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THE DYNAMICS OF COMPETITION WITHIN THE BASIC BANK MARKETS IN THE UK

by

Michael G. Whitehead, BSc

A Master's Thesis submitted in partial fulfilment of the requirements for the award of Master of Philosophy of the Loughborough University of Technology

April 1990

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To my parents for their support and encouragement
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ABSTRACT

THE DYNAMICS OF COMPETITION WITHIN THE BASIC BANK MARKETS IN THE UK

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This thesis examines the competitive forces that are currently restructuring the basic bank markets. These markets are primarily concerned with retail deposits, the payments system and a range of lending related services. In the past, they have been the traditional preserve of the large clearing banks and more recently the building societies - now an increasing number of players such as foreign banks, retailers and credit card companies, have entered, or are threatening to enter, this market.

It is the contention of this thesis that the adoption of a marketing concept is vital to the success of these market players, who will need to restructure their organisations and become more customer and market-orientated. A further contention is that to be able to respond to the market more efficiently, the marketing ethos must permeate the entire organisation.

The thesis also contends that technology of all the catalysts of change in the market has done the most to affect the competitive environment. It has reduced processing costs, increased efficiency and enabled a whole range of players to compete on a more equal basis. In future, technology certainly has the capacity to radically alter patterns of competitive behaviour in the basic bank markets.
Finally, some of the implications relating to the new approach to marketing and the introduction of new technology are considered. Particular reference is made to the changing staff and management profile requirements of the banks and an assessment is made of the possible organisational issues.
INTRODUCTION

FOREWORD

During the 1970s and the 1980s, a great deal of structural change occurred within the market for retail financial services. This was aided by systematic deregulation as the financial sector moved away from a cartelised oligopoly. The introduction in 1971 of Competition and Credit Control was the initiating factor in signalling the demise of the clearing banks' cartel on interest rates and competition. The entry of the banks into the UK mortgage market was a key factor in the movement away from traditional business, an action facilitated by the abolition of the Corset in 1980 - allowing banks to compete with building societies on a more equal basis.

The Building Societies Act of 1986, has enabled societies to offer a wider range of products and services to their customers. To fund this new, diversified business, societies have the choice of converting to a public limited company or retaining their mutual status. As legislation allows many institutions to offer a more diversified portfolio of products and services, we have observed that many financial service providers in the UK are organisationally grouped in such a way as to be able to offer a 'supermarket' variety of financial services and products. Pioneered in the US, such financial conglomerates should, theoretically, benefit from economies of scale and an improved customer relationship.
In addition to deregulation, new technology, in particular, has enabled new entrants to attack significant niche markets within the basic bank markets. These new entrants, particularly retailers, have a history of successful marketing in a highly competitive market.

Hence, legislative and market pressures have combined to increase the number and competitiveness of the players within the market for basic banking products and services.

Accordingly, this thesis will examine the changes in market structure that have taken place as a response to technological developments and increased competition. The need for players to be more market-orientated is also examined. Emphasis is therefore placed on the two forces that are considered to be of primary importance in driving change in this marketplace - marketing and technology. Finally, the thesis will close with some concluding remarks and recommendations for further research.

METHODOLOGY

By undertaking such a wide-ranging area of research, I have consciously chosen to look at many of the influencing factors on this marketplace. It is my opinion that the evolution of this market results not from a single dominant force, but from the interactions of a variety of forces that merit inclusion in this research.

The nature and recent history of this market indicates that competitive changes occur rapidly, as do the corresponding responses. Levels of product innovation have been high in the market because of the need to maintain competitiveness. Product replication has also been made easier by
advances in technology, and this fact combined with increased competition has generally shortened product life-cycles. An extensive literature survey of periodicals and journals was, therefore, found to impart more up-to-date information than the textbooks. This fact is reflected in the prominence of recent reports and articles in the references and bibliography.

To achieve more meaningful research in this dynamic market, I chose to combine theoretical research with empirical work. This latter aspect took the form of a series of interviews with senior financial managers, invaluable insight being gained into the possible future development of this market. Rather than quote these managers directly, which may result in opinions that differ to those of their company, an attempt has been made to identify generally held views about the market and its future development. Within this context the research will allude to the views of the "interviewees" to substantiate the basic premises of the research.

In conjunction with my supervisor, I opted not to utilise a postal questionnaire for several reasons. Firstly, I felt that written questions need to be narrowly defined and tend to produce short, rigid answers. Secondly, the opportunity to ask follow-up questions is lost. Finally, for reasons of competitive advantage, little if any new information is given.

During my time at the Banking Centre, I was fortunate to be part of a team of three researchers, examining current trends in retail financial services. I must thank Nick Wells of TSB England & Wales plc and Hugh Davies of the Royal Bank of Scotland plc, for a valuable exchange of ideas and information.
PART I - FRAMEWORK AND OVERVIEW
1. EVOLUTION OF RETAIL FINANCIAL SERVICES

1.1 PAST DEVELOPMENTS

In the 1970s, clearing banks looked to expand the international and corporate sides of their business. The corresponding failure to compete effectively in the domestic retail market provided an ideal opportunity for competitors to improve their market position. This particularly applied to the building societies, who targeted their marketing campaigns to secure an increasing proportion of retail deposits. The image created was that of an approachable, flexible organisation which resulted in the societies becoming the largest holders of personal sector deposits, overtaking the banks in 1975.

Subsequent deregulation of the basic bank market meant that competition from other "banks", specifically the TSB and the National Girobank, increased as they were permitted to provide a much wider range of services. This was facilitated by the TSB (Trustee Savings Bank) Act and the Post Office (Bank Savings) Act of 1976.

The early 1980s saw the clearing banks respond to these changes by focusing their attentions back towards the profitable domestic markets. They commenced a defence of their traditional markets (particularly, the acceptance of retail deposits and the provision of money transmission services) and started to compete in new markets - of which the house mortgage market was perhaps the most significant. This increased even further their range of products and services. Market forces and increased use of technology have resulted in all market players attempting a re-structuring to be more cost-effective and competitive.
The move towards the increasing importance of domestic retail banking has been replicated world-wide. Within a few years, Citicorp believe that 60-70% of its income will be contributed by its domestic retail banking operations (up from the present 45%).[8] Indeed, Citicorp has picked out consumer business as its chief priority for the 1990s. John Reed, Chairman of Citicorp, sees the bank doing most of its future business with individuals rather than companies. The bank is targeting an annual growth of 20% per annum for its domestic retail business. The bank is also looking to increase its involvement in the UK domestic retail banking market.

"For us to come into the UK marketplace and attempt to create a transaction-orientated, branch-based business would imply a major commitment. We are seeking to pace these commitments."

John Reed, Chairman, Citicorp, May 1988

Essentially, foreign institutions will look to enter specific segments of the UK domestic banking market. This could be through niches such as the credit card market, eg Chase Manhattan or through mortgage provision, as have a few European banks. Bankers in the UK also acknowledge the threat from the Japanese, as they switch their attention to domestic retail markets. The enormous capital bases of some Japanese banks, mean that they have the potential to consider bidding for a significant share of retail banking business in the UK.

Traditional demarcations between different financial institutions have been steadily eroded, with institutions moving into each others traditional preserves. This has resulted in the present financial system being less structured and delineated than in the past.
Llewellyn[26] identified the current pace of change as a potential factor in leading some institutions to enter markets they are ill-equipped to serve.

Retail organisations have followed the example of Sears Roebuck in the US and have started to offer a limited range of financial services. Generally, they are well placed to enter this market as they have an effective distribution channel in the form of a wide network of outlets, convenient opening hours and a good image in the form of a reputable name. This proliferation of market players has resulted in financial products becoming even more homogeneous.[20] Competitive advantage through product differentiation, if it ever was possible in the past, is now very difficult to achieve without incorporating some aspect of the new and emerging technology into the design of financial products.

1.2 CURRENT SITUATION AND COMPETITIVE FORCES

The study revealed that the basic bank markets are changing predominantly because of the following three reasons:

- The consumer is becoming more financially sophisticated and aware.
- Deregulation is removing traditional barriers of entry to many markets.
- Technology is changing the basis of competition.

A major cause of change has been deregulation, which has removed many legislative barriers which traditionally protected the markets. For instance, building societies have been freed from the legislation which essentially restricted their activities to accepting retail deposits.
from society members and lending them back to the same members in the form of house mortgages. They can now offer a wide range of banking services and products in addition to widening their asset base by borrowing more readily on wholesale capital markets. Moreover, if they choose to be converted into companies they will be controlled by the Bank of England rather than the Chief Registrar of Friendly Societies.

Information technology is capable of decreasing in-house costs, lowering expensive labour-intensity and offering new strategic opportunities to management through the potential provision of accurate cost and margin information by product line and customer group. Delivery systems and product design which incorporate reliance upon specific technologies are already beginning to emerge. Technology is also internationalising retail financial markets - a UK credit card holder can make world-wide payment transactions with almost immediate authorisation.

Although most commentators have placed particular emphasis on the effects of technology and the deregulated marketplace changing customer attitudes are equally important. Citibank, for instance, has placed particular emphasis on changing customer attitudes and has identified the following important factors:
- Less debt conscious
- Less willing to save
- More receptive to new technology (especially the young)
- More willing to explore service alternatives
- Less customer loyalty

In the process the customer market has become increasingly fragmented. For instance, some individuals are seeking a more specific financial
service to match their particular needs. Others seek to trade-off convenience in purchasing financial products against the time involved in searching out the best product. Probably the largest element of customers, consider themselves ill-informed about a market they don't really understand. They prefer to rely on the image of a reputable supplier who will provide them with good value for money. The first type of customer contains business with the highest margins, if not the highest total value. These individuals are looking for specialist independent advisers or institutions that provide private banking facilities. The other customer types contain the lower to middle income sectors traditionally associated with the clearing banks. Increasingly the point of sale of such products is going to be associated with convenience and familiarity with the institution. The growing importance of the key "life products", eg, mortgages, insurance products and pensions, may well see the clearing banks competing against life insurance companies, pension funds, unit trust managers etc for their traditional customer base.

1.3 FINANCIAL SUPERMARKETS

"The bank is dead. Long live the financial supermarkets."[19] The concept of financial supermarkets has been frequently cited as the way forward in retail financial service provision. A financial conglomerate would be able to provide a full range of services by horizontal diversification. The basic rationale behind the concept of financial supermarkets lies in two principal areas: firstly, economies of scale will be achieved by spreading fixed costs over a wider product range and secondly, a closer customer relationship should be possible if all products could be purchased from one institution.
Market forces, however, are now requiring institutions to position themselves very carefully within the total market and to efficiently service a niche segment or niche segments of the total market. This focus strategy (see Chapter 2) would seem to be at odds with the concept of financial supermarkets. Additional difficulties may be encountered in obtaining synergy from the different departments within the organisation. Without this synergy some of the economies of scale could be nullified. Some of the interviewees also questioned, whether staff and management could deliver the required level of service with such a large product range.

An alternative approach to the financial supermarket may be the joint venture. Foreign banks, insurance companies etc see the joint venture as an ideal way of obtaining an initial foothold in the UK market for personal financial service. It is also a method typically used by smaller building societies to enable them to provide money transmission services to their customer base. The joint venture would seem to correspond more closely with the idea of focus, as it enables each partner to provide the services they can best provide, to the customers they already know.

Despite the advantages of each method, it would appear that there is no conclusive proof as to the desirability of either alternative.

"No particular combinations of activities can clearly be shown to be more conducive to the achievement of synergies, or economies of scope, than others. Rather it would appear that there is no obvious superiority - or inferiority - of financial services companies associated with conglomerates relative to independent
companies of the same type. Success or failure appears to be much more a function of the particular managements and competitive situations of the individual firms."[22]

1.4 THE THREAT FROM NON-BANK FINANCIAL INTERMEDIARIES

As mentioned, some non-bank financial intermediaries (NBFI), especially the building societies, were successful in attacking the personal sector in the 1970s. To compete effectively against this increasing threat the clearing banks have redefined their business to view these entrants as major competitors.

New entrants will always have an advantage over established players: unencumbered by previous commitments they have the ability to focus and specialise in the segments they believe to be most profitable. Consequently the marketing campaign for most clearing banks typically has to be spread over a wide number of products or "brands".

Recently, we have seen that the NBFI have invested heavily in advertising, direct selling and the development of strong corporate images. Investing in "branding" is one of the responses used by the clearing banks to counteract the marketing advantage attained by the NBFI. The need to create captive customers helps offset high customer acquisition costs, by selling an integrated package of products and services over a long-term relationship. It has been estimated that if the customer is satisfied with the overall relationship, a competitor wishing to poach one element of business could have to offer at least 3% more for the money.[28]
The clearing banks also face greater pressure on their profitability compared to NBFIIs, which is a direct reflection of their balance sheet structure. For a typical clearing bank, deposits from the UK retail sector (which are being won at an ever increasing cost as competition intensifies) represent around 30% of liabilities, but only 14% of assets are accounted for by lending to the UK retail sector where spreads tend to be higher and default risks lower than for wholesale lending.[28]
2. STRATEGIC OPTIONS

Not until the past few years have banks made any significant attempt to formulate strategies specifying the markets they aim to enter and retain. Recently, however, the significance of corporate and strategic planning has been realised and departments concentrating on these areas have grown accordingly.

This chapter will examine competitive threats that face organisations and show that by the use of positioning the organisation can perceptually differentiate itself from the rest of the competition. This will be followed by an analysis of the three generic strategic options cited by Porter [34] [35] as the fundamental strategic options facing the organisation. This is further complimented by the work of Miller [29] who examined the relationship between strategy, corporate structure and operating environment. A brief analysis of the Porter framework is followed by a consideration of new product diversification as a strategy. Finally, the importance of competitor analysis in a dynamic marketplace is stressed. Particular emphasis has been placed upon this chapter to match the significance of the subject matter within the overall context of the thesis.

2.1 COMPETITIVE THREATS

The strengths and weaknesses of a company, combined with the values of its personnel determine the company's internal limits to competitive strategy.[34] When looking to formulate its strategy a company must be aware of its own internal position and additionally, the competitive forces that effect the industry in general:
"The company's strengths and weaknesses are its profile of assets and skills relative to the competitors, including financial resources, technological posture brand identification etc ..."[34]

Within the limits of this thesis, I believe that it is worthwhile considering the external competitive forces upon companies in general and then their applicability to financial service providers specifically. The state of competition in an industry depends on five basic competitive forces:[34]

1) Threat of new entrants
2) Bargaining power of buyers
3) Threat of substitute products or services
4) Bargaining power of suppliers
5) Rivalry among existing firms

1) Threat of Entry

Porter[34] identified the following major barriers to entry:

i) Economies of scale and capital requirements - tend to deter entry by requiring high initial set-up costs. For instance, the Bank of England will impose capital adequacy requirements on certain institutions. The alternative is to enter on a small scale, looking only to serve a narrow market.
ii) Product Differentiation - established companies have acquired brand identification and customer loyalty (inertia in this market?) A new entrant may have to spend heavily to overcome this position, maybe through advertising eg. First Direct.

iii) Switching Costs - the one-off costs faced by the buyer of switching from one supplier to another. In financial services, these costs are usually measured in terms of time and inconvenience rather than in monetary terms.

iv) Access to Distribution Channels - to set-up a distribution network will be costly. Alternatives for the new entrant are to use an existing channel (maybe through a joint venture with an existing supplier) or, as in the case of First Direct, to create an entirely new distribution channel.

v) Government Policy - can act as an implicit or explicit barrier to entry, depending on the nature of the regulation. The current moves towards the liberalisation of economies may reduce the importance of this barrier.

2) Bargaining Powers of Buyers

Especially powerful threat when a single buyer purchases a significant percentage of the seller's output. Clearly, this is not the case within the basic banking markets - although "good customers" may be able to negotiate a better deal than otherwise.
3) Threat of Substitute Products

Porter[34] identified that substitute products that deserve the most attention are those that:

i) Are subject to trends improving their price/performance trade-off

ii) Are produced by industries earning high profits

The interviewees claimed not to be concerned about the substitutability of existing services. Although, all acknowledged the potential impact on profits of interest-bearing current accounts.

4) Bargaining Power of Suppliers

A supplier group will be powerful if the industry is dominated by a few companies and it is not obliged to contend with substitute products. Given that the basic banking market has become significantly more competitive in terms of the number of players, the bargaining power of an existing supplier is being reduced.

5) Rivalry Among Existing Companies

The level of rivalry among existing players can be something of a "double-edged sword". If existing rivalry is low, then it may be easier for new entrants to add to competitive pressures. However, if the existing rivalry is perceived to be low a new entrant may question the profitability of that market. The opposite may be true when perceived rivalry is high.
When the company's internal capabilities have been assessed in conjunction with the external threats - the company is then able to look at its position within the industry.

2.2 POSITIONING WITHIN THE INDUSTRY

Inherent in a differentiated or focused strategy is the concept of market positioning. Market positioning refers to the relationship between a bank and its products/services relative to its competitors. The purpose of positioning is to perceptually differentiate, particularly, in a competitive market, the organisation and its products/services from the competition. It is important for clearing bank and building society marketeers to realise that customers have a perception of their bank and its offerings and that it is a vital task to shape and control that perception as a consistent part of the bank's strategy.[20]

The task increasingly facing clearing banks and building societies is to decide whether to position themselves as challengers to the market leader or as specialists in market "niches" which are too small to be attractive to the leader and challengers. Experience in non-financial markets would suggest that the challenger's role in marketing is frequently exciting but seldom as profitable as that of the leader. In order to challenge the leader, small, less dominant institutions in the basic bank markets must resort to relatively expensive promotional efforts, offer lower prices, and ensure that they offer more value than the leader. In effect, most challengers become price competitors unless they can position their product as offering unique advantages over the leader. Institutions which neither challenge the leader with
differentiated products nor seek out uncontested market positions may find themselves perceived as low-cost, low-value institutions who inevitably must offer their products at lower relative prices to attract customers.

Positioning determines whether an institution's profitability is above the industry average. Competitive positioning is often more important than the potential of the market. Hence, a clearing bank or a building society that is well positioned can earn high rates of return, even though the average profitability of the market is low.

Porter argued that an effective corporate strategy must take both offensive and defensive action in order to create a defendable position against competitive forces. Hence, a player in the basic banking market must position itself in such a way as to compete against existing players (defensive strategy) and additionally look to possess an innovative range of products and services that will give it a competitive advantage over existing players and potential competitors (offensive strategy). The defensive and offensive strategies may be combined when the company looks to anticipate shifts in the factors underlying the competitive forces.

The present less regulated banking environment makes the positioning decisions of clearing banks and building societies a vital part of strategy if the new competition is to be met successfully. Too many organisations have responded to competition by attempting to re-position themselves merely by a change of name or logo. Other firms have added non-bank services without addressing the impact of these changes on their competitive position.
2.3 THE GENERIC STRATEGIES

At the broadest level, Porter[34] identified three generic strategies (which can be used singularly or in combination) to help create the defendable position in the long-run and help the company to outperform competitors in the industry.

1) Overall Cost Leadership
2) Differentiation
3) Focus

Effectively implementing any of these generic strategies usually requires total commitment and supporting organisational arrangements that are diluted if there is more than one primary target.

