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Retail is in the Detail:

How Financial Institutions Can Grow Revenue in the 21st Century

A Deloitte Research Financial Services Study

Our study of the European retail financial services landscape and survey of top financial institutions has revealed several striking insights into re-igniting the growth agenda. Product demand is likely to go through a marked change over the next five years and few banks have a necessary grasp of detailed business operations to sufficiently flexible business model to be able to benefit fully. We sketch a portrait of the winners.

- The balanced agenda: While revenue growth correlates well with share price performance, cutting excess and prioritising spending are equally important for share price outperformance. The ability to grow sustainable revenue streams by taking market share from rivals will be key.
- New patterns of product demand: Italy, Spain and France offer strong loan growth opportunities over the next five years, driven by low levels of consumer debt and rising female participation in the workforce. In the UK and the Netherlands however, savings is the key growth opportunity, in the aftermath of a long consumer boom.
- Process not product: bancassurer, distributor, monoline are all product based business models which mean little in determining the ability to sustainably generate revenues and suggest that a business has failed to appreciate the significance of process over product. Revamped finance and risk systems are essential to understand profitability at a customer, product and channel level.
- Responsible Selling Machine: The ability to create a sales engine based on new management processes, re-aligned sales incentives and a distinct business ethos will separate winners from losers. Near obsessive micro management of human capital and business performance is essential. The ability to provide real time data on profitability and performance and convey this to investors, will highlight those institutions with sufficient process flexibility to succeed —the difference will be in the detail.

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Summary

Alone cost reduction does not confer a competitive advantage and the focus has switched to revenue growth. Yet in developed markets, the key battle is for the wallet share of existing customers. This places far greater emphasis on efficiency, flexibility and competence than ever before.

- We expect retail loan growth to range from over 10% p.a. in Italy to just 0.8% in the Netherlands over the next five years. Spain should continue to see the fastest near term growth, with strong potential released in France over the next two years.
- The UK and the Netherlands are likely to see among the slowest growth in retail credit because of the borrowing boom of recent years. Savings products will become relatively more important, especially, life, pensions and mutual funds.
- While revenue growth has been an important indicator of share price out performance, cost control is equally important. Many banks have yet to prioritise spending in the areas where they have a strong competitive advantage.
- Innovative products can be replicated and bettered by the competition. It is far more important to have the processes in place to identify revenue growth opportunities and to support this with sufficiently flexible delivery systems. Too many banks continue to seek to manufacture or buy the knock-out product.
- The debate over whether it is better to manufacture or to distribute is largely redundant. In the ideally regulated environment, banks will move freely between own manufacture and third party products in response to changing customer needs.
- Delivery and service are the key responsibilities of management. The bank must have a clear and simple business plan, built around the core process competences, which is easily explained and illustrated to staff, customers and investors alike.
- The business plan must be sufficiently flexible to deal with the myriad of customer relationship situations which arise in a retail bank. The correct training, motivation and incentives for staff is absolutely critical to success.
- Few banks have impressed on us that they have the necessary management information to make all decisions required to emerge as winners. We provide an investor check-list, so that the reader can make their own comparison between the institutions.

Cultural revolution

Some say the trouble with banks is that they are run by bankers. Desperate to re-ignite their growth potential, many of Europe's retail financial institutions are undergoing a two-pronged cultural revolution. First, sober-suited bankers are hiring high flyers from grocers, telcos and travel companies. Their aim: to inject the fundamentals of retailing into financial services to create a super-charged selling-machine. At the same time, and just as significant, is the fundamental shift that is occurring in the skills and behaviour of staff — in the detail of everyday.

After years of being obsessed with cost reduction, today more and more bankers are rebalancing this view by focusing on growth too — and rightly so. Across Europe, financial services companies have recognised that to be successful in future they must have strong and sustainable revenue growth. The key to success lies in maintaining a dual focus: continuing to emphasise cost optimisation while at the same time building a strong selling machine to enhance share price growth.

The battle to gain a greater share of a customer's business will not be won buying more technology or inventing exotic financial products, however. For the financial services industry, the key to future success lies in bringing about a cultural revolution in the skills, ethos and quality of people and simplifying the processes used to offer personal financial services. This cultural revolution is one of the key themes of our report.

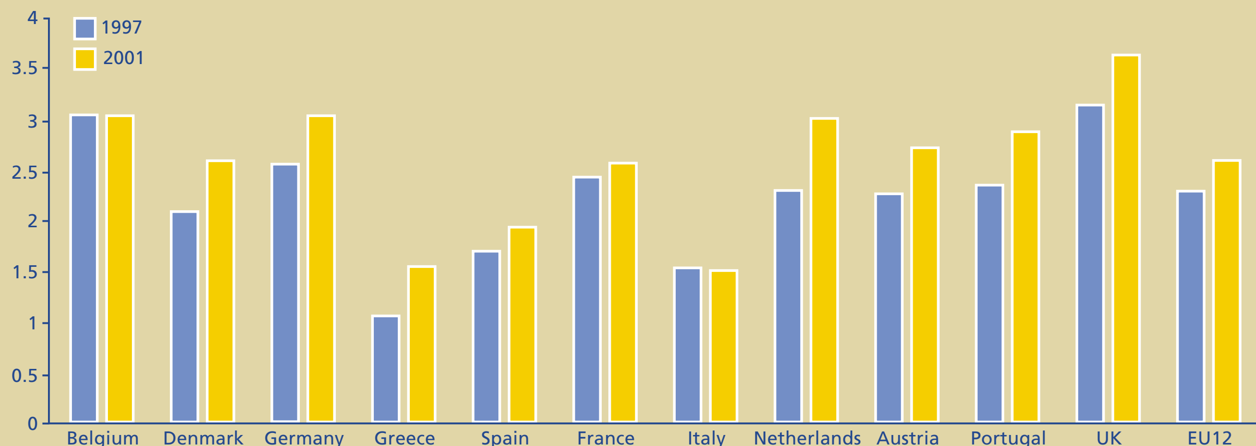
These are difficult times for financial services providers. Overall industry profitability across Europe has decreased due to the economic slow-down and poor conditions in the capital markets. Return on equity ratios peaked in 2000 and have since been steadily declining[1] . More importantly, income as a percentage of total assets has been dropping since the mid-1990s.

Not all is gloom and doom, however: retail banking units in most European markets have been performing very well, which has helped maintain overall operating results. For instance, one major UK bank has been shifting its focus for over a decade in an attempt to boost overall performance. The results have been impressive: retail lending now makes up 62% of the bank's UK lending, up from 38% in 1991. During the same period its lending portfolio grew from £64 billon to £141 billion. Focusing on the retail market is likely to increase substantially as a result of the Basel Accord, which makes consumer lending more attractive in terms of regulatory capital usage.

During the strong economic growth of the 1990s product penetration rates rose and markets matured. This was able to occur because of the strong link between economic growth rates and the propensity to buy retail financial services products - a relationship highlighted in the chart below (and covered in more detail later in our report). The exhibit shows that in nearly every major European economy the total assets of credit institutions increased. The picture is the same for the insurance industry, where premiums as a percentage of GDP have risen in most European markets (Figure1).

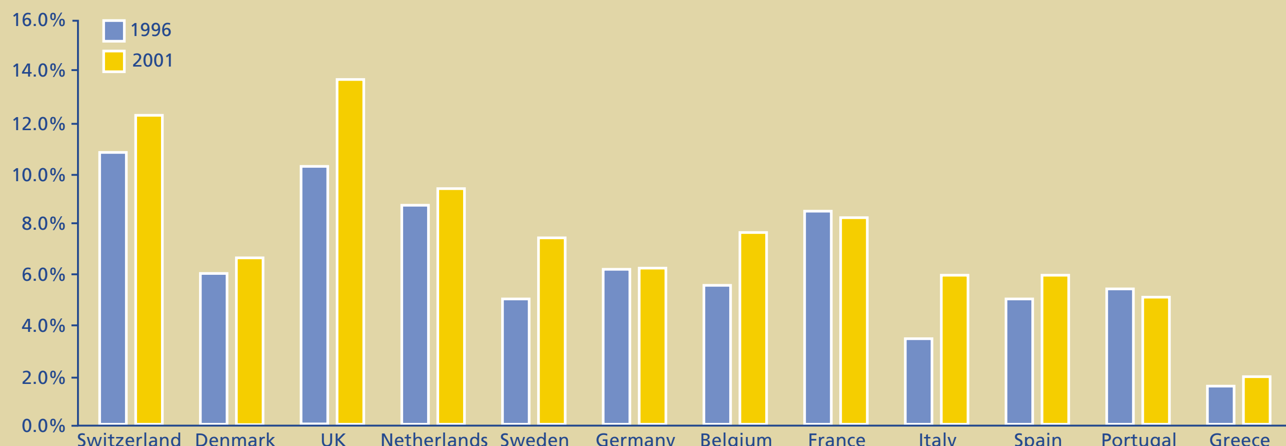
Figure 1. Economic Growth Drives Financial Services

Total Assets of Credit Institutions per GDP, 1997/2001



Source: ECB

Insurance Penetration: Premiums in % of GDP, 1996/2001



Source: Swiss Re.

The challenge going forward is how to re-ignite the growth agenda, in a low growth, low inflation environment. There are a few bright spots on the horizon, for example Europe's rapidly ageing population profile potentially boosting the needs to save and the flow of funds retuning from offshore locations. The battle to extract more from each and every customer is likely to be fought between today's major players, with only a bit part for new entrants.

It is unlikely that traditional mergers and acquisition transactions can restore revenue momentum, however. The sector already has a history of consolidation and most major financial groups across the continent are the result of a least one major merger. In addition, there is substantial evidence to suggest that such 'mega' deals have not yielded value for investors. In future, while we expect to see a rise in the number of deals, they will tend to be smaller with the focus on building scale in specific business competencies /segments in key markets.[2]

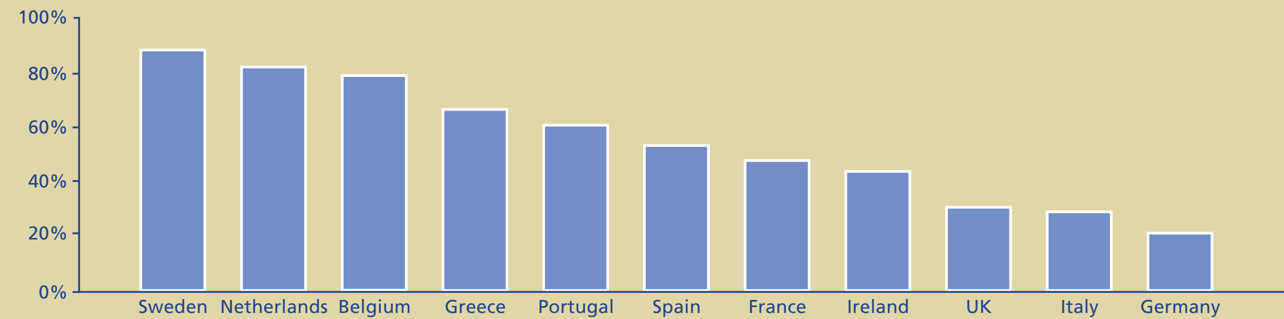
In revenue terms, more importantly, the integration of the merged organisations has often been poorly executed, leaving the resulting financial institution with a set of deeply fragmented, siloed and extremely complex business operations. Such complex organisations find it difficult to achieve process improvements and scaleable revenue growth.

In context, it is important to note that Europe still has a very heterogeneous market for retail financial services. The current situation which is the result of differing tax and regulatory regimes, will impact the ability of institutions to increase revenues in future.

Examples of this patchwork can be seen in distribution patterns, levels of concentration and margins. For instance, 60% of customers in Spain visit a bank branch at least once a month compared to just 21% in Sweden. The top five players in the Netherlands and Belgium control around 80% of the market as opposed to less than 20 percent in Germany. UK consumer credit margins are highest in arguably Europe's most competitive market at around 10% versus only 4% in Germany and Spain (Figure 2).

