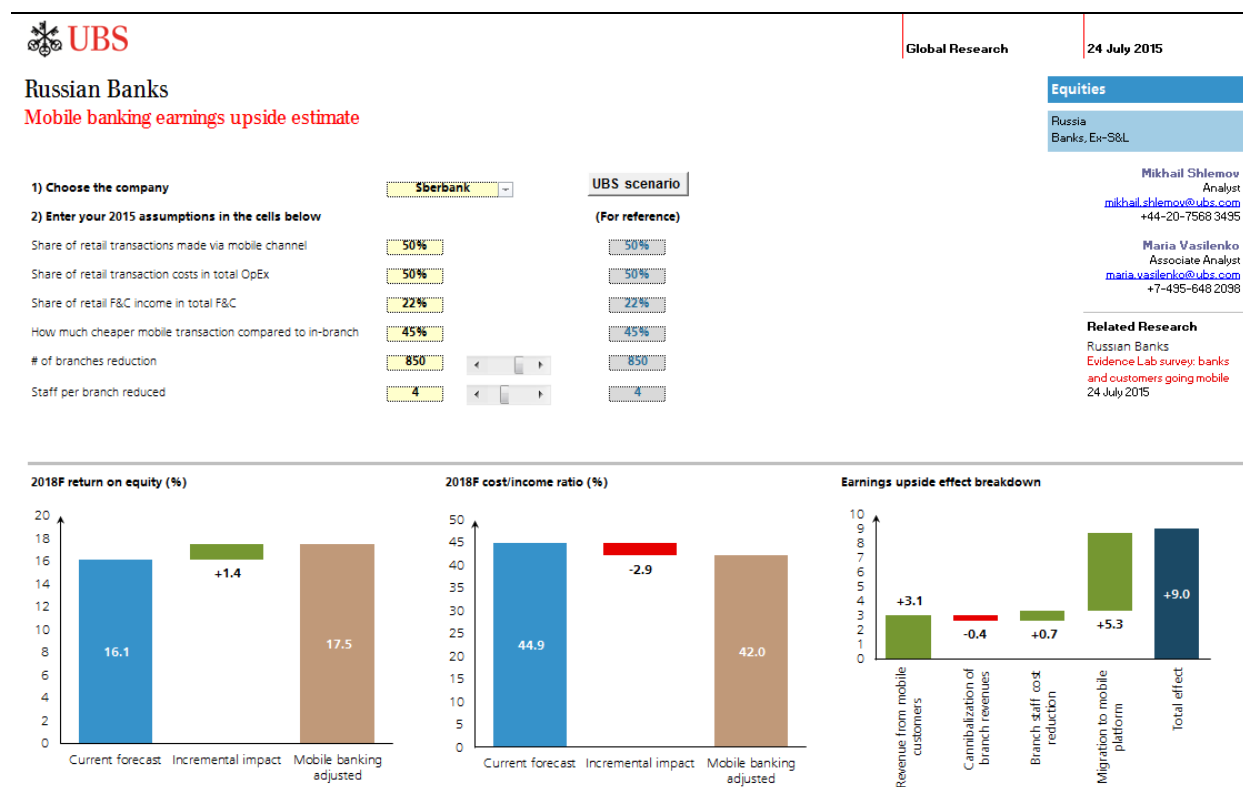
We have developed a simple [interactive model](#), which helps to gauge the impact of mobile banking on banks' 2018E P&Ls under different scenarios. We considered the revenue and cost effects of migrating transactions from in-branch to mobile banking platforms, assuming that retail net fees and commission income are equally distributed by channel.

Our bank management survey suggests that over the next three years the share of transactions made via the mobile channel could double (from 25% to 50%). Taking into account the proportion of net fees and commissions that banks generate from retail transactions, and assuming that net fees and commissions are evenly distributed by channel, we estimated the potential additional earnings generated by mobile banking. Also, we think that as the mobile banking market matures and increasing numbers of clients use mobile banking applications, mobile banking customers will visit branches less often than conventional customers, which is currently the case in Sweden which we discuss further. Swedish mobile banking market is mature and advanced and we take the Swedish ratio of relative frequency (1.14x) as a target. We then roughly estimate the negative effect of mobile banking cannibalizing in-house earnings if mobile customers visit branches 12% less frequently. Under our base-case assumption the operating revenue uplift is c0.2-1.2%, which is less than the banks' average estimate, according to the survey (8.5%).

We also consider cost effects arising from migration to cheaper mobile channels and from branch staff reductions. We estimate that the effect of cost reduction ranges between 0.3% and c6% (of total opex) under our base case. Our model shows that mobile banking story is rather about cost reduction as it is the main contributor to earnings enhancement. In total, we estimate 2018E earnings and ROE upside of 9% and 1.4 pct pts for Sberbank and c4% and 0.4 pct pts for VTB, respectively. The difference in results looks quite natural to us, given that Sberbank has a much larger cost base than VTB and has invested a great deal in IT to facilitate the migration to digital channels, while VTB has in contrast plans to expand their branch network. We highlight that this is a rough estimate only (given the assumption of equal distribution of net fees and commissions between channels), but the model still allows to look at the main drivers of the mobile banking earnings enhancement potential

Potential earnings benefit of migrating to mobile channels more pronounced for Sberbank than for VTB

Figure 15: UBS interactive model for estimating mobile banking earnings upside



This interactive model was developed in conjunction with the published report listed above; please reference the report for details on the model's assumptions. The model provides graphical scenario outputs based on changes the user can make to certain inputs. These outputs are hypothetical and do not reflect the research analyst's views, forecasts or valuations. The model is not updated after being first published and therefore may not be current.

This material has been prepared by OOO UBS Bank

Source: UBS research analysis

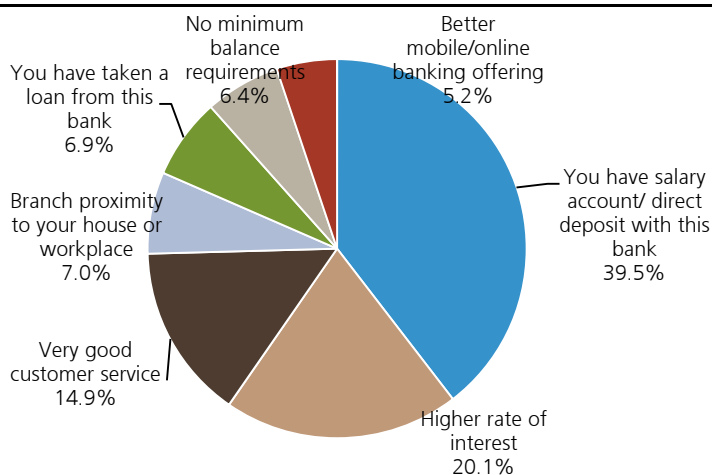
Bank consumer survey

How does digital banking change customers' behaviour and preferences?

The UBS Evidence Lab consumer survey was conducted to get a grasp of mobile users' behaviour and preferences, and to evaluate their experience of mobile banking usage compared with non-mobile users. Evidence Lab surveyed 20,681 respondents who evaluated 206 banks across 18 countries (for methodology details, please see the Appendix), including 1,100 respondents in Russia.

The study shows that remote banking channels are becoming more important in the bank-client relationship. For example, among the **most popular services** used from a primary bank after 'plain vanilla' savings/checking accounts are **online payments and credit cards**, which indicates that digital channels are now playing not just supplementary but rather a leading role in a bank's relationship with a client.