1) Overall Cost Leadership - to yield an above average return in this highly competitive industry, a bank may choose to be the lowest cost producer. This will be a defendable position but is likely to have involved high up-front expenditure through up-to-date equipment or aggressive pricing. Most of the interviewees agreed that their institution was trying to improve its cost income ratio - meaning that competitive advantage in this area may be hard to achieve.

2) Differentiation - "creating something which is perceived industry-wide as being unique".[34] Differentiation tends to provide insulation against competitive rivalry because of brand loyalty by customers and the resulting lower sensitivity to price. Achieving differentiation may sometimes preclude gaining a high market share as it often requires a perception of exclusivity, which is incompatible with high market share.
Most interviewees stated that their organisation was aiming to differentiate itself from its competitors

(3) Focus - essentially this is market segmentation. The entire focus strategy is centred upon serving a particular market very well, rather than catering for the whole market. Hence, a focus strategy will achieve low-cost or differentiation for its target but not for the market as a whole.

"We believe that tomorrow's most successful banks will be built on focus not diversity."

Lloyds Bank Annual Report 1988

The bank will then be able to serve this sub-group more effectively than its competitors who are serving the whole market. Coutts & Co. is an excellent example of a player which has successfully pursued a focused strategy. It has managed to protect this strategy from erosion by more broadly-based competitors or by imitators, and at the same time has managed to prevent its customers from being lured away by other retail banks.

Increasingly, the clearing banks and building societies will adopt one, or more, of the above strategies. For those which do not and attempt to provide a wide range of services in a universal market, it is likely that their profitability will fall as a consequence of losing the high volume customers who demand the low-cost option and also lose the high margin business to those competitors who focus.
2.4 PROBLEMS WITH GENERIC STRATEGIES

Although it would appear apparent that one (or a combination) of the above strategies has to be followed for competitive success, banks must be wary of the possible problems associated with each strategy.

(1) Overall Cost Leadership - as already mentioned cost leadership is difficult to maintain when the whole industry is looking to reduce costs. Porter\[34] argued that the firm must also be able to significantly undercut the prices of its competitors to maintain this as a competitive strategy. When an organisation, regardless of industry, solely concentrates on cost reduction, it may lose the ability to see a necessary product or marketing change in short, it may lose its innovativeness (this is especially dangerous when innovative new competitors are entering the marketplace).

(2) Differentiation - this would probably be unable to preserve brand loyalty if the low-cost option was significantly cheaper. More important, is the increasing difficulty in achieving differentiation via innovative products, as technological improvements mean that replication can be achieved quickly. Differentiation based upon product designs which incorporate specific technologies or systems may, however, be an increasing facet of the basic bank markets in the future.

Industries in which it is difficult to convince the customer of the existence of genuine product differentiation will, in the words of Michael Porter,\[34] be characterised by "intensive price and service competition". Porter also suggests that where product differentiation
is difficult, differentiation by image, although intangible, is easier to achieve and sustain, but this has not been the experience of the clearing banks. Differentiation based upon technology, however, may be an important and increasing facet of bank competition in future.

(3) Focus - cost-effectiveness will fall if the focusing strategy is pursued too rigorously. However, this disadvantage is not as great as those previously mentioned as it is within the control of the focusing bank. To prevent the possibility of the following problem arising, constant monitoring of the profitability of segments should be implemented.

"A focus strategy concentrating on a segment is vulnerable to the disappearance of that segment. This may be the result of changes in the environment, technology or competitive behaviour". [34]

2.5 LINKS BETWEEN STRATEGY, STRUCTURE AND ENVIRONMENT

Miller[29] empirically examined the correlation between corporate strategy and both structure and environment. He furthered the work of Lawrence and Lorsch[25] and Khandwalla[23] who had identified three structural variables used to handle contingencies posed by their operating environments: uncertainty reduction, differentiation and integration. Uncertainty reduction relates to the measures taken to mitigate environmental unpredictability. Differentiation involves the promotion of measures necessary for adaptation and innovation. Organisational integration relates to the methods by which greater internal controls and communications may be achieved.
In stating the correlation between strategy and structure, commentators[10][37] had previously stated that **structure followed strategy**. Whereas the opposing view is that **structure contains strategy**, by a combination of environment, common beliefs and organisational culture[1][31]. Bourgeois[7] had stated that structure is determined by the environment.

We can now merge the Miller[29] findings into the Porter framework. Although Porter had stated that only one of the generic strategies should be adopted as the primary target, Miller and Friesen[30] found that strategies of differentiation and cost leadership could be pursued simultaneously. Miller[29] distinguished further between Porter's differentiators by separating **Complex Product Innovation** (CPI) (also see 2.6 Diversification Into New Product Areas) and **Marketing Differentiation** (MD). Whereas marketing differentiation is defined in a similar way to Porter's differentiators, complex product innovation involves the degree to which the organisation introduces major new products or services. Miller [29] used the strategy of breadth (the opposite of Porter's focus) to describe the range of products, services, customers and territory the organisation covers in a given market. The strategy of conservative cost control (CC) is the same as Porter's cost leadership.

2.5.1 ENVIRONMENTAL FINDINGS

Organisations in dynamic environments are most likely to pursue more innovative strategies than those in stable environments. Additionally, the adoption of the CPI strategy may lead the organisation into newer, more dynamic environments. New products may even create a dynamic market segment.
Marketing differentiation will typically be used in response to a hostile environment. As with CPI above, reverse causality may raise the level of market competition as the market segments with providers looking for their niche.

The strategy of breadth strongly correlates to environmental heterogeneity. Miller\cite{29} argued that breadth could be pursued through innovation, where there is likely to be a positive relationship with dynamism. Alternatively, breadth may be pursued via a cost control strategy, where a positive relationship with stability is likely.

In general a cost control strategy is found in a stable environment, although the results were not conclusive in this area.

2.5.2 STRUCTURAL FINDINGS

The pursuit of the CPI strategy necessitates the avoidance of formal rules, procedures and hierarchies. There tends to be a structure that favours flexible attitudes and a flatter management structure.

With a strategy of marketing differentiation, there tends to be a structure with a high level of support staff and middle-line personnel. As this structure requires market responsiveness, flexibility and adaptability are important. Less bureaucratic devices and more integrational devices that facilitate collaboration are evidenced. The need for efficiency is likely to lead to a high frequency of cost controls and management information systems (MIS).

Miller\cite{29} combined breadth with innovation (BI) and breadth with cost controls (BS) to define strategies more precisely. If a BI strategy is
adopted, then structure will be closer to that of CPI - with a high frequency of integration and less bureaucracy. If more of a BS strategy is adopted then more bureaucracy will be evidenced.

Organisations that follow a strategy of conservative cost control are likely to employ formal policies and standard operating procedures that will increase efficiency. However, they tend to reduce flexibility by reducing the range of tasks and making their performance routine. Marketing and innovation will tend to be low but the evidence of devices used to reduce uncertainty will be high.

Miller[29] concluded that the direction of causality could not be determined, but that particular strategies and structures were commonly evidenced together and often found in a particular environment.

2.6 DIVERSIFICATION INTO NEW PRODUCT AREAS

The strategy of service provision diversification shall be examined in detail later. It is nevertheless worth briefly considering it as an option at this stage. The rationale of service diversification is simply to increase profitability by offering a wider range of services to your customers. The probability of successful diversification is likely to decline the further one moves from the existing customer base. Michael Porter[35] argues:

"In some cases diversification will strengthen a firm's position against competitors, while in others it will be dictated by the need to match competitor's diversification defensively".
"Successfully attacking a leader always requires some kind of strategic insight. A challenger must find a different strategy in order to neutralise the leader's natural advantage and recognise or create impediments to leader retaliation."

The corporate planning function must, therefore, examine the range of products/services that the organisation currently provides and those it wishes to provide in the future. Within this context the competitive strategy must assess the likelihood of the organisation being able to compete effectively in that market. It is vital that new products and markets are correctly chosen and matched, as exit costs are often high, both in terms of money and reputation. Marketing theory suggests there is no clear advantage to be gained by producing "me-too" products, although experimentation may be desirable until the comparative advantages of the various providers of financial services becomes clearer.[14]

The involvement of a wide range of personnel (including line staff) in corporate strategic development may be important where the provision of new products is being examined. These are the people, after all, who will be selling the product. As operational staff may be less aware of the strategic context in which the change is proposed, it is therefore important that the reasons for certain corporate actions are clearly explained.

The success of product diversification will always be difficult to assess, especially in financial terms. Those building societies that diversified into money transmission would probably consider that their current accounts have been a success - their reputation and standing
within the financial community has certainly improved. Yet the initial set-up costs were very high and the most successful, the Nationwide Anglia FlexAccount, is only just breaking-even, notwithstanding the one million account holders.

As organisations offer new services, difficulties may be encountered with the level of staff expertise. Additionally, new services/products may be difficult to categorise within the existing organisational structure. The concept of strategic "search" for activities which "fit" into the existing organisational structure was noted by Ennew and Wright.[14] The constant quest for new markets may lead to unsuitable acquisitions which may need to be divested.[14] This was confirmed by the Nationwide Anglia Building Society, which has decided to shed 50 of its estate agency branches with the downturn in the property market.

2.7 COMPETITOR ANALYSIS

Financial institutions must increasingly examine existing and future competitors when considering its strategic position. In the increasingly deregulated financial services environment, the analysis of potential competitors is especially important.

The threat of new entrants entering the basic bank market is rising even though there are enormous costs and capital requirements. There has been an increase in the number of outside competitors, whether these be foreign players or those from a different commercial sector such as the major retailers. Significantly, rivalry is no longer constrained by size - with small players attacking niche markets very effectively.
Technology is more widely available and significantly cheaper than in the past. This allows for reproduction of services and products in a short space of time. Increasing financial deregulation and liberation has additionally increased the threat of substitutes.

Accordingly, we have seen a substantial rise in the importance of competitor information. In such a dynamic marketplace, there is a constant stream of new players, products and services. Many financial institutions have now developed in-house databases to track this market information.

2.8 CONCLUDING REMARKS

The choice of corporate strategy is increasingly important as the market becomes more competitive. Corey[12] made the analogy between business and military strategies. Organisations will increasingly look to position themselves within a market segment that they will be able to dominate. This control will be achieved by a combination of a focused strategy and cost-effective service provision. Market definition is an important yet difficult step in the process of strategy formulation. However, the importance of explicitly defining objectives to give purpose and direction to strategies is vital[12]. Buzzell[9] stated that the determination of the scope of the served market is a basic strategic decision. Porter[35] would argue that a focus strategy is the only one that can be profitably maintained, although it is interesting in this respect that Midland Bank has declared its aim to be the lowest cost producer in the retail banking market.
Ennew, Watkins and Wright[15] looked at strategic patterns across the different players in the market. They found that clearing banks are already strongly reliant on differentiation strategies. They also noted that most institutions in the basic bank market are moving away from cost-based strategies to one of focus or differentiation. Competition will therefore increase and comparative advantage will be harder to achieve.
3. STILL SEARCHING FOR EXCELLENCE?

3.1 INTRODUCTION

The much vaunted concept of "excellence" has been applied to many organisations within the major industrial and commercial sectors. Conspicuous by their absence have been the major clearing banks. Although the concept is difficult to define, the thesis will concentrate on the area of service quality. This has been chosen as it is the factor that effects the customer most directly.

Poor service to personal customers has been estimated to cost American banks about $2 billion per year and UK banks around £125 million.[40] Bankers have turned to total quality management (TQM), to help give the customer service he has every right to demand.

When annual reports refer to improvements in quality, they often allude to internal measures of efficiency such as the faster approval of loans or improvements in communications. Although these will indirectly benefit the customer, they principally benefit the bank. A large, bureaucratic organisation tends to militate against quality. A financial service provider occupies a unique position in the customer's mind - errors are totally unacceptable and hence quality expectations are much higher than for other retail organisations.
3.2 WHO DEFINES QUALITY?

The interviewees were in total agreement concerning the gradual shift of emphasis away from quality being defined by bankers, towards quality being defined by customers. This is evidently a function of increasing competition and greater marketing orientation within the financial services market. An increase in customer sophistication combined with an expanding array of products and services, has also facilitated this increasingly "external" definition of quality.

3.3 QUALITY CHARACTERISTICS

Davis[13] identified several factors that are pre-requisites of an "excellent" organisation. His study concentrated upon a much wider spectrum of "banks" than this thesis and included wholesale and retail banking organisations. Its applicability to the basic banking market, however, is in no way reduced by this fact:

(i) An Open Culture - Horizontal and vertical communications should take place as a matter of course, as should the process of decision making by consensus. Senior management should be visible and approachable.

(ii) Strong Shared Values - Davis identified that pride in the bank's performance and heritage often results from internal promotion. However, this can lead to parochial thinking and the inability to respond to new competitive pressures. Common beliefs and strategic aims must run through the company.
(iii) Profit Performance as a Value - Most excellent banks have a dual emphasis on profits and the value of the service. To rely on only one of these aspects is a short-term view. Although quality of customer service is the vogue, the banks must remember that they are in business to make a profit.

(iv) Customer Driven Orientation - Traditionally, banks have appeared to be less customer-orientated than many other commercial organisations. However, banks are beginning to make a real effort to go to the customer and determine his needs. In a free market, customer needs will eventually be satisfied.

(v) Willingness to Invest in New Products - The vast majority of well-managed banks are prepared to invest considerable funds and management time when they are convinced of the merits of the project. Citibank are especially noteworthy in their total commitment to new product development and innovation.

(vi) Strong and Consistent Leadership - "Strategy and planning comes from the minds of the people, not from a paper document".[13] In addition to the paper document, the corporate objectives need to be in-bred into the minds of all staff.

(vii) Commitment to Recruit the Best People - This refers to the recruitment of those people who are most suitable to that particular organisation - not necessarily the "brightest and the best". Skills such as adaptiveness, commitment and ability to work as a team-member are essential. Recruitment is an area that is likely to receive an increase in resources in the near future.
Mid-career recruitment is also likely to increase especially among the clearing banks.

(viii) Investment in Training and Career Development - Resources, including management time, must be poured in this direction. Many of the excellent banks also appear to have a near obsession regarding executive succession eg. JP Morgan and Deutsche Bank.

(ix) Matrix-Based Management Information Systems - The development of product and client management information is one of the most visible trends among the excellent banks. Developing data which will measure the profitability of different segments and the performance of the product range is a pre-condition for a client-orientated strategy as well as the effective cross-selling of products.

By incorporating the aim of excellence within the corporate strategy, banks are taking a positive step to improve the quality of their products/services. The interviewee at Chase Manhattan firmly believed that quality of service is closely linked to the focusing of efforts and resources, ie not trying to be all things to all markets - focusing will lead to better service for those targeted groups. Indeed, the Chase corporate strategy of focus is based on the assumption that the objective of service quality is to differentiate the organisation from the competition and thereby strengthen customer relationships. It is, therefore, an integral part of their decision process.
3.4 WHO IMPLEMENTS QUALITY?

The very people who have the direct contact with the customer, and therefore personify and represent the organisation, are those who are near the bottom of the pay scale and are probably least motivated to do that little bit extra. These are the people who have the least understanding of, and interest in, the long-term future of the organisation. Yet paradoxically, these are the very people who know what the customer requires and how products and services can be improved to meet these requirements.

Most banks have been quick to state their commitment to quality, and specifically quality of service, now it needs to be put into practice. A one-day course for sales staff however is insufficient - the quality concept must permeate throughout the whole organisation.

To implement quality Davis identified the following:

(i) Employment Practices - The pressures for performance are becoming so strong in banking, that effective lifetime employment is on its way out. There will now be a need to evaluate performance on a more quantifiable and explicit basis (ie results-orientated achievements). Indeed, the concept of merit-related pay has finally been brought into the UK clearing banks.

(ii) More Recruitment of Outsiders - A major challenge for the excellent banks with a "home-grown" culture will be to increase the level of outsiders without destroying the corporate culture. Internal development may not provide the essential skills quick
enough, as the stress placed on marketing and technology increases. Outsiders can also look at the business from a different viewpoint.

(iii) Higher Education Standards - Increased recruitment from universities is likely by all banks. Improved training must be offered to all entrants, in the style of that offered by the challenging US bank training programmes. It is likely that the automation of many clerical tasks will reduce the need for staff of a lower academic level.

(iv) More Effective Cross-Selling - There has been a recognition that when a bank is part of a financial services group, a profit-centre mentality will hinder the total progress of the group.

(v) Focus on Technology - The impact of telecommunications and data processing technology is at the forefront of many banks' preoccupation for the future. It requires a substantial financial commitment without assurance of technical success or incremental revenues to justify the investment. Technology will undoubtedly alter the delivery systems of the future and it will also enable non-financial institutions to play a part in the payment systems. The underlying theme is that technology implementation must add value for both the customer and the financial organisation.
3.5 CONCLUDING REMARKS

Competitive advantage will be increasingly difficult to achieve and sustain in the basic bank markets. Quality of service has been identified by most clearing banks and building societies as the way to gain comparative advantage over their competitors, however, the standards for service and product quality are customer, rather than bank, defined. Cooper[11] recognised the importance of not compromising quality for cost, as this is self-defeating. This may have serious implications for those organisations that have elected to follow a cost-based strategy as opposed to a strategy of focus or differentiation (see Chapter 2). Quality standards will be continuously improving - that which is quality service today, may be inadequate tomorrow. Moreover, the attainment of quality service is an objective that has implications for every facet of the business as evidenced by Davis' quality characteristics and their implementation.

"We will need to ensure that our organisation is rigourously efficient, responsive to the markets in which it operates, and well equipped to foresee and seize opportunities for growth. The strength of the TSB today stems from the priority given to customer service. No higher priority exists."

Sir Nicholas Goodison, Chairman TSB Group, Annual Report 1988
4. THE RETAILER CHALLENGE

4.1 INTRODUCTION

Retailing will have a double-sided role in the future of the basic bank markets. Firstly, retailers will be an increasing threat to existing providers of such services and secondly, somewhat paradoxically, these existing providers are looking to re-structure their business along the lines of a retailing concern. The thesis will examine the competitive threat posed by the retailers and then consider whether clearing banks and building societies should assume certain retailer characteristics.

4.2 RETAILERS AS PROVIDERS OF FINANCIAL SERVICES

In 1987 Marks & Spencer was granted a deposit taking licence by the Bank of England under the provisions of the Banking Act 1979. This caused a certain amount of concern in financial circles, many believing that they would follow the formidable examples of Sears Roebuck in the US and, more recently, Seibu in Japan. Both these organisations are large retailers who have very successfully diversified into providing a range of personal financial services. Originally, Marks & Spencer denied they had aspirations to enter the basic bank markets (they claimed they merely wanted to clarify their legal position with respect to outstanding debts on the company's charge card). This attitude may have been revised in the light of the success of the subsequent products they have launched. Their charge card has been particularly successful. In terms of interest it is one of the most expensive on the market, but despite this they have built up a card base in excess of 2.3 million customers in a short space of time, 90% of whom settle their account in
less than 28 days. The average purchase on the charge card is £24 compared with £22 by cheque.[3] Additionally, they have begun to offer personal loans and more recently introduced a unit trust which was taken very favourably by the market. It does not seem unreasonable to assume that they will eventually enter other financial service markets such as the mortgage market, which until now has principally been the domain of the clearing banks and the building societies.