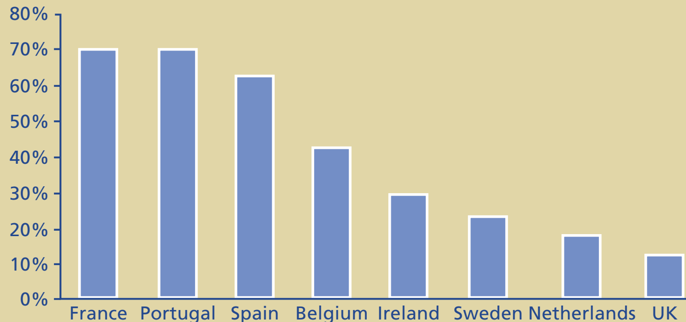
Figure 2. A Patchwork Across Europe

Share of the 5 Largest Credit Institutions in Total Assets (%)



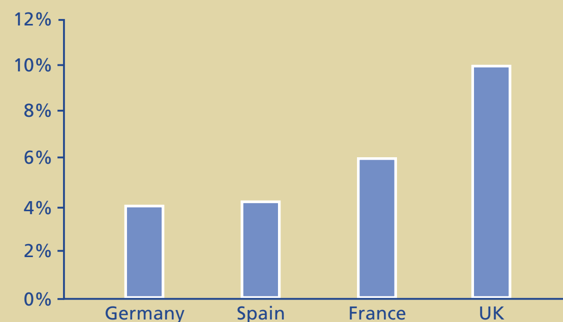
Source: ECB, 2002

Life Insurance Distribution by Banks, 2000



Source: Limra, Swiss Re

Margins for Consumer Credit in %



Source: ECB, 2002

In general it costs around five times more to acquire a customer than to sell to an existing customer. Surely then the challenge for Europe's major retail financial groups is to develop their existing relationships with customers. Many of Europe's major financial powerhouses have more than 10 million customers each. Few, if any, use these relationships effectively to increase revenues. Although they have a degree of customer trust, regular contact and good retention levels, most have failed to significantly increase their overall share of customers' spending on financial products. Cross-sell ratios range from 2.8 products per customer in France to around 2.1 in the UK, although this is higher than 2.0 for US financial institutions (Figure 3). However, it is worth noting that there are still no common revenue measures and indicators within the industry.

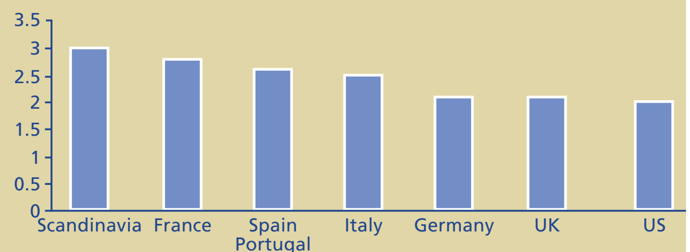
There are a number of benefits of selling to existing customers. These include increased product volume, decreased sales and marketing costs, decreased cost of servicing, and effective channel usage.

At the same time banks face strong internal obstacles in bringing about change. Perhaps the biggest obstacle for banks is shedding an administrative and transaction-based culture in favour of a strong sales culture. There are also a number of challenges facing insurers. Many are in the process of rebuilding capital strength and have significant distribution issues.

Few would argue that sustainable revenue growth is now of prime importance for retail financial institutions. The critical issue is how this is achieved, rather than why is this important. The issues confronting the financial services industry in reigniting the growth agenda can be grouped under four broad themes.

Figure 3. Cross Sell Rations

Average Cross Sell Ration



Source: Celent, 2001

- What is the size of the revenue opportunity across Europe - how much headroom is there for growth? How strong is the link between economic performance and growth in the lending and savings markets? Which products in which regions offer the best opportunities?
- How will regulatory developments shape revenue growth opportunities? How much will local rules influence the regulation of products? What role is the Financial Services Action Plan - which is designed to facilitate the growth of a Single Market across banking, securities, insurance and investment products -likely to play in creating barriers to sustainable growth? How will the proposed Basel II rules influence business opportunities going forward?

- Have banks understood the primacy of process over product? Innovative and exciting product opportunities are borne out of identifying and exploiting gaps in the market, which requires continued feedback from customers. The winning strategy will move effortlessly between bancassurance, distributor and monoline, without being hung up on the primacy of a single model.

- Which business capabilities are required to implement the above business models? Do most banks and insurers have such capabilities? If not, how quickly can they acquire and integrate the needed resources into their business model? What changes in people competencies and technology systems are required to optimise the performance of the selected business model? Finally, how can progress be qualitatively and quantitatively measured and communicated to staff, customers and investors?

The arguments presented in this report are based both on the proprietary research of DrKW and Deloitte into the retail banking markets of Europe and on an extensive survey of senior management at European retail financial institutions. The structure of this report follows the broad themes detailed above and provides insights into the issues. However, first we turn to the relationship between top-line growth and share price performance.

The importance of growth

Top line growth correlates well with share price performance, especially when combined with cost control. The strongest driver of revenue growth in retail banking is the progression of lending and in particular consumer debt.

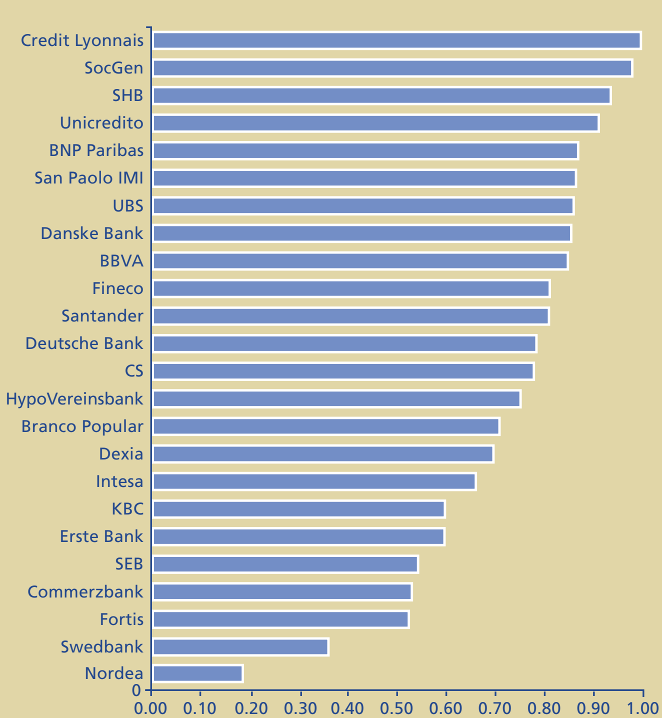
A study of recent growth trends shows that share price performance is well correlated with growth in both revenues and operating profits. With an era of cost cutting coming to an end, we believe that revenue growth will be the primary determinant of share price performance.

History shows us that there is a strong correlation between revenues and share prices. We have back tested this correlation for as long as data is available, but there must be at least a five year history for inclusion in the analysis.

The high R-Squared of these correlations suggests a significant correlation between revenues and share price performance. In a 27-strong sample, 60% of the correlations were statistically significant (Figure 4A and 4B).

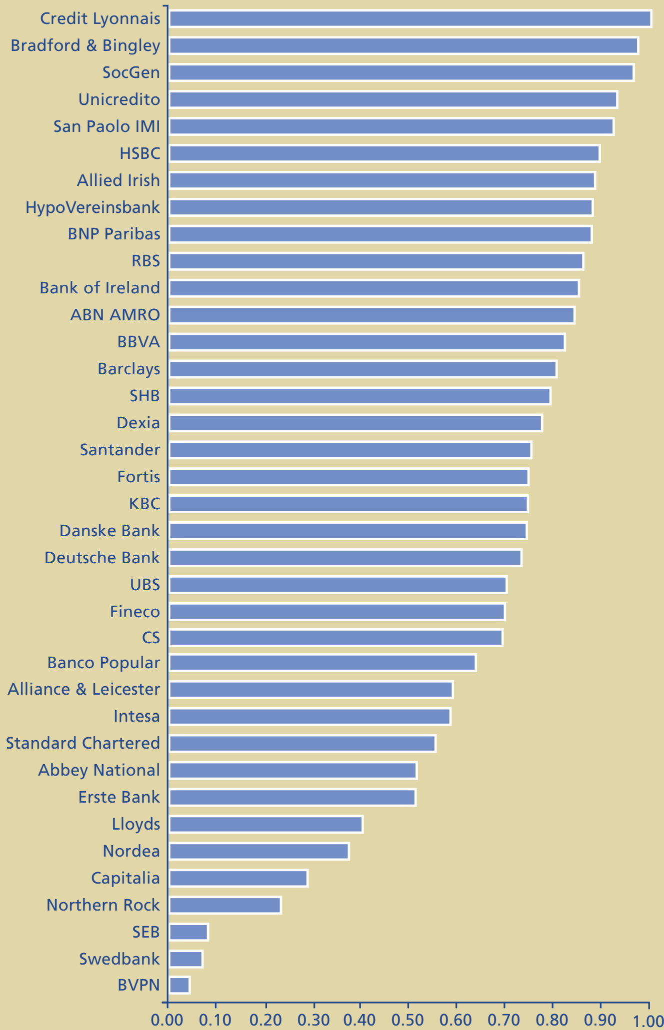
Extending the test to the correlation between operating profit and share price, we again find a strong result. The availability of more data, most obviously on the UK, has increased the sample size to 41.

Figure 4A.R-squared of Revenue vs. Share Price (Minimum 5 Years Data)



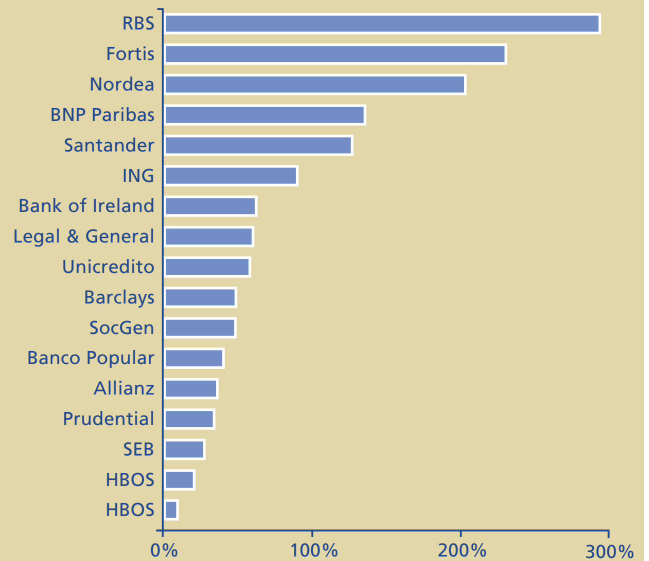
Source: Thomson Financial Datastream

Figure 4B. R-squared of Operating Profit vs. Share Price (Minimum 5 Years Data)



Source: Thomson Financial Datastream

Figure 5. Growth in Total Revenues, 1998-2001



Source: Thomson Financial Datastream

61% of the R-squares are statistically significant (Figure 4B). This suggests that while revenue growth is an important driver of share price, a tight rein on costs is also important. The correlation is not significant for Nordic banks, some UK retail banks and emerging market plays Standard Chartered and Erste Bank. As provisions have been very low at Nordic and UK retail banks in recent years, this suggests that operating profits have not translated into share price performance, because of expectations that growth is not sustainable.

Across the survey sample, acquisitions have had a strong influence on growth rates. In some cases this appears to have been rewarded with share price out performance, as with RBS and in others it has not. Fortis, for example, has been plagued by balance sheet concerns that have overshadowed the high growth rate in revenue. Nordea has grown revenues, but cost and provision problems have dogged the share price.

Retail Proxies

In the absence of credible data for retail divisions, we have focussed on domestic retail banks to try and identify a link between retail banking revenue growth and key macro variables.

Our analysis shows that the strongest correlation for net interest income is with consumer debt, consumer debt to GDP and lending. It is interesting that the correlation is negative with GDP, consumer debt growth and consumer debt over GDP.

The highest number of observations are at HVB Group, KBC, Popular and Bankinter, while the relationship at BMPS and SHB is least dependable. Adjusting the correlations above for the degrees of freedom, we obtain the following results.

The strongest link with net interest income is not surprisingly with lending growth, then consumer debt and consumer debt to GDP. The question is whether this holds for total revenue as well as net interest income.

Table 1. Correlations With Net Interest Income

R-squared

GDP	Cons Confidence	Cons debt	Cons debt growth	Cons debt/GDP	Lending	Lending growth	
Alliance & Leicester	0.26	0.00	0.91	0.87	0.92	0.87	0.12
Northern Rock	0.02	0.13	0.60	0.56	0.63	0.53	0.09
HVB Group	0.18	0.00	0.76	0.64	0.68	0.79	0.54
KBC	0.25	0.01	0.03	0.36	-	-	-
Popular	0.09	0.05	0.48	0.05	0.47	0.55	0.10
Bankinter	0.03	0.06	0.89	0.12	0.90	0.88	0.66
BMPS	0.19	1.00	1.00	0.06	1.00	0.93	0.76
BPVN	0.14	0.09	0.77	0.09	0.78	0.75	0.02
SHB	0.01	1.00	-	-	-	0.19	0.93
Swedbank	0.14	0.00	-	-	-	0.81	-

Note: Correlation of GDP, Consumer debt growth and Lending growth with Net Interest Income is predominately negative
Source: DrKW Equity research estimates

Table 2. Degrees of Freedom

	GDP	Cons Confidence	Cons debt	Cons debt growth	Cons debt/GDP	Lending	Lending growth
Alliance & Leicester	5	5	5	5	5	5	5
Northern Rock	5	5	5	5	5	5	5
HVB Group	10	9	10	9	10	10	9
KBC	10	9	10	9	10	10	0
Popular	10	9	10	8	10	10	9
Bankinter	10	9	10	8	10	10	9
BMPS	3	3	3	3	3	3	3
BPVN	6	6	6	5	6	6	6
SHB	3	3	3	0	3	3	3
Swedbank	6	6	6	0	6	4	3

Source: DrKW Equity research estimates

Table 3. Is R-squared Statistically Different From Zero?