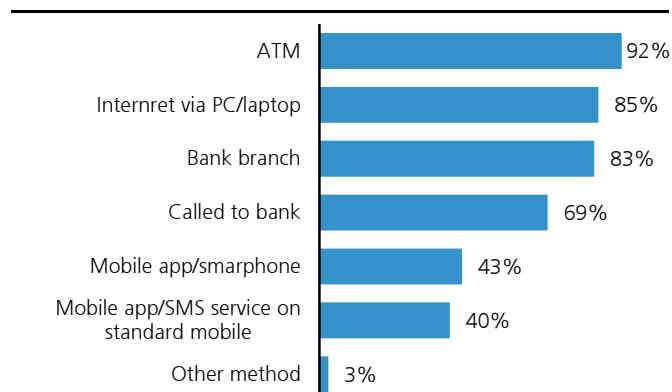
Figure 16: Key reasons (ranked #1) for the choice of a primary bank



Source: UBS Evidence Lab

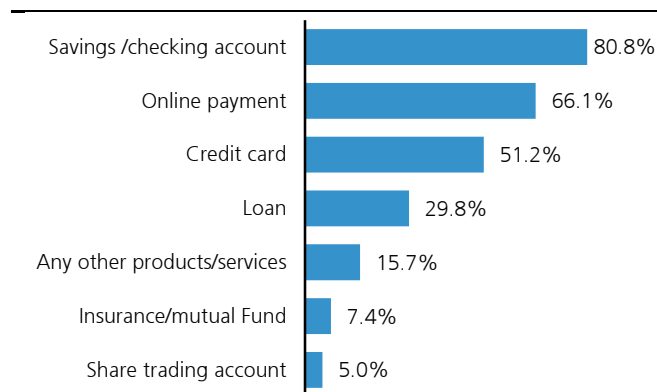
When deciding on a primary bank, the vast majority of survey respondents (40%) 'anchor' their choice to the bank that services their salary account and/or deposit account. Some 20% of respondents pay most attention to pricing factors (e.g., interest rates). Good customer service and better online/mobile banking are important factors in choosing a bank for c15% and 5% of respondents, respectively. Still, as we shall see further on, the desire to switch a primary bank might be facilitated by better services offered, including more advanced online/mobile banking services.

Figure 17: Methods used to interact with bank in Russia



Source: UBS Evidence Lab

Figure 18: Services used from a primary bank in Russia



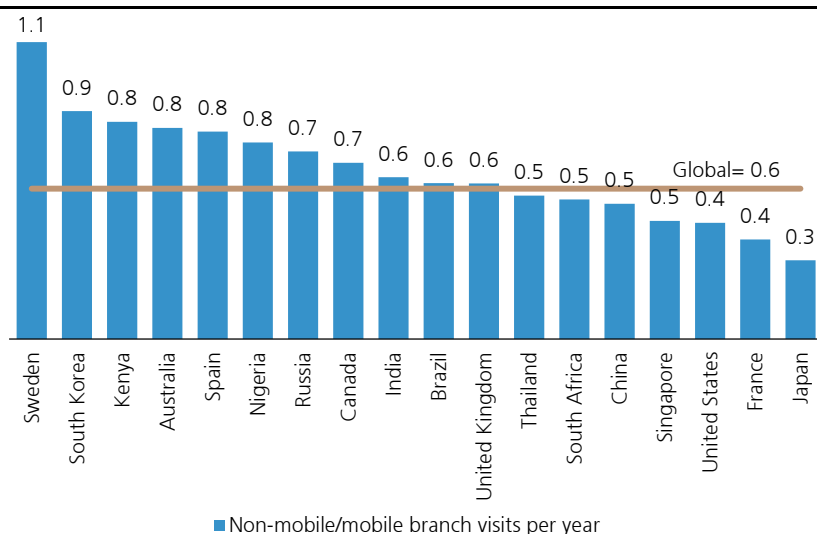
Source: UBS Evidence Lab

From a demographic point of view, quite expectedly, the mobile banking smartphone users ('users') that participated in the survey are generally younger and wealthier, with 52% of users being 18-35 years old (versus 41.3% in the non-users subsample) and 36% stating annual household income above RUB 1m (versus 20.7% among non-users). This might also suggest that users are more active in using financial services, more technologically savvy, and are looking for more personalised service offerings.

Remote channels are used more frequently than traditional branch and ATM visits and phone calls. Some 15% of those customers who use mobile banking apps on their smartphones do this at least once every day and another 56% do this at least weekly. Among internet bank users, c12% make transactions at least once a day and 63% at least once a week. In contrast, only 19% of respondents visit branches weekly or more often.

However, when we estimated the average number of branch visits for purposes other than ATM, we were surprised to find out **that non-mobile banking users in Russia visit branches 28% less often than mobile users**. But this is not just the case in Russia – almost all countries, except for Sweden, showed similar results. This result looks counter-intuitive and difficult to explain. However, we suppose that, since mobile banking is a relatively young banking service, its early adopters are probably those customers who are generally more active in banking services usage. Only Sweden shows a 'normal' relative frequency level, where it is non-mobile customers who visit branches 1.14x more often than mobile customers. The UBS global banking team estimates that Sweden stands out as the most advanced country in terms of mobile banking services, also having the highest mobile app capability (75%; Figure 5). So the Swedish case might suggest that, as mobile banking apps functionality improves and as mobile banking penetration grows over time, customers are more likely to substitute branch visits with digital banking channels, eventually leading to a reduction in the number of branches.

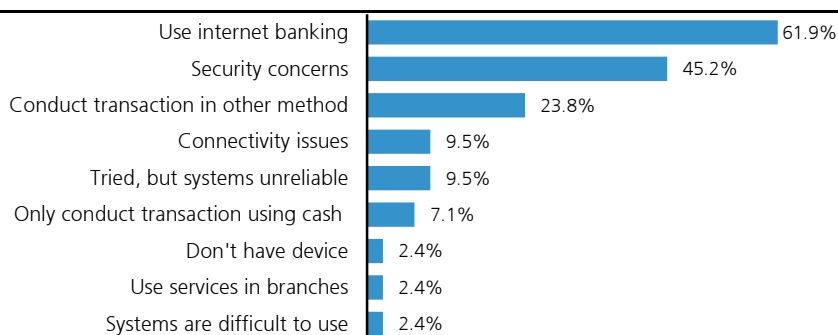
Figure 19: Relative frequency of branch visits for non-mobile customers versus mobile customers



Source: UBS Evidence Lab, UBS research analysis

In order to gauge why some users are reluctant to use mobile banking platforms, the survey asked those who used a mobile banking platform infrequently (less often than once a month) why they did not use it more often. **While digital channels are often associated with lower security, this is only the second most important reason why customers rarely use mobile apps for banking transactions.** The primary reason is that they do the same transactions via online banks. Surprisingly, such problems as connectivity issues and unreliable systems are mentioned by c10% of respondents. This might suggest that banks should put more effort on differentiating and leveraging mobile banking to extract all the benefits it provides. It is worth mentioning Sberbank in this context with its fast reaction to customer needs and its ability to tackle security problems. In order to prevent fraud and ease security concerns, Sberbank has completely rebuilt its Android app in partnership with Goggle, introducing a free in-house anti-virus programme for the smartphone.

Figure 20: Reasons behind less often use of mobile banking



Source: UBS Evidence Lab

How satisfied are customers with their primary bank?

Our customer survey allows us to assess which banks named by respondents as their primary bank are seen as more attractive for both mobile and non-mobile banking customers. We consider the top-10 primary banks named by customers, which together account for 51% of the market (by total assets), and divide them

into three subgroups: (1) state banks – market leaders (Sberbank and VTB Group) and other state banks (Gazprombank (GPB), RSHB); (2) private banks (Promsvyazbank (PSB), Alfa Bank, FC Otkrytie); and (3) foreign banks (Figure 21).