High street retailers who wish to move into the area of financial service provision, need to deal with the following key issues:[16]

- Customer acceptance with respect to buying financial services together with other kinds of products.

- The extent of competition from other providers.

- The form of organisation used to provide the financial service.

To a greater extent the resolution of these issues will be heavily influenced by the type of customer involved, the type of product being sold, and the image of the high street retailer selling the product. Retailers may be able to take advantage of a major issue in the market place - many of the developments which are occurring are supply-side led.[16] A substantial segment of customers remain unsophisticated about the choice of financial products and may well prefer convenience and reasonable prices from a name they know, rather than paying a premium for specialist advice. This mass market approach is likely to result in further entry by retailers, which is likely to erode the market shares of traditional suppliers of personal financial services.
One scenario could be that in the future mass market financial products are provided by retailers and building societies, leaving the clearing banks to concentrate on the more specialised and lucrative niche market?

Reed\[36\] has argued that retailers have a particular advantage over banks - namely the timing of their entry into the basic bank markets. Reed argues that this late entry gives retailers a better cost structure, the choice of a limited product range and the benefits of the latest technology. Specifically, they can enter the markets they perceive to be most attractive - using the experiences and failures of other market players to discount particular products and sectors.

To counterbalance this argument, retailers suffer from several weaknesses and competitive disadvantages. Firstly, a lack of experience and expertise means a very steep learning curve, particularly when it comes to setting-up control systems. Secondly, the limited product range doesn't help to reinforce the image of a retailer as a provider of "bank" services. This image may be critical, as is the perception that there is a first-class name behind the financial part of the transaction.

Recently, however, belated but, nevertheless, dramatic progress has been made by retailers in such areas as charge cards, share shops and funds transfer. Marks & Spencer have over 2.3 million card-holding customers and Debenhams is reported to obtain over half of its operating income from their wholly-owned finance house, Welbeck Finance. In-store credit schemes are a way of creating customer loyalty, even when they are funded and administered by an outside finance house. The customer database, which is updated with each credit sale, will provide

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opportunities for follow-up sales and cross-selling. Retailers are becoming adept at techniques like credit-scoring in an attempt to reduce the learning curve. The bad-debt knowledge gap is also narrowing. So it may only be a short step for the retailer's finance house to become an in-store bank. Certainly this was a view shared by the interviewees. Indeed, the consensus of opinion was one of surprise that retailers have not made advances in this market even more speedily.

4.3 CAN BANKING BE SOLD AS A RETAIL PRODUCT?

Clearing bankers traditionally dissociated themselves from the image of salesmen and selling, yet in the present highly competitive marketplace, they see a visibly retail image, as a key to success. They have modernised their branches to make them less intimidatig and more conducive to cross-selling, - and they have spent heavily on advertising, to portray their organisations as customer orientated and approachable.

Unfortunately, basic bank market services cannot be sold in the same way as consumer goods - they aren't, for instance, bought on impulse. Consequently, many of the promotional activities used in the retailing trade are inappropriate for this market. Retailing techniques will have to be carefully modified if they are to be introduced into the basic bank market.

The interviewees had mixed views over the adoption of 'retailing' techniques to the marketing and selling of financial services. Some believed that this was the necessary way of the future, whereas an equal number were of the opinion that customers expect a more 'dignified'
approach from their bank. By comparing the opinions of the interviewees with the socio-economic mix of their customers - it would appear that financial service providers that appeal to the mass-market advocate a 'retailing' approach, whereas institutions that look to target the upper socio-economic groups tend to favour a more traditional approach.

4.4 CONCLUDING REMARKS

The majority of the interviewees perceived that retailers' involvement in financial services would increase. However, they were reluctant to admit that their own organisation would be under threat from this increased involvement. Those institutions that appeal to the 'mass-market' believe that they have much to learn from the retailers' knowledge of marketing and selling techniques. Clearing banks will possibly need to go further in their drive towards better sales and distribution of services. The following requirements were identified by Reed.[36]

- Sales related reward schemes should be extended to include commission for all targetable sales volumes.

- A more rapid transition to open plan and flexible branch layouts. Managers freed up to sell, relieved of administrative burdens.

- A greater emphasis on presentation and visual merchandising of bank products.

- Greater exploration of the profitable use of branch floor space.
The clearing banks, and to a lesser extent the building societies, are likely to increasingly adopt retailing techniques. For instance, Brian Goldthorpe, Chief Executive of Midland Bank, has introduced a range of designer clothing - reflecting the bank's determination to be viewed as a major, quality retailer.
5. THE BUILDING SOCIETY CHALLENGE

5.1 INTRODUCTION

The most significant competitive threat to the clearing banks, in the basic bank market, is generally perceived to be that of building societies. During the period that the clearing banks concentrated on the corporate and international side of their business, the societies were making strategic incursions into the retail market. At a time when banks were seen as distant and aloof, the societies were regarded as approachable and friendly. Accordingly, their share of this market expanded rapidly. [27]

Unless the decline was halted an extreme view could have envisaged the societies as the personal bankers of the 1990s. Consequently, the banks responded to the challenges, albeit in a reactive rather than proactive manner, and this has helped to re-establish their position. Although they must still regret allowing many strategic branch locations to be taken by the building societies.

Prior to the stock market crash of October 1987 and suffering severe competitive pressure from the retaliating banks, the building society industry suffered its worst year in 1987. They were losing a significant proportion of their core mortgage business to the banks and Britain was enjoying a 14 year unbroken bull market. At this stage several analysts produced pessimistic outlooks for the societies' medium term future. [27]
However, in the wake of the stock market crash, savings poured into the societies to make 1988 the industry's record year. Net receipts were 80% above the 1987 level at £13.6 billion and lending was £23.7 billion. Societies were well placed to be formidable competitors of the clearing banks. They have a good image with the public and are regarded as efficient organisations which have a commanding and successful position in the market for basic personal banking services.

5.2 EXPANDING ARRAY OF SERVICES

Since the early 1980s, clearing banks and building societies have been moving further into each other's traditional territories (both in terms of liability structure and range of business) - and customers have come to expect a wider range of services from both organisations. Most building societies now offer cheque book accounts, credit cards, personal loans, insurance and pensions in addition to the traditional savings and mortgage products. Offering cheque-book services is relatively easy for a small society which can provide this and other services through an arrangement with an outside specialist. However, for a large society it is a highly expensive undertaking. Halifax Building Society, for instance, held back for many months, deterred by the high cost of paper-based money transmission. The Alliance & Leicester has to date resisted issuing a cheque-book on grounds of cost. Nationwide Anglia (the first entrant into this market), however, believes that it is now approaching break-even point on FlexAccount at approximately 1.2 million customers. The FlexAccount has been a very successful product in attracting customers; in its first year FlexAccount drew over 500,000 customers and a quarter of all new current accounts. Paradoxically these are the very customers that the
clearing banks need most - the financially sophisticated; 80% of FlexAccount holders have a bank account and 66% have credit cards, as compared with the overall UK average of 36%. [24]

Cheque-book services are the most expensive banking services provided by building societies. For this reason the Halifax Building Society initially introduced electronic money transmission services for its customers (they have 3.5 million customers using the CashCard current account system). The fact that it lost a significant number of its most important customers to societies who did offer a cheque book service subsequently resulted in a reversal of this decision and Halifax now intend introducing such an account. on the personal lending-side, all the top 20 societies now offer secured loans and most offer unsecured personal lending - though this is very often done through an agent.

Building societies have also examined the possibility of expanding their operations away from money transmission products. Until recently the vogue had been for expansion into the estate agency business. The Halifax Building Society was among the first to be involved, spending an estimated £100 million on a 600-branch network. As the core mortgage business is under such competitive pressure, the commissions earned from cross-selling such products as life policies, pensions and insurance is vital. Naturally, the success of moving into estate agency is closely linked to the state of the housing market and the recent downturn has impacted heavily upon this decision. This downturn will have an additional effect on commission products - insurance commission which has been a big growth area for the societies accounting for up to 15% of their profits, is tinder considerable threat. [39]
5.3 THE MUTUALITY DEBATE

The Building Societies Act 1986, allowed societies to move into the basic bank market, through the provision of a greater range of products and services, particularly personal loans and credit cards but also pensions and unit trusts - additionally, new business opportunities such as estate agency became available. The choice of whether to utilise these opportunities and become a broad-based provider of financial services or whether to stay mainly with the core mortgage business is an important issue facing the building societies and is likely to be principally determined by the size of the society.\[42\]

Diversification was perhaps more predictable for the larger societies, however, they are now faced with a more difficult choice. The need to fund new diversified business resulted in the Abbey National Building Society deciding that it must convert from mutual to public limited company (plc) status. No other society as yet has followed this path, which is relatively surprising considering the initial enthusiasm with which the possibility of shedding mutual status was greeted. It is believed that the Alliance & Leicester and the National & Provincial Building Society are the closest to conversion.\[42\] The list of those who strongly advocate remaining mutual is long - Halifax, Leeds Permanent, Nationwide Anglia, Bradford & Bingley and Cheltenham & Gloucester.\[33\] Although it can be argued that the larger societies have most to gain from conversion - Halifax, the largest society, believes that it can offer a fully diversified range of services from a mutual base (at present it successfully offers a wide range including a credit card and owns a 600-branch estate agency). Llewellyn\[29\] argues
that in time the larger societies will become indistinguishable from banks with respect to the provision of retail financial services.

Although the arguments for conversion are easier to define for the larger societies, the same cannot be said for the smaller ones. Below the industry leaders there are more than a dozen societies which are too big to be considered local or regional and yet not large enough to appear as viable independent players in the financial services markets of the 1990s. Their relatively small size, judged by the standards of the financial service sector as a whole, suggests that a stock market flotation would probably not raise sufficient for these societies to diversify. They may eventually have to chose between merging with each other or finding a way to link up with a larger group outside the industry. If the smaller societies lost their mutual status it would be likely that they would have difficulty in withstanding a hostile takeover (societies have five years statutory protection after conversion, during which time an outsider is prevented from acquiring more than a 15% stake). The key issue currently facing the smaller societies is should they stay out of banking and so be permanently cast in the role of niche players, or should they try to become as bank like as possible? Some smaller societies have decided there is no point in becoming bank-like:

"We are a niche specialist with 60 branches, we rely on direct mailing to up-market customers and our members are the sort of people who already have cheque-books. We offer services which may appeal specifically to them such as health and car insurance, personal loans and on-line share-dealing."
Furthering this commitment to innovation, in December 1988 the Skipton Building Society took over the administration of Kleinwort Benson's mortgage book, believed to be in excess of £1 billion. This was the first time that a bank had transferred its mortgage book to a building society for administration. This deal reflects a growing trend by building societies away from traditional mainstream mortgage business and into specialist housing finance operations. Additionally, the society is selling mortgages for France's Société Générale. This innovative behaviour applies to other smaller societies - Scarborough Building Society has linked up with Algemene Bank Nederland to offer an "integrated mortgage scheme".

The one strong proponent of conversion has been the Abbey National, which effectively became a bank in July 1989. When Abbey's board recommended conversion, they believed they were responding in the best way to a changing market:

"We had to do something fast. The market is changing so quickly that we cannot continue to try to compete in a mature, narrow and, we believe, a declining market."

Peter Birch, Chief Executive, Abbey National (Annual Report, 1988)

The Abbey has diversified rapidly and if this was to continue the only way to raise the required capital was via the stock market. When its range of products is combined with its obvious European expansion plans,
the Abbey would appear to have done more than any other to diversify from its traditional business.

Smaller societies are likely to find it worthwhile to agree to a friendly takeover by another institution, perhaps an insurance company or a foreign bank.\[32\] The branch network of a society would make it an ideal target for a predator wanting to enter the personal market.

"We are looking for an acquisition with a branch network and a wide range of retail outlets."

Gerry Scanlan, Chief Executive, Allied Irish Bank (Annual Report, 1988)

Foreign institutions such as Citibank Savings, Deutsche Bank and National Australia Bank have also had talks with the larger building societies.\[33\] Kleinwort Benson's June 1989 review states that companies beyond the financial sphere could also be attracted to societies partly because of their under-utilised potential. The Morgan Grenfell report\[32\] would indicate that societies numbered between four and fifteen in terms of size would be the most likely targets. Apart from the top two or three societies, few of the second tier societies are large enough to resist takeover once the statutory five years protection after conversion has passed.

Patrick Frazer, banking analyst at Morgan Grenfell, "One possibility is takeover by one of the large US banks, which have so far failed to establish their name in the UK retail market. The concept could be quite attractive - they could come in with masses of extra cash and use the society as their spearhead".\[32\]
Many of the senior executives question how long the societies can survive in their present form in the competitive, deregulated financial services markets of the 1990s, where banks and mortgage lenders will make increasing inroads into their traditional business. In 1988 Britannia, a society that opposes flotation, issued a study that predicted that the present 112 societies would dwindle to nine or ten in a decade.[17]

The belief that mergers between building societies on a much greater scale than previously, is a prevalent view. All societies, possibly with the exception of Halifax, are small enough to be vulnerable to takeovers if they convert into limited companies. In the final analysis it is difficult not to feel that for some societies, this may be the clinching argument for merging and remaining mutual.

5.4 EUROPEAN ASPIRATIONS?

Building societies are not large enough to compete on a pan-European scale, therefore, if they have European aspirations they must look to enter specific niche markets.[32] However, societies were warned by the Governor of the Bank of England in November 1988, of the difficulties of entering a foreign market.

"Housing markets across Europe are very different from one another - different in terms of the mortgage product, ... but also different in terms of cultural and political attitudes to owner occupation." (Banking World, November 1988)
Four main reasons have been identified why specialist lenders should concern themselves with the development of markets in Europe.

- Competition in the UK is such that there are many European-based institutions competing on equal terms in the UK mortgage market. It is, therefore, certainly worthwhile looking at the home markets of some of these institutions to see if the battle cannot be carried over to their own territory.

- There are markets in Europe where home ownership is not nearly as well developed as it is in the UK. A simple analysis suggests that there are opportunities for selling mortgages in these markets.

- Involvement in Europe allows the lender to spread its risk across more than one market.

- The projected opening up of the markets in 1993, means that UK mortgage providers should be thinking much more in terms of a market in excess of 300 million potential customers.

However, societies cannot expect to be able to simply introduce the housing finance systems which have been developed in the UK because the likelihood is that at the most basic level, they will not fit into other European markets. It is principally for this reason that the majority of building societies are likely to concentrate on the domestic markets.\[42\]
5.5 OTHER KEY ISSUES FACING BUILDING SOCIETIES

The market for personal financial services is becoming saturated with an increasing range of institutions (banks, insurance companies, foreign banks and building societies), who have targeted the personal sector simultaneously. All these organisations are looking to diversify as the traditional demarcations between sectors are removed.[27]

The dynamics of the market have put pressure on building societies to reduce their expense ratios, change their organisational structure, and pay more attention to training. Whilst substantial changes have already taken place, societies face problems in recruiting sufficiently experienced staff, particularly, in the areas of computers and product design. The general level of management expertise may also be insufficient to meet the new challenges, especially in the smaller societies. Rationalising the branch structure may be difficult because of the disadvantages of closing a branch in terms of customer disapproval. However, merger and the subsequent closure of overlapping branches may be a solution to this problem.[17]

As competition has increased the main traditional competitive advantages of the societies have been undermined. They are particularly vulnerable in terms of the efficiency and appropriateness of their distribution channels.[24] The top three societies have fewer than 2,500 branches and cannot rely on passive sales to sustain and generate new business and more complicated business. Accordingly, societies have invested substantially in technology to build sophisticated distribution channels and marketing databases. They perceive information technology as a key factor in their future strategic success.[21] The 14 largest societies
are set to spend over £750 million on computer hardware and software over the period 1989-1992.\textsuperscript{[17]} It is likely that this technology investment will lead to a widening of the gap between the larger and smaller societies. This is because the investment of the larger societies is growing at 15-18\% per year, while that of the smaller societies is negligible.\textsuperscript{[17]}

5.6 CONCLUDING REMARKS

Over the last five years the number of building societies in existence has already diminished\textsuperscript{[24]} and reports would indicate that this trend will continue at an increasing pace.\textsuperscript{[17]} Despite this rationalisation of the movement, a number of the very small societies may continue to flourish. Offering their investors and borrowers a key personal service unavailable from the leading societies, may safeguard a loyal customer base.

Several of the most profitable societies are being stalked by foreign players. A survey by Phillips & Drew\textsuperscript{[42]} ranks societies as follows.
1988 BUILDING SOCIETY PERFORMANCE

<table>
<thead>
<tr>
<th>Position</th>
<th>Position</th>
<th>Asset Size</th>
</tr>
</thead>
<tbody>
<tr>
<td>1988</td>
<td>1987</td>
<td></td>
</tr>
<tr>
<td>Abbey National</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Chelt &amp; Gloucester</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>Alliance &amp; Leicester</td>
<td>3</td>
<td>5</td>
</tr>
<tr>
<td>Town &amp; Country</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>Yorkshire</td>
<td>5</td>
<td>9</td>
</tr>
<tr>
<td>Halifax</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>Northern Rock</td>
<td>7</td>
<td>4</td>
</tr>
<tr>
<td>Bradford &amp; Bingley</td>
<td>8</td>
<td>8</td>
</tr>
<tr>
<td>Leeds Permanent</td>
<td>9</td>
<td>11</td>
</tr>
<tr>
<td>National &amp; Provincial</td>
<td>10</td>
<td>13</td>
</tr>
<tr>
<td>Britannia</td>
<td>11</td>
<td>14</td>
</tr>
<tr>
<td>Birmingham Midshires</td>
<td>12</td>
<td>10</td>
</tr>
<tr>
<td>Woolwich Equitable</td>
<td>13</td>
<td>12</td>
</tr>
<tr>
<td>Nationwide Anglia</td>
<td>14</td>
<td>15</td>
</tr>
<tr>
<td>Bristol &amp; West</td>
<td>15</td>
<td>7</td>
</tr>
</tbody>
</table>

Source: UBS PHILLIPS & DREW[42]

'Performance' in the above table relates to a combination of twelve key financial ratios calculated by UBS Phillips & Drew.

Significantly, the survey shows that there is little or no relationship between asset size and financial performance. The table indicates the Yorkshire Building Society as the most rapidly improving society.