	GDP	Cons Confidence	Cons debt	Cons debt growth	Cons debt/GDP	Lending	Lending growth
Alliance & Leicester	NO	NO	YES	YES	YES	YES	NO
Northern Rock	NO	NO	NO	NO	NO	NO	NO
HVB Group	NO	NO	YES	YES	YES	YES	YES
KBC	NO	NO	NO	NO	-	-	-
Popular	NO	NO	NO	NO	NO	YES	NO
Bankinter	NO	NO	YES	NO	YES	YES	YES
BMPS	NO	-	YES	NO	YES	NO	NO
BPVN	NO	NO	YES	NO	YES	YES	NO
SHB	NO	-	-	-	-	NO	NO
Swedbank	NO	NO	-	-	-	NO	-

Source: DrKW Equity research estimates

Table 4. Correlations with total revenue

R-squared

	GDP	Cons Confidence	Cons debt	Cons debt growth	Cons debt/GDP	Lending	Lending growth
Alliance & Leicester	-	-	-	-	-	-	-
Northern Rock	-	-	-	-	-	-	-
HVB Group	0.14	0.00	0.85	0.72	0.78	0.89	0.49
KBC	0.25	0.00	0.00	0.35	-	-	-
Popular	0.10	0.07	0.88	0.00	0.87	0.90	0.32
Bankinter	0.16	0.05	0.90	0.10	0.90	0.88	0.32
BMPS	0.57	1.00	0.89	0.37	0.82	0.98	0.99
BPVN	0.16	0.00	0.93	0.15	0.93	0.91	0.08
SHB	0.71	1.00	-	-	-	0.96	0.13
Swedbank	0.28	0.02	-	-	-	0.88	-

Source: DrKW Equity research estimates

Table 5. Degrees of Freedom

	GDP	Cons Confidence	Cons debt	Cons debt growth	Cons debt/GDP	Lending	Lending growth
Alliance & Leicester	9	9	9	9	9	9	9
Northern Rock	9	9	9	9	9	9	9
HVB Group	10	9	10	9	10	10	9
KBC	10	9	10	9	10	10	0
Popular	10	9	10	8	10	10	9
Bankinter	10	9	10	8	10	10	9
BMPS	3	3	3	3	3	3	3
BPVN	6	6	6	5	6	6	6
SHB	3	3	3	0	3	3	3
Swedbank	6	6	6	0	6	4	3

Source: DrKW Equity research estimates

Table 6. Is the R-squared statistically significant from zero?

	GDP	Cons Confidence	Cons debt	Cons debt growth	Cons debt/GDP	Lending	Lending growth
Alliance & Leicester	-	-	-	-	-	-	-
Northern Rock	-	-	-	-	-	-	-
HVB Group	NO	NO	YES	YES	YES	YES	NO
KBC	NO	NO	NO	NO	-	-	-
Popular	NO	NO	YES	NO	YES	YES	NO
Bankinter	NO	NO	YES	NO	YES	YES	NO
BMPS	NO	-	NO	NO	NO	YES	YES
BPVN	NO	NO	YES	NO	YES	YES	NO
SHB	NO	-	-	-	-	YES	NO
Swedbank	NO	NO	-	-	-	YES	-

Source: DrKW Equity research estimates

Again, the correlation is strongest with consumer debt, consumer debt to GDP and lending. However, lack of data for the UK limits the results.

While our analysis is hindered by extremely limited disclosure about the pure retail banking divisions of listed European banks, there does appear to be a meaningful link between lending growth (total bank lending to the private sector) and revenue growth. For European banks, this is to be expected and puts a premium on lending growth forecasts as an indicator of where the best growth opportunities lie.

Headroom for growth

We expect a major turnaround across Europe over the next five years. Where consumer lending has been strongest, we anticipate the greatest opportunity to be in savings products. In contrast, where employment is rising and consumer debt levels low, we expect a surge in mortgage and other consumer borrowing.

Consumer boom

Over the past five years personal sector lending has grown at 3-4 times GDP growth across Europe. In 2002, growth was above country averages in is all countries (Table 7).

Table 7. Personal sector lending growth as a multiple of GDP (96-02 & 2002) and h/hold debt to GDP

	Multiple (96-02)	2002	Household debt/GDP
Belgium	4.6	9.5	50.9
Netherlands	4.6	18.4	N/A
Italy	3.1	10.1	28.9
Spain	3.2	4.5	65.9
Germany	9.6	52.9	76.5
France	0.6	1.9	39.7
UK	2.9	3.6	82.0
USA	5.5	3.2	N/A
EU	2.7	5.7	74.2

Source: OECD

The factors which have helped this boom, could also trigger a downturn.

- **Unemployment:** Much is made of the absolute level of household debt, but if consumers have jobs and employment prospects are rising, then borrowing will grow. However, unemployment is high and rising in economies such as France and Germany and rising in Belgium and the Netherlands. UK unemployment is unlikely to fall much further from record lows and only the employment markets of Spain and Italy look to be growing.
- **Interest rates:** low interest rates have boosted affordability of debt and pushed up absolute debt levels. When the interest rate cycle turns, this will apply a natural break to the expansion of debt.
- **Demographics:** Europe's ageing population is expected to be saving more, but several countries have seen housing booms in part driven by a large population of household forming age. Homes are often seen as saving by everyone except the statisticians, who focus on the consumption triggered by home ownership.

Savings market

From 1996 to 2002, the average growth of savings has been slower than the average growth of lending in every country across Europe. This is not surprising as consumption and savings are two sides of the same coin. Thus we would argue that low interest rates have more likely dented savings ratios through a rising propensity to borrow, than because of lower nominal returns. The reality is also that in several countries savings have been channelled into housing, rather than mutual funds or pensions, and this has not been captured by the savings ratio.

Household savings rates declined in most countries up to 2000 and are now beginning to rise. At the same time, falling equity markets, rising unemployment and the transition from public sector saving to deficit, have all dented consumer confidence and the propensity to consume in economies such as France, Germany, Italy and the Netherlands. Countries which have seen continued housing booms, such as the UK and Spain, have more stable savings ratios (Table 8).

Table 8. Household saving rates (% of disposable household income)

	1998	1999	2000	2001	2002
Belgium	14.5	14.1	13.4	13.0	13.7
France	10.8	10.4	10.8	11.5	12.2
Germany	10.3	9.8	9.8	10.1	10.4
Italy	17.3	15.4	14.5	15.4	16.0
Netherlands	12.9	9.6	6.7	9.6	10.7
Spain	12.2	11.1	10.6	10.2	10.1
UK	6.0	5.3	4.3	5.5	5.2

Source: OECD

The UK and the Netherlands share a high allocation of savings to life insurance and pension funds, which account for around a half of saving in each country. Unlisted shares, or stakes in family firms, account for the second highest source of saving in Italy, France and Spain, which may explain relatively high cash liquid savings in cash and deposits; to cover unforeseen events. Cash is also high in Germany, which has a broader spread of savings products, which may owe something to weak consumer confidence and rising unemployment and part to the fragmented nature of the retail financial industry.

The cultural differences in the savings markets across Europe are obvious – the UK and Netherlands have more financial assets in insurance and pension products and a lower exposure to mutual funds. Continental Europe have a greater exposure to non-listed shares.

While pension funds in the Netherlands and the UK are private sector products, they are not always in the control of individuals and have generally been falling in value along with equity markets[3] . During the same period, demand for guaranteed funds has risen rapidly across Europe. For UK regulators and financial institutions wishing to address a perceived savings gap (which home equity withdrawal helps close, which is then classed as borrowing) abandoning regulated private pensions in favour of the free market in savings products (including guaranteed funds) has to be an option.

Table 9. Composition of financial assets at the end of 2000, %

	Italy	France	Germany	Netherlands	Spain	UK
Currency and deposits	24	30	34	18	36	22
Money market funds	1	1	1	0	3	0
Securities other than shares	19	3	10	2	2	1
Listed shares	9	5	6	12	11	9
Non-listed shares	19	20	10	5	23	9
Mutual funds	16	9	11	6	10	6
Life insurance	6	23	14	15	6	28
Pension funds	1	2	5	38	5	22
Others	6	7	10	4	4	4
Total	**100**	**100**	**100**	**100**	**100**	**100**

Source: OECD

The headroom for growth

France and Italy stand out as the economies most likely to see strong consumer credit growth, while the UK and the Netherlands are likely to have to rely on the growth of savings (Table 9).

Estimated lending growth rates

We forecast lending growth relative to both GDP and assumed changes in the appetite for borrowing, driven by employment, labour market participation and existing levels of household gearing (Table 10).

Table 10. Growth rates of personal sector lending and Household debt to GDP ratios

	CAGR 95-02	CAGR 02-08	GDP/H/ hold debt, 2002	GDP/H/ hold debt, 2008E
Belgium	6.6	5.9	50.9	61.0
Netherlands	6.7	0.8	162.9	155.0
Italy	4.5	10.5	28.9	50.0
Spain	10.5	6.4	65.9	85.0
Germany	5.9	5.8	76.5	88.0
France	1.8	5.4	39.7	52.0
UK	7.3	3.9	82.0	91.0
EU	5.8	5.5	72.4	83.1

Source: DrKW Equity research estimates, Datamonitor

Italy and France have greatest potential for personal lending

The marked pick up in Italy is due to an expected increase in labour force participation, especially among women, which will drive employment, GDP growth, consumption and borrowing. France is also likely to see accelerated consumer lending, but only once unemployment falls from current high levels, meaning we forecast above average growth only from 2006 (Table 11).

Table 11. Labour market data for European countries

	Unemployment	Total participation rate	Female participation rate
France	8.7	55.7	49.1
Germany	7.9	57.4	48.8
Italy	9.5	48.7	36.4
Netherlands	2.7	62.6	53.5
Spain	10.5	51.9	39.4

Source: OECD

UK to face slower personal lending growth

UK household debt to GDP is second only to the Netherlands within Europe, spurred by the strong housing market as well as high levels of credit card and unsecured lending. Given low unemployment and interest rates, we do not subscribe to the saturated market thesis, but would not expect debt levels to continue to mount at historic rates. The primary cap on consumer debt is likely to be after tax disposable income, which is likely to slow to address the fiscal deficit. We expect consumer credit to slow from 7.3% p.a. 1995 to 2002 to 3.9% to 2008.

Germany to face weak growth

Household debt to GDP is skewed up by lending to smaller companies and family-run businesses, while consumer debt growth has been sluggish by European standards. This is in part explained by the weaknesses in the housing market brought about by construction overhang post unification in 1991. However, high unemployment and labour market rigidities do not help and neither does weak capital in the banking system. There is room for accelerated lending growth, but as ever, there has to be the political will to cut red tape.

Spain to experience continued growth

Spain has experienced rapid growth in personal sector lending since the mid-90's as unemployment halved from extremely high levels around 20%. Given demographics, a strong financial system and structural reform, Spain has benefited from negative real interest rates which have not surprisingly triggered a lending and housing boom. We expect credit growth to continue to average more than 6% p.a. to 2008, starting at higher levels and slowing gradually.

Netherlands to face poor prospects

Over the past decade, The Netherlands has benefited from labour market reforms and a booming housing market as the government privatised public housing. However, this impetus has run out, with unemployment now rising sharply from low levels. The Dutch household debt to GDP ratio is the highest in Europe, facilitated by full mortgage interest tax deductibility and high marginal rates of tax. Loan-to-value is over 100% because of this benefit and the high propensity (around 86%) of Dutch households to invest secondary secured loans in home improvement, although the government recently announced some restrictions towards tax deductibility.

The outlook for consumer products in the Netherlands looks dismal. We forecast personal sector lending to grow on average by less than 1% p.a. and for the household debt to GDP ratio to fall.

Savings products

We assume that the rate of growth of savings is in line with nominal GDP.