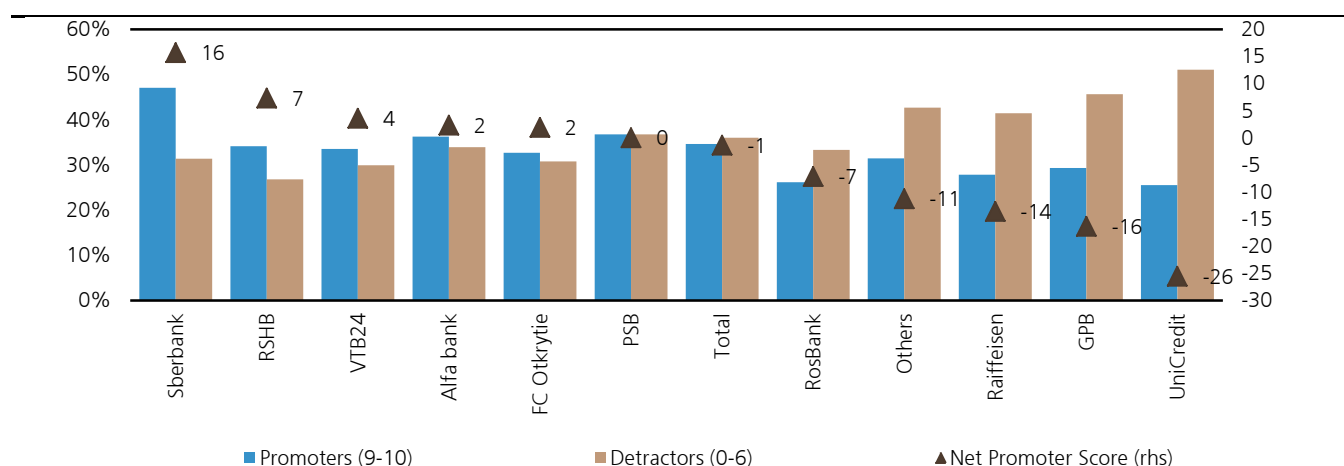
Figure 21: Subsamples of primary banks

	Total assets, market share	Retail deposits, market share
Sberbank	27.7%	41.6%
VTB24	3.4%	8.2%
GPB	6.1%	2.5%
RSHB	2.9%	1.7%
Subtotal	40.1%	54.0%
UniCredit	1.7%	0.6%
RosBank	1.2%	0.9%
Raiffeisen	1.1%	1.5%
Subtotal	4.0%	3.0%
FC Otkrytie	3.0%	0.6%
Alfa	2.5%	2.7%
PSB	1.4%	1.2%
Subtotal	6.9%	4.6%
Total (as % of banking system total assets)	51.0%	61.6%

Source: Interfax, CBR

In terms of customer satisfaction levels, measured as the likelihood that customers would recommend their banks to friends (based on a score of 10-1 where 10 meant 'would definitely recommend'), customers of Sberbank look most satisfied, with 47% of respondents being very likely to recommend the bank to friends. A 'net promoter'¹ scoring system underpins this result: Sberbank gets the highest net promoter score (NPS) of 16. At the other end of the scale stand foreign banks with NPS below the average of -1.4%, with UniCredit being the clear laggard in that respect (NPS -26). VTB24 looks good among the peers, though RSHB gained a NPS of 7.

Figure 22: Recommendation of a primary bank



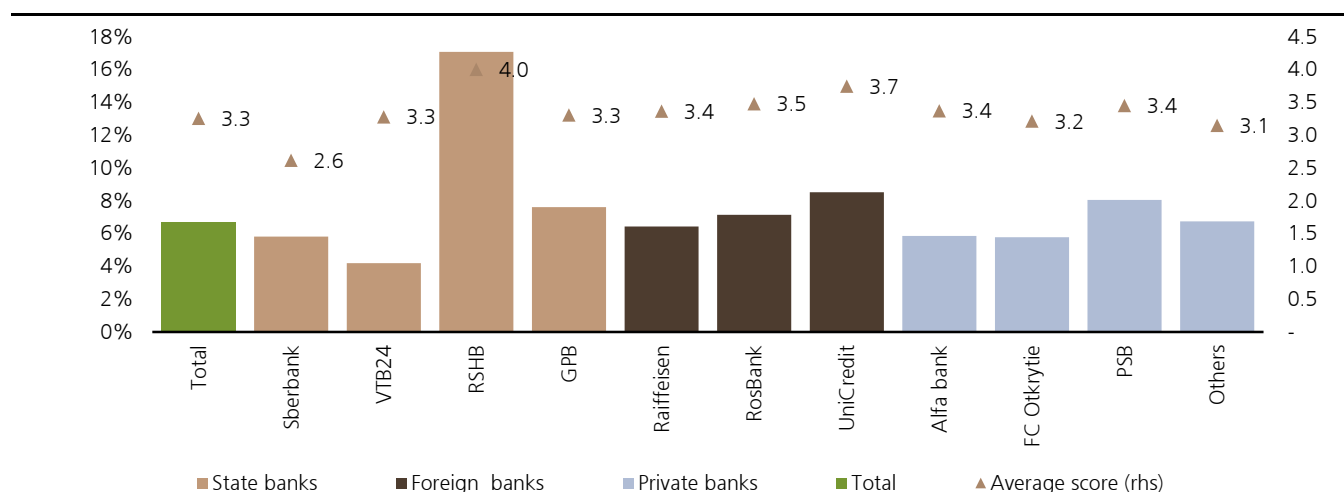
Source: UBS Evidence Lab (base: all respondents)

¹ A net promoter score (NPS) is based on allocation of those who chose 10-9 to the "promoter" basket, those with scores 8-7 to "passives" and 6-0 to "detractors". NPS is calculated as the ratio of (promoters - detractors) to (promoters + passives + detractors)*100.

Another measure of loyalty – the likelihood to change the primary bank (10-1 scoring system, with 10 standing for 'will definitely change') – again shows that Sberbank stands out as a clear leader. VTB24 and FC Otkrytie also do well, showing scores in line with or below peers. Foreign banks are losing ground on that score, posting results slightly above the average (3.3). At the same time, contradictory to the previous result on high NPS score, clients of RSHB are more inclined to change their primary bank.

Among the key reasons behind the decision to switch the bank, the mobile banking quality is ranked #1 or #2 by 14% of respondents. The most important factors influencing the decision are those related to (1) pricing ('more attractive interest rate from competitors' – 61.4% of all respondents ranked it #1 or #2; 'lower fee/lower transactional fee from competitors' – 43.6%); and (2) the overall quality of service ('poor or bad service, experience with current bank' – 35.8%). In general, while customers of Sberbank and VTB are mostly concerned about interest rates and fees (more than the total average), clients of other state banks (GPB and RSHB) and some foreign banks (Raiffeisen and UniCredit) are looking for better mobile banking services and/or a better customer experience.

Figure 23: Likelihood to change the primary bank, top 3 box (scores 8-10 – most likely) and average score



Source: UBS Evidence Lab (base: all respondents)

When we compare mobile and non-mobile banking customers (Figure 25), we see that the former (naturally) pay more attention to mobile banking services and transaction fees. We would also note that, for mobile banking users, branch proximity is a less important factor than for non-users. This appears natural because mobile banking customers are less dependent on branches, but it also underpins our view that mobile banking could trigger further branch reductions.