Larger societies will meanwhile pursue acquisition strategies. The aforementioned survey predicted before the house market crash of 1988-89 that estate agents would remain an important acquisition of the society. They are also likely to acquire firms specialising in fund management, property development and life assurance. Almost all the survey respondents noted a lack of management expertise, particularly, in the smaller building societies. This common feature will place an emphasis
upon training and recruitment and upon acquisition and merger strategies in the future.
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PART II - MARKETING IMPLICATIONS
6. MARKETING

6.1 INITIAL INTRODUCTION

The basic UK banking markets and retail banking world-wide are experiencing an era of unprecedented change and new challenges. Retail banks face a growing array of new competitors, and new forms of competition appear with increasing frequency. It is within this expanding and increasingly competitive market that clearing banks and building societies are emphasising the importance of marketing and the profile of their marketing departments. The main players in the basic bank markets now face a retailing challenge, and strategic marketing is developing as an important competitive impetus.\[5\]

Liberalisation in financial markets has stimulated more innovation, and this has helped to increase competition in the retail banking market. An important result of this new environment is that British retail banking is no longer a supply-led business dominated by the main clearing banks. It is now much more demand-orientated - consumers are generally richer, often more sophisticated and they are much more actively marketed by competing institutions.\[5\] On the supply-side clearing banks now face increasing competition from retailers, pension funds, life companies, unit trust companies, building societies etc. Institutions and companies which traditionally did not compete in the basic bank market but which, facilitated by the Financial Services Act (1986), will increasingly pose significant competitive threats to the clearing banks and building societies. All the interviewees concurred with this view and regarded it as possibly the most serious competitive threat in the 1990s.
6.2 CHANGING PRIORITIES

Marketing strategies will have to be constantly reviewed as the business of the basic bank markets totally changes during the next decade. Marketing techniques will have to be further refined if an organisation is going to compete effectively in the deregulated financial services marketplace. "Cross-selling", "market positioning" and "market segmentation" are at present the key elements in all the clearing banks' marketing strategies. The banks have moved away from generic products aimed at the universal banking market and now increasingly concentrate upon specific target markets.

The emphasis on marketing has already led to the reduction in importance of traditional banking priorities. Understanding the retail financial environment and responding successfully to the resultant competitive influences will increasingly differentiate the successful institutions from the remainder. Banks that rely solely on traditional methods of conducting business, developed in a different banking environment, are likely to encounter problems at best; at worst they will be left behind by more innovative operators. This exemplifies the so-called "failure of success" syndrome[5]: successful policies in the past may not work in the same manner when conditions change. This is not to imply that the traditional banking strengths and policies are redundant. Traditional strengths must be exploited in a way that is appropriate to the new conditions.

Clearing banks and building societies are acutely aware of the fact that the nature of their business is changing. No longer will the taking of deposits and the granting of loans be sufficient in the financial
services era of the 1990s. Indeed, the basic bank functions are increasingly being done by ATMs. Citicorp in America and Lloyds in the UK say that 80% of their cash withdrawals are via ATMs[16]. The interviewees all expressed the opinion that branches should be increasingly turned into sales offices for more profitable services such as unit trusts, insurance and pensions. They also recognised that things may be more difficult than first expected. There are two basic problems associated with turning a branch into a sales office. The first is that the people managing the branch have traditionally not been salesmen. Financial services are intangible, expensive and often complicated and therefore need informed and effective salesmen. Clearing banks also offer a huge range of products, typically in excess of 250,[11] sold primarily through the branch network. The second problem relates to the "passive" nature of the branch network, ie if customers do not automatically come into the branch then how do you attract them? Although most banks active in the basic bank market still insist that a customer opens an account at a branch, this is changing. Citicorp, for instance, is automating the opening of its accounts by using expert systems.[3] These distil the experience of managers into a computer program which asks customers questions that vary according to preceding answers.

The strategic marketing function in basic banking activity has evolved through a number of stages, and the present stage has been labelled "market-orientated"[5]. In this stage the selling concept is more strongly emphasised, and greater efforts are directed at promotion. Putting this into practice has resulted in the establishment of in-house marketing departments within banks. Whereas the remit of the marketing function had previously focused on image projection and general product
advertising, marketing departments are now undertaking sophisticated computer analysis, identifying and anticipating consumer needs, playing a more important role in product/services range design and distribution strategy, evaluating pricing tactics and generally attempting to help educate employees in the "art" of effective selling.

A recent study by Cardiff Business School uncovered the degree of marketing in the UK financial services sector\[12\]. The study looked for tangible evidence of a growth in the importance and understanding of marketing in retail banking organisations. The most obvious evidence of this is the existence of a marketing department. The survey found that nearly 78% of UK financial institutions have a formally organised marketing department. Most of these marketing departments were set up in the 1980s, indicating that there is a link between the environmental changes of the last decade and a change in attitude towards marketing.

A majority of respondents (75%) felt that in their own organisation management recognised the importance of designing and providing the products and services which serve the needs and wants of chosen markets. 53% of respondents felt that their companies developed different strategies for different segments of the market. However, only 15% of respondents felt that management in their organisations knew the sales potential and profitability of different market segments.

Another part of the survey used attitude statements to discover the aims of the marketing strategy in the respondent companies. 66% of respondents felt that the main aim of their marketing strategy was to increase market share.\[12\] This confirms the competitive stance taken by most companies in the financial services sector and indicates that marketing is now being used as a competitive tool in this environment.
53% of respondents also believed that the best way to achieve the strategic goal of increased market share was to develop new products for existing markets. Product development was placed well above market development and diversification by most of the respondents.

Clearing banks and building societies are now moving into the final stage of strategic marketing evaluation, the "marketing-controlled"[5] era. This stage involves an intensification of the marketing-orientation concept, which means that the twin forces of marketing and associated profitability become the ultimate driving forces for the whole organisation. Banks are transformed from financial firms that undertake marketing activities to marketing firms that undertake financial activities.[3] Areas traditionally outside the direct influence of marketing, like finance and capital expenditure, become directly influenced by strategic marketing considerations. In short, marketing control implies that marketing considerations ultimately drive the whole organisation.

6.3 MARKETING STRATEGIES

Financial inertia is beginning to change. It is not too extreme a view to claim that banks cannot ignore the new attitude of customers who are prepared to shop around for the best deal in financial services as in everything else, and who demand a high level of customer service as a matter of right.

In the past, financial service organisations, and in particular clearing banks, have been seemingly disinclined to adopt the marketing concept and have been largely product-led. During the 1980s, however, there
have been a number of environmental changes which have impacted upon the marketing function in financial services organisations:

i) Technological Developments: These have led not only to benefits in terms of efficiency in the provision of services but have also changed distribution patterns (especially ATMs and EFTPOS) and are beginning to have design implications for products. New information processing capabilities have had major implications in terms of speed in the provision of financial services.

ii) Deregulation in Financial Markets: In common with a world-wide trend, the UK financial markets have been radically affected by legislative changes. These changes have introduced a much wider array of financial players into a common financial market, whereas, traditionally they all operated in exclusively demarcated markets. In the future, therefore, clearing banks will be competing increasingly with pension funds, life companies, unit trust funds and possibly European and "other" financial institutions.

iii) Increasing Financial Awareness of Customers: The rapid inflation of the 1970s and the losses that consumers suffered in real terms undoubtedly changed consumers' attitudes towards money. This financial awareness has been compounded by a sharp increase in advertising in the financial services sector, and by government efforts to encourage private sector shareholding, pensions, savings etc.
These changes have combined to increase competition across the broad spectrum of the financial services market. Sherden[15] argued that the changes in competitive environment have been linked with a change in the corporate attitude towards marketing as both a function and a business policy.

In the past a written statement of objectives (the so-called 'Corporate Mission') would have been extremely rare in banking. It is now more commonplace and will be a necessity in the future. Fundamental to the mission statement will be the adoption of the Marketing Concept. This basically requires that all activities that have any relation to the consumer should be influenced by the marketing department. A co-ordinated approach to marketing permeating from the centre outwards is, therefore, highly desirable. Potentially, at least, this may lead to the marketing controlled organisation[5].

During the interview conducted with a Citibank manager, it transpired that the following marketing objectives have been identified in an endeavour to increase market share in the UK retail financial services market. Essentially, these objectives apply to all players in the market, regardless of size and experience.

- Increase the number and value of product relationships per customer.
- Increase the number of customers.
- Shift the indirect customer base towards a direct relationship.
- Increase direct sources by targeting.
- Improve image as a reputable, different, service orientated, innovative, classless, approachable, recognised bank.
- Increase loyalty among growing customer base.
- Develop integrated range of products offering life-cycle financial services for targeted customers.

We have already identified the three main generic strategies open to the financial organisation, by noting the work of Michael Porter. With respect to marketing, the main competitive strategies are as follows:

(i) **Cost Leadership** - to be competitive the product must meet the demands of the customer and must possess attributes comparable to the products of competitors. The standardised range of products offered enables savings in administrative expenses and staff costs as neither highly trained staff or professional intermediaries are really necessary to sell products.

(ii) **Differentiation** - this strategy will appeal to those customers wanting a personalised, individual service albeit at a higher price.

(iii) **Focus** - the organisation identifies specialist market segments which it seeks to supply at the exclusion of others. As in the general case, it can either seek a cost or differentiation advantage. Such specialised or target marketing requires the seller to distinguish among many market segments, select one or more segments and develop products and marketing mixes tailored to that segment (product positioning).[8]

This implies that banks must manage a collection of marketing mixes if they sell services to diverse target markets. The characteristics of the market have to be ascertained before the bank can formulate its
marketing strategy. The TSB interviewees stressed emphasis on local marketing, i.e. pick media that work in a specific locality. This concept has been taken several steps further by the Bergen Bank in Norway. Not only does each branch have responsibility for its own marketing, but must also formulate its own strategy and control its budgets. Each branch is treated as a profit centre which requires the creation of common values if the negative effects of diseconomies of scale are to be offset.[4]

Responsibility for marketing deployed to individual branches, perhaps based on the "Hub and Spoke" concept may well be increasingly accepted within the UK, especially as the branch loses its exclusivity as a delivery system. Similarly, the increased role of technology in marketing, both at local and national level, would appear to be assured. This is discussed in detail in Chapter 7.
7. IMPLICATIONS OF TECHNOLOGY FOR MARKETING

7.1 STRUCTURAL CHANGE IN DELIVERY SYSTEMS

"A branch network will no longer be essential for conducting retail operations, and all kinds of institutions will be able to offer payment services."[13]

If substantial reductions are made in the size of the branch network, the clearing banks and building societies will lose their primary delivery channel for the sale of financial products. Customers are conducting an increasing proportion of their banking transactions through remote locations and accordingly the need to visit their branch is reduced. The marketing implications of such a scenario are highly significant and the banks' responses are discussed below.

Initially, it may seem that the introduction of improved delivery systems, which have been facilitated, particularly, by improvements in technology, will make the marketing function more difficult for the bank. However, technology has played a vital role in establishing the strategic importance of marketing. Whereas technology has been traditionally used to reduce costs, in the future success will almost certainly be based on "managing" technology to generate revenues. The application of technology to marketing information and research will provide the keys to this success. Marketing information, customer and product behaviour, profitability data, and the results of cross-selling campaigns will all be held on computer. This will provide the basis for a much more accurate and cost-effective marketing campaign in the future.[15] The success of electronic product delivery will depend upon
how the benefits are marketed to the customer. But if one accepts that convenience is important to the customer, then direct access to financial service providers through electronic product delivery channels must gain customer acceptance.

It is possible to reduce costs in the back office, because these delivery systems can be linked directly to transaction processing systems, and it is possible to gain benefits in the front office because pricing and promotional decisions can be made directly through account executives working via workstations.[2]

The mechanisms for gathering behaviour information and cross-selling new products can be incorporated through delivery channels that reach the customer directly in the office and in the home. New product promotions can be broadcast directly to the customer's terminal. The challenge will be to design systems that are flexible enough to respond to demands for new and improved products and to ease competitive pressure.

7.2 MARKETING INFORMATION SYSTEMS

The marketing function has been one of the most neglected areas for the application of technology, irrespective of whether one looks at marketing information systems or marketing research systems.[4] Consider how much more effective marketing information systems could be if they could be utilised to:

- Maintain household information in addition to single account relationships with a meaningful amount of account history.
- Track customer behaviour to improve cross-selling opportunities, keeping results of prior efforts.

- Maintain and analyse customer and product profitability data regularly.

However, for the marketing function to benefit from technology the interviewees were in total agreement that several important steps must be taken:

(i) The application of technology has to move from "function-driven" to "customer-driven" and it should include revenue generation in addition to cost cutting.

(ii) New systems have to be flexible enough to respond quickly to the changes in the marketplace. Many changes will be dictated by the marketing function.

(iii) Household information and improved demographic information must be added to customer databases in an endeavour to understand customer behaviour more fully.

(iv) Customer behaviour must be monitored by means of profile records that track customer activity, in an endeavour to manage cross-selling efforts more efficiently.

Central computer systems were not designed either to allow the easy introduction of radically new products or to provide the analytical information required to identify and track the behaviour of very specific consumer groups. Branch systems in general were still primarily focused on efficient administration and efficient voucher processing rather than on customer service. The fact that in many cases the customer remained happy with the services provided was
probably largely due to a combination of the patience of the British customer and the motivation of the branch staff.

It is imperative, therefore, to provide bank marketing officials with up-to-date information about the banks' customers whenever and in whatever form it may be required. It is impossible to design innovative products to meet the needs of particular customers if the details and scope of their relationship with the bank is not fully known.

This includes the development of a consumer-driven marketing information system that can serve as a basis for product development and marketing strategies geared to particular customer segments. Clearing banks in particular are in an excellent position to create such a system using information already contained in their databases. For example market opportunity lists can be compiled by checking high-balance customers against various kinds of accounts such as money market savings, interest-bearing cheque accounts, and credit cards. Information in customer files can also be used to measure penetration levels of a specific product by determining how popular it is with different customer groups.

The marketing information system (MkIS) has been defined in many ways, but the most common definition is that used by Kotler:

"A marketing information system is a continuing and interacting structure of people, equipment, and procedures to gather, sort, analyse, evaluate, and distribute pertinent, timely and accurate information for use by marketing decision makers to improve their marketing planning implementation and control."
In exploiting the database as a marketing tool the bank is providing itself with the opportunity to develop a marketing strategy for customers, to build a comprehensive picture of the customer's needs and to use that knowledge as a guide to the types of products and services to offer. A significant bonus may well be the opportunity to enhance customer retention and loyalty. The ability to "lock-in" customers is increasingly being sought by the financial institutions, according to the interviewees.

American Express is recognised as being the leader and, therefore, a good example of an organisation which uses its computers to manipulate data about its customers (they have a detailed customer information file on 35 million cardholders).[15] On some of its year-end statements, it can break a customers' spending down by place and type as well as time. Besides impressing customers, this technique helps the company build up a psychological picture of its customer. It knows his spending pattern so well that it uses this as a computer check against fraud. This knowledge can also be put to more immediate uses, American Express can target potential purchasers of its goods and services more accurately.

The financial services industry, and in particular the basic bank markets, have undergone such radical changes in the past decade that it has become an ideal industry in which to observe the introduction and development of Marketing Information Systems. To date progress has been slow: traditionally the basic banks paid little attention to management skills, concentrating rather on "established banking skills". As a consequence technology was essentially used to develop large and sophisticated electronic data processing systems which were designed not with marketing or strategic planning in mind but with facilitating the
administration of the basic bank functions.\textsuperscript{[3]} The rapid changes in the nature of the banking business and the information technology revolution have provided both the stimulus and the mechanism for improvements in the usage and processing of information. In the light of the preceding analysis, it would appear that fundamental changes in the usage of technology by basic banks will become increasingly apparent in the near future.

As technology increasingly provides both the information and the means to initiate effective marketing strategies the actual techniques of marketing will both change and become increasingly sophisticated. The justification of this statement is discussed in detail in Chapter 8.
8. MARKETING TECHNIQUES

8.1 INTRODUCTION

The shift to a more market orientated attitude, combined with the increasingly competitive environment, has resulted in financial institutions adopting more aggressive marketing techniques. Essentially, more accurate targeting of potential customers is the principal aim, which will enable the cross-selling of a wider range of financial products. This has been greatly facilitated by the increased use of marketing information systems which has already occurred and allows precise segmentation of the total market.[10]

8.2 CROSS-SELLING

Cross-selling is the current vogue in retail banking. The aim is to secure the current account and then market a suitable range of additional products and services to specific sub-groups. Midland Bank have taken this concept a stage further with the introduction of multi-service accounts (MSAs), whereby the core current account is part of a package of services which is targeted at specific sub-groups. However, in some cases bankers are even prepared to sell to customers who do not keep their current account in order. One of the many side-effects in present bank marketing is the growing understanding that a bad current account customer may still be a good prospect for a loan, a mortgage, insurance or other services.

Cross-selling does more than add to sales revenues. It also builds customer relationships. It has been well documented that the
probability of retaining a customer is directly related to the number of services the customer uses. Someone who has a cheque account, savings account, bank card and a major loan is 99% likely to stay with that bank (see Table below). For a customer with only a cheque account the probability is only around 50%[14]

Direct marketing can be very successful in cross-selling products to existing customers. In marketing terms this is very important since the chances of retaining a customer increase dramatically with each additional product or service sold.

<table>
<thead>
<tr>
<th>Service Used By Customer</th>
<th>Chance Of Retention</th>
</tr>
</thead>
<tbody>
<tr>
<td>Savings Account only</td>
<td>50%</td>
</tr>
<tr>
<td>Current Account only</td>
<td>67%</td>
</tr>
<tr>
<td>Savings and Current Account</td>
<td>91%</td>
</tr>
<tr>
<td>Savings and Current Account plus Loan</td>
<td>95%</td>
</tr>
<tr>
<td>Savings and Current Account, Loan and Credit Card</td>
<td>99%</td>
</tr>
</tbody>
</table>

Source: BUILDING SOCIETIES GAZETTE 1988[14]

Evidence would suggest that as many as 70% of customers are "faithful" to one bank.[1] Much of this so-called loyalty is in fact inertia, born of a feeling that all banks are really the same and that there is no point in changing. As the market becomes more product-led then that inertia will decline. In the more innovative US market, 75% of customers use more than one account. New services are being adopted by as many as 19% of the population in one year and old services are being dropped at a similar rate.[1]
In addition to being an effective way of keeping competitors away from customers, cross-selling is rapidly becoming a financial necessity. Narrowing margins in all financial services are rendering single sales channels - whether branches, sales forces or direct marketing programmes - economically unfeasible. Cross-selling, as one of the few means of increasing the productivity of a sales channel, is an attractive alternative to abandoning or sharply curtailing existing channels. Unfortunately, the major financial services sales and distribution channels such as bank branches are not always present at the point of need. Attempts to sell investment products and insurance to branch customers in the US were largely unsuccessful, as 95% of branch traffic at any given time has no need for the products. The cross-selling merely wastes valuable marketing resources while potentially annoying branch customers.

If by purchasing a group of products from a single company the customer can gain a lower price, increased convenience, or some other form of added value, the customer will be far more amenable to cross-selling. Citibank enjoyed impressive results with an aggressive cross-selling programme directed at customers applying for home mortgages in the US. The communications strategy was based in part on relationship pricing. Customers were told that if they did all their banking with Citibank they would receive a preferred customer rate. 98% of those who got a new mortgage with Citibank accepted the preferred rate and brought all of their business to the bank. For financial service firms, however, opportunities for adding value through cross-selling are more limited. Substantial price advantages can be difficult to achieve. At best, banks must ensure that they do not remove value by offering a
broad array of products without any specialised knowledge to back up the sales.