Table 12. Forecast personal savings market growth, 2002,2008E

	Savings	Mutual Funds	Equities	Bonds	Retail Life/ Pensions	Total
Belgium	-0.5	7.3	-0.5	-3.1	6.9	2.1
Netherlands	0.7	5.1	0.1	1.2	2.8	2.1
Italy	2.3	6.1	7.4	-6.3	8.2	3.1
Spain	0.6	8.8	5.8	-6.5	6.5	3.1
Germany	1.0	3.8	-0.7	-6.9	3.8	1.7
France	0.5	3.8	3.8	-9.3	3.2	2.4
UK	3.0	6.9	4.7	-4.2	4.7	4.3
EU	1.4	5.42	3.8	-5.6	4.6	3.0

Source: DrKW Equity research estimates, Datamonitor

The UK is expected to show the strongest growth in the savings market over the next five years. Growth in savings should be faster than in household lending, which is also our forecast for the Netherlands. We expect the strongest growth in mutual funds, life and pensions products and equities, driven by a firmer stock market and continued regulation in favour of simpler and cheaper mass-market savings vehicles (Table 12).

Table 13. The composition of the savings market

		Savings	Mutual funds	Equities	Bonds	Life & pensions
Belgium	2002A	30.6	24.0	9.6	23.3	12.5
	2008E	26.1	32.3	8.2	17.0	16.5
Netherlands	2002A	28.7	15.1	16.6	3.7	35.9
	2008E	26.5	17.9	14.7	3.5	37.4
Italy	2002A	19.9	27.8	11.2	27.5	13.6
	2008E	19.0	33.0	14.3	15.5	18.2
Spain	2002A	34.6	17.5	15.2	1.8	30.8
	2008E	27.0	22.0	16.1	0.9	34.0
Germany	2002A	48.7	15.8	6.7	5.5	23.3
	2008E	46.8	17.9	5.8	3.2	26.3
France	2002A	30.4	30.8	4.3	2.7	31.8
	2008E	27.3	33.5	4.6	1.3	33.3
UK	2002A	27.8	9.5	11.3	1.7	49.7
	2008E	25.7	11.0	11.5	1.0	50.8

Source: DrKW Equity research estimates, Datamonitor

In the UK, an ageing population will have to replace savings lost through pension schemes and underperforming investment products, but should have some help from increased inter generational transfers. The average UK inheritance is estimated to be around £150,000, to be split three ways. After debt repayment and some spending, an estimated £25-30,000 per beneficiary will be saved, although the household balance sheet will be improved by a greater amount given debt repayment (Table 13).

Table 14. Summary matrix of attractive markets (relative to other domestic markets)								
	Mortgages	Personal Loan	Credit Cards	Savings	Mutual Funds	Equities	Bonds	Retail Life/ Pensions
Belgium	Y				Y			Y
Netherlands					Y			
Italy	Y	Y	Y					Y
Spain	Y	Y	Y		Y		Y	
Germany	Y		Y		Y			
France	Y	Y	Y					
UK				Y		Y	Y	
EU	Y	Y	Y		Y			

Source: DrKW Equity research estimates

We expect the fastest growth in household lending from 2002-8 in Italy, as the consumer leverages up on the back of improved job creation and then Spain, where GDP growth is strongest across Europe's main economies. The Netherlands and then the UK should see the slowest household lending growth, because penetration of credit products is already high.

We expect the fastest growth in the savings market over the same period in the UK, as household's adjust their balance sheets after over a decade of heavy borrowing. Savings should also grow fastest where the labour market and the economy are the strongest, which under our forecasts is in Spain and Italy (Table 14).

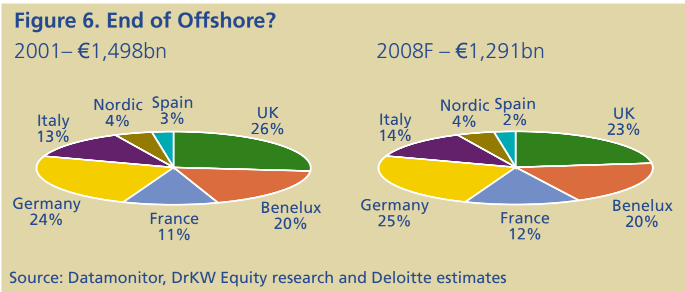
Repatriation from offshore

The EU Savings and Tax directive could trigger the repatriation of funds from offshore to onshore markets. This could be an additional source of growth for savings products in the larger European economies. Studies predict a decline in offshore investments from European countries of 13.8% between 2001 and 2007.

The push for the EU directive comes from a desire to curb tax evasion anti terror measures post 9/11. Rising fiscal deficits and high social security obligations fuel the need for reform.

On 1 Jan 2004, the 12 Member States will implement the automatic exchange of information. Countries outside the member states fall into three categories – those likely to implement full information exchange, those likely to implement a withholding tax and other offshore territories.

Figure 6. End of Offshore?



Source: Datamonitor, DrKW Equity research and Deloitte estimates

Those implementing full information exchange will remove their secrecy and tax advantages. Those with a withholding tax will keep their secrecy but increase the cost of holding money in these offshore locations. The other offshore locations (predominately in Asia Pacific) will not be included in the directive.

The implication is that money held in territories coming under the directive will fall, although some increase in territories outside its remit should be expected. The net effect is expected to be a decrease in offshore investments.

The main EU countries investment in offshore accounts is set to decline 13.8% from €1,498bn in 2001 to €1,291bn in 2008, a drop of €207bn. Around 10% of these funds is expected to flow further offshore territories to places such as Singapore and Hong Kong. The other 90% should flow back into the banking system within the member states, giving a boost of €186bn to the European savings market (Figure 6).

The UK is set to benefit from the large funds held in places such as the Channel Islands and the Caribbean. The UK savings market is set to increase assets by around €90bn due to the directive (Table 15).

Table 15. Movements from offshore to onshore by region, 2002-2008E		
	Amount moving onshore (€m)	% of current offshore
Benelux	28,555	10.0
France	16,276	9.6
Germany	34,244	9.6
Italy	14,577	7.7
Nordic	7,907	13.2
Spain	13,138	31.9
UK	92,347	23.4
Total	**207,044**	**13.8**

Source: Datamonitor

Regulation: A barrier to sustainable growth?

Regulation towards an integrated financial market is progressing slowly at supra-national level and even more slowly at the implementation phase. Key developments are the Financial Services Action Plan and Basel II.

Regulation to shape revenue streams

The lack of trust in today's financial markets has led to significant regulatory change. At the same time there have been a number of other major regulatory developments: the creation of the single financial services market being set-out in the Financial Services Action Plan (FSAP), the Basel Accord and a raft of domestic regulatory changes in most countries such as N3, the integrated Prudential Source Book, de-polarisation and the Sandler Review in the UK. As a result, the European financial services landscape is likely to be dramatically transformed, with markets radically reshaped and financial institutions left to grapple with some very significant issues. These new regulatory frameworks will have a fundamental bearing on growing future revenue streams.

The last major attempt by firms to develop the European retail financial services markets occurred in 2001. At that time UK and US firms in particular, perceived a one-off opportunity to extend their distribution cost effectively via the Internet. These new distribution channels were combined with more traditional support mechanisms to capture the so-called "mass affluent" and high net worth investors of Europe. Largely, however, firms failed to make more than small inroads into cross-border European business because they overlooked the localised product preferences of European consumers and the domestic focus of their regulators.

In an environment where seemingly straightforward products such as credit cards are difficult to market cross-border, the simpler the proposition the better, from a product and a regulatory perspective. Take for example the Internet bank Egg and its significant investment in its French business to create local brand recognition. The situation is similar in other more complex product markets such as mutual funds (Table 16).

Table 16. Roadblocks Ranked by Mutual Funds Companies
(1=no importance, 7=crucial importance)

Roadblock	Rank
Discriminatory taxes	6.2
Tax and regulatory barriers	6.0
Fragmented infrastructure	5.6
Language difficulties	4.6
Differing consumer protection rules	3.8
Consumer confidence	2.5

Source: Wall Street Journal Europe 03-09-03

Roadblock ahead

The growth of cross-border products has been impeded by the lack of recognition of the product or the provider in the local jurisdiction. For example, the French have traditionally used debit cards far more than credit cards. Local regulators have also made efforts to safeguard the interests of their local consumers with additional requirements for foreign entrants or delays in registration. Finally, there is the burden and complexity of European legislation and its slow (and sometimes non-existent) application by local Member States. Paradoxically, the regulators' desire to ensure that there is responsible product selling in their local jurisdictions could potentially mean less product choice for their consumers.

The European Commission recognised the need for change in May 1999 when it first raised the idea of a Financial Services Action Plan (FSAP). The Plan is supposed to create a single wholesale market place by 2003 and an open and secure retail market by 2005. A new decision making process for the adoption of legislation, particularly affecting the securities markets was constituted. A committee chaired by Baron Alexandre de Lamfalussy proposed a new decision

taking structure which was endorsed in March 2001. In simple terms, it proposes the adoption of a four-tiered structure that comprises:

- **Level 1:** Adoption of Directives or Regulations proposed by the European Commission following consultation by the European Council and the European Parliament.
- **Level 2:** Adoption of Community legislation by the European Commission and drafting of the technical details to support the framework principles agreed at Level 1. The Committee of European Securities Regulators ("CESR") acts as technical advisor in this process.
- **Level 3:** CESR facilitates the implementation of the legislation by issuing common guidelines and standards. It also reviews national regulatory practices.
- **Level 4:** The European Commission monitors compliance by Member States with European Community legislation and takes enforcement action as appropriate.

This model was seen as one that could facilitate the reorganisation of the securities sector of the European financial services industry. Bear in mind that the regulation of banking, securities, fund management and insurance products are subject to separate European directives and are more or less integrated across Europe already (it should be noted that insurance is the least integrated).

The benefits of an integrated financial services market place are significant. A report for the European Financial Services Round Table estimated the increase in gross domestic product from a well functioning retail market place as being between 0.5% and 0.7% in individual member countries.[4] Failing to integrate the financial services industry could result in the loss of significant business to offshore jurisdictions as improved communications allow firms to position business processes around the globe. The thrust of the FSAP is partly a commercial one and partly a quest to bring all European Member States up to an acceptable level of compliance.

Herein lies the basic dilemma of the Financial Services Action Plan. In creating a single market place, the aim is to adopt the highest standards of compliance as the norm in regulating European business, for example by creating new retail conduct of business standards, or equivalent market abuse provisions. The Lamfalussy plan is coupled with some potentially significant increases in oversight and regulatory capital charges in areas such as financial regulation (Basel II and the Risk Based Capital Directive), the taxation of interest income (Taxation of Savings Income Directive), and the consolidated oversight of mixed purpose financial groups, including bancassurance groups (the Financial Conglomerates Directive). The result is a regime where, without the benefits of proper enforcement, the advantages of a single market place will be submerged under the cost of potentially increased capital and local regulatory requirements.

Online stockbroking – case study

The online retail brokerage industry is the best example to date of how to achieve effective cross-border business under existing European regulations: in a nutshell, keep it simple. Nonetheless, online broking helps to illustrate the complexities of existing European financial services regulation – and how the FSAP provisions for liberalising the market place may actually increase those complexities:

- **Sales and marketing of products.** The existing Investment Services Directive allows Member States to apply their own individual "general good" provisions to the sales of investments to their citizens as the "host state", despite the fact that the financial services firm has a passport to do business in any EU country under the rules of its own "home state" regulator. Online brokerage firms have spent significant time and effort to build into their websites the local marketing rules of each jurisdiction in which they can be accessed.

  The advent of the E-Commerce Directive in June 2000 under the FSAP facilitated the use of home state conduct of business rules by firms undertaking purely online business. However, it does not apply to more traditional sales support methods, (e.g. telephone or written communications), thus making it difficult for firms wanting to rely on its provisions for wider customer business.

- **Scope of services.** Great care needs to be taken in constructing the website for an "execution only broker", which is how the majority of online broker sites are set up in order to gain the efficiencies of purely online delivery and interaction with customers. While there may be research on the website and "educational" material, such as online calculators/risk profilers, these are clearly separated from the firm's "execution only" client services. This is to avoid more onerous "know your customer" procedures that apply if a customer's relationship is an advisory or discretionary one.

  The CESR harmonised conduct of business standards issued in April 2002 as part of the FSAP initiative, propose a level of oversight by the execution only broker for the suitability of products sold to customers which could render the above business model cost ineffective. This issue has been recently debated by the European Parliament as part of the discussions around the Investment Services Directive.

- **Privacy.** While the UK operates an opt-out regime ("tick here if you do not want to receive further information on our products") for financial services, most of the rest of Europe operates an opt-in policy, requiring specific consent from a customer before he receives marketing material, or enters a website containing marketing material. The link to an appropriate privacy policy suitable for each jurisdiction needs to be prominently and regularly displayed on the site. The policy should cover such Member State specific provisions as the likely need to obtain (sometimes in writing) a customer's consent for the use of "cookies", including potentially those that carry a customer's secure password. The privacy policy should also cover consent for the "transfer" of a customer's data to a third party processor (more precisely providing access to their data) which is not in a jurisdiction with equivalent regulation.