Figure 24: Most important factors for switching the primary bank

	Total	Sberbank	VTB24	GPB	RSHB	Raiff-eisen	Rosbank (SocGen)	UniCredit	Alfa bank	FC Otkrytie	PSB	Others
More attractive interest rates from competitors	61.4%	67.4%	70.1%	51.1%	53.7%	59.3%	73.8%	44.7%	58.5%	55.8%	58.6%	68.5%
Proximity of branches of competitors	15.0%	15.7%	9.6%	14.1%	14.6%	15.0%	14.3%	21.3%	15.8%	17.3%	19.5%	15.7%
Poor/bad service, experience with current bank	35.8%	35.5%	26.9%	40.2%	36.6%	40.0%	28.6%	29.8%	39.2%	32.7%	44.8%	37.1%
Better quality of mobile banking services from competitors	14.0%	13.4%	8.4%	19.6%	19.5%	20.0%	7.1%	21.3%	13.5%	13.5%	9.2%	12.4%
Lower fee from competitors	43.6%	43.0%	52.7%	43.5%	36.6%	32.9%	52.4%	61.7%	48.0%	46.2%	36.8%	30.3%
Better reward programmes from competitors	24.4%	20.9%	30.5%	18.5%	36.6%	27.1%	19.0%	19.1%	19.9%	28.8%	25.3%	27.0%
Other factor	5.6%	4.1%	1.8%	13.0%	2.4%	5.7%	4.8%	2.1%	5.3%	5.8%	5.7%	9.0%

Source: UBS Evidence Lab

Note: Cells represent the percentage of respondents who ranked the factor #1 and #2; highlighted dark within the category are cells with top-3 max values

Mobile banking users are more active and ... mobile

Comparing the attitude of mobile and non-mobile banking customers towards their primary bank, we see that while the former are more likely to recommend their primary bank to their friends, they are also more willing to switch the bank. Rosbank (SocGen), however, seems to be an exception from the rule, showing quite the opposite.

Figure 25: Difference between mobile banking users and non-users

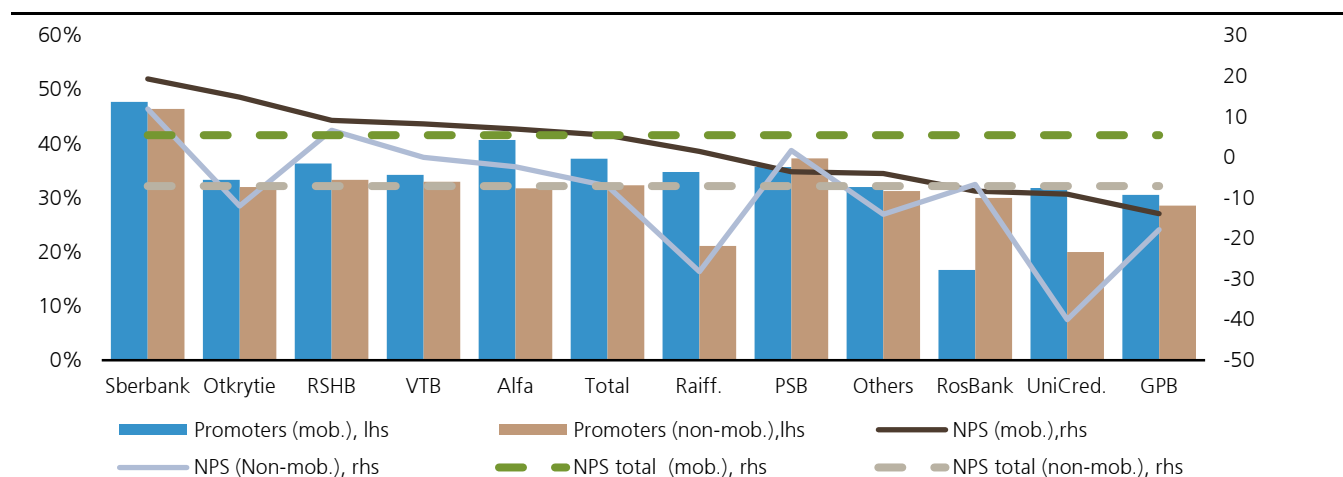
	Total mobile cust.	Total non-mobile cust.	Diff.	Sberbank	VTB24	GPB	RSHB	Raiff-eisen	Rosbank	UniCredit	Alfa Bank	FC Otkrytie	PSB	Others
More attractive interest rates from competitors	61.4%	61.8%	-0.4%	-3.1%	9.4%	16.5%	13.6%	-2.6%	-21.7%	10.0%	-10%	7.3%	-7.4%	-6.3%
Proximity of branches of competitors	14.5%	15.6%	-1.1%	-4.2%	-4.9%	-9.5%	17.3%	7.6%	15.0%	-14.4%	-3.7%	2.5%	2.8%	0.4%
Poor or bad service, experience with current bank	35.0%	36.8%	-1.7%	-0.5%	-1.6%	-11.3%	12.1%	-1.7%	18.3%	-13.3%	7.7%	-14.1%	-8.2%	-7.1%
Better quality of mobile banking services from competitors	15.3%	12.8%	2.5%	0.5%	-2.7%	-4.8%	-1.8%	9.1%	1.7%	2.7%	8.0%	-4.9%	2.2%	5.1%
Lower fee/lower transactional fee from competitors	45.1%	42.4%	2.7%	9.6%	-6.0%	10.7%	12.1%	-4.8%	-3.3%	12.2%	-5.2%	4.1%	14.2%	-3.3%
Better reward programmes from competitors	23.7%	25.0%	-1.4%	-3.3%	9.0%	10.7%	-50.0%	-4.9%	-3.3%	6.7%	-0.2%	1.6%	-11.0%	1.4%
Other factor	5.0%	5.6%	-0.6%	1.0%	-3.2%	-12.3%	-3.3%	-2.7%	-6.7%	-4.0%	3.4%	3.4%	7.3%	9.8%

Source: UBS Evidence Lab, UBS research analysis

Note: Highlighted dark within the category are cells with top-3 max values; highlighted green are cells with top-3 min values

We think the primary reason behind the general trend is that mobile banking users are younger (c52% are aged 18-35 versus 41.3% in the non-users group), thus have fewer ties with a particular banking brand, and are probably more technologically savvy and mobile. In the case of Rosbank, the very same reason – the age of the group – may explain why it deviates from the common pattern. While 50% of Rosbank mobile customers who participated in the survey are aged 18-34, among non-mobile banking customers of Rosbank this share is higher and reaches 60%.

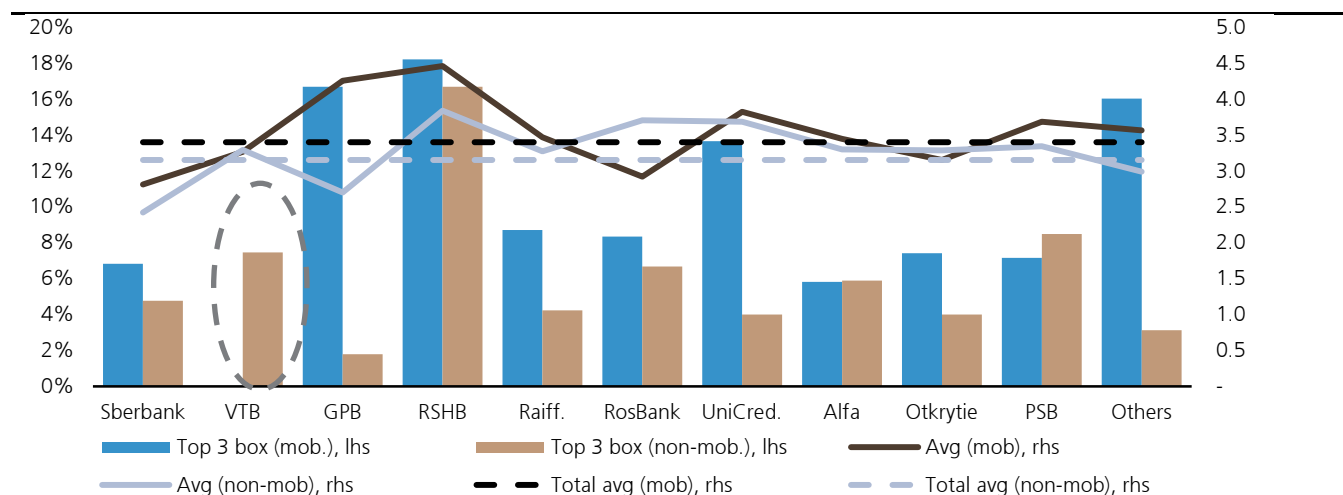
Figure 26: Recommendation of a primary bank by users and non-users of mobile banking



Source: UBS Evidence Lab, UBS research

Importantly, the survey suggests that mobile banking might be useful in improving retention rates and loyalty. We find this view justified by the case of foreign banks as we observe a big difference in attitude towards the primary bank between the two groups of customers for Raiffeisen and UniCredit. In both cases, mobile banking customers are much more likely than non-mobile customers to recommend the bank to friends (with NPS differences reaching c30 and 31 pct pts, respectively). VTB is another interesting case in the sense that users of mobile banking are reluctant to switch from the bank – nobody in the group of VTB customers displayed a strong (scores 9-10) desire to change the bank.

