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Research on the Operational Transformation and Development of Commercial Banks Under the Trend of Narrowing Interest Margins

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Abstract: This paper reviews the transformation experiences of international banking sectors and analyzes the core challenges faced by China's banking industry amid the ongoing trend of narrowing net interest margins (NIM), along with corresponding strategies. It introduces Zhejiang Province's "Financial Consultant System" as a practical case study of comprehensive transformation. The case demonstrates that by establishing a new ecosystem characterized by public welfare leadership and integrated services, banks can shift from a "hunting-style" scale-expansion model to a "farming-style"value-creation model, effectively enhancing customer stickiness, expanding revenue sources, and advancing risk management. The case shows that by building a new ecosystem featuring public welfare leadership and comprehensive services, banks can realize the transformation from a "hunting-style" scale expansion model to a "farming-style" value creation model, effectively enhancing customer stickiness, expanding income sources, and advancing risk management.

Keywords: Net interest margin narrowing; Low net interest margin (NIM); Financial consultant

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1. Introduction

In recent years, the banking industries of many countries around the world have continuously faced the challenge of narrowing net interest margins. The net interest margin of China's commercial banks has also declined to approximately 1.42% in Q2 2025, down from 2.75% in 2012. This trend is mainly driven by multiple factors such as macroeconomic downturn, advancement of interest rate liberalization, intensified financial disintermediation, and rigid deposit costs [1]. To address this structural change, domestic and international banks have actively explored transformation paths, carrying out extensive practices in asset-liability management, revenue structure, business layout, and risk management. Banks in developed economies have groped in a low-interest rate environment for many years and formed various distinctive and effective transformation models.

2. International experience

The core of German banks' response to low NIM through its universal banking model and precise adjustment of asset-liability structure. In terms of business, they implement differentiated hierarchical operations. On the asset side, they increase the proportion of medium and long-term loans to lock in returns and increase the allocation of non-credit assets such as derivative financial instruments. On the liability side, they vigorously raise the proportion of current deposits to effectively control costs [2]. Through mixed operation, the non-interest income ratio of German banks has reached nearly 50%, successfully offsetting the impact of narrowing interest margins on profitability.

Large U.S. banks have maintained relatively high net interest margins through precise customer stratification and asset allocation. Wells Fargo, relying on its large retail customer base, allocates more than 50% of its interest-earning assets to loans, while obtaining a large amount of low-cost non-interest-bearing deposits, achieving the ideal combination of "high-yield assets + low-cost liabilities". By actively developing asset management business, it contributes more than 60% of non-interest income, becoming a stabilizer to cope with interest margin fluctuations [3].

Japanese banks have adopted more aggressive restructuring and expansion strategies in the low-interest spread environment for more than 30 years. To make up for the domestic "asset shortage", large Japanese banks have vigorously expanded overseas businesses. They have significantly reduced operating costs through mergers and acquisitions, layoffs, and branch reductions [4]. Despite the extremely low domestic net interest margin (about 0.6%), through overseas businesses and cost control, the non-interest income ratio has reached about 60%, maintaining overall stable operations [5].

Low interest rates are not entirely equivalent to low NIM. During periods of low interest rates, banks may still maintain relatively stable interest spreads. For example, during the period when the United States implemented quantitative easing policies, its policy interest rate was close to zero, but the overall net interest margin of the banking industry was still significantly higher than China's level in Q1 2025 (about 1.43%). Under the same low-interest rate background, the average return on equity (ROE) of the U.S. banking industry remained above 10% most of the time except for special years affected by the epidemic. In contrast, due to its long-term ultra-low interest rate environment, the ROE level of Japanese banks is generally lower than that of China. Currently, the ROE of China's banking industry has also dropped below 10%, and the ROE of the five major state-owned banks is only 9.99%.

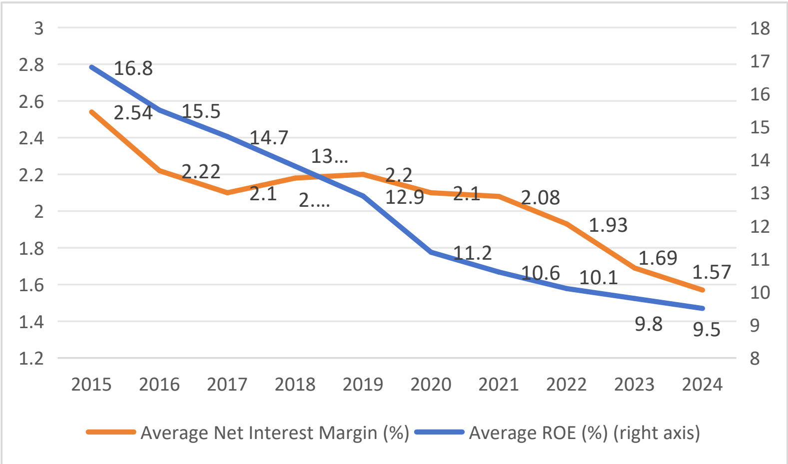

Figure 1. ROE and net interest margin levels of listed banks in China (2015–2024). Note: Data sources include annual reports of listed banks, National Financial Regulatory Administration, and Wind data.

