Profitability is going to be a bigger issue than ever for banks

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It's strange to think that only a few weeks ago banks were digging in their heels about paying 2019 dividends. How times change. Yesterday HSBC laid out starkly the challenge facing the sector, with first-quarter profits down by half, bad debt provisions up fivefold and a warning that profits would be "materially lower" this year.

Regulators rightly dismissed the lobbying about dividends on the grounds that banks needed to conserve capital to fight the damage to the economy caused by the pandemic. But thinking about how to get back to normal, to a time when dividends can be paid, is very important for banks.

Moreover, the task is huge because banks have to do much more than return to the status quo. Ever since the financial crisis, big lenders have been in near-constant restructuring mode, first to deal with existential emergencies, then to find ways to achieve a basic goal — profitability above their cost of capital and at a level that is attractive for investors. Most attempts have fallen well short.

And all that has been during a long period of economic stability, low unemployment and negligible bad debts. It seems almost impossible to imagine how banks will manage to claw their way back and then go further to reach those lands of profitability that their investors yearn for. The task will be all the harder as banks have had to suspend their restructuring programmes while they fight the impact of the pandemic.

Their action plan will need to be made up of capital, revenues and costs. Then there are the more elusive factors, such as how the pandemic will change everyone's behaviour, including how they bank.

Regulators' insistence on banks building up billions of pounds in capital in the past 12 years is one of the biggest reasons for their lacklustre profits. The business of banking has become far more expensive than it was before the coronavirus outbreak. Banks have been told to draw on their capital buffers to pump funds into the economy now, but in the same breath the guidance has been that the capital will have to be built up again. Some analysts believe that total capital levels will be pushed even higher in future.

Revenues also do not look like a promising source of greater profitability at a time when companies and individuals will need some time to get over the virus. One possibility for the big banks that hope to be left standing relatively intact might be that smaller rivals, especially those outside the banking system, may be wiped out by not being able to get into government-backed lending schemes, creating a possibility for fatter fees for the survivors. But that would require customers who could pay them.

The biggest lever will be costs. Banks already know this and have been trying to pull it. Progress has been relatively slow. That is because taking out meaningful amounts from financial institutions that have multiple creaking IT systems; requirements to serve customers in branches and over the internet; questions about what products can be cut from investment banking divisions without losing key relationships with clients — all are complex problems to solve. That is before getting to the issue of pay.

As long as banks are stable, some may argue that perhaps it doesn't matter much if they are more like utilities than big profit generators. But it does. British banks are lowly rated compared with their peers in America and elsewhere. If they cannot push themselves out of the discounts to book value at which they were trading even long before this crisis, they risk foreign takeovers, constrained ability to lend and questions about viability.

That is not how anyone will want to go into the next crisis, whatever form it takes. So profitability should be a key priority in the years ahead, just as stability was last time round.

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