Figure 27: Likelihood to change the primary bank by users and non-users of mobile banking



Source: UBS Evidence Lab, UBS research

Comparing Russia with other countries, Russian banks show above-average levels of customer satisfaction but the readings are almost in line with those for Brazil, while the difference in NPS between mobile and non-mobile customers is above that in Brazil. This might suggest an opportunity for Russian banks to improve customer satisfaction by leveraging customer advocacy benefits, which typically lead to higher uptake of mobile banking services and thus cost savings.

Figure 28: Customer satisfaction – based on 'recommending your bank to a friend'

Country	Mobile customer 'recommend to a friend' score	Non-mobile customer 'recommend to a friend' score	'Recommend to a friend' difference	Mobile net promoter score	Non-mobile net promoter score	Net promoter difference
Japan	5.2	4.5	0.7	-70	-82	11.8
China	7.0	6.3	0.7	-9	-35	26.3
Thailand	6.9	6.2	0.6	-17	-33	16.2
United Kingdom	7.5	6.8	0.6	6	-10	16.0
South Korea	6.2	5.6	0.6	-45	-60	15.4
India	8.0	7.4	0.6	30	11	19.5
Spain	6.2	5.6	0.6	-35	-47	12.1
South Africa	7.7	7.2	0.5	22	3	19.0
Kenya	7.7	7.2	0.5	18	7	11.3
Global	7.1	6.6	0.5	-3	-17	14.1
Nigeria	8.2	7.7	0.4	36	23	13.0
Russia	7.4	7.0	0.4	5	-7	12.0
Singapore	6.8	6.4	0.3	-21	-33	12.5
Brazil	7.4	7.2	0.2	10	4	5.4
Canada	7.3	7.1	0.2	3	4	-1.0
Australia	7.1	7.0	0.1	-8	-6	-1.5
United States	7.8	7.7	0.1	19	20	-1.5
Sweden	6.7	6.6	0.0	-14	-11	-2.4
France	6.6	6.5	0.0	-26	-23	-3.1

Source: UBS Evidence Lab, UBS research analysis

The likelihood of switching the bank among Russian customers is above the average across the countries but lower than for BRIC peers.

Figure 29: Likelihood of customers to change bank – by country

Country	Mobile customer 'likelihood to change bank' score	Non-mobile customer 'likelihood to change bank' score	'Likelihood to change bank' difference
India	4.6	3.4	1.2
United States	3.6	2.6	1.1
France	3.6	2.7	0.8
Brazil	3.5	3.0	0.5
United Kingdom	3.3	2.8	0.5
Canada	2.5	2.0	0.5
Japan	2.7	2.3	0.5
Global	3.3	2.8	0.5
Australia	2.6	2.2	0.4
Thailand	3.5	3.1	0.4
China	3.6	3.3	0.3
South Korea	3.8	3.5	0.3
Singapore	3.1	2.8	0.3
Russia	3.4	3.1	0.2
Sweden	2.6	2.4	0.2
Spain	3.6	3.4	0.2
South Africa	2.6	2.5	0.1
Kenya	2.9	2.9	0.0
Nigeria	2.5	2.5	0.0

Source: UBS Evidence Lab, UBS research analysis

Thus, given that customers apparently have not cemented their relationship with their primary bank, stronger players in Russian banking, such as Sberbank, could be able to enhance their position by offering more advanced services and winning customers from competitors.

Case study: Russian banks' app downloads and ranks – Sberbank in top position

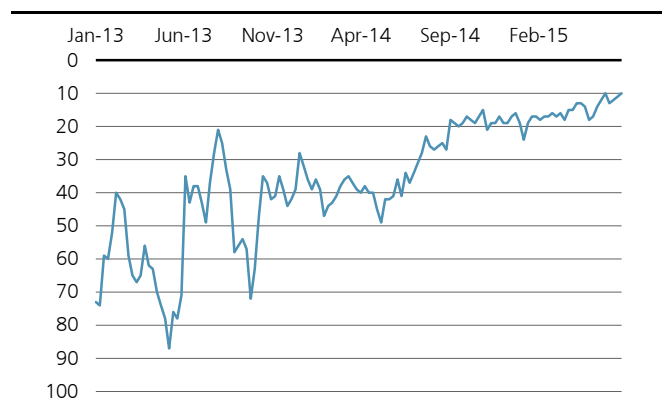
Attempting to get an insight into the popularity of mobile banking applications, as well as tracking the progress of banks in their transition to mobile banking, the UBS Evidence Lab team looked at iOS rankings of 15 mobile banking apps across the Russian banking universe. **The findings of the analysis confirm Sberbank as leading the transition to mobile banking** among Russian banks. Only Sberbank's mobile app is popular enough to consistently feature in the top-500 of all downloaded apps in Russia over the past three years, and has recently reached a top-10 rank (Figure 31).

Figure 30: Relative share of downloads among banks, January 2014 – June 2015

	Jan-14	Jun-14	Jan-15	Feb-15	Mar-15	Apr-15	May-15	Jun-15
Sberbank	77%	70%	77%	75%	74%	74%	74%	75%
VTB 24	6%	7%	6%	7%	7%	7%	7%	7%
Alfa bank	9%	12%	6%	6%	7%	6%	6%	6%
Tinkoff	4%	4%	3%	4%	3%	3%	3%	3%
Raiffeisen	2%	3%	2%	2%	2%	2%	2%	2%
Rosbank (SocGen)	0%	0%	0%	0%	1%	2%	2%	2%
Bank of Moscow	0%	0%	2%	2%	2%	1%	1%	1%
PSB	1%	2%	1%	1%	1%	1%	1%	1%
Gazprombank	1%	1%	1%	1%	1%	1%	1%	1%
FC Otkrytie	0%	0%	1%	1%	1%	1%	1%	1%
RSHB	0%	0%	0%	0%	0%	0%	0%	0%
<i>Total mobile banking apps downloads growth, y/y</i>			60%	80%	70%	90%	90%	100%

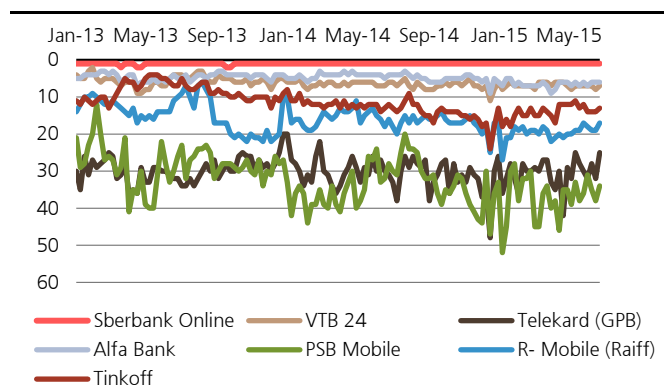
Source: UBS Evidence Lab, Sensor Tower

Figure 31: iPhone rankings, all applications RU - Sberbank



Source: UBS Evidence Lab, Sensor Tower, UBS research analysis

Figure 32: iPhone rankings, finance category – RU banks



Source: UBS Evidence Lab, Sensor Tower, UBS research analysis

Another way of looking at the development of mobile banking platforms is to compare banks' relative market share in terms of app downloads with their relative share in deposit markets. On this score, Sberbank again takes the lead as its mobile download share exceeds its relative deposit share by 10 pct pts. This does not come as a surprise to us because Sberbank claims the largest number of retail deposit holders (over 100m people) and could be considered a 'people's bank', which may explain such a high download market share. Other state banks, while among the top-10 in the total deposit market, are clear laggards, with VTB24's (VTB Group's retail subsidiary) relative app download market share 6 pct pts below

its relative deposit market share. Our analysis confirms that mobile banking may not just be a supplementary but rather a primary leg of retail banking, as vindicated by the Tinkoff Bank case, a pure online retail monoliner, whose relative mobile app download market share is 3 pct pts above its relative deposit market share.