UK banks are finding that traditional customer loyalty is becoming weaker and are, therefore, being forced to respond with more active marketing. It is classic marketing theory that in a highly competitive market, in whatever industry, the only way to stay ahead is to differentiate, add value to the product and segment the market.[10]

8.3 SEGMENTATION

When the clearing banks first embraced the marketing concept, segmentation was one of the first areas considered. Originally, this was done on demographic and geographic lines, but now the emphasis is on a psychographic dimension based on consumer behaviour i.e. different needs, buying styles and responses.[4] Additionally, techniques have advanced from investigations on single products into investigations on a package of products. This is now more appropriate as most bank services are now offered in packages. The interviewee at TSB said that life-cycle segmentation is no longer used by the bank, rather they look at Cluster Analysis. Emphasis is placed on the products held by a particular customer and this is compared to the average for that market segment. This is achieved with a link to expert systems and relationship pricing.

In developing an effective approach to market segmentation there is no single correct formula. There are principles that must be followed, but any system that seeks to categorise its customers too narrowly has its drawbacks. The aim is to find a basis for segmenting the market which
answers the real need and to link this to buyer characteristics. In adopting a market segmentation approach, there will not be any one method of analysis that will provide the consumer understanding and market focus that is required.[1]

Customer needs are fundamentally unique. However, the differences among them can often be used to divide the market into distinct customer groups with similar characteristics. By focusing on the common denominators of these groups, banks can create a cluster of products, services, delivery channels, and promotional techniques geared to a particular customer segment.

To implement strategies successfully focus must be placed on individual transactions. In any large institution products have to be designed for the average customer, and yet the banks' staff are delivering these products to thousands of individual customers, none of whom conforms to the average. The successful bank, therefore, is the one whose customers feel that in their transactions with staff they receive real value over and above the bare "products" actually purchased.

Most methods of segmentation tend to focus on customer categories which are not directly relevant to the delivery of the service. Geographic locations, socio-economic groupings etc. do not by themselves adequately define the nature of the demands made by those segments or the ability of the bank to deliver.[3] Much more relevant customer characteristics include: demands made on staff time, the customer's need for information and advice, the sophistication of the customer's demands, the dynamism of the customer (some categories will be more
prone than others to initiate a demand for new products), their need for specialist advice or knowledge etc.

A useful by-product of segmentation is that it encourages bank managers to think more about the customer, developing a balance between the managers' understanding of his financial services and that of his clients'. It also means that the bank should be in a better position to predict the behaviour of potential customers.

Those customers who use a bank solely for money transmission requirements (the mass market), will welcome technological innovations that keep the cost of these services to a minimum. However, this segment of the market will only prove to be profitable if economies of scale are achieved that compensate for the large investment in technology. It will be difficult to cross-sell more lucrative services to this group as, in general, they will be financially unsophisticated in their requirements. The middle socio-economic groups will have slightly greater demands, and will therefore offer more potential for the banks. To build share in this increasingly competitive market, the interviewees stated that a high quality of service is a necessary prerequisite. High net-worth individuals will be prepared to pay for services and premises of a higher quality. Their requirements will be more sophisticated and increasingly both UK and foreign banks are looking to expand their private banking facilities.

One segmentation strategy would be a broad market approach.\[3\] This suggests serving many different segments, depending on capital availability, the extent of geographic coverage and the breadth of product lines. A narrow market approach, on the other hand, suggests
concentrating on a few markets and serving them well.\textsuperscript{[3]} Present thought as indicated by the interviewees indicates that the trend is towards broad product lines in narrow market segments. But this raises the question as to how competitive advantage will be gained in these segments at reasonable rates of return. Markets are more likely to be selected in which potential customers have relatively less bargaining power over the service providers. Evidence from the interviews would indicate that clearing banks will in all probability concentrate on middle market businesses and top income consumers - the two segments that they believe will be the most attractive and profitable in the 1990s.

8.4 BRANDING AND COMMUNICATION

Establishing and maintaining a consistent brand character is another key to success in customer retention. Brand character is the unique combination of benefits that consumers come to expect from any product under a company's brand name. A bank catering for a broad spectrum of consumers might define its brand character as high quality service at a fair price. A financial institution intent on serving the needs of a more select, upscale group might choose to adopt the brand character of a respected adviser for serious, smart investors. As deregulation of UK financial institutions progresses, a secure and steady brand character will become increasingly important. It will help banks differentiate their services in a market crowded by building societies and other competitors. Howcroft and Lavis\textsuperscript{[8]} identified the benefits of branding with reference to the 'St. Michael' brand of Marks & Spencer, which is synonymous with quality. Careful attention to brand character reassures customers that all products offered by the bank now and in the future
will be consistent and compatible with one another. In this way brand character provides a solid foundation for cross-selling.

Communication is essential in improving customer retention and loyalty. It is important to keep the bank’s name in front of customers and to reinforce their sense of association with the institution. Banks also have a large number of customers whose ties with the organisation are limited to a single transaction - a car loan for example - or a single service such as a current account. In communicating with these customers, an informative and educational approach is likely to prove much more successful than hard sell tactics. The general opinion of the interviewees was that all communication is moving toward influencing expectation rather than performance.

"Only customers themselves can accurately report the true market impact of a company's service. Only direct feedback, or external measures, assess if customers are service satisfied. To install external measures the first step is to determine what service elements or attributes are most important to customers"

Citicorp Sector Service Quality Manual 1987

Hard sell seldom works unless a product or service has a clear-cut product advantage and offers obvious benefits. Otherwise people react to aggressive sales pitches by becoming wary or "switching off". However, by viewing customer communications as an educational process, banks can appreciably strengthen their bonds with the customer.
Product marketing from an infrequently used branch network is not the only option open to the banks in their drive to sell to new and existing customers. Direct marketing is considered one of the main areas of potential in the future. Direct marketing is probably the most effective way of reaching specific targets and measuring their response for future reference. As the consumer market continues to fragment, then marketing to these narrowly defined groups is the natural progression. The development of the computerised customer database is giving direct marketeers the ability to do just this. Walter Stewart, former marketing manager of the Royal Bank of Scotland said that direct marketing - which includes telephone marketing, mail order, house-to-house distribution, and coupons in newspapers and magazines - is the "way of the future" in the bank's geographical spread southwards.

In Britain, the financial institutions - banks, insurance companies and credit card companies are now the leading users of direct mail. In 1988 they accounted for 36% of the total direct mail, compared to less than 25% the previous year. Total expenditure on direct mail in the UK in 1988 amounted to £530m. The advent of more well-known and respected organisations into direct marketing has helped to improve its image. It has been estimated that some 60% of the population is happy to receive and read postal advertising.

One of the best markets for financial services is an institution's existing customer base, a group that is frequently overlooked in the search for new business through greater market share. However, a growing number of banks are coming to the realisation that it is often
more profitable to focus direct marketing efforts on retaining existing customers and cultivating their loyalty. A financial institution's existing customer base is one of its most valuable assets and obtaining new customers is a very difficult undertaking. Usually, it involves attracting them from a competitor, which requires superior salesmanship and/or superior products. Consequently, bank marketeers are discovering that it often pays to focus direct marketing efforts on retaining existing customers and building a more profitable relationship with them.

Direct response advertising, using a coupon or "Freephone" number, might be used to generate an initial list of respondents with an interest in a banks' financial products or services.[7] Direct mail could then be used to refine that list in terms of the degree of interest shown or the potential for specific business. A tele-marketing follow-up could finally pinpoint the best prospects for a personal call or invitation to visit the branch. Each stage assists the next, building information about customers and prospects, making it more efficient and less costly to market specific products and services. As the direct marketing database builds, it provides accurate and measurable research with tangible evidence of the most productive market segments; the relative effectiveness of alternative offers; how best to position the product or service; the elasticity of demand by alternative prices and how to adapt the product or modify the marketing via post-marketing analysis.[7]

The Nottingham Institute of Financial Studies' survey of financial service institutions indicated that 40% of respondents believe that direct marketing will be a major influence in the period to 1990 and a
further 33% believe that it will have some influence in their marketing strategy. [17]

The setting-up of the Direct Mail Services Standards Board in 1983 aimed to improve standards of practice and conduct in direct mail. [7] These safeguards are important as direct mail delivers a personalised rather than a public message, in a sealed addressed envelope. Increasingly banks and building societies will use this sales method. The statement envelope used by banks and by some societies on a regular basis is a ready-made opportunity for sales offers of other products.

To enter this market will involve an increasingly costly "learning by experience" process. Mailing lists will become more accurate and detailed and by cross-tabulation with ACORN groups and postcodes, for example, very specific target audiences can be accessed.

One of the principal advantages of direct marketing is that the prospect is approached in isolation from competing advertisements. [17] Additionally, direct marketing can appear highly individualised - which is the key to future financial service provision. [3] Also accurately targeted direct marketing helps to cross-sell other services once the initial purchase has been made. The principal disadvantage, is that the message reaches the prospect at a time chosen by the company and not by the prospective customer. [17]

Whichever marketing technique is chosen and irrespective of market penetration, an emphasis upon image and advertising is in many respects a necessary prerequisite for success in a competitive market. Chapter 9, therefore, specifically addresses image and advertising.
9. IMAGE AND ADVERTISING

9.1 INTRODUCTION

"A bank's image is an important non-material asset that should be managed so that it supports and keeps in step with the developing strategy". [11]

As the boundaries between traditional financial sectors continue to dissolve, sellers must concern themselves more with developing and maintaining a distinct image in the market place. When market penetration is low, the marketing campaign can be directed primarily at expanding the total market and there is still considerable room for such expansion in the UK. However, as the market matures, a change in emphasis is required which is directed at encouraging brand loyalty. Because of search and information costs, it is easier to sell additional products to existing customers than to acquire new ones. [14]

9.2 IMAGE

Arguably the image of the bank in the customers' mind is the most important type of branding it can offer, and should, therefore be the central component within any marketing strategy. [8] As the banks move to a position of offering an ever increasing range of financial services, then creating a uniform image may be difficult. The TSB Group, one of the more diversified financial service providers in the UK, has had difficulty in establishing a corporate identity which encapsulates the component businesses. Howcroft and Lavis [8] identified the following requirements to help establish the required image:
Develop coherent corporate identity campaigns that will help to bridge the gap between them and their customers. It will often be necessary to produce particular identities and images for the consumer market, but which in turn contribute to the corporate identity and ethos.

The external appearance and internal design of the branch should more fully fulfil its retail purpose, and should act to break down the barriers between staff and the customer.

Meidan[11] believes that the increased priority given to siting branches in out-of-town shopping developments may lead to a loss of image and identity for the banks. Although site location is a crucial factor in attracting accounts, the emphasis away from traditional high street corner locations should not adversely effect corporate image provided that branch design is uniform. This could be a significant factor as banks look to increase the number of remote sites.

9.3 ADVERTISING

As banks have moved away from cost-based strategies to ones which emphasise differentiation and focus, there has been a commensurate increase in the importance of promotion - especially advertising. As competition in financial services increases, it is difficult to see the level of advertising expenditure doing anything other than increasing rapidly to continue the recent trends. UK bank expenditure in 1988 totalled £95.1 million, a 20% increase on 1987.[16]
In return for the high levels of expenditure, one can assume that banks would expect consumers to be more aware of services available and have a more positive attitude towards banks relative to their main competitor, the building societies. However, comparing results of a survey by the Plymouth Business School on banks in 1983 with the school's more recent research on consumer buying behaviour shows only minor changes in consumer awareness, and no change in the attitude that banks are less caring and helpful than building societies. Assuming that the research is a reasonable indicator of the low effectiveness of recent promotional effort, then one can assume that the financial services sector is somewhat different to the market for tangible consumer goods. Given the differences in the market environment the banks may wish to re-examine promotional strategies. Over recent years the big UK retail chains have recognised the inefficiencies of relying upon national advertising campaigns. To enhance effectiveness these organisations are now placing emphasis on building customer loyalty at the point of purchase. A key advantage of this approach is that the contact between customer and employee provides a more effective mechanism to respond to the specific and varying needs of customer groups.

In this market advertising has a number of prime objectives. Increasing customer awareness of the bank is of particular importance. Television advertising is especially useful in creating a memorable company or brand image. All the major banks and most leading building societies feature a heavy use of TV advertising in their marketing strategy. Television is primarily used to build image, making prominent use of bank logos to personalise their organisation. The press is then often used as a "back-up" media, through which specific details of the financial product can be conveyed.
While High Street banks have been known to the public for many years (as evidenced by the 90%+ scores in unprompted awareness tests) the same has not been true for other personal financial service firms. As competition increases between banks, building societies and other providers of personal financial services, so it is that these other players eg. insurance companies, have moved increasingly to television to establish a stronger corporate and brand identity in the minds of customers.

A clear image that has been accentuated by a targeted advertising campaign will help the organisation to establish and sustain competitive advantage. The interviewees in the financial service sector accede to the view that competitive advantage through product differentiation is now virtually impossible to establish. Those organisations who can establish an image of high quality and excellent value will win an increasing amount of business.

Chapter 10 discusses pricing which, having traditionally been regarded by banks as essentially a cost consideration, is now increasingly being perceived as a marketing concept and being used to actively sell products and maintain/increase market share.
10. PRICING

10.1 INTRODUCTION

Pricing is a vital element of the marketing mix as it represents the only variable which creates revenue rather than costs. This situation applies to all industries, most of which spend a great deal of time over their pricing policy. However, prices in banking are often set without reference to overall marketing strategy and without any real understanding of cost structures. This resulted from the traditional practice of cross-subsidisation of products and services. Historically, there has been a failure to identify the costs of providing individual services or servicing individual customers - rather there has been a concentration on profitability at the branch or area level.

It is envisaged that as the industry becomes more competitive, price will be the most likely component of the marketing mix to respond. Bankers will need to develop a better understanding of pricing strategies and the effect that the pricing variable can have on revenues and profits. The increasingly competitive marketplace combined with more specific segmentation strategies has forced bankers to favour a fee-based pricing strategy.

10.2 PRICING OBJECTIVES

Howcroft and Lavis identified the five following pricing motives which could apply to a basic banking market:
1) Pricing for market share
2) Pricing to encourage use
3) Pricing based on cost
4) Pricing as a component of service
5) Pricing based on perceived benefit

As it is likely that these objectives will never be mutually exclusive, the pricing decision is particularly complicated. Howcroft and Lavis\(^9\) also noted that many products are based on co-operation between institutions, a situation which they believe may well increase in the future. This further reduces pricing flexibility. However, I believe that it is equally possible to agree that in times of heightened competition and de-regulation, co-operation may diminish allowing for an increased degree of price flexibility.

In the above list, the first three motives are currently used by most institutions. However, the emphasis in the future is likely to switch to pricing based on perceived benefit. This will directly reflect the added value that the bank provides to the customer, through the attributes of the product or service. This more realistic approach to pricing is market orientated because it takes into account the quality of the product and additionally considers competitors' products. More importantly, it considers the customers and how they might react to the pricing decision.\(^2\)

Relationship pricing has evolved as a consequence of market segmentation and specifically, cluster analysis, which looks at the group of products held by a customer. The attitude of considering the total relationship between the customer and the bank was pioneered by Citibank. With the
adoption of relationship pricing the further use of integrated account statements would seem a natural progression. Banks can promote cross-selling through relationship pricing that rewards customers for consolidating their business with a single institution. Someone who has several different product relationships with a bank practising relationship pricing, will pay incrementally less than a one-product customer. It has many advantages: it increases customer loyalty and should maximise the bank’s return from a customer relationship. Pricing will be a function not of individual product profitability objectives, but of segment profitability objectives.

The stage in a product’s life-cycle, rather than just its quality, is also an important factor in determining price. The price of a new product is often set higher to generate sufficient revenue to cover the cost of its planning, costs and introduction. This practice recognises the fact that a portion of the market is willing to pay higher prices for a new product. As the product matures the price gradually drops and appeals to a new sector of the market. The market is effectively segmented on a price sensitivity basis. This policy known as the "skimming policy", is polar to the policy of "penetration pricing" in which the product is introduced at a low price to gain market share. It is particularly useful in highly competitive markets. Market share is related to long-term profitability, so that early purchase represents an investment in future profitability.

10.3 PRICING STRATEGY

Pricing is a highly sensitive issue. A bank with an "upmarket" reputation does not want to cut prices suddenly as this could give the
appearance of discounting. By standing back and thoroughly scrutinising its product portfolios and its long and short-term goals, a bank can derive a good perspective on what its prices should be.

The introduction of new technology and the increasing competition in this market has led to a reappraisal of the use of pricing strategy. At present banks may sacrifice their strategic position by operating market rate pricing because they do not know their own underlying service cost structure.[3]

Those organisations which provide a full range of retail banking services (especially money transmission) may find that scope for further price competition in the existing market is restricted. Howcroft and Lavis[9] identified the following factors which will be crucial in the banks future pricing strategies:

- The use of differential pricing will increase, to induce the use of specific services and to attract particular segments.

- Pricing must reflect cost, whether on a specific product basis or through a relationship.

- Cross-subsidisation between sectors and products (except in the case of relationship pricing) should be avoided, to enable banks to employ competitive pricing policies.

As customer databases are built up it should be possible to identify products and segments which are profitable. This will further enable marketing strategies to be designed which utilise pricing policy as a vital element in meeting the needs of specific customer segments.
11. MAIN IMPLICATIONS AND CONCLUDING THOUGHTS ON MARKETING

Banks must increasingly endeavour to create added value through distribution systems that are tailored to the needs of customers. Similarly they must attempt to move away from traditional fixed-site, independent branch delivery systems to distribution systems that deliver products to the home or to the office, through the ATM, cable TV, telephone or the mail. This strategy means expanding electronic delivery systems, which will probably become increasingly acceptable as the population ages. Product value can be created by adding an information component. Consumers want to be informed; they equate knowledge with financial power, A bank that focuses on explaining and emphasising product attributes or that designs its products around information valuable to the consumer will have an information advantage and a way to differentiate its products.

Additionally, quality of service must be emphasised. In the 1990s, the empirical work carried out would suggest that the banks will almost certainly use technology and information to customise financial services to the individual as much as possible. Quality of service will be a vital area for gaining competitive advantage. The creation of value in financial service provision is a key area for banks to attain this advantage. Aside from quality of service and the lowering of costs, banks must create value that customers are prepared to pay for. A major step in achieving this challenging task is through the individualisation of product/service provision. Customers will obviously still want security, efficiency and value from their financial institution - but extra services such as information and uniqueness of products are desirable attributes from a customer's perspective. The industry should
try to avoid price competition and instead place greater emphasis on creating a sales and merchandising environment.

Merchandising may well be a salient issue in the future - and it may be that if banks cannot match the non-banks in this area, they will continue to lose customers.

Information systems are now critical to the cross-selling of products. The banker must know existing product relationships, potential needs and customer/product profitability. Without such information the bank will waste an enormous amount of time looking for opportunities within a large customer base that only contains a small percentage of suitable prospects. The more advanced the cross-selling technique, the more important the need for an effective information system.