3. Challenges faced by China's banking industry and responses

3.1. Over-reliance on interest margins for profit model, urgent need for revenue structure transformation

In the early stage of narrowing net interest margins, banks attempted to maintain the total interest income by expanding asset scale. However, when loan interest rates dropped to a low level, the strategy of "compensating for price with quantity" failed, and the dilemma of "increased lending leading to greater losses" began to emerge. Simply relying on the growth of credit lending volume has been difficult to make up for the losses caused by price declines, and the expansion of non-interest businesses of banks is under pressure.

3.2. Escalating difficulty in asset-liability management, refined capabilities become key

On the asset side, banks are facing the superposition of "asset shortage" and risks. The scarcity of high-quality assets has led banks to fall into "involutionary" competition in credit lending, further reducing asset yields. To pursue returns, if some banks over-involved in high-risk areas, it may lead to an increase in non-performing loans and erode profits.

3.3. How to balance digital transformation and inclusive services

In the process of digital transformation, banks have streamlined or migrated a large number of basic services online, highlighting the problem of digital divide. For elderly groups or special groups who are not familiar with intelligent devices, this has instead created a significant barrier to access, potentially preventing them from enjoying financial services equally.

3.4. The contradiction between capital supplement and consumption has become increasingly prominent

The narrowing of net interest margins directly leads to slower profit growth of banks, and the decline in profitability weakens the ability of internal supplement. This undermines banks' ability to supplement core capital through retained profits (internal capital), which is the core and most sustainable way for banks to supplement capital. The banking industry generally faces bottlenecks and high costs in external capital supplement.

Combining international experience and national conditions, some studies have proposed optimizing the asset-liability structure and improving pricing capabilities. On the liability side, reduce interest-bearing costs; on the asset side, optimize allocation and extend duration [6]. It is recommended to focus on intermediate businesses and develop light capital businesses such as wealth management, asset custody, investment banking, and transaction banking. Meanwhile, combine national policy orientation with commercial sustainability, delve into the "Five Major Articles on Finance" to build differentiated competitive advantages, and optimize credit structure [7]. Banks can follow the pace of Chinese enterprises "going global" and optimize overseas layout. By increasing asset allocation in emerging markets with high interest margins, they can effectively hedge domestic interest margin pressure [8]. At the same time, strengthen risk management and refined management, improve digital risk control capabilities, and reduce operating costs.

4. Practical case of bank operational transformation: Innovative exploration of comprehensive financial consultant services

Against the backdrop of continuously narrowing net interest margins, the traditional "hunting-style" business model relying on deposit-loan interest margins is unsustainable, and there is an urgent need to transform into a customer-centric “farming-style” service model. The Financial Consultant System originating from Zhejiang is a practical case of addressing this challenge and exploring operational transformation. By building a new paradigm featuring public welfare leadership and comprehensive services, it provides a feasible path for the operational transformation and development of the industry.

4.1. Transformation choice to address profit pressure and service shortcomings

The narrowing of interest margins directly impacts the core profitability of banks, exposing three deep-seated contradictions of the traditional model and spurring the internal demand for transformation as follows:

(1) Resolving the contradiction between functional deficiencies and profit pressure: Driven by profit assessment, financial institutions’ resources naturally concentrate on “large customers”, resulting in insufficient services for the large number of small and micro enterprises. This is not only a lack of financial functional responsibilities but also exacerbates banks’ profit dilemmas and customer loss risks when interest margins narrow. Adhering to “financial functionality as the primary principle”, the Financial Consultant System aims to develop new business growth sources by building long-term trusted customer relationships, realizing the unity of commercial sustainability and social value;

(2) Making up for the contradiction between segmented services and comprehensive needs: Under segmented supervision, a single bank license is difficult to meet customers’ diversified needs, leading to insufficient excavation of customer value. The Financial Consultant System innovates the “1+N” model, where one financial consultant leads and coordinates banks, securities, insurance, legal, and other institutions to provide one-stop solutions, breaking license barriers and enhancing customer stickiness and comprehensive returns;

(3) Compensating for the contradiction between professional capabilities and risk resolution responsibilities: Local governments assume the main responsibility for regional financial risk disposal but often face a shortage of professional forces. Financial Consultants act as the “financial relatival core team” of the government, embedding professional services into local financial governance, fulfilling social responsibilities, and enabling financial institutions to deeply connect with local industrial planning, creating conditions for precise credit lending, optimizing asset structure, and advancing risk prevention and control.