The cross-read of this analysis for mobile banking revenue enhancement potential is that the leading position of Sberbank's mobile app makes it an attractive advertiser for third parties. Given decent advertisement conversion rates, we see potential for Sberbank to generate additional revenue streams from advertising facilities of mobile banking apps.

Figure 33: Relative market shares

	Mobile app downloads, relative market share	Deposits, relative market share	Delta
Sberbank	75%	65%	10%
Tinkoff	3%	0%	3%
Alfa bank	6%	4%	2%
Rosbank (SocGen)	1%	1%	0%
Raiffeisen	2%	2%	0%
Bank of Moscow	2%	2%	-1%
PSB	1%	2%	-1%
FC Otkrytie	1%	3%	-2%
RSHB	0%	3%	-2%
Gazprombank	1%	4%	-3%
VTB 24	7%	13%	-6%

Source: UBS Evidence Lab, Sensor Tower

We have also looked at research on Russian mobile banking apps recently published by Marksw Webb Rank & Report. The company surveyed internet users and banking customers, and tested mobile banking apps of Russian banks on their functionality and usability. According to its findings, the Tinkoff app has held absolute leadership positions across all mobile platforms (iOS, Android and Windows Phone) for the third year in a row. Sberbank has shown a big improvement and now ranks among the top-4 on almost all platforms (top-3 for iOS). The most prominent result in terms of banking apps for Android – the most popular platform in Russia – is Sberbank whose mobile application has gained 14 ranks over the year to become a top-4 app (moving 5 positions up to top-3 in iOS ranking). This suggests that Sberbank's IT investments start to pay off.

Mobile banking strategy can contribute to operation/cost optimisation

We see Sberbank as a key beneficiary of the mobile banking strategy, as it provides opportunities to reduce its legacy of the largest branch network in the country. We think growing mobile banking penetration and transaction migration from traditional to digital channels could lead to further optimisation of Sberbank's branch footprint (from currently almost 17,000), as well as lowering the cost of the banking transaction business. We should, however, note that we do not consider the socio-economic consequences here.

We think Sberbank is well positioned to cut its operating expenses further, for the following reasons:

- (1) Considerable investments in IT (2014: RUB 65bn, or 5% of pre-provision profit (PPP) provide substantial cost-cutting upside once these technology investments start to pay off.

- (2) Sberbank aims to reduce its network by 3,000 branches (currently: 16,974) by 2017. We think mobile banking penetration, which we expect to double on a three-year horizon, could allow to further optimize branch footprint; UBS is ~850 branches.
- (3) Sberbank's operating cost basis relative to its average assets looks high compared with VTB, the second-largest bank in Russia, with cost/TA 2014 at 2.8% versus 2.3%, respectively (2015E: 2.6% versus 1.9%, respectively). It is also above the level of CEE peers, such as RBI and Erste and banks in Poland, where mobile banking has already gone mainstream (see the Appendix for an EM EMEA peer comparison table). This underpins our view that Sberbank is likely to benefit in particular from mobile banking, as the migration of transactions to less costly remote channels should bring its cost base and cost/TA ratio down to peer levels.

Bottom line: We believe that the cost-cutting and revenue opportunities arising from growing mobile banking penetration, and Sberbank's commitment to advancing in digital banking, are not yet priced in. This makes Sberbank an attractive mobile banking play, in our view. According to research by the UBS global banking team (see Q-series® on *Mobile Banking: Is a Bank in Your Pocket The Next Big Thing?* by Philip Finch and Peter Carter et al., 7 July 2015), Sberbank ranks among the top-30 (#26 out of 88 banks) of emerging markets banks best placed to benefit from expansion in the mobile banking industry.

Will mobile banking trigger changes in the Russian banking landscape?

Our answer is: most likely YES, but we think digital banking is more a facilitator of change than the core driver. The most vulnerable players are likely to be those that are unable to cope with the growing demand for better online/mobile services. We think state banks other than Sberbank and VTB are among the challenged players. Foreign banks might also face difficulties in light of business descaling and cost-cutting which could militate against additional IT spending on online/mobile banking infrastructure. In this section we consider the development of Sberbank's mobile and internet banking strategy, and benchmark it against the positions of other players.

Digital banking more a facilitator of change than a key driver, in our view

Debate #1: Are there opportunities for Sberbank to further strengthen its position?

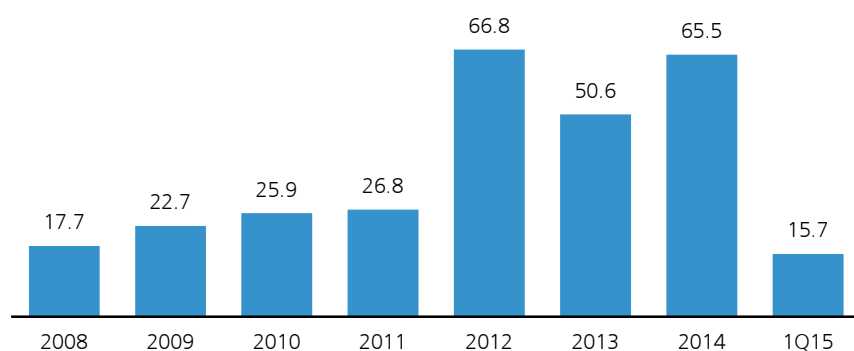
We think so. Sberbank has become one of the leading Russian players in terms of IT development, 'Big Data' collection, operation and usage. Deputy chairman Lev Khasis² says Sberbank is now positioning itself in essence as 'an IT company with a banking licence, while the physical branch network acts as an interface, supplementing the opportunities of the bank's remote channels'.

Sberbank now positioning itself as 'an IT company with a banking licence'

In 2014 the bank started to implement its 2015-18 Technological Development Strategy aimed at simplifying its IT landscape, centralizing and enhancing the reliability of its IT systems, and further developing its remote banking channels. It also made major improvements to its Sberbank Online and Sberbank Mobile services, with Sberbank Online gaining recognition as the best online retail bank in Russia and CEE, according to Global Finance magazine.

Sberbank employs 10,000 IT specialists in-house and has significantly increased its IT budget over the last two years, spending RUB 65bn (USD 1.7bn) on IT in 2014, +18% y/y), or 5% of pre-provision profit (PPP)– more than "Russian Google" internet company Yandex.

Figure 34: Sberbank IT expenditure, 2008-14 (RUB bn)



Source: Sberbank

² Interview to www.rbc.ru

Sberbank has the highest levels of customer satisfaction, according to the Evidence Lab consumer survey (with a net promoter score of 16 – well above the average of -1.4), and the lowest churn rate (as measured by likelihood to change primary bank) both among mobile and non-mobile banking customers.

In the Evidence Lab consumer survey, 40% of respondents said they choose their primary bank because they either have their deposit account there or have their salary paid into an account there. Since **Sberbank is the #1 Russian bank by retail deposits (45% market share) and payroll clients (48% market share as of 2014)**, it is naturally well-positioned to be chosen as a primary bank.

In addition, legislation liberalizing payroll accounts came into force in November 2014, allowing employees to choose for themselves the bank into which their salary is paid. According to research conducted by Superjob.ru, one of the largest online career portals in Russia, 29% of employees were willing to change their payroll bank (though only 9% did so in 1H15) while over 50% were reluctant to do so. We believe this might further strengthen Sberbank's positions since it has long-established expertise and is considered to be a 'safe-haven' bank by many customers.