Finally, ideally marketing should not be the sole responsibility of the marketing department, the concept must be adopted by the whole organisation. None of the components of the traditional marketing mix - product, price, place and promotion - can sustain competitive advantage in isolation. To establish advantage in the marketplace, the bank must be organised around a marketing concept of quality service delivery.
PART II - REFERENCES


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PART III - TECHNOLOGY DEVELOPMENTS
12. TECHNOLOGY OVERVIEW

12.1 INTRODUCTION

Information technology has arguably done more to alter the competitive environment in personal financial services than any other single factor. It has helped to break down the barriers between traditionally autonomous areas and enabled a whole range of players to compete on an equal basis. Information technology also introduces the potential to reduce unit transaction costs, for both the financial institution and the consumer. For services with the characteristics of convenience goods, the technological changes have reduced the need for personal contact and hence offered the potential of significant savings in labour costs.[7]

Technology improvements will mean that bank employees and customers need to prepare for a decade of change,[21] in which many long-accepted banking ideas will be cast aside. Technology will be able to replace many of the basic cashiering functions, which will impact on the type of service that a customer receives. Personal service will still be available at a cost, but customers may have to travel longer distances to obtain this type of service. This is because many existing branches will possibly be closed or converted into self-service establishments. The buildings which are no longer needed for payment services will possibly be converted into specialist "shops" that can be used to market a much more extensive range of bank facilities, for example; insurance, travel facilities, share purchase and sale, and property transactions. Those customers who demand a high level of personal service may possibly find it difficult to obtain to the degree that it is available.
Accordingly, customer loyalty may be diminished as automation weakens the traditional bank/customer relationship.

As the level of technology required to produce and process financial services becomes more widely available, then an increasing number of diversified players will be able to enter the market. Hence, it will be more difficult to differentiate the product provided by one bank from that of another, as any technological advantage gained will be short-lived. Technology may, therefore, prevent any sustainable product advantage and may lead to future product standardisation. However, for technology to have its full impact on banking, it needs to be accepted by bank staff. Will the automation of many clerical tasks mean that staff are free to perform more interesting jobs? How will the further automation effect job security? The banks need to answer these and other questions as part of their information technology strategy.

12.2 IMPLICATIONS OF INCREASED TECHNOLOGY USAGE

The move to increased usage of technology in financial services provision would appear to be inevitable according to the views of the interviewees. Chiplin[7] identified the following three major effects of an increasing reliance on technology:

i) New distribution systems will result in increased efficiency, greater competition and the generation of new customers and larger total markets than would otherwise be the case. However, the market size and share for any one company will depend on its own competitive ability and not just on its level of technology expenditure.
New product development allows the introduction of innovative and improved financial services. The introduction of new products expands the total market amongst existing customers and attracts new customers to the market.

Changes in the distribution system will be the most visible impact of technology for many customers. The most significant of these could be the much vaunted concept of "cashless" shopping via the inaugural EFTPOS scheme, which should roll-out into a national scheme approximately 12 months after introduction. The "smart card", the French invention which incorporates a microchip in a plastic bank card, seems to be finding international acceptance as a form of plastic money. The concept of a world-wide electronic debit/credit network is coming closer as operators of ATM networks agree to share their services.[14] Direct electronic banking (home and tele-banking), although generally of minority interest, is gaining acceptance. In the basic bank markets this especially applies to tele-banking due to its introduction by more banks and building societies.

12.3 IMPLICATIONS FOR THE TYPE OF MARKET

Technology advancements may well alter the structure of the basic bank market. Chiplin[7] argued, when considering this matter, that it is economies of scale and scope that are significant. Economies of scope (gains from the production of more than one product) are likely to be of more significance in financial markets than economies of scale (gains
from the increased size of the firm), due to wide availability of the
technology and the inherent substitutability of financial products.

The technology changes taking place in financial markets no longer
necessarily favour the large organisation. There are opportunities
for joint ventures and the small organisation can effectively exploit a
niche market. We may also see the entrance of yet more "outsiders" into
this market, Information service companies are growing in importance and
links with financial institutions have already taken place. New
entrants could include such powerful companies as IBM or British
Telecom.

12.4 STRATEGIC PLANNING FOR TECHNOLOGY IMPLEMENTATION

Technology can create new business opportunities for a bank, but the
risks associated with implementation are also high. The banker needs to
consider how technology fits in with current and future strategic plans
and weigh this against the high costs of installation. As advances in
information systems are implemented more widely, Hastie believes that
all financial institutions will have to:

- re-assess their current and future range of products/services

- formulate a definite strategy for delivery systems

- consider the economics of substituting technology and capital for
  labour
Technology will play an increasingly important role as it will allow the banks to move further into non-traditional areas. Given the constant need to add value, technology will be one of the principal mechanisms in meeting this goal. For instance, information on loans and rates can be an area of value-added performance. Being impersonal, an application for a loan via a terminal may be more acceptable to certain customers who are reticent about asking for a loan (and hence possibly being refused). The First Oessterreichische Sparkasse, an Austrian bank, provides a good example of paperless loans. It has some 60,000 private files and opens some 12,000 new loans per year all via on-line terminals.\[9\] Significantly, once this sort of system is in place it can easily be transferred to a home banking environment.

The personnel implications of increased technology implementation will be substantial. It is likely to lead to a re-organisation of the lines of command which will probably impact on the hierarchical structures associated with the traditional bank.\[9\] Automation in Swedish branches has resulted in staff numbers falling to approximately one third of those in equivalent UK branches.\[14\] There will be a move towards employing more technology experts. How these people fit into a banking environment and how they affect the banks' culture will be a critical factor. It is possible that the use of expert systems will have a greater effect on bank personnel than any other form of automation.\[8\]
12.5 EXPERT SYSTEMS

Expert systems are software packages that enable non-experts to access a database of knowledge, usually in question and answer format. Top financial experts produce application programs to solve problems in specialised fields, by distilling their knowledge into the program. Expert systems is an area where banks have shown a great deal of interest, however, as yet there has not been much evidence of practical usage - especially in the basic bank markets.

One of the main areas of potential interest is loan approval. Many banks have selected it because it has a high probability of success and high visibility.\[8] The systems can reduce to minutes procedures that may previously have taken several days and the time reduction for the customer is an obvious area where institutions can gain competitive advantage. The area of assessment of credit-worthiness by expert system, is currently being used by Bank of Ireland and Citibank.\[27]

The TSB uses an expert system as a marketing tool for selling financial advice to UK residents working abroad. The replies to a questionnaire are fed into the system which can produce a ten-page letter of recommendation in 15 seconds. Added value and competitive advantage are guaranteed.

Another expert systems application area is the ATM environment - developing the ATM into an electronic teller. Typically, an electronic teller will be able to query clients and prospective clients as to the services which they need, open new accounts, give advice, and present the whole range of products and services supported by the bank.
Enriched with an expert system, the electronic teller goes beyond the self-service banking concept of ATM, into direct client involvement.[8]

Whybrow[27] believes that artificial intelligence (AI) and expert systems in particular, will not begin replacing bank employees for at least 20 years. Instead the technology will improve the productivity and accuracy in repetitive operations such as credit approval and funds transfer.

The lifting of restrictions on market players, allowing them to compete in non-traditional areas, has meant that many institutions and their employees need to know about a far wider range of products. The use of expert systems is one method of overcoming the problem of lack of product experience amongst existing staff and will also reduce the amount of external recruitment necessary.[27]

12.6 THE EFFECT OF TECHNOLOGY ON PAYMENT METHODS

If present trends are maintained, by the end of the century there will have been a substantial move towards electronic transfers, which in the UK could make up 10-15% of all payments and considerably more than 50% of non-cash payments.[21]

Total non-cash money transmission volumes in the UK increased by 8% in 1988, continuing the trend of 7% to 8% annual growth experienced during the 1980s. Cheques and paper credits accounted for around 60% of total 1988 volumes, with automated and plastic media each contributing a further 20%[21] Total volumes are expected to continue increasing, although at a diminished rate. While automated and plastic volumes are
expected to grow rapidly (partly helped by differential pricing and the implementation of EFTPOS), paper volumes are projected to plateau in the early 1990s.[1]

Over 70% of adults now have a current account with a bank or building society, which provides a cheque book and the facility to make automated payments. This figure is expected to rise to around 80% by the end of the 1990s. The proportion of adults holding ATM cards and credit cards has risen to 50% and 40% respectively. Although the number of adults having access to cheques and automated payments is approaching saturation, there still remains scope for wider ownership of these cards. Debit card holding is expected to increase dramatically in the next few years.[23]

12.7 COSTS OF TECHNOLOGY IMPLEMENTATION

The amounts expended on computing equipment by financial services have been - and will almost certainly continue to be - prodigious. Sales of computers to the banking sector alone are expected to exceed $8.4 billion in 1989. Predictions are such that by 1994, worldwide sales will be more than $14 billion.[14]

Citibank of the US was the pioneer with heavy spending on technology and its senior executives were always aware of and enthusiastic about how technology could help the bank. In the late 1960s, for example, it bought a small software and hardware developer, which gave it an invaluable in-house IT capacity. It was then able to bring its ATM programme to market before its competitors.[2]
In the next five years, six of the UK's leading banks and building societies will spend over £4 billion on automating their businesses.[17] The National Westminster Bank, plans to spend £3 billion on technology in the five years to 1994. The investment will be the group's largest single tranche of capital expenditure in this period. The bank's demands for processing power were growing at over 50% per annum and the demand for information storage at 40% per annum.[17]

12.8 CONCLUDING REMARKS

The need for high technology expenditure is undoubted in the financial services industry if a provider is to keep pace with the competition. However, Chorafas[9] identified organisational inertia and resistance to change as the principal reasons for delays in technology implementation, rather than the high costs of installation.

It would appear that a competitive strategy that does not include detailed proposals for a technology policy, will leave the institution in a very uncompetitive position. Yet the most likely savings from a wholesale technology policy are still likely to be process rather than product orientated.[7]

Professor Jack Revell[24] has expressed the following view of the financial system of the future:

"It consists of a number of different kinds of terminals linked to the central computers of banks and enabling bank customers to carry out most of their needs and obtain much of the information that they need without involving bank staff. The terminals will
be ATMs (probably reduced to the functions of dispensing cash and taking deposits), EFTPOS terminals in retail shops and petrol stations, terminals connected to TV sets or microcomputers in the office or home, and terminals on bank premises or in any other building to which the public has access. Connected to the system will be facilities for carrying out all sorts of other financial transactions, such as the buying and selling of securities and the negotiation of insurance."

Electronic technology has allowed the new entrant to offer much the same level of service as the larger organisations, unhindered by the lack of a branch network. For instance, Adam & Co., established itself as an up-market bank, providing its customers with a wide variety of banking services by arrangement with other institutions. Its success in offering a completely branch-independent service is reflected in the fact that 20% of its customers live in and around the London area - 400 miles from the bank's own office in Edinburgh.[25] Hence, we have a situation where the 'traditional' qualities of banking are supported by the use of the latest technology.

One of the major concerns with all forms of technology application is the protection of consumer interests. For instance, the banks' future reliance on detailed databases for the cross-selling of products, will mean that a great deal of personal information can be accessed. The Jack Report[18] recommended that EFTPOS systems should be made on-line to counteract fraud. Refusal of an EFTPOS transaction will imply certain negative facts about the potential user and if this refusal is mistaken it is possible that the customer could take the bank to court.
for defamation of character. Hence the need for detailed legislation in a relatively new area for bankers.

Technology will continue to provide definite opportunities to improve both productivity and profitability; it will increasingly assist institutions in developing new products and services and it will be fundamental in providing management with accurate and timely information critical to the support of both operational and strategic decision-making. A survey by Arthur Andersen & Co.[2] also indicated that bankers believe that technology implementation helps to create a positive image which is advantageous in attracting and retaining both customers and employees.
13. AUTOMATED TELLER MACHINES AND SELF-SERVICE BANKING

13.1 INTRODUCTION

The convenience of automated teller machines has become an accepted part of banking life for most people in the UK and developed countries (Appendix 1). Initially, however, they were met with a certain degree of mistrust by the customers, who preferred the more traditional banking halls. The banks that pioneered the introduction of these machines undoubtedly made losses to begin with, but in the long-run they probably did better than those institutions which sat on the side-lines. For the financial institutions, engaged in a fierce struggle for the newly deregulated retail banking market, these machines have now become a vital component of their marketing strategy. In the UK, building societies, banks and others now compete head-on in the personal banking sector and all groups are striving to offer a service that will protect or expand their market share. The longer opening hours of the societies, their reputation for being more friendly and personal, and their ability to offer more attractive interest-bearing current accounts posed a particular challenge to the banks.

A major part of the banks' response was to cover the country with ATMs (Appendix 2), making cash and other banking services available on most days. This increase in ATM installations has been matched by a large increase in the number of ATM cards in circulation (Appendix 3) and also by the way that the machines have been accepted by the public (Appendices 4 and 5). By taking over routine functions they have the potential to relieve the cashier to sell services while at the same time cutting labour costs. The ATMs themselves can also provide information
about the institution's products. Originally banks tried to put as many services as possible on to the ATMs (for instance an extra £850 on the cost of a machine gives a deposit accepting facility). Japanese cash dispensers (of which there are usually five or six per branch), can accept deposits of bank notes and can count and sort them before storing them ready to be dispensed to another customer. As a result, such machines are largely self-sufficient. Indeed, the Japanese financial institutions project that 80% of teller operations will in the future be performed by ATMs.[9] However, in recent years in the UK there has been a move towards single function ATMs. This is to alleviate the long queues often associated with multi-function machines.

Speakers at the European Financial Self-Service Conference in 1987 agreed that it has now become an essential part of the competition in financial services to provide customers with a large number of convenient machines and that cost savings (the original purpose of the machines), had become a secondary consideration. However, a contrary view is that of RBJ Van Eldick, President of the European Council For Payment Systems:

"Our most important criterion for the installation of a cash dispenser is its contribution to the profitability of the bank. Placement of a cash dispenser must lead to the saving of at least one full-time job."

The National Westminster sees wide scope for extending self-service banking. It has introduced customer activated, screen-based systems for share transactions and is investigating the possibility of using this system to extract insurance quotations.[4] Interactive video units
could offer information and quotations on personal loans, travel facilities and mortgages. Lloyds Bank and TSB are also experimenting with an interactive videodisk system. The idea is to use a mixture of video, graphics and computer calculation facilities to show the institution's products and provide quotations to the customer on branch premises. In theory, deals could be clinched if the machines are linked to customers' accounts and to credit scoring systems. Printed loan or contract documents could then be produced at the conclusion of the transaction.

The ANZ Bank opened a Day and Night Banking Centre in July 1986. The laser-vision terminal offers the customer a number of alternatives which can be accessed via a touch screen and a person on the video screen talks them through the latest products available and gives them details. The technology is virtually limitless in its use. The bank could sell tickets for the theatre, sporting events, or even travel packages.

13.2 CURRENT SITUATION

The sharing of money transmission and delivery systems has been predicted for some time. The economies of scale this represents will help to reduce the banks' cost/income ratios which are currently viewed as one of the key indicators of bank efficiency.

The announcement that the Link (which now includes the Halifax Building Society) and Matrix networks are planning to share their ATM facilities, means that there will shortly be three major networks in the UK.
- Clydesdale, Midland, National Westminster and TSB - 5,300 machines and 13 million cardholders.

- Bank of Scotland, Barclays, Lloyds and Royal Bank of Scotland - 4,400 machines and 11 million cardholders.

- Link/Matrix - 3,400 machines and 10 million cardholders.[4]

The banks are noticeably more reticent about informing their customers of the shared facilities than are the societies. This may well reflect the traditional unwillingness to implicitly advertise another bank's services. However, the opening of ATM facilities on an international basis is, by contrast, more widely publicised. In 1988 Visa claimed to have provided cash dispenser facilities to cardholders at 33,000 machines in 35 countries (up from 24,000 machines in 25 countries in the previous year).[4] Most enterprising of the UK banks has been Girobank, which became the first member of the Link consortium to connect up to the "Plus" network, which provides facilities in the US, Canada and Japan.[4]

Twenty four hour cash dispensing is fast becoming a utility - this is popular with customers, but it is increasing the banks' costs. A recent significant US development has been the decision by some banks to charge customers for this facility.[25]

Just as the banks and building societies have spent heavily on establishing customer databases, financial institutions are stepping up investment in machines which customers can use for routine transactions within the branch. Originally, most banks opted to locate ATMs
"through-the-wall", which at the time enabled the greatest access to the machines outside bank hours. Internal machines, however, attract customers into the branch where the institution has a greater chance of selling other services. It now seems probable that ATMs installed by major UK banks on a "through-the-wall" basis may be close to an optimum level, especially when network sharing arrangements are taken into account.[21] Inside banks, there may be room for more basic cash dispensers, especially if prices can be brought down to significantly less than £10,000. Special "Lobby Banks", something Lloyds pioneered ten years ago, seek to provide the best of both worlds. The annual Banking World survey of ATM installations by High Street banks[4] revealed, for instance, a surge in installations in 1987 by Barclays (up 29%) and by Midland (up 32%) on in-branch machines: neither bank, however, yet approaches the numbers of in-branch machines already installed by Lloyds, National Westminster and the TSB. National Westminster are adding to their ATM network at around 200 new sites per year.[28]

With some 11,000 machines installed by the banks, at present rates of increase there will be as many machines as bank branches in a few years (Appendix 6). Indeed the TSB is currently unique, being the only bank to have more ATMs than branches (Appendix 7). The building societies are increasing their ATM installations but the difference between branches and ATMs remains reasonably constant (Appendix 8). The move to remote locations is gathering momentum: Barclays and Midland have doubled the number of installations on such sites as university campuses, factories, industrial estates, hospitals, military bases and shopping centres.[4]
13.3 PLASTIC CARD DEVELOPMENTS

Commensurate with the increased use of ATMs has been the increased preference, from bankers and customers alike, for plastic card accounts. One of the main reasons for this recent proliferation is that it enables the bank to control the account in a way which is impossible with a cheque book. Additionally, they are considerably cheaper to maintain - according to John Reed, Chairman of Citibank, plastic card accounts cost little more than 10% of the cost of conventional accounts. The annual figures being in the region of $20 \text{ v } $175 for Citibank. These figures are supported by Lloyds who estimate the costs to be approximately £20 \text{ v } £80.[15]

A recent trend in plastic cards has been the integration of several functions into a single card. Thus, virtually all credit cards can be used to obtain cash from ATMS, while some banks (eg. Midland) issue combined ATM, cheque guarantee cards and debit cards. In some countries a single card can be used in ATMS, to draw cash from either chequing or credit card account, whilst elsewhere the cardholder can make a similar choice at the point of sale about the account he wishes his purchase to be debited. At some building societies a single card can be used to control both chequing and savings accounts.
13.4 CONCLUDING REMARKS

The interviewees were agreed that the future use of ATMs will be increasingly concerned with this revenue generating capability and less with their cost benefits, especially when compared with branches. The future of ATMs, therefore, may well be inextricably linked with future developments in cards. This future may be well assured if we accept the possibility that a single plastic card could effectively become a bank in the customer's pocket. With sufficient internal memory and logic, there is no limit as to what could be achieved with the so-called smart card. One or more segments of the card could act in place of cash, operating public telephones, parking meters, and public transport ticket machines. A major benefit would be the ability to store all details of transactions made with the card, thus providing the independent evidence that is necessary for resolving disputed transactions.