The Distance Marketing Directive of September 2002 under the FSAP will further restrict firms' ability to provide unsolicited financial services information to consumers where the communication is taking place remotely. It will also require that additional information is provided to retail consumers before or immediately after the conclusion of a contract and the consumer will have enhanced rights of withdrawal after the contract is struck.

FSAP – the potential benefits

The intention of the FSAP is to improve the willingness of national regulators to open the door to cross-border business more widely. Where does European regulation stand at the moment? At a crossroads, given the high volume of new European legislation proposed in the period to 2005. Firms will either see the next two-to-three years as a difficult but worthwhile transition to a more efficient European financial services infrastructure, or a costly period of overlapping regulation. The most important provisions in the liberalisation of European retail financial markets under the FSAP include the following:

- The revised Market Abuse, Prospectus, Transparency and Money Laundering Directives, while increasing the level of regulation in the short term, particularly for alternative market places, will at least move towards a level playing field where Member State regulators can trust the underlying regulatory principles adopted by their counterparts across Europe.
- The revised Investment Services Directive has some potentially powerful provisions to allow the passporting of settlement and clearing services, which would help to sever the often expensive link between national exchanges and the central settlement depository. However, changes in this area, for example with the merger of CREST and Euroclear, are being driven primarily by the market place. The revised ISD also restricts the use of the general good provisions by individual regulators so that such provisions would require a proportionality test.
- The Collateral Directive is designed to increase the ability to rely on collateral held for cross-border transactions.
- The proposed Consumer Credit and Distance Marketing Directives are designed to improve the level of disclosure which consumers receive when undertaking cross-border business.
- The two UCITS Directives are intended to liberalise both the types of assets in which funds can invest (thus opening the door to wider access to hedge funds, money funds, and funds of funds for example). The Directives also set common standards for prospectuses to facilitate the passporting of funds across Europe in the same way as securities services. Anecdotally, the level of debate around the ability of the Directive to facilitate funds passporting (apparently a number of local regulators are disputing this) demonstrates the difficulties of drafting clear framework-level legislation that will be consistently interpreted and adopted.
- The Insurance Mediation Directive is introducing an EU framework for the authorisation, capitalisation and regulation of intermediaries and brokers that sell insurance products. In addition, updated solvency standards are being put in place for life and non-life insurers, and reinsurance supervision is in the course of being reviewed.

The cost of evaluating and complying with the above provisions, not to mention Basel II and the adoption of new accounting provisions, including International Accounting Standards in 2005, will clearly be very significant. Unfortunately, gaining any competitive advantage from them appears a long way down the track.

Towards an open and secure retail market?

The success of the FSAP in growing European retail financial services will be determined by two key factors: the level of enthusiasm with which individual regulators and legislators embrace the development of the single market (which means an end to super-equivalent regulation) and the willingness of the European Commission in enforcing sanctions against dissenting Member States and regulators.

While the potential for revenue growth at an individual firm level from the implementation of the FSAP is hard to predict, the economic advantages of a fully integrated single market at a European level could be significant. The Cecchini Report in 1998 estimated a potential 1.5% increase in European GDP from a fully integrated European financial services market. More recently, in November 2002, research estimated the increase to GDP at 1.1% over the longer term. This was assessed in terms of a prospective reduction in the cost of capital, with all EU countries gaining potentially significant benefits from integration.[5]

These studies both tend to focus on the inefficiencies avoided by integration, rather than growth in financial services firm revenues. Clearly the growth of cross-border European business is likely to increase the level of choice for consumers. As consumers gain access to new financial services providers, they are likely to buy more cross-border products. However, as the development of the UK online broking market also shows, there is a difficult period of discounting, reduced margins and market fragmentation to go through before the true winners and losers of the of the single market can be declared. A period of consolidation is likely to follow resulting in price increases to allow the winners to reap the rewards of increased profitability.

Such scenarios are likely to evolve over a five-to-ten year period at best, and the winners will require deep pockets. The FSAP, which will include the European implementation of the Basel II proposals, is likely to engender is a landscape of bigger, more integrated financial services houses dividing up the spoils. Small, thinly capitalised niche players will generally have to compete much harder in a world of increased regulatory capital charges and greater consumer choice.

For major financial services firms, which increasingly see their product delivery bundled across banking, securities, fund management and insurance products, the period up to 2005 and the full implementation of the FSAP is likely to offer little revenue growth. This is due to the fact that the relevant regulations around each of these product areas develop at different paces. Furthermore, individual jurisdictions are likely to adopt them at different speeds. The potentially most exciting phase of European regulation - when the regulations surrounding the different products start to cross over and merge - is still another set of directives away. Formidable legal obstacles still stand in the way of the cross-border development of some products, such as general insurance. It will also take time to build up trust in regulators from different jurisdictions to provide a level playing field of regulation across similar products.

To return to the opening theme of this section, what the market place really needs is an upsurge in demand across the entire product range. There is nothing like a surge in cross-border customer demand to help quicken the pace of regulatory convergence.

Basel II – Reshaping the landscape?

A key factor shaping the value of banking stocks is The Basel Committee on Banking Supervision capital rules otherwise known as the Basel rules. Basel I – the first set of rules – fundamentally reshaped the world of banking in the late 1980s and the 1990s. Basel II – the Revised Capital Accord - is likely to be just as important when it is implemented in Europe as the Risk-Based Capital Directive now likely to be in 2007. When it is finally agreed banks will need to take urgent action in order to prepare their risk management and regulatory capital arrangements.

The still to be finalised rules primarily focus on matching regulatory capital with economic capital. The final framework is likely to contain both pros and cons for financial institutions, with the charge against most risk-weighted assets likely to fall if firms take advantage of the internal credit model approaches, but with a balancing capital charge being required for operational risk. A key concern some banks have with the proposed rules is the significant disparity between regulatory capital and economic capital. There are likely to be major changes in competitive dynamics and industry structure as financial institutions struggle to realign their business activities and the risk management of their portfolios.

The Basel II proposals are likely to have a major positive impact on retail banks. Indeed, many see retail banks as being the big winners from the Basel II shake-out. The proposed rules will allow banks with significant exposure in retail lending to reduce the amount of capital allocated to risk-weighted assets such as mortgages, unsecured loans and credit cards. This is because the risk profile of these types of products is now deemed by Basel II to be much lower then under the previous capital rules and thus requiring less capital.

This is a critical point. Some rating agencies are taking a harsher view than Basel II on default levels on these types of products. Standard & Poor's (S&P) made it clear in its submission to the Basel II committee that it will benchmark banks against the level of capital required rather than the minimum regulations as contained in the proposed rules.[6] Indeed, S&P have warned that since most major economies have not experienced a full-blown recession during the recent downturn many banks are probably underestimating the default ratios within their retail portfolios.

So who might the winners and losers be from the implementation of Basel II? In spite of the concerns of rating agencies it is likely that retail banks will gain a positive benefit from the revised rules. This will further increase the intensity of competition within European retail banking. Equally, Basel II is likely to favour large banking groups. This is because the cost implications of adopting standardised versus advanced systems favours those with economies of scale that can tailor risk systems to the advanced standards.

At the same time, Basel II could have negative implications for financial institutions that run a universal provision model. Financial institutions with fund management and capital markets activities are likely to suffer due to a re-alignment of regulatory and economic capital. Meanwhile, for bancassurers the implications of Basel II are unclear, leaving the door open for a variety of interpretations and potential continuing competitive inequalities.

Overall, we believe that the Basel II rules are likely to enhance the competitive dynamic within the retail arena. In turn this requires a renewed focus on the most appropriate business model to generate sustained revenue growth.

Process over product

Not only is there no single, winning business model, a focus on which model is more effective misses the bigger picture – how are the processes managed. Product innovation will work for one bank, but not for another. The battle for wallet share will be won by those with a simple and short chain of command, which creates a flexible business best able to handle the myriad of customer relationships. In other words, the victory will go to the best managed human capital.

The battle for wallet share

While banking penetration of a population varies across Europe from the less developed Iberian countries to the highly banked German and French markets, the battle across most European markets is one for wallet share. The most attractive and affluent customers in each country already have more than one bank relationship and the banks will grow by a combination of increased demand for products from these customers and supplying more of their total financial needs.

We have already seen that there should be solid natural growth in credit demand in Italy, Spain and eventually France, so that the battle for wallet share is at least played out against the back drop of a rapidly expanding wallet. In the UK and the Netherlands, the battle is likely to focus more on wresting products from other banks and financial institutions. These two markets have the highest life and pensions share of savings across Europe and the lowest bank control of distribution. Thus, we should not necessarily assume a zero sum game for the banks.

Product versus process

Our survey results showed a surprising difference in views about whether a product could provide a sustainable competitive advantage. Some banks argued that innovative products could be copied rapidly and hence provided little advantage. Others cited examples, such as offset mortgages in the UK or guaranteed investment funds in Spain, where a meaningful outperformance of the industry had been achieved through being the innovator.

However, the banks which identified these killer products are also institutions which we have identified as more advanced in IT and customer relationship management systems. We believe that the ability to identify the customers who will buy offset mortgages, or guaranteed return funds, backed up by the efficient distribution of product and after sales service, combine to create the product success. The product in the hands of a bank without this level of process support would have been far less successful.

Consider the case of misselling in the UK. Innovative investment products were sold by banks and insurance companies, promising returns which have proved impossible to deliver. The processes of control in product creation and after sales management of customer expectation failed and, in some cases, have been exacerbated by over zealous and inappropriate sales. These are all failures of process as much as product.

Banks which we identified from our survey as being the most advanced in selling techniques, said that they had moved on from product push. This was a concept introduced from the US in the mid nineties, aimed at shifting large volumes of a relatively narrow range of products to the customer base. This remains an extremely effective way of selling the simplest and cheapest banking products.

However, from the turn of the century, especially with the introduction of advanced technology frequently pioneered in the credit card industry, banks sought to better segment their customer bases. This allows the bundling of products to customers with similar profiles. The more advanced the bank has become, the closer this segmentation has migrated to the individual financial review. This detailed, face-to-face consultation has become a most important weapon in triggering customer switching.

Identify, deliver and follow up

A typical list of requirements for successful selling includes affluent customers, trust in brand, staff competence, regulatory approval, correct incentives for staff, strong management, multiple products and advisory services. Product is only mentioned once. It thus follows that business models that focus on product are not capturing the whole picture.

The bank has to identify the customer opportunity. It is widely assumed that banks are better at this than other financial institutions, because they have more frequent access to customers and better data about financial holdings. However, successful management of a customer database is a crucial element of any business, whatever the product.

An appropriate product must also be delivered to the target customer, which is again an assumed competitive advantage of the bank, given frequency of interaction with customers. Yet the continued wide use of mail shots, flyers attached to statements and a heavy reliance on third party distributors, all suggest that we are someway from excellence in distribution. Banks are also continually juggling the desire to migrate customers to low cost distribution channels, with the reality that the most productive relationships are still face-to-face.

Once delivered, a product relationship must also be managed, as customer retention is arguably the most important source of profitability for a bank. The after sales service creates another selling opportunity, as well as reinforcing the relationship with the customer.

Cross selling and up selling

We define cross selling as converting asset based customers into savers and vice versa. Up selling seeks to increase the number of products per customer on one side of the balance sheet. An example is when a bank attempts to sell a mortgage customer similar products such as a credit card, consumer loan and creditor insurance.

The key product hook for both cross and up selling tends to depend on prevailing product demand. Our survey revealed that the more asset based the growth strategy, the more banks believed the mortgage was the key cross sell product. Where loan growth was expected to slow however, more emphasis was placed on the instant access deposit account. This response was particularly the case in the UK, where the large banks are traditionally weaker in mortgages than in current accounts.

Up selling involves layering products onto an existing customer. This creates issues of brand integrity and performance, as for example disappointment with a home insurance policy may de-rail a more valuable mortgage relationship. However, these are after sales issues, which the selling institution should seek to manage in-house, regardless of who is manufacturing the product.

Cross selling is a much more time consuming and random process, where hit rates are likely to be much lower. Long term savers may have little demand for borrowing (home equity release is a notable exception), while catching the borrower as a specific event triggers the desire to save is extremely hard. As a consequence this task is best performed through technology, both to handle the large volumes of information and to avoid staff fatigue.