4.2. Practical path of building a new service ecosystem led by public welfare

The system’s feasibility lies in its replicable and sustainable operational mechanism. For instance:

(1) Building a sustainable “public welfare + market-oriented” model: Taking public welfare services as the entry point and trust cornerstone, the system provides non-profit activities such as “financial family doctor”–diagnosis for enterprises, financial fraud prevention publicity for residents, and industrial planning consulting for governments. These non-profit activities establish deep client connections, generating demand for financial services and creating a virtuous cycle from “intellectual support” to “financing”;

(2) Creating organizational guarantees of “workshops + teams”: By establishing physical financial consultant workshops and forming a financial consultant team with bank employees as the core and cross-field experts participating, the professionalism and stability of services are ensured;

(3) Deepening strategic coordination of “county-level + ecological”: Deeply integrating the financial

consultant system with the construction of county-level comprehensive financial ecology is an important starting point for cultivating the local market. Through consultant services, banks gain an in-depth understanding of county-level industrial layout and government planning, not only driving deposit accumulation and intermediate income through businesses such as wealth management direct investment and bond issuance matching but also establishing differentiated competitive advantages in serving local characteristic industries.

4.3. Transformation effects of achieving a win-win situation of social and commercial value

Through public welfare services, banks have won the trust of the government and the recognition of residents, transforming from "honored guests" to "insiders". Cooperating to establish a "Comprehensive Financial Service Demonstration Zone" in Linping District, Hangzhou, a "dual-leader" mechanism jointly led by the top leader of the local Party committee and the person in charge of financial institutions has been established, laying a "green channel" for business entry. By acting as "financial family doctors", financial consultants can understand enterprises' operational conditions and potential risks earlier and more in-depth, thereby identifying risks before loans, dynamically managing after loans, realizing the transformation from passive risk response to active risk management, and providing strong support for maintaining excellent asset quality in a complex economic environment.

5. Conclusions and policy recommendations

Against the background of continuously narrowing net interest margins, China's banking industry urgently needs to transform from the traditional business model relying on interest margins to a diversified, refined, and digital direction.

5.1. Optimize asset-liability structure and improve pricing and management capabilities

Banks should actively adjust their asset-liability structure and enhance interest rate risk management capabilities. On the asset side, they should strengthen credit lending to small and medium-sized enterprises and key industries, optimize loan pricing mechanisms, and improve risk-adjusted returns. On the liability side, they should expand the proportion of low-cost settlement deposits, control the scale of high-interest liabilities, and reduce overall interest-bearing costs.

5.2. Vigorously develop intermediate businesses and promote the growth of non-interest income

Banks should actively expand intermediate businesses such as wealth management, investment banking, transactional finance, and asset custody to increase the proportion of non-interest income. Non-interest income accounts for more than 60% of institutions such as JPMorgan Chase and Bank of America in the United States, effectively offsetting the impact of narrowing interest margins [9,10]. By building digital platforms, China's commercial banks have promoted the growth of fee and commission income, with the non-interest income growth rate of many city commercial banks exceeding 19% in 2024.

5.3. Promote digital transformation and improve operational and service efficiency

Banks should increase investment in financial technology, promote the online and intelligent transformation of business processes, and reduce operating costs. The banking industry in New Zealand has improved service efficiency through digital platforms, with a cost-income ratio of only 31.8%, leading the world [11,12]. Many city commercial banks in China have realized the full-process onlinezation of multiple products by building intelligent middle offices and open banking systems, effectively improving customer experience and operational efficiency.

5.4. Focus on characteristic operations and cultivate regional and niche markets

Small and medium-sized banks should base themselves on local resource endowments and carry out differentiated operations around regional economic characteristics and specific customer groups [13]. For example, Heartland Bank in New Zealand has achieved a relatively high net interest margin and customer stickiness by focusing on niche markets such as mortgages for the elderly and rural finance [14].

5.5. Strengthen capital and risk management and consolidate the foundation for stable operations

Banks should establish and improve capital supplement mechanisms, enhancing capital strength through issuing perpetual bonds and Tier 2 capital bonds [15]. In 2024, nearly 20 city commercial banks effectively improved their Tier 1 capital adequacy ratio through the issuance of capital instruments. At the same time, they should strengthen asset quality control and stabilize provision coverage ratio.

Disclosure statement

The authors declare no conflict of interest.

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