The great memory capacity of future generations of cards will allow other much more sophisticated methods of controlling fraudulent use, such as signature dynamics. Fraud control is already being achieved in France by programming cards to initiate an on-line transaction if the purchase is above a certain value, or if a certain number of off-line transactions have already been made in succession. Cards could also be programmed to access the appropriate cardholder account, depending on which piece of equipment it was being used to operate. It would be useful, for example, to have a card which debited the customer's current account when put into an ATM but which acted as a credit card when used to pay a retailer by EFTPOS. Cards could be individually tailored so
that they would automatically make the sort of payment choices that the cardholder would make himself.[1]

Although such a card will no doubt be technically feasible very shortly, it does not necessarily follow that it would be welcomed by customers. The consequences of losing such a valuable piece of plastic would be far reaching and the extra cost of such a card compared with much simpler and cheaper cards would have to be borne by somebody.

According to the report by the Jack Committee[18] the development of multi-function cards "seems desirable and inevitable." However, customers who require only one function from the card are exposed to unnecessary risk if they are given a multi-function card. "A bank should not be at a liberty to refuse a card for a single function, if its customer does not require more." The report recommends that unwanted functions should be simply blocked-off the card.
14. SMART CARDS

14.1 INTRODUCTION

Visually a smart card appears identical to the familiar magnetic stripe card. However, the card will contain a microchip that is able to store and record a great deal of information. As the customer's account data is held on the card, there is no need for a terminal or ATM to refer back to a central computer for transaction verification. This means that systems could be maintained off-line, resulting in lower costs for data communication. In France, where the technology was invented in the 1970s, more than 17 million of the cards are currently in use.\[26\] Even so, the French programme for the distribution of these cards during the period 1986-1988, was well behind schedule - the main obstacle being the retailers' reticence to install the necessary terminals. By 1990, French banks hope that all of their customers will own one. Their importance also looks set to grow in the US - it is estimated that the market for smart cards and associated products will be worth $3bn by 1990 in the US alone. Smart cards could also drastically effect shopping patterns. By 1990-91, it has been estimated that French bank card holders will use their cards 53 times a year compared with 25 tunes at present, and cards will be used for 20% of transactions compared with 8% in 1987.\[26\]

According to the "1989 Smart Card Annual", 200 million integrated circuit (IC) cards are forecasted to be in circulation around the world by 1995. Of those, 120 million (60%) will be IC memory cards, and the remainder will have microprocessors. Of this remainder, 30 million will
be cards issued by Visa and Mastercard. It is estimated that Visa and Mastercard will enter the mass market around 1993.[26]

14.2 MAGNETIC STRIPE CARDS OR SMART CARDS?

At present (1989) there are approximately 40 million magnetically striped cards in issue in the UK and this figure is growing rapidly due to competitive pressures on financial institutions.[26] The stripe on the back of such cards comprises a number of tracks which can store a limited amount of information. Significantly, not all of the available tracks are used in present applications. This poses the question: is there any need at present for the smart card?

Barclays believe that further development of the magnetic stripe should take place and that currently there is no cost justification for introducing the microchip to the core product (the Barclaycard). They feel strongly that technology is leading the market, which is a view also supported by Bo Gunnarsson of the Swedish Bankers Association. He believes that bankers have been fascinated by the available technology and are now looking for an application, rather than adopting a more market-led approach.

The costs of the smart card are undeniably high. Even though the cost of basic integrated chip cards has fallen substantially over recent years: suppliers will still quote $5 a card for bulk orders, although the price should come down even further now that several Japanese manufacturers have entered the market. However, it is believed that the figure for price competitiveness is still around $2.50 per card.[22] Traditional magnetic stripe cards only cost around 15 cents to produce.
Equally, the benefits of the card are undoubted and the interviewees made the following claims in their favour: they help cut down on paperwork as well as improving control over bad debt. Most importantly smart cards will help to cut down on fraud because they offer much greater security than magnetic stripe cards, ATM cards and electronic transfer cards. Smart cards have the demonstrable advantage of making transactions undeniable, by recording them on the card. Verification of such cards is also much quicker because there is no need to have the checking machine on-line.

The power of smart cards is increasing rapidly, and already a new generation of cards, called super smart cards is being tested in Japan. Visa, the international financial services organisation is testing a card supplied by Toshiba.[26] The card has a miniature liquid crystal display screen and contains a keyboard clock, calculator and electronic notebook. It can also be used to buy airline tickets, invest in securities, transfer funds as well as being used as an ordinary debit or credit card. Advances also include a card that can carry a record of the holder's signature. When the card is used, the card holder will be asked for a signature which a terminal will analyse and compare with the signature information on the card. The Jack Committee on banking[18] said signature recognition would be much more secure than the use of PINs.

"When signature recognition has been fully developed it has been claimed that the smart card will be virtually fraud proof."
14.3 MICRO MARKETING APPLICATIONS

Focusing on the target market at the individual level, known as Micromarketing, has been a long-standing business goal for many bank marketing executives. Using smart cards to gather, store, process and administer information on a real-time basis enables a cost-effective, targeted marketing program.

Collecting micromarket information on the smart card allows the marketing executive an additional direct channel of communication with each individual buyer. Through this link, direct promotions targeted to individual banking preferences can be administered cost-effectively. Specific products and services can be offered that distinguish the bank and the branch from the competition. Offering more information to the branches - on a real-time basis - will give branch level management the opportunity to improve the level of service (and hence increase the value to the customer) without having to "purchase" loyalty: an expensive alternative, particularly, in an industry where margins are being squeezed from all sides.

In the UK, banks in the basic bank markets still tend to be undifferentiated. They will need to further segment their markets, if possible down to an individual branch.[28] Collecting information on product/service purchases and monitoring dynamic changes in the customer’s circumstances, can allow a branch to meet its customers' needs more efficiently. Further, using the smart card, each branch can develop more direct marketing (micromarketing) campaigns that will offer benefits to individual households. The branch that knows its customers and their needs will have a major competitive advantage over its rivals.
It is likely that smart cards will initially be introduced into niche markets and other closed environments (such as the current Loughborough University trial). At present there is a certain amount of disagreement in the industry as to which format of smart card is preferable. Barclays would prefer the chip to be on the front of the card, whereas Midland favour a contactless system with the chip embedded inside the card. However, the technicalities are probably unimportant at this stage - what needs to be established is the customer demand for such a product. Without this, the predictions of a technology-led rather than a market-led product will probably be true. Visa has been the only company to produce a cost-benefit-analysis for the introduction of smart cards, although this was as far back as 1985. Surely the rapidly changing competitive environment would ensure that these projections are now inaccurate if not totally meaningless.

The key to the future success of the smart card lies in its flexibility and its multifunctionality in the provision of services. This capability simply does not exist in the passive magnetic striped card. If it can be shown that the need for this extra flexibility exists, then the technology is there for smart cards to be an area of real competitive advantage in the next five years. The card companies have yet to convince customers that the cards provide a sufficiently improved service to be worth the time and effort needed to learn how to use them. Technophobia may yet prevent their successful introduction.
15. CREDIT CARDS

15.1 INTRODUCTION

Credit cards have probably done more to revolutionise and improve the world’s payment systems than virtually any other payment media. They are easy to use, widely accepted and if used carefully, enable the holder to benefit from a substantial period of interest-free credit. Unlike other methods of payment, bankers perceive them as being profit centres, not cost centres. Consequently, they actually want their customers to have credit cards and to use them repeatedly. Therefore, they have spent large amounts in establishing the infrastructure to make credit cards a practical method of payment.

The last few years have seen a rapid growth in credit cards. Between 1975 and the end of 1987, the number of major credit cards in circulation rose from 6.29 million to 23.98 million, an increase of 281% (see Appendix 9). Currently in the UK there are over 25 million bank credit cards available through 20 million accounts, with a turnover last year of £17 billion.[13] 38% of adults in the UK have a credit card. Equally there has been a rapid growth in retailer store cards. At the beginning of the decade there were some 3.5 million store cards in circulation compared with some 12 million in 1988 with one or more retail cards being held by 10% of the adult population. Bank credit cards and store cards together, were up 30% in turnover in 1987 over the previous year with total new credit card lending up 14%[5] Bank credit card usage is currently expanding at the rates of:

- 20% per annum in terms of cards issued
- 25% per annum in terms of turnover[5]
This growth has been prompted by a number of factors, not least of which is the large profits made by the sponsoring banks - resulting in extremely favourable terms of issue. Additionally, consumers have become more financially sophisticated and are aware of the advantages of card holding (evidence from the banking industry would suggest that society now believes that debt is more acceptable than in the past). Thirdly, banks (and more recently, building societies) have embarked on large advertising campaigns to promote their credit cards.

Cards are increasingly being used as a method of payment rather than as a source of credit. Approximately 46% of Barclaycard's customer base regularly settle in full at the end of each month, with the remainder taking on average four months to repay the transaction.[12] Consequently, credit cards (despite many consumers' concerns) generate quite a low level of borrowing, possibly due to the very high cost of such credit. A statistical profile of the typical Access client shows a credit limit of £1,026, an outstanding balance of £406 and a typical transaction value of £31.[30] In the past, the cost of free credit had to be borne by the retailers, but it now looks increasingly likely that annual subscription charges, as is the practice elsewhere in the world, will be introduced in the UK. The recent enquiry by the Monopolies and Mergers Commission on credit cards did not enforce the charging of an annual fee as many banks had hoped. In the US the introduction of charges led to a sharp fall in the number of cards in issue.

There has been increasing concern, frequently highlighted in the press, that the rise in consumer spending has been fuelled largely by the increased availability of credit cards. In 1986, Barclaycard received 861,000 applications for new cards and they approved 590,000 of these, a
record number, although by June 1987 they were turning down more than 34% of applicants, compared with 24% for the same month in 1986.[30]

15.2 OVERVIEW OF DEVELOPMENTS

There can be few areas in the financial services sector where competition is increasing as dramatically as in the credit card market. This market has been transformed over the last few years by the entrance of foreign players, building societies and retailers. Additionally, the duality of membership of both Visa and Mastercard organisations theoretically means that the banks could double the number of credit cards they issue.

The cartelised world of the credit card business has suddenly become much more competitive. The prospect of an all-out credit card interest rate war threatened when Chase Manhattan and Save & Prosper introduced cards with considerably lower interest rates to compete for the more creditworthy Barclaycard and Access customers. However, a consoling factor for the banks to note is that most customers tend not to be interest-rate sensitive in their purchase of items on credit (otherwise all borrowing would be via considerably cheaper bank personal loans) - although they are very sensitive to the size of their actual monthly repayment.[30]

There is also the additional impact of the major building societies entering the market. Here the Leeds Permanent was particularly innovative by offering to donate money to charity every time their card is used. These so-called Affinity cards were first pioneered in the US,
but are spreading to the UK. Affinity cards have become a standard feature in the US for breaking into a saturated market.

In addition to building societies and foreign players, retailers play an important role in the UK market for credit (the average bank cardholder has fewer than three cards as compared with a figure of about eight in the USA indicating that there exists further scope for multiple cardholding in this country).[12] The vast expansion in the number of store cards available was probably initiated by the Marks & Spencer Charge Card in April 1985. This attracted one million cardholders in its first year and has continued to grow rapidly to a current figure of 2.3 million.[30] Companies such as Marks & Spencer and Welbeck Finance may well be significant financial forces in the basic bank markets in the years to come, provided they continue to have:

(i) Clearly defined strategies and goals.
(ii) Accurate knowledge of their customer base.
(iii) A long experience of strategic marketing in a highly competitive marketplace.

These companies have already entered and exploited selective niche markets. They are now in a position, if they so choose, to expand their involvement, yet without incurring the excessive costs of a branch network or a money transmission service.

Along with the greater competitive pressures on the cardholder side, where the larger clearing banks are competing with smaller institutions, there is the possibility that banks will earn less from the retailer side of the business.
All four of the big clearing banks now belong to both the Visa and Mastercard organisations and can issue cards carrying either brand. This process was initiated by Lloyds Bank, who joined Visa last year, making it the first UK bank to be able to offer the cards of both networks. The rationale behind Lloyds' decision to belong to both Visa and Mastercard became clear when it announced that it intended to enter the business of dealing with the retailers' end of the credit card transaction.[17] The technical term for the job is merchant acquirer and it covers recruiting the retailer to the network and then servicing their requirements. Although not particularly exciting business at present, a national EFTPOS system will hopefully be soon implemented. This aims eventually to recruit every retailer of any size to accept cards in electronic terminals. The retailers must be recruited separately to accept credit cards, like Mastercard and Visa, in their terminals. Hence, the banks need to be able to offer a retailer the ability to process both cards. Prior to setting-up the merchant network, a bank had, in the past, to become a card issuer under Visa International's rules. The MMC report says that current rules are a restriction on competition and a barrier to entry into the market and that these rules are against the public interest. About a third of the income from credit cards comes from commissions paid by retailers on each sale by the card.[12]

15.3 REASONS FOR ENTRY

Profits in the credit card business are undoubtedly high. Barclaycard provides the majority of the profits in Barclays Bank's Central Retail Services Division (CRS). In 1986 this division made £92 million profit - 10% of the group's total.[12] Trustcard at the TSB group contributed
£12.4 million, 4% of the group’s total profit.[30] Each Barclaycard holder on average, therefore, contributed £11 of profit in 1986.[12] At TSB group the average profit per cardholder of £5 no doubt reflects the lower level of borrowing by Trustcard holders.[30] If the profile of customers at other banks is assumed to be similar to that of Barclays, then it is possible (and the MMC report suggested this) that the banks’ total profits from their credit cards were about £300 million in 1987.

The credit card profitability of the four largest clearing banks in the UK, was higher than that of their overall business. Their returns on credit card lending were also higher than the returns on lending in the rest of their domestic lending business.

However, most of the new entrants have another reason for entering the market: that of cross-selling other even more lucrative services. Save & Prosper is a good example of this principle - applicants for its low-interest card are carefully credit-scored to eliminate high-risk, low-income individuals and to secure an affluent customer base to whom other financial services can be sold. Save & Prosper became the first Visa issuer to charge for their card, when they introduced a £10 annual fee in February 1988.

Like Save & Prosper, Chase Manhattan offers a low-interest card to more creditworthy customers. Fewer bad payers will mean lower interest rates to the card base.

In February 1988 American Express launched a credit card in the UK for the first time alongside its traditional charge card, in an attempt to win credit business from the banks. The new card, known as Optima, offers customers much more credit than is available on other cards. The
card is intended for use by upmarket customers who need a little prudent borrowing from time to time. Optima was created because a large number of American Express customers had asked for a credit facility on their charge cards. Optima will give its holders access to a minimum credit limit of £2,500 and substantially higher amounts will be available where appropriate. For this holders will have to pay an annual fee of £10. At present there is no published intention by American Express to the effect that they intend offering Optima customers current accounts.

Banks claim to be unperturbed by the arrival of Optima, as American Express has a much smaller cardbase (750,000 cardholders as against 13 million for Access and 9 million for Barclaycard). However, the significant factor for the banks, with the entry of niche market competitors, is the potential loss of their most profitable customers i.e. those who take extended credit for longer periods. The interviewee at Barclaycard suggested that it is for this reason, that further segmentation of the credit card market (see 15.5) is an inevitable progression.

Although the largest building society, the Halifax was not the first to join Visa (although it was the first to offer a card). The Leeds Building Society, the sixth largest, which joined Visa International in February 1988 issued its card last September. It is an affinity card - linked to a charitable organisation. It is generally assumed that the idea behind the card is to broaden the customer base and build up a list of credit worthy individuals to whom other financial services can be sold.
Building societies choose Visa rather than Access for two reasons. Firstly, Visa appears to many to be the dominant brand with greater domestic and European recognition. Secondly, Visa as an association is easier to join than Access, which is a company with shareholders.[30]

In general, building societies have been more imaginative than banks in their credit card-linked products. Allied Irish launched a Visa card offering a low rate of interest and a cheque account facility in return for a nominal monthly fee. The new card offers customers a cheque book on which to make payments drawn on their credit card account, which means that effectively the credit card could replace the current account. This is a significant product development and must be carefully considered by other institutions. The card was initially issued through a mail shot to 60,000 existing customers of the bank. This shows how the smaller more innovative institutions are prepared to try new marketing techniques to reach their target market.

Credit cards have recently gone through a second Monopolies and Merger Commission enquiry. This criticised the banks' evident failure to compete effectively but also recognised that competition was beginning to increase and therefore made few recommendations for change. The terms of reference of this report were, however, questionable, as debit cards, store cards and charge cards were not included. Since the interest rate charged on store cards is even higher than that of bank credit cards, the omission of these cards is particularly baffling. The level of interest rates was not criticised, although the high profits of the credit card companies was acknowledged.
The report stated that the increased competition within the industry meant that a new regulatory framework was unnecessary. Controversially, the report also recommended that retailers should be allowed to give discounts for cash purchases. This recommendation is likely to upset bankers, who are hoping to increase the number of payments made by electronic methods. In practice, it may be found that a surcharge is imposed for those who pay by credit card, rather than a discount for cash purchasers. If this is the case, the popularity of the debit card may well increase.

15.4 THE IMPACT OF RETAILERS

It is through the provision of charge cards that many retailers have entered the financial services market. They have now established a significant card base and are a major competitive threat to the credit cards issued by banks and building societies.

From the retailer's point of view, a vital ingredient of successful retailing is promoting customer loyalty. A retailer with an own label credit card is able to communicate directly with the customer via the monthly statement and in this way builds up a "privileged customer" relationship which sustains customer loyalty. Add to this the fact that the retailer has first hand knowledge of exactly what the customer has bought, not only in the previous month but throughout the whole length of their relationship, and the possibility exists of targeting special merchandise offers to customers with known buying habits. The retailer can in addition offer a variety of financial services, banking, insurance, money management, all offered in normal retail hours and in
an atmosphere of familiarity in which many customers feel more at ease than they do in conventional banking locations (see Table below).

Research also claims that consumers perceive retailer cards as offering emotional benefits such as "private" and "autonomous" source of finance which the bank manager or spouse may never know about. These considerations help to explain why many people use a retailer card (often more expensive), rather than a bank credit card.

ADVANTAGES OF ISSUING OWN CARDS 1987

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<td>Customer service</td>
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<td>Easier administration</td>
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<td>Tailor scheme to own needs</td>
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Source: EUROMONITOR[13]
Base: 36 retailers

Banks are wary that retailers will take advantage of EFTPOS to enter into direct competition with them to provide financial services to the public. The worrying example here for the banks is the US retailing giant Sears Roebuck, which offers the Discover card, a nationwide credit card tied to a range of financial services, including savings accounts, mortgages, stock brokerage, real estate and insurance. Marks & Spencer are now looking at SEIBU (a Japanese department store) as their
Michael Bliss, Chief Executive of Fraser Financial Services, describes own-label credit cards as the marketing tool of the 1980s/90s and believes that retailers who integrate them into their total retailing strategy can only increase profits, through improved customer relations and the ability to gain a higher proportion of their spending. It is, therefore, not surprising that the credit card market is so active, with both banks and retailers competing for position and both apprehensive about the entry of other players.