Sberbank well placed to benefit from payroll account liberalization

Debate#2: Weakening positions of foreign players and some state banks allowing stronger players to gain market share

We believe foreign banks have been cutting back their business investments, which, together with the tough macro situation, is likely to weaken their competitive position. The weakening positions of these foreign players as well as of some state banks should allow Sberbank and some private domestic banks to grow their retail businesses by gaining market share, despite the challenging macro environment.

As we have shown above, the Evidence Lab consumer survey results indicate that some state banks (other than Sberbank and VTB) and foreign banks have low customer satisfaction levels (net promoter scores for Gazprombank, UniCredit, Raiffeisen and Rosbank being -16, -26, -14 and -7, respectively – significantly below the average of -1.4).

Some foreign banks are restructuring or scaling down their Russian operations. For example, having suffered a loss of €493m last year, Raiffeisen is rescaling its Russian business alongside its activities in other markets (Asia, the US, CEE), aiming to raise its CET1 capital from 10% to 12% by end-2017. For RBI, Russia is no longer a priority market and the bank plans to reduce RWA by 20%. In addition, foreign banks' corporate clients are also reducing their exposure to Russia, putting additional pressure on their Russian financial services providers.

Weakening positions of some foreign and state banks should allow Sberbank and others to gain retail market share

Figure 35: Likelihood of customers to change bank – by bank

	Mobile customer "likelihood to change bank" score	Non-mobile customer "likelihood to change bank" score	"Likelihood to change bank" difference
Gazprombank	4.3	2.7	1.6
RSHB	4.5	3.8	0.6
Others	3.6	3.0	0.6
Sberbank	2.8	2.4	0.4
PSB	3.7	3.3	0.3
Raiffeisen	3.5	3.3	0.2
Alfa bank	3.4	3.3	0.1
UniCredit	3.8	3.7	0.1
VTB	3.3	3.3	(0.0)
FC Otkrytie	3.1	3.3	(0.1)
Rosbank (SocGen)	2.9	3.7	(0.8)
Total	3.4	3.1	0.2

Source: UBS Evidence Lab, UBS research analysis

State banks such as Gazprombank and RSHB have low customer satisfaction levels, especially among younger and more active customers who use online/mobile banking technologies. They have the highest scores of 'likelihood to change bank' among mobile banking users, with Gazprombank having the biggest difference in score between users and non-users of mobile banking – 1.6 points. (vs. 0.2 on average).

The cases of Raiffeisen and UniCredit, which have the largest differences in net promoter score between mobile and non-mobile banking customers, illustrate that a well-implemented mobile banking strategy could substantially improve customer satisfaction levels. However, we think investment cuts could weaken foreign

players' positions, and especially at a time when Sberbank is making huge IT investments. This analysis also shows that Gazprombank's retail franchise is at risk, as the bank has one of the lowest net promoter scores in both customer categories, with a small difference between groups, which indicates that its mobile banking strategy lacks the power to drive changes in customer perception.

Figure 36: Customer satisfaction – based on "recommending your bank to a friend"

	Mobile customer "recommend to a friend" score	Non-mobile customer "recommend to a friend" score	"Recommend to a friend" difference	Mobile net promoter score	Non-mobile net promoter score	Net promoter difference
PSB	6.9	7.0	-0.2	-3.6	1.7	(5.3)
Rosbank (SocGen)	6.9	6.9	0.0	-8.3	-6.7	(1.7)
RSHB	7.3	7.2	0.1	9.1	6.7	2.4
Gazprombank	7.0	7.0	0.0	-13.9	-17.9	4.0
Sberbank	7.6	7.6	0.0	19.3	11.9	7.4
VTB	7.7	7.3	0.4	8.2	0.0	8.2
Alfa bank	7.5	7.3	0.1	7.0	-2.4	9.3
Others	6.9	6.8	0.1	-4.0	-14.1	10.1
FC Otkrytie	7.6	7.3	0.3	14.8	-12.0	26.8
Raiffeisen	7.4	6.9	0.5	1.4	-28.2	29.6
UniCredit	7.3	6.6	0.6	-9.1	-40.0	30.9
Total	7.4	7.0	0.4	5.4	-7.1	12.5

Source: UBS Evidence Lab, UBS research analysis

Bottom line: The restructuring processes that foreign banks are undergoing, and the low customers satisfaction levels of some state banks (RSHB, GPB), in our view create an opportunity for Sberbank and some other large market players, including VTB and private domestic banks (such as Alfa Bank, FC Otkrytie and pure-online retail monoliner Tinkoff) to gain share in the retail segment. We would highlight that Sberbank is particularly well-positioned to leverage further its retail franchise given the scope of its IT investment.

Appendix

1: Methodology

For this report, UBS Evidence Lab conducted three surveys: a consumer survey, a survey of banks' management teams or decision-makers (bank management survey) in the mobile banking space, and a mobile app download survey.

UBS Evidence Lab consumer survey

The UBS Evidence Lab consumer survey was sent out via an online methodology to a representative selection of adult consumers (18+ years of age) across Russia in April-May 2015. In total c1,100 respondents completed the survey. The qualification criteria were based on holding a bank account with one of the banks in the survey. Sampling focused on providing a sufficient base size for the key banks, which included Sberbank, VTB Group, Gazprombank, RSHB, Alfa Bank, FC Otkrytie, Promsvyazban, and the Russian subsidiaries of UniCredit, Raiffeisen and SocGen (Rosbank). The margin of error for whole-sample responses is +/-3.1.

UBS Evidence Lab bank management survey

The UBS Evidence Lab bank management survey was sent out via an online methodology to a selection of banks across Russia in May-June 2015. Of the nine banks approached, three responded, accounting for 45% of total assets and 52% of the retail deposit market, giving a response rate of 33%. The survey was conducted both in English and Russian on an anonymous basis.

UBS Evidence Lab mobile app download analysis

UBS Evidence Lab tracks daily rankings for thousands of mobile applications in the iOS store across more than 50 countries. It also monitors mobile application reviews and ratings. Data presented in this report is current as of the last week of June. For this report, UBS Evidence Lab calculated the share of app downloads in the finance category by country. This metric provides us with a benchmark for understanding the relative traction of mobile banking apps by country.