During our interviews, it was clear that banks which had pioneered customer segmentation and complicated product / client bundling, were simplifying the process of prompting sales staff to chase cross selling leads. This is a clear case of value creation through process innovation and yet was cited by one of the banks which had championed product leadership. Too many customer leads may have led to more revenue opportunities, but the absolute number of rejections per member of staff was also rising. This factor was hampering the cross sales initiative because staff were increasingly confused and de-motivated.

Demographics are important

Customer demographics tends to make up selling easier than cross selling. Borrowers are typically younger and savers older. One European institution believed that the peak of products per customer came in the 25-35 age range, where mortgage and other borrowing requirements dovetailed with the beginning of pension provision. Even moderately affluent customers of this age could be expected to buy six or seven financial products. However, they did not necessarily buy them all from one financial institution.

As a consequence, most institutions foresaw a progressively more competitive retail banking arena, where increasing the wallet share of existing customers was the priority. In this environment, the differentiating factor would be soft skills such as the buying experience, as well as product performance. This is particularly the case when customers have accounts with multiple institutions and places an emphasis on brand.

Brand potential

Regulation has had an important role in shaping financial institutions across Europe and the development of brands. The fragmented development of the UK combined with customer inertia has resulted in banking groups assembling portfolios of brands to ensure distribution across the full range of customer demand. In Europe, where banks have been free to offer a wider range of products for longer, the bank has been able to offer a lot more under a single brand.

Limited brand reach in the UK

In the UK, the separate development of building societies and clearing banks has shaped brand association. The former clearing banks dominate the distribution of branches and also have large shares of the current account, credit card, convenience savings (typically less than £2,000) and of SME accounts. These products developed from the stranglehold on the money transmission network.

In contrast, the building societies including those now converted to banks, dominate mortgages and long term savings. Before the 1980s building societies were barred from offering current accounts. These institutions have built a loyal and affluent customer base, but at a much lower margin than other banks.

Mortgage bank customers are more affluent because they have a house or long term savings. They also have a banking relationship with one of the other institutions. One of these others conducted a recent survey and received responses from clients who would never consider using a bank for a mortgage. Given banks have been offering mortgages for over 20 years, this brand association is remarkable. It has also persisted despite the two largest mortgage lenders, HBOS and Abbey National, both converting into banks.

Mortgages which facilitate home purchase and savings which pay interest, typically reward brands with a feel good factor. Meanwhile, the bank brand risks an association with problems, such as delayed transmission. Yet the larger banks have a reputation for competence in transmission, which may prove as hard to break down as the mortgage banks' dominance.

UK institutions are natural brand acquirers

The legacy of regulation and related brand awareness is such that banks such as Barclays and RBS are focused far more on distribution than manufacture. This leads to a strategy of expansion through brand acquisition, which of late has been encouraged by a regulatory block on large, cost cutting mergers. Management of a brand portfolio, especially setting the correct incentives for staff to sell multiple products with very different profitability, also means a heavy focus on technology. This may work against mega-mergers in the medium term.

Institutions with large natural shares in long term savings have pursued the bancassurance route. If you already own the savings pool, it is far harder to contemplate sharing the revenues with another provider. In contrast, those attacking the market seek the strongest brand to attract customers, which has encouraged joint ventures. The familiarity with brand acquisition could make several UK banks more acquisitive overseas than their European counterparts and thus prompt European expansion at a time of slowing consumer credit at home.

In-house manufacture dominates European institutions

The desire to avoiding sharing revenue pools was a strong feature of our interviews with European institutions. Having grown up being allowed to offer most products to customers, the banks have developed as financial conglomerates, combining bank, insurer and asset manager. Customers approach the group through the branch or other channel and are sold the product they desire, provided they desire an in-house product.

There are obvious exceptions to this unilateralism. Italian banks have joint ventures with insurance companies to offer savings products and share profits as a consequence. Spanish banks sell internationally branded mutual funds where their own asset management capabilities are weak. But the general rule is to do as much as possible in house, which has resulted in far greater product penetration than in the UK.

For this reason, the multi brand strategy which is proving so popular in the UK, is limited in much of the rest of Europe. In Italy, Unicredito has developed a 158 branch network of private banks, branded as Unicredit, but clearly exclusive and not open to the mass market. The bank predominantly sells its own Pioneer asset management and RAS joint venture products.

In a similar fashion, Allianz believes that as a pioneer bancassurer in Germany, offering the full suite of products manufactured in house, that it is best placed to capture the future growth in German financial services. The virtues of scale in manufacture and distribution may sound odd to a UK banker, but are likely to be the winning strategy in the German market. The reason for this comes down to customer inertia.

Maximising brand potential, wherever you operate

While the bank may need several brands to cover the financial spectrum, they will try to maximise the potential of each brand. Only the smallest listed UK bank, Bradford & Bingley, has followed a strategy of selling loans from other institutions.

While UK banks have used acquisition to grow in new product areas, they are now experimenting to see how far the acquired brands will extend. The strategy is to cover the full breadth of a de-regulated and disintermediated financial services market with the fewest possible brands. Some noted that regulation in favour of product commonality was hindering this aim.

This strategy is exactly the same in the rest of Europe. The difference is only in the number of brands required, as in Europe inertia binds customers to their existing institution. There are still multiple banking relationships, but trust is an issue and the new institution is likely to be local, branch based and a familiar brand.

Does bancassurance work?

The natural model to be pursued in Europe is one of bancassurer, manufacturing products for distribution. Even in private banking, separately branded or not, the goal is to meet client needs in-house. Yet the banks in Europe do not generally refer to themselves as bancassurers.

Bancassurance in the sense of cross selling or up selling insurance products to customers is absolutely essential, but does not require ownership of the product being sold. We have argued that up selling is often easier than cross selling and so the general insurance sale on the back of a loan, or the life policy to the long term saver, is probably a lot easier than general insurance to a saver or a life policy to a credit card holder. However, the winning model will offer all permutations and some will work better than others. This is not a distinct business model.

Bancassurance in the sense of banks owning insurers or vice versa is a different choice. In the UK, we believe that the banks with large pools of existing savings revenue have been drawn into bancassurance to avoid sharing those pools with insurance companies. Banks without a high savings market share, see long term savings as an additional revenue pool and are keen to penetrate it as fast as possible. This generally means selling the existing products of established brands.

In Europe, it may make sense for an insurance company to buy a bank in order to secure distribution of its products. For this reason, bancassurance may be superior to a temporary tie-up or an agreement which is subject to change. Yet simply securing access to customers does not make bancassurance a winning model. The processes put in place through out the organisation will determine winners and losers and the cultural differences between two institutions may hinder that process.

Managing human capital

We have argued that identifying selling opportunities is a technology intensive process. However, keeping the output from the database simple and effective is a management issue. Trial and error is moving the banks towards the right answers.

The delivery and after sales service are far more reliant on staff. Finding the correct motivation and incentives for sales to be both profitable and responsible (i.e. no misseliing issues) is trial and error on a much larger scale. The constant refining of processes is a definite competitive advantage and even if it could be replicated in the same way as products can, a process would not transfer to another institution with a different history and culture.

Our survey research has shown that the most effective management systems have simple targets and strong incentives to reach them. The systems are flexible and constantly updated in response to staff and customer feedback. Yet a simple message can only be managed through close attention to detail in execution and it is to that which we now turn.

Retail is in the detail

Going forward we see two key differentiators – the 2P's: people and processes — for retail financial services groups. First, human capital is a real differentiating factor between financial institutions: survey results from across Europe place a premium on employee change management, training, sales incentives and empowerment. Second, detailed process innovations - especially around finance and risk systems – will allow institutions to more efficiently, effectively and sustainably grow revenues.

Building a responsible selling machine

The case for and against integrating banks and insurance companies, we believe is largely academic. Rather the focus needs to be on the heritage of the organisation. The core product portfolio and customer franchise should be the building blocks of any future growth strategy.

Pivotal to building a selling machine in retail financial services is the identification of core (product and process) capabilities and cultural strengths. Around these can be added product clusters which compliment the core strengths. For instance, for many banks the pivotal product is the current account, but this does not necessarily translate to all financial institutions. In our survey one institution saw its credit card and consumer lending franchises as the foundation for growth, another believed its heritage in savings and mortgage lending will be pivotal in selling more products. Again we do not see any one-size-fits-all solutions, rather a granular understanding of the business as being the competitive differentiator.

A second issue that will fundamentally shape the building of a selling engine will be changing product economics within the sector. These new economics are being driven by two forces: market pressures to reduce operating expenses and (in some countries) government rules influencing product pricing. For instance in the UK the stakeholder pension and forthcoming Sandler type products are forcing providers towards a one percent cap on fees charged. Our work suggests that acquisition costs could be reduced significantly by streamlining processes within the business.

The cultural revolution

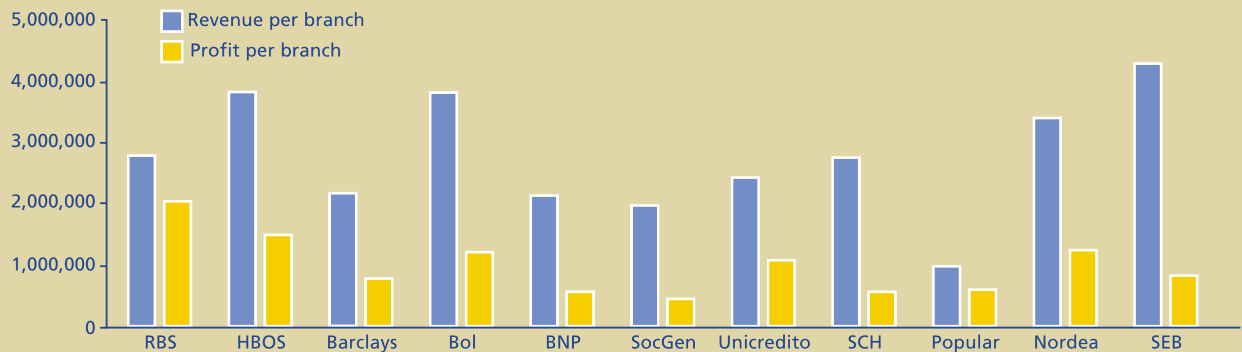
The prospect of sluggish growth is fuelling interest amongst banks and insurers about how to improve revenue flows. Getting this right is dependent on aligning strategy and execution. Nothing could sound simpler. However, financial institutions are highly complex; consequently making the transition from a primarily transactions-driven business to one with a sales and service ethos at its core will be very difficult. No financial institution should underestimate the current challenge or ignore the fact that in future the challenge will continue.

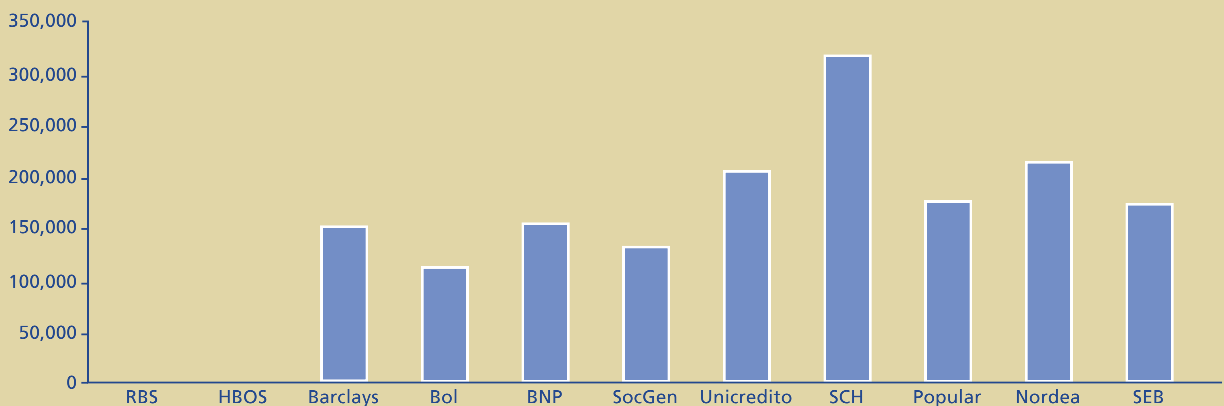
Essentially, this requires financial institutions to embark on projects that will bring significant differentiation, thus ensuring both enhanced shareholder returns and tangible benefits for staff. In short, this means constructing processes and shaping a culture that can drive revenue growth within the regulatory framework - nothing less than building a (responsible) selling engine at the heart of the business. Our survey revealed that many banks and insurers have set out on this journey with varying degrees of progress and success.

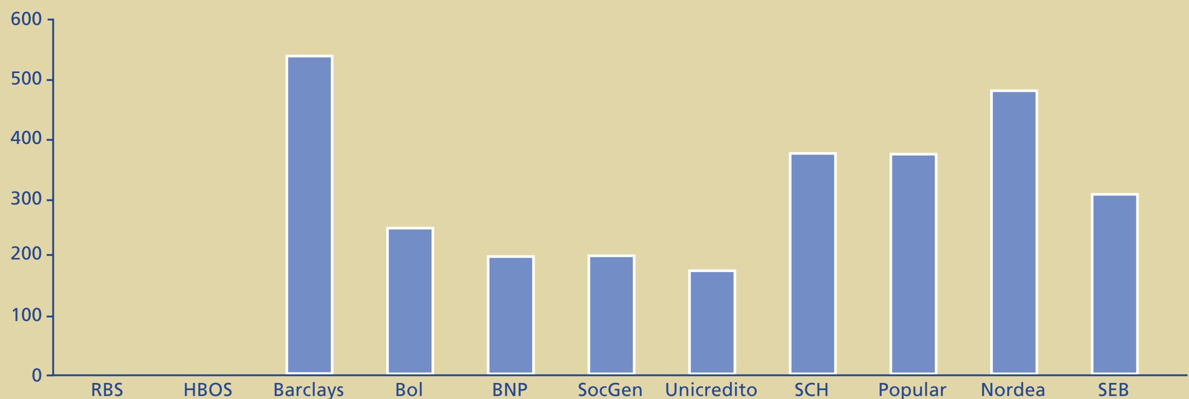
A clear message from our discussions with executives is that immediate action is required to kick-start revenue engines. As one respondent put it "don't be fooled that you can stand still, the big issue is that financial institutions desperately need to adapt". For financial institutions addressing this issue the challenges are clear: they must revolutionise their internal culture and their technology.

Transforming the culture of banks and insurance companies will not be achieved easily, or indeed quickly. For example Rabobank, the mutual based in the Netherlands, is implementing a 20-year change programme to achieve such a shift in culture. As the pendulum

Figure 7. Revenue Indicators of Retail Financial Services







Source: Various Deloitte analysis

swings towards a growth agenda, institutions need to adopt the best elements from the world of retailing. According to one respondent, "retailers are people who understand how to grow revenues — bankers are not". Equally, legacy technology systems are a "millstone around our neck" in attempting to super-charge the revenue potential of the organisation.

Our research shows that across Europe major retail financial institutions are a heterogeneous group – particularly regarding revenue indicators (Figure 7). The chart below shows that for a range of indicators there is little commonality between revenue per employee, customer per employee or profit per branch. It is important to note, therefore, that there is no "one-size-fits-all" solution to growing revenues. Rather it is necessary to tailor actions around two closely connected issues –- people and processes.

Going forward the winners and losers will be determined by execution, not just strategy. With new business economics now coming into play — a result of regulation and a low-inflation environment –- tough decisions need to be made about how to kick-start revenue generation. What is paramount is that the organisation has a clearly articulated vision and has implemented actions that link strategy, structure, brand and culture –- nothing less a fundamental transformation of the business.

In this section we deal with how to build a selling machine focusing on: people and process, the critical role of the branch as the focal point of transformation, and finally the management required to optimise the performance of the selling machine.

People — the only real differentiator

It has become something of a cliché to single out people as the key asset of a business. However, financial institutions have not gone far enough in using this mantra within their business. The CRM fad focused almost exclusively on the capabilities of technology, largely ignoring the critical role of people. Going forward nothing less than a cultural revolution is required to build sustainable competitive advantage. For example, it is easy to replicate a competitor's pricing propositions; in contrast it is far more difficult to copy strategies based on people and cultural change.

Such structural changes may seem straightforward on paper. However in our survey we found that they are proving extremely challenging for financial institutions and their employees. Notably, individuals are often reluctant to change the way they work or their reporting lines. While processes and technology change are important, behaviour must also change if revenues are to be increased on a sustainable basis. In addition to increasing revenues there are other benefits to be gained from implementing structural changes. [For example, the removal of process duplications and the creation a resilient, difficult to replicate culture.] The challenge is that change — notably around expense reduction - is now almost endemic, with over three-quarters of European financial services employees experiencing an increase in the amount of change in their organisation during the last year.[7]

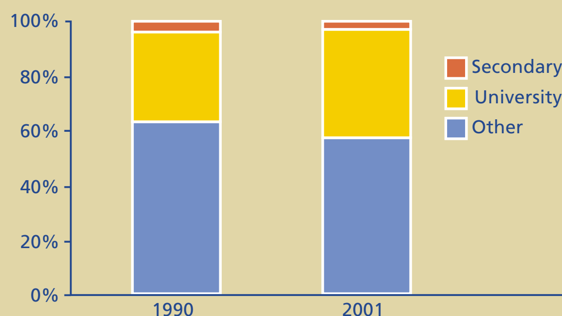
Another major challenge for financial services is the profile of their staff. Many banks and insurance companies have an unbalanced age profile. A glance at the banks in France shows that nearly one in three employees was over 50 in 2001 compared with one in five in 1997.[8] Financial institutions need to radically change their staff profile, towards a better balance in age and skills (Figure 8).

The results of our survey indicate that action is required in four key 'people' areas in order to build a successful selling machine: changing the structure and profile of employees, training, sales incentives and empowerment.

First, action needs to be taken to change the skills profile and structure/reporting lines within the business. The vast majority of financial services now accept that such a shake-up in skills and reporting lines is essential to ensure success. The key to achieving this goal is changing the skills profile of the staff to blend managerial positions with lower paid positions. This situation is often seen in the retail environment and a change in the profile of banking staff can already be observed in some markets.

Figure 8. Enhancing Skills!

Average Education Level at Belgian Banks



Source: ABB, 2002

In order to inject some of the skills of retailing into their businesses financial service providers have been actively recruiting top-level staff from supermarkets, telecommunications, travel and utility companies. Many of the banks and insurers we interviewed had hired such staff. Of prime importance is to ensure that this new group of hires are not just the icing on the cake, but bring their full experience to bear in transforming the business. The majority of banks in our survey also outlined how they were changing the profile of front-office staff particularly in the branch (this is discussed in more detail below).

Perhaps the greatest challenge faced by retail players face is making sure that middle management is able to implement the strategy they have put in place. Indeed one bank cited this as the biggest issue the organisation faces in increasing revenues. Getting people with the right skills to manage in the new and evolving environment is a huge hurdle. It is this group who must implement the orders from senior executives as well as motivate and supervise front-office staff.

Another institution estimated that one-third of its middle management adapted easily to a new strategy, a third are gradually moving towards the required behaviour while a third will never make the grade. Replacing these people with others with better skills is likely to have a significant positive effect on the revenue line. Ultimately to be successful one respondent believes "managers must manage, not sell or pitch for customer business". According to the same respondent, these people must focus on how they can make their teams of 10-to-12 work efficiently and effectively.

Second, training budgets need to be bolstered. If human resource change is really to reap dividends it is critical that development spending is increased. One bank in our survey was planning to benchmark training spend against other sectors notably retailing. The seriousness which some banks are taking this issue is demonstrated by one Belgium bank setting up a "School of Retail".

Third, action is required to put optimal sales incentives packages in place. The financial services industry has been beset with misselling and it is critical that any incentives reduce the recurrence of this situation.

One major UK bank has been attempting to introduce a sales orientated culture since the late 1990s. There has been a high turnover of people due to the mis-alignment between the existing skills and the new high- pressure environment. This bank feels that incentives are playing a critical role in this transition. Two years ago the bank had on average 14 incentives to measure each sales person. The system was deemed to be too complex and had little motivational impact on staff. In order to reduce complexity and align revenue growth to people's abilities the old system was replaced with a simple percentage-based commission linked to specific product sales. As a result there has been a change in staff behaviour, greater discretion used by the sales force and growing sales volumes. The incentives use higher commissions to retail simple products.

Fourth, staff empowerment is the final piece of the jigsaw. The move from a "transaction-culture" to a "sales-culture" at one bank we surveyed involved a significant behavioural change in delegating power, especially at the branch level and to the sales force. This required a strong focus on the quality of people management at the branch level, where managers were given autonomy to manage the team and improve utilisation of time. Empowering branch managers represented quite a change in the bank's culture. There was a strong focus on the quality of the customer contact. Each relationship manager now has a target of eight customer meetings a week. Other institutions we interviewed related how they had made each branch a profit centre with specific targets, but also with significant autonomy to meet local demands.

Cultural and behavioural change is critical. However, without a similar transformation in business processes many financial institutions are likely to see little return on their investments.

Process innovation – generating sustainable competitive advantage

The key to lasting future success lies in building a business with a culture and processes that are not easily copied. The benefits from changes in culture can only be gained if they are deeply connected to improvements in process. As Sir John Bond, Chairman, HSBC plc said a few years ago, "product innovations will yield a competitive advantage that will be eroded in three months. However, a process improvement can yield an advantage of 12 months and more".[9]

This is a message that has been repeated again and again during our research, particularly from the insurance industry where the traditional focus has tended to be on product innovation. The logic behind such thinking is that a new and often more complex product will yield another step change in revenues. However, this approach is ill-fitted for today's environment where the emphasis is on simpler products, especially in the UK, and overall product profitability.

Another challenge we discovered from the respondents is how to build a technology platform that allows the business to scale sales volume with limited extra cost. Some European institutions have poorly integrated and fragmented systems. Thus due to process bottlenecks any rise in market demand does not translate into improved profitability since service this business requires many more hands to be hired (Figure 9). As a result, any rise in demand will not translate into improved profitability because of process blockages. However, if a scaleable platform were built significant productivity gains can be achieved. One Spanish bank had increased mortgage volumes 50 percent over the last five years with no increase in staff numbers.

The results of our survey highlighted three areas of process innovation that can help build sustainable revenue growth: value chain inefficiencies, IT improvements and sales force effectiveness.

First, many processes across financial institutions are heterogeneous with little standardisation. We estimate that there are around ten steps involved in selling a typical insurance or investment product. Within the ten steps core processes vary considerably (Figure 10). It is only through the standardisation of the processes outlined in the exhibit that cost and quality improvements can be obtained from of the overall process. The more processes become automated the fewer variations in the system, and the better the compliance, cost and quality exposure. As one insurance CEO put it: "there is considerable competitive advantage in implementation expertise".

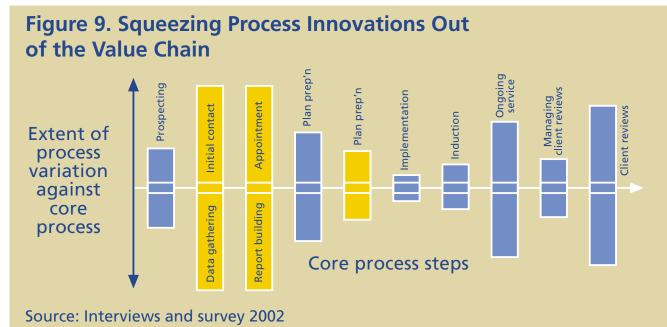


Figure 9. Squeezing Process Innovations Out of the Value Chain

Source: Interviews and survey 2002

The second area of process innovation involves a major focus on improving the efficiency and effectiveness of IT systems. European financial institutions spend heavily on IT. For example, Europe's top 10 banks spend around €20 billion per year on IT equipment. This figure appears to be stabilising with less being invested in systems such as CRM. Many organisations in our survey indicated that their focus was on improving IT processes and linking them to people changes, rather than installing new systems. For instance, one UK bank has changed its user interface so that customer facing staff now receive 20 — rather than 200 - different sales prompts from their CRM systems during a customer interaction. This reduces complexities and allows the staff to use more discretion.

Finally, the processes around sales force effectiveness are being enhanced. We believe that understanding the customer purchase journey is critical in enhancing such processes (see chart below). At each stage of the purchase the customer uses different channels to gather information, buy and transact a financial service.

Sales and operational effectiveness can be increased by linking process improvements to how the customer interacts with the bank or insurer. One option we would advocate is the use of so-called "paraplanners". These are staff are trained to a lower standard than traditional financial advisors. Therefore they can focus on servicing standardised products yielding significant increases in productivity. A Belgian bank uses a similar type of thinking in its branches, with young tellers dealing with standardised "daily" banking needs.