2: Costs to average total assets

Figure 37: EMEA peer group– costs/average total assets

Company	Mkt cap	Costs/average total assets				
	US\$m	2014	2015E	2016E	2017E	2018E
Russia						
Sberbank	29,560	2.8	2.6	2.6	2.6	2.5
VTB	16,692	2.3	1.9	1.8	1.7	1.6
Median		2.5	2.2	2.2	2.1	2.1
Georgia						
Bank of Georgia Holdings PLC	1,056	3.7	4.0	3.7	3.6	3.4
TBC Bank JSC	502	4.4	3.9	3.7	3.6	3.4
Median		4.0	3.9	3.7	3.6	3.4
Kazakhstan						
Halyk bank	2,1254	2.1	2.1	2.1	2.1	2.0
Poland						
PKO BP	9,941	2.5	2.1	1.9	1.9	1.9
Pekao	11,396	2.1	2.0	1.9	1.8	1.8
BZ WBK SA	7,717	2.6	2.2	2.1	2.0	2.0
Median		2.5	2.1	1.9	1.9	1.9
CEE3						
OTP	5,591	3.9	3.5	3.4	3.2	3.0
Komercni	8,572	1.5	1.5	1.4	1.3	1.3
RBI	4,483	2.4	1.9	1.7	1.6	1.6
Erste	12,987	1.9	1.9	1.9	1.9	1.9
Median		2.2	1.9	1.8	1.8	1.7
Turkey						
Akbank	11,101	1.9	1.9	1.8	1.7	1.7
Garanti Bank	12,782	2.3	2.3	2.3	2.2	2.2
Halkbank	5,704	2.0	2.1	2.0	2.0	2.0
Isbank	9,154	2.5	2.4	2.3	2.3	2.3
Vakifbank	3,800	2.1	2.1	2.1	2.1	2.1
Yapi Kredi Bank	6,137	2.4	2.3	2.3	2.2	2.1
Turkey Median		2.2	2.2	2.2	2.1	2.1
South Africa						
Barclays Africa	13,168	3.8	3.8	3.8	3.8	3.8
Capitec Bank	4,348	7.7	8.1	7.9	8.6	8.9
FirstRand Ltd	25,374	3.8	3.8	3.8	3.7	3.7
Investec	8,596	2.7	2.9	2.9	2.9	3.0
Nedbank	9,725	3.2	3.2	3.1	3.1	3.0
Standard	20,569	0.0	0.0	0.0	0.0	0.0
SA Median		3.5	3.5	3.5	3.4	3.4
EM EMEA Median		2.5	2.3	2.3	2.2	2.1
Latin America						
Banco do Brasil	19,856	3.2	3.1	3.0	3.0	2.9
Bradesco	44,447	4.0	3.9	3.8	3.7	3.7
Itau Unibanco	58,908	3.7	3.6	3.6	3.5	3.5
Santander Brasil	20,087	4.4	4.0	3.8	3.8	3.8
Banorte	15,116	2.8	2.6	2.6	2.5	2.5
Inbursa	15,374	2.0	2.0	1.9	2.0	2.2
Santander Mexico	12,445	2.7	2.5	2.3	2.2	2.1
LATAM Median		3.5	3.4	3.3	3.3	3.2

Source: UBS research analysis

Statement of Risk

The key risks relate to the macro outlook, and the depth and duration of the slowdown in Russian economic growth, RUB exchange rate (affected by oil price and capital outflow), as well as asset quality in the banking sector. Given state ownership both banks are subject to corporate governance risks.

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Neutral	FSR is between -6% and 6% of the MRA.	42%	32%
Sell	FSR is > 6% below the MRA.	13%	20%
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Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	less than 1%	less than 1%
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Source: UBS. Rating allocations are as of 30 June 2015.

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Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
Sberbank ^{4, 5, 18}	SBER.MM	Buy	N/A	RBL72.70	23 Jul 2015
Sberbank Preference ^{4, 5, 18}	SBER_p.MM	Buy	N/A	RBL50.76	23 Jul 2015
VTB ¹⁸	VTBR.MM	Sell	N/A	RBL0.07	23 Jul 2015

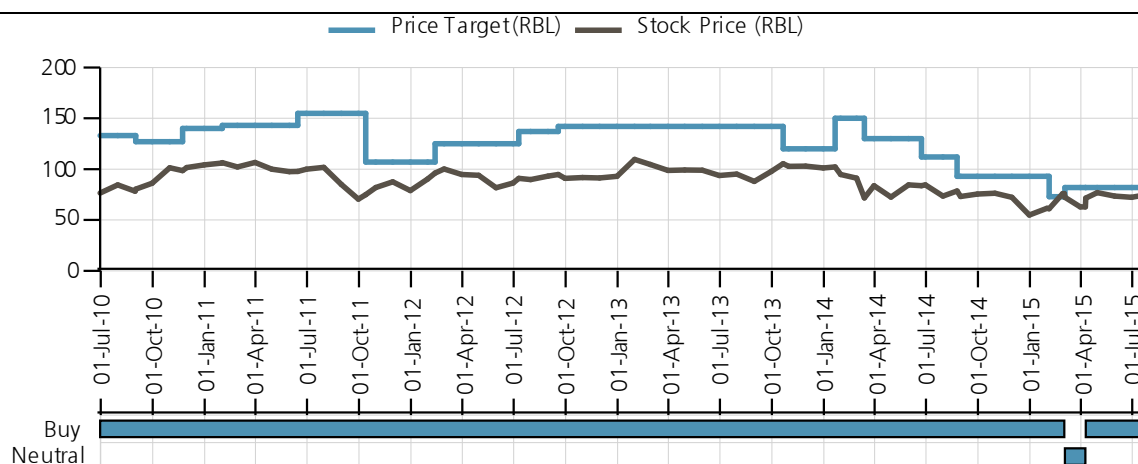
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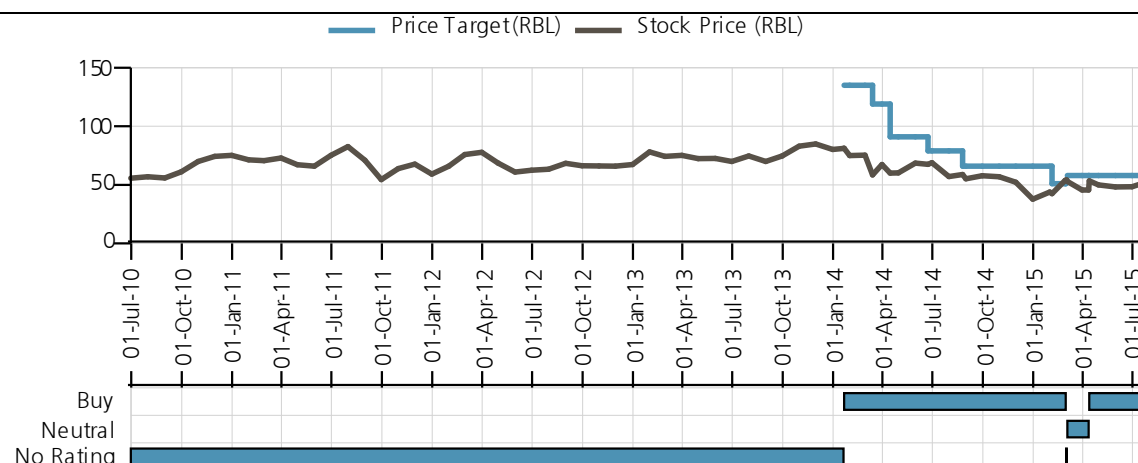
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Sberbank (RBL)



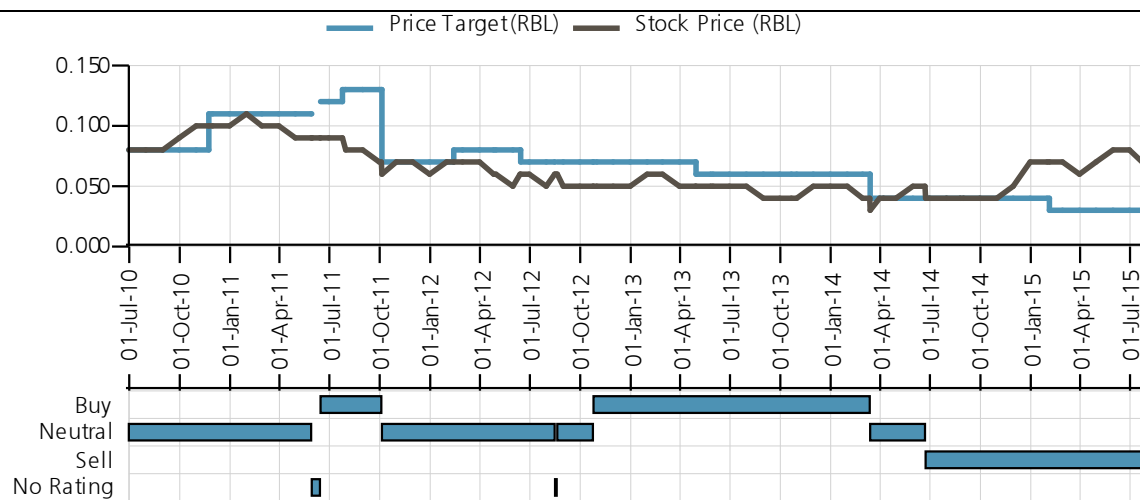
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VTB (RBL)



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