Figure 10. Customer Purchase Journey

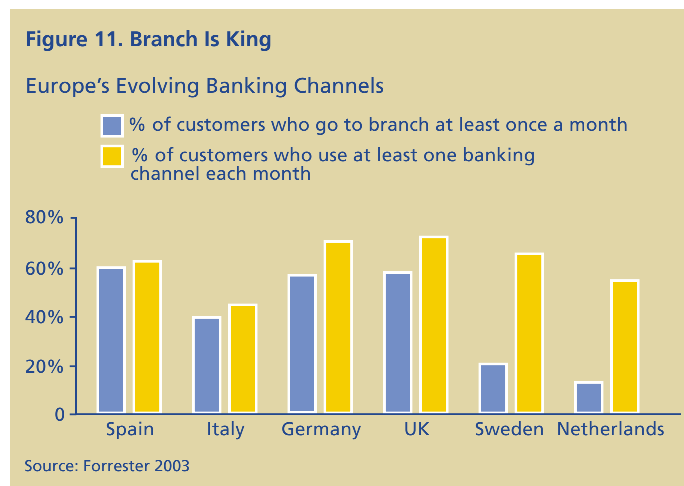
Source: Deloitte

The Branch – the battlefield of the future

The branch will be central to future success. It provides a show case for changes elsewhere in the organisation. If the people and process changes have been implemented well –- and linked to the strategy and structure of the organisation -– revenues and service quality are likely to rise significantly. In short, the branch will be critical both in manifesting changes made within the business and as a flagship of the organisation. Without doubt, the branch will be the battlefield of the future.

The customer sees the branch as central to being a retailer in financial services. Deloitte research shows that the branch is the preferred channel of over half of all customers in the UK.[10] Other data shows that customers in most major European markets visit a branch at least once a month (Figure 11).

Figure 11. Branch Is King



Source: Forrester 2003

With branches accounting for up to two-thirds of the operating costs in a typical European retail bank there is still strong pressure for further branch closure. Our survey found that many players were grappling with how to optimise use of the branch within their overall business. Many of the institutions which responded were themselves the result of a large domestic merger; requiring a rationalisation of branches. However, there appears to be no consensus in the industry on the optimal density, staffing levels and service offerings offered in a branch. Indeed, the average number of staff at a typical branch across Europe has remained almost constant over the last 10 years.[11]

Our survey showed that many institutions are turning their attention towards the branch network. The case of a Belgian bank highlights the role the branch is beginning to play in the cultural and business transformation of financial institutions. The division of responsibility at the branch has changed radically, with 20 percent of branch staff now tellers dealing with "daily banking" needs. Often these roles are filled by young people.

The bank has also introduced dedicated teller tools such as 'one click' for total customer information. In some instance these tellers also sell simple products that are very easy to handle. The tellers have clear instructions to send customers to either retail advisors (these are operational advisors who work on their portfolio of customers, make late appointments and answer queries), or to professional advisors (who independent advice for wealthier individuals or small enterprises). Some branches also have administrative staff: the bigger the branch becomes the more administrative people you need. However, other survey respondents have moved all processes out of the branch.

There are many reasons why the branch is at the core to building a successful selling machine. They include the shift from an administrative culture to a service culture, manifestation of the brand, creating an experience that delivers on the brand promise, and optimises customer service. The bank that takes the lead in balancing its investment in branch infrastructure with its investment in branch culture is likely to achieve significant competitive advantage. In short, getting it right in the branch is likely to be what differentiates the winners from the losers.

Making it happen — Micro-management

Surviving and prospering in the retail financial services market of the future requires one simple ingredient – obsessive focus on the day-to-day detail. Micro-management, if you like. Financial institutions are complex organisations that rarely reward this type of behaviour. However, some banks and insurance companies are now shedding the shackles of "old" banking practices, to run their business much more efficiently and effectively.

Central to an effective micro-management strategy is the ability to track the correct data. We would recommend the following five categories for measuring data: customers, product sales, staff, profit and branch/channel usage. For instance, under the category of customer measures such as customer satisfaction, footfall and churn are key indicators. In the profit category, margin per product and branch profitability are two possible measures. What is critical is that these data are available at the branch level within 24 hours.

A huge challenge for large financial institutions involves capturing and collating the correct metrics. However, the vast majority of institutions were not built to deliver this kind of information. This presents an opportunity for new entrants to build Greenfield business infrastructures that deliver key performance indicators as part of the day-to-day functioning of the business.

It is paramount that the infrastructure can collate, analyse and send out sales targets on a daily basis. While this is only a pipe dream at present for many financial institutions, others are making more progress. One major UK bank already has such a system in place. Another expects to have a branch P&L breakdown for each product sale within 24 hours sometime next year. This marks a fundamentally different way of operating an organisation going forward. Such systems allow true micro-management from the centre as products are pushed that meet customer demand and have attractive margins. This provides the type of model that will have online, real time reporting systems.

The future winners are likely to be banks and insurance companies that embrace this transformation. The blending together of retailing, finance and technology skills across the organisation will pave the way for a more adaptive, flexible and profitable organisation. Nothing less than a complete cultural and business transformation will allow businesses to succeed –- and the difference will be in the detail.

Conclusions

This report has attempted to convey the major challenges financial institutions face in attempting to transform their organisation in re-igniting the growth agenda. A key theme of this report is that many players need to re-learn the habits of growing revenues after a period of intense expense reduction.

In this document we have focused on providing insights into what will differentiate winners from losers. Putting clear blue water between one financial institution and another can only be achieved through flawless execution — in generating revenue, but also in controlling expense levels. Nothing less than a cultural revolution needs to take place in order to effect this change within the organisation. In essence moving the institution from a transaction orientated culture to one focused on sales and customer service. To be successful in the future requires the blending of traditional financial acumen with savvy retailing and astute technology architectures.

Moving forward retail financial services will become a key battleground for financial institutions to re-ignite their growth agenda. Many already derive a significant component of their profit pool from retailing financial services. In future this focus is likely to be reinforced for several reasons. First, the Basel Capital Accord is likely to drive institutions to shift their focus towards retail to take advantage of the less onerous capital measures currently proposed. Second, the economic environment is likely to see a (slowly) improving picture over the next few years resulting in a gradual rise in interest rates – such a scenario would also favour retail financial service activities. Finally, the personal sector makes up around two-thirds of economic activity, so the bulk of money flowing through the economy at any one time is largely dependent on consumers propensity to spend or save.

However, the level of activity on either side of the balance sheet will be determined by the level of consumer debt. For instance in some countries notably the Netherlands and the UK, record high levels of personal debt are likely to see financial institutions focusing on savings and investments. Equally, Italy and Spain still offer significant opportunities to grow lending and consumer debt revenues. Overall Europe is likely to see swings towards saving and investment behaviour over the medium term, yet we believe that this change is unlikely to be significant enough to solve the pension shortfall. Much will depend on any return of the equity culture that took hold in the late 1990s, only to wither on the vine in the early years of the new Millennium.

To compound the issue, large scale growth is very difficult to attain. This is especially true in European retail financial institutions which are hugely complex organisations. For example, when Jack Welch announced his intention for GE to become the first $70 billion growth company he was setting the bar high for his organisation. This proclamation from Welch provides an important message for financial services firms. Few have a leader setting the tone in such clear and unambiguous terms –- everyone in GE understood the message from the top.

In sum, building a competence for growth requires three cornerstones: commitment, strategy and capability.

Commitment: A deep commitment to growth is required. Value-creating growth does not occur by accident. A financial institution must place the growth agenda high on the priority list and be prepared for the long-haul.

Strategy: Deploying a strategy that appreciates that growth is dependent on both people and (business) processes is critical. Aligning brand, people, processes and technology lies at the heart of a successful business transformation. In particular it is important to have the branch at the core of all aspects of the transformation. Nonetheless, the value lies in executing against this strategy.

Capability: In building a (responsible) selling engine at the heart of a financial institution it is necessary to grow or acquire key capabilities. 1) The ability to implement a high performance, sales and service orientated culture needs to be central. 2) Developing finance and risk systems that allow the business to micro-target customers and provide detailed profitability data at all levels of the organisation. 3) Creating management hierarchies that prevent any in-appropriate sales while motivating employees to build sustainable revenue streams.

The critical point to note is that all three of these factors must be in place to build a (responsible) selling engine within the business. The inter-dependence and equal weight of these cornerstones cannot be over-emphasised.

Tomorrow's Agenda

Around these three cornerstones, financial institutions need to build an agenda for change. Here are five action points for financial institutions to consider in re-igniting the growth agenda.

The Balanced Agenda: To re-ignite the growth agenda it is critical to focus on revenues, but do not neglect the cost issues. There has been an almost obsessive approach to cost reduction in recent years. A continued focus on operating expenses needs to be maintained but blended with growing revenues sustainably. What progress has your business made in creating a balanced agenda?

Responding to Basel II and New Product Economics: As is widely acknowledged it is far more costly to acquire a new customer compared to selling to an existing customer. A variety of factors in the marketplace –- including regulatory, market and Basel Capital pressures – are combining to make a more detailed understanding of product economics critical. Going forward it is essential to have a detailed grasp of the changing risk profile the institution. This can only be achieved by building a financial and risk infrastructure that collates analyses and communicates this material to management. Best practice will dictate in the implementation of such systems moving forward. Does your organisation have the quality of data required to take such decisions? What infrastructural investments are required to comply and exceed regulatory mandates?

Meeting the Regulatory Challenge: Understanding the movements associated with the tax and regulatory environment is increasingly challenging. At the European level FSAP is attempting to harmonise rules governing the operation of financial institutions. Complying with the myriad of local tax and regulatory codes is equally challenging. Does your business fully understand the implications of depending tax and regulatory codes emerging at both national and the Europe level? How will these help or hinder your business in attempting to grow (sustainable) revenues going forward?

High Performance Culture: Reshaping the way your people behave and interact with customers is core to growing revenues. This type of transformation requires more than speeding up transactions or producing more brochures. It is about radically reshaping how you manage the customer experience from the moment that the customer interacts with the business. Successfully delivering this type of change requires a focus on people. How are you changing the way people work to better align them with business objectives? What training and skills programmes are in place to achieve these objectives? How have retailing skills been fused with financial services skills? Ultimately there needs to be a cultural revolution in the way staff are led, managed, trained, measured and rewarded.

Micro-management: At the core of successful revenue generating firms is an absolute focus on detail. This will separate leaders from laggards in financial services. Building a (responsible) selling machine will be dependent on building new inter-linked people and process capabilities. This will require risk, finance and management systems that can provide granular (almost) real time data. To grow revenues going forward requires a near obsessive focus on the customer, channel and product profitability. Does your business have systems that can deliver on these demands? What changes in people behaviours and practices will drive future revenues? Above all does your institution have a grasp of the detail?

Investor checklist

As the battle for wallet share intensifies, increasingly execution is going to determine the winners and losers. We have prepared a checklist of key issues to help determine whether a bank is sufficiently focused on execution.

The balanced agenda

How does your institution determine the balance between revenue growth and cost control?

Are your sales incentives base on revenue or profit growth?

Which processes do you believe give you a competitive advantage in growing revenues in a sustainable fashion?

Which products are important for you in generating deeper customer relationships?

Do you feel it is more important to be a product innovator or an efficient provider?

The regulatory regime and new product economics

Does your organisation have real time data on product and channel profitability?

What are the implications of Basel II for your business model?

What infrastructure investments are required to comply and exceed regulatory mandates?

Does your business fully understand the implications of depending tax and regulatory codes emerging at both national and the Europe level?

How will these help or hinder your business in attempting to grow (sustainable) revenues going forward?

What checks do you have in place to prevent misselling?

How does your institution balance customer needs with the desire to sell more products to the customer?

High performance culture

Do you have the right people in place at senior management, line management and customer relationship levels?

What is the age profile of your staff?

How have retailing skills been fused with financial services skills?

What is your annual training requirement and how does it compare to the regulatory minimum?

Is your sales force regulated?

How are you changing the way people work to better align them with business objectives?

What is the average age and period of tenure of your customer facing staff?

What incentives are available for your staff to grow revenues an control costs?

Do you believe that your institution has a performance based culture?

Micro management

Does your business understand customer, product and channel profitability?

How readily available is this information?

Is this information disseminated around the group or is kept as a management tool?

How frequently do you change your sales targets for each channel?

How frequently do you adjust your sales incentives?

How frequently do you assess the progress of your staff and make changes to personnel?

What changes in people behaviours and practices will drive future revenues?

What additional information do you wish that you had available in order to improve decision making?

End Notes

[1] ECB 2003

[2] Deloitte Research/Linklaters "Beyond Traditional M&A 2003."

[3] Pension funds in The Netherlands are also public funds – public funds include ABP, while private funds include insured pension plans. These funds are controlled by individuals with investment returns blocked during the lifetime of the pension policy.

[4] The EU Financial Services Action Plan: A Guide" prepared by HM Treasury, the Financial Services Authority and the Bank of England in July 2003.

[5] The EU Financial Services Action Plan: A Guide" prepared by HM Treasury, the Financial Services Authority and the Bank of England in July 2003.

[6] Financial Times 28 August 2003

[7] Deloitte Research ''Certainty of Change" June 2003

[8] French Banking Federation 2002

[9] Keynote address Annual Cornhill Club Dinner. March 2000

[10] Deloitte & Touche. Branching Out? 2003

[11] European Branches. Unisys. 2003

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