"With more and more participants in a finite market place - and we have yet to see what the foreign banks and building societies can fully do in credit cards - the important thing is to offer more and more services to your customer and to differentiate your card from the others."[12]

Peter Ellwood, formerly Chief Executive of Barclaycard

The situation in 1989 is that some retailers are well up the "learning curve" as regards the management and marketing of credit and they are now looking to take on the banks not only in the provision of credit but also in offering other financial services to their customers. This marketing opportunity exists because the UK clearing banks took their customers for granted for many years.[17] Retailers are well positioned to capitalise on the growing market in Europe for payment cards and financial services, although few of them appear to visualise such an opportunity as yet. Barclaycard admit that customers aren't interest
rate sensitive, don't understand annual percentage rates (APR) and are attracted by discounts, special shopping nights etc. (obviously an area that the banks can't compete against).[12] Point-of-Sale selling will always be an area of competitive advantage for retailers.

As yet it would appear that little use is made of the purchasing information available to the card companies to identify specific segments from among their card user files. For instance, it is possible to interrogate such a card file to observe which individuals use their cards for travel, entertainment, household purchases, motoring etc. and via the monthly statements to offer supplementary products and services of particular interest to those individuals, as is currently the practice with American Express. The future may include utilisation of a technique called "Behaviour Scoring",[26] which was developed in the US - the bank looks at spending patterns rather than demographics. American Express has detailed customer information files for 35 million cardholders which is currently coming on-line. This will enable wholesale, accurate cross-selling opportunities.[26]

With the increased competition between Visa and Mastercard and with EFTPOS on the horizon - retailer acquisition will be a crucial area. Retailers are now in a very strong position and will be able to bargain effectively from this position of strength. Banks need to work for a total relationship with the retailer rather than merely providing credit card voucher handling. It is for this reason that National Westminster, Lloyds and Barclays have invested substantially in establishing comprehensive credit card processing packages for retailers.[23]
Barclays' mission statement aims for the Barclaycard brand to be the most profitable credit card operation. In terms of branding they are the market leader at the moment and their aim is to be the number one provider of credit card services. Currently they have 9 million cardholders which represents a broad cross-section of the public (obviously within a certain credit-risk criteria) and Barclaycard are happy with this mix, although they don't want to attract down-market customers. With a diversified market of 9 million customers, they need to segment the total market e.g. Premier, Assent.

15.5 CONCLUDING REMARKS AND THE FUTURE

The credit card market has seen a rapid expansion in the number of established bank cards and an unparalleled increase in the number of new card issuers entering the market. Competition has brought with it not only new products and services - but niche entrants, low-cost players and those who differentiate their products - it has also brought new entrants such as retailers and foreign players. Often these new organisations are likely to be alert to new markets, staffed by experienced professionals, with clear objectives to reduce the original participants' market share and their profit. The falling cost of computer hardware, increasing availability of card processing software and the emergence of third party processors have significantly lowered entry barriers. Five years ago there were eight financial organisations in the UK that were members of the VISA organisation. There are now 39 (August 1989) and this figure is continuing to rise.

Credit card issuers are working from a position of strength - they know their customers, what their spending patterns are, where they live,
whether their cards have been lost or stolen - and this knowledge is available instantly and can be accessed worldwide. The accessibility of this knowledge gives credit card issuers the confidence to authorise and guarantee payments made on the other side of the world, payments made by telephone and payments of virtually unlimited amounts. Similar information is simply not available about the banks' current account customers on the same worldwide basis.

Citicorp realised that what a bank needs in retail banking is not branches but customers. Confined by the rules that prevented interstate banking, it used the idea of a national product - credit cards - to establish a customer base. The bank was more interested in getting its cards out than who got them (interesting in the light of the current highly credit scored, segmented marketplace). The bank still writes off large losses ($1.2bn in 1988 alone from a portfolio of $90bn) because of this aggressive strategy. Yet last year was an improvement, five years ago the write-offs were running at three times the 1988 level.

Citicorp's initiative changed the philosophy of the banking business in America. Previously banks had made it difficult for individuals to borrow spending money. Now customers shop around for credit and banks treat credit card lending as a commodity business. The more customers a bank has, the lower the unit cost of overheads such as credit control and processing. In America the number of cards a bank has to issue to break even is generally considered to be around 300,000.

This aggressive philosophy of targeting the total credit card market has increasingly been rejected by UK financial institutions. Higher net
worth individuals are the current marketing targets. In the near future, the interviewees indicated that we will see the application of strategic marketing techniques to all aspects of banking. However, it is the credit card market, with its easily identifiable creditworthy customers, that will see particular activity.

To meet the needs of customers more accurately, the banks have segmented their current account base and now provide accounts that will appeal to customers with certain "lifestyle" characteristics. Logic would indicate that this will naturally progress into the credit card market. Already we have seen the introduction of cards with lower rates of interest for those customers who are more creditworthy than average. Barclays launched Assent, aimed at the segment of cardholders who do not repay in full each month but want a cheaper alternative than store cards, for the purchase of major consumer durables. The best example of a segmented credit card strategy exists in Hongkong - the International Bank of Asia has launched a credit card exclusively for women. It has been so successful that they are now looking to introduce more targeted brand-type cards - at shoppers, travellers and lawyers. The interviewee at Barclaycard believed that it is likely that in the future the UK credit card market will be fully segmented, with a different card and associated group of services for nearly all consumer groups.

Currently the most contentious issue in the credit card market concerns the charging of an annual subscription. The move towards charges has been prompted by growing competition between credit card companies and the new card issuers that have emerged, who have been prepared to compete aggressively on interest rates. These issuers have made little headway into the large customer bases of the big banks, but have begun
to eat away at their more sophisticated and potentially more profitable customers. This must be a major concern to the banks as a good credit card customer provides a ideal opportunity to cross-sell other more lucrative financial services.

For the 46% of credit card customers who pay off their bills each month, and are currently charged nothing for their cards, a credit card "is probably the most under-priced product in the British financial services market at the moment" according to Peter Ellwood, formerly chief executive of Barclaycard.[12] These cardholders are effectively subsidised by the remaining 54%, who pay a higher rate of interest than would otherwise be necessary. Banks in many countries charge cardholders an annual fee and Britain is now something of an exception. If charging becomes the practice in this country, Barclaycard believe that it is likely that nearly all of those who have more than one card will simply revert to one card with a higher credit limit. This would then require the issuing companies to ensure that some product differentiation was apparent, this in turn must be beneficial for the long-term success of the industry. Lloyds Bank took a bold initiative by announcing the intention to introduce a fee for its Access card - it would be the first of the major UK banks to do so. They potentially risk a wholesale desertion to other Access issuers or to one of the Visa members.

However, Barclaycard believe that an annual charge will be difficult to introduce and "may not be worth the effort".[12] Barclays will be aiming to offer the core product (Barclaycard) at cost, ie with no annual charge - but to charge for the cards that are aimed at specific market segments eg. Premier, Assent. The lack of an annual charge may
well be used as a source of competitive advantage, the company could
potentially build up a significant customer base to which no charge is
made and then at a later date introduce a charge when the market is not
so price sensitive. Most banks appear to be planning to introduce fixed
charges through the back-door - by offering a package of financial
services, which includes a credit card, and then charging a fixed fee
for the package. This is best exemplified by the Midland (the bank
which is pursuing the most overtly segmented approach to marketing). It
is likely that this would be more acceptable to the customer and may
gain, rather than lose, competitive advantage.

The combination of a credit card with a chequing facility could be a
major threat to the existing current account. However, the UK is
currently taking to the idea of the debit card - if this card was
combined with a line of credit then there would be no obvious need for
an additional credit card. Those banks which are part of the SWITCH
debit card network (currently 10 million cards in circulation, which can
be used through 18,000 terminals), are looking at this area as a
possible source of product innovation.[6]

The reasons for and the implications of, financial institutions being
members of both Visa and Mastercard have been adequately discussed. It
is feasible that in the future duality could have a more marked effect -
namely, the amalgamation of the two networks, as card issuers cut their
credit card costs.

At present the banks are competing to be the first to introduce
comprehensive Customer Information Files (CIFs), that will enable
accurate targeting of prospects and enhance cross-selling opportunities.
This information is already at the disposal of the major credit card companies. It is principally for this reason, that many interviewees believed that the credit card business will grow in importance within the UK financial services market. Many further suggested that as competition intensifies credit card companies will be best placed to exploit their existing customer base, additionally they do not have the excessive cost burden of a branch infrastructure. As the customer demand for credit increases along with the realisation of the benefits of being an issuer, then it is possible that an already competitive market may become saturated.
16. ELECTRONIC FUNDS TRANSFER AT POINT OF SALE

16.1 INTRODUCTION

Electronic Funds Transfer at the Point Of Sale (EFTPOS), is a method of payment for goods and services by the electronic transmission of transaction details to the retailer's bank and to the customer's bank - without the need for supporting paper vouchers. Its advocates believe that it is the ideal method of reducing the amount of paper in the banking system, which will correspondingly reduce the banks' processing costs. They also believe that EFTPOS will result in a faster checkout at terminals, hence adding value to the service given by the retailer. Those with the opposing view believe that there is insufficient customer demand for the introduction of the expensive infrastructure required for a national system.

16.2 BENEFITS TO THE VARIOUS PARTIES

For cardholders the system should be easy to use and procedures will be identical at all payment points. The ease of use should mean that payment will be quicker (there is an aim to be as quick as cash) and that queues should be shorter. It will provide an additional and alternative method of payment and reduce the need to carry cash. Additionally, pricing is likely to be competitive for those customers that pay bank charges; most banks have already set differential pricing to encourage the use of automated payment methods. However, to gain full customer acceptance there will need to be a programme of customer education - not only in how to use the equipment but also to remove some of the negative perceptions.
Retailers will benefit from a system which provides a guarantee of payment for every properly authorised transaction. They will also reduce the amount of back-office paper to be handled and, importantly, there will be a reduction in the need for cash handling. In the same way that the customer benefits, the retailers will also profit from simpler procedures and a faster checkout. Additionally, the retailers may offer a cash withdrawal service as well as accepting EFTPOS cards for payment, this is called Purchase with cash back (already common in the USA).[6] The implications of a retailer acting as a bank must be carefully considered by retailers and bankers alike.

The major benefits will undoubtedly accrue to the financial institutions.[29] A reduction in the growth of paper-based transactions will lead to significant cost savings and the further introduction of technology should improve efficiency. If an on-line system is utilised then significant fraud reductions will be possible, which will help to reduce much of the initial set-up costs.[29] However, it should be remembered that EFTPOS is very much a bank-led initiative. It won't give an individual bank a competitive advantage (not initially), but will help to increase overall industry profitability.

The above advantages indicate that the benefits will accrue mainly to the banks. Indeed, the following savings per transaction have been calculated by the Retail Consortium:[26]

- 1.4p for the customer
- 2.6p for the retailer
- 28.0p for the bank
Retailers are only too aware of the potential cost savings for banks with the successful implementation of a national EFTPOS network. This raises the possibility of payment to retailers who are prepared to accept debit cards and install EFTPOS equipment.

Converting the benefits into financial terms shows that the banks are the main recipients, achieving returns of nearly 50%, in spite of their larger investment[29] In practice competitive pressure will ensure that the benefits are shared more equally. Customers may well be offered financial inducements to switch to the new form of payment and there will be competition between the banks to persuade retailers to offer EFTPOS capacity. It is the threat of differential pricing that has led some people to believe that the introduction of EFTPOS could, paradoxically, lead to a reduction in the number of payment methods available to the customer. This could happen if retailers, having invested heavily in EFTPOS, start to refuse other forms of payment. This is one of the consumer issues dealt with by the Swiss Commission Fédérale de la Consommation in its report on plastic money[10]. It concludes that new technology should not make it more difficult for consumers to use cash and that the consumers' right to pay in cash should be maintained.

16.3 EFTPOS DEVELOPMENTS

Despite these benefits of EFTPOS, the concept has had to overcome many hurdles since it was first discussed. EFTPOS UK Ltd, a consortium set up by the banks to oversee the implementation of a national scheme, has had its problems convincing the retailers the system will work and that customer demand will exist. However, it is the apportioning of the system cost between banks and retailers, which has caused most problems.
These problems have resulted in a delay to the scheme. The original target date was autumn 1988, that deadline slipped to April 1989, and at the time of writing this has been further delayed to August/September 1989.

The EFTPOS experience in Denmark is worth noting at this point. PBS is the centre for the joint electronic payment system and it offers a broad range of information and payment products. PBS has taken 20 years to build and is jointly owned by all of Denmark's savings and commercial banks. Even though EFTPOS had a broad-based support, its development was slowed down by legislation and bureaucracy. However, they learned that a joint debit card helped to reduce some of the confusion over the new payment method.[6]

The retailers' doubts follow a double blow to EFTPOS UK Ltd with the withdrawal from the national system, of both Girobank and the Nationwide Anglia building society. Girobank withdrew because it believed that its money could be better invested and also the bank wanted to concentrate on its privatisation - it remains to be seen whether the attitude will change since purchase by the Alliance & Leicester. Nationwide Anglia withdrew because it believed that the market has changed and that they now have more alternative routes open to them. Both organisations are free to re-join the scheme at any time in the future.

It would appear that a certain amount of hesitancy also exists on the part of customers themselves. In a survey carried out in 1985,[21] it appeared that eight out of ten Britons were ignorant of EFTPOS and more than 60% of those who did understand it were not in favour. Similarly, in a survey of retailers over 60% thought there was no consumer demand for EFTPOS but, on the other hand, 77% saw it as an inevitable
development. Despite this lack of enthusiasm many interviewees thought it inevitable that by the mid-1990's Point of Sale terminals will be commonplace in many of the larger retailers.

Additional problems have been caused by a difference of emphasis over security. The banks, fearful of the implications of seeing accounts automatically debited (with inherent bad debt and fraud risks), want a scheme with tight security. However, retailers feel that measures are too excessive and want a wide-ranging EFTPOS network implemented as soon as possible - Sainsburys, in particular, have been quick to criticise the slowness of development.

Despite the ambivalence, there has been an undoubted growth in the number of terminals available to provide shoppers with the ability to pay without the need for paper vouchers. From less than 10,000 terminals at the end of January 1988 there has been a rapid expansion to some 42,000 at the end of January 1989 (see Table below).

<table>
<thead>
<tr>
<th>ELECTRONIC FUNDS TRANSFER TERMINALS AND OUTLETS</th>
<th>JANUARY 1989</th>
</tr>
</thead>
<tbody>
<tr>
<td>OUTLETS</td>
<td>TERMINALS</td>
</tr>
<tr>
<td>ACCESS</td>
<td>3662</td>
</tr>
<tr>
<td>BARCLAYS</td>
<td>6218</td>
</tr>
<tr>
<td>LLOYDS</td>
<td>235</td>
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<tr>
<td>MIDLAND</td>
<td>2650</td>
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<tr>
<td>NAT WEST</td>
<td>4225</td>
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<tr>
<td>RBS</td>
<td>295</td>
</tr>
<tr>
<td>OTHERS[*]</td>
<td>115</td>
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</table>

[*] Clydesdale Bank, Co-Operative Bank, Funds Transfer Sharing and Girobank

Source: BANKING WORLD[6]
Although credit cards account for nearly all the transactions handled by the present fragmented UK EFTPOS system (currently one third of all payments handled by the Joint Credit Card Company are electronic), some argue that the debit card is the key to growth of EFTPOS in the UK. This card works in the same way as a credit card, except that it debits the current account rather than the credit account. The interviewee representing EFTPOS UK Ltd strongly believed that success is dependant on the availability and acceptability of cards in general and that a distinction between credit, debit and smart cards needn't be made. It is important to note that immediate debiting of the current account won't take place, clearing and settlement between EFTPOS UK Ltd members will be the same as for cheque clearing. However, the timing of value transfer to the retailer is a competitive issue.

Smart cards are likely to be the natural progression from debit cards as a payment media and they can be easily incorporated into an EFTPOS system. Smart cards are considerably more expensive than their magnetic stripe counterparts (see Chapter 14), but authorisation terminals for use with them are much cheaper. This can considerably reduce total system costs where large numbers of terminals are envisaged, as in EFTPOS applications in large retail outlets.

When setting-up an EFTPOS network, a major choice that has to be made is between on-line and off-line operation. On-line systems are preferred in most European countries where an EFTPOS network has been established (France being a noticeable exception). Off-line systems are cheaper, but they do not give the same degree of protection against fraud or bad debts. To counteract this problem, French banks have adopted smart cards to provide better security. The UK has shown a growing preference for off-line EFTPOS. The UK EFTPOS system presently allows members to
choose between off-line and on-line operation. It may well be that the cost differences are reduced when the effects of fraud are added to the off-line system.

16.4 EFTPOS UK LTD - THE ENABLING BODY

"EFTPOS is here to stay and a national EFTPOS system will go live in under a year."

Brian Allison, General Manager, EFTPOS UK Ltd. (September 1988)

EFTPOS UK Ltd was set-up to advance the concept of electronic funds transfer at the point of sale within the UK. It is now responsible for the development and implementation of the national EFTPOS system that is planned to be operational in August/September 1989. The inaugural service will be located in Southampton, Leeds and Edinburgh.

The inaugural service will "roll-out" into a full national service, i.e. this is not a pilot scheme, the implication being that no major strategic changes would be made from any feedback gained during the year. It is hoped that by the end of the inaugural year there will be at least 2000 terminals in each of the three locations. It is anticipated that expansion will then be retailer-led, rather than by geographical spread. Hence, growth of the system will be dependant on initial retailer response. Successful expansion would appear only to be possible if the large retailers gain appreciable benefits from the system.

It is envisaged that EFTPOS UK Ltd will be disbanded when so requested by the members and not necessarily at the end of the inaugural year. It will then be left to the member institutions to fight for market share.
However, there is a distinct possibility of the present system being too disjointed - institutions can be any, or all of; retail processor, card issuer processor, terminal sponsor, card issuer. Without a single company to help coordinate all of the activities, the whole system will become even more fragmented. EFTPOS UK Ltd are very strong believers in a competitive marketplace and believe that one central system would be too bureaucratic (as has been proved with the New Zealand experience).

Despite the reservations of certain groups, the UK would appear to be structurally an ideal location for a national EFTPOS network. The UK is a geographically compact country with three major conurbations London, Birmingham and the North West. It has a relatively small number of major banks and other financial institutions which makes implementation much easier than in, say, the USA which has many thousands of banks. There is already a very large card base in the UK; it is estimated that there are over 40 million magnetically stripped cards on issue and this figure will grow rapidly in the increasingly competitive environment.[28]

There are commonly accepted requirements which must be met to provide a basis on which the national system can be built. Naturally, a predominant requirement of the system is that it must be simple to operate at the point of sale, by both cardholders and the retail staff. If this benefit is not apparent to the customer, then usage will be restricted. The system must reduce the time taken by customers to pay to less than that of paper-based systems and ideally be as quick as cash (it has been estimated that on average it takes 30 seconds to complete a cash transaction, whilst the time taken for credit card and cheque payment ranges from 75 to 90 seconds).[29] Secondly, terminals must accept all cards currently issued by retailers, banks and building
societies - and importantly, be able to accept any cards that are issued in the future. Finally, the system should be open to all retailers who wish to participate. It will give retailers a guarantee of payment for transactions which have been properly authorised and processed through the system.

16.5 RETAILERS' PERSPECTIVES

In the present competitive retail environment, knowing the customer is definitely the key to success. To achieve a competitive advantage, retailers have turned to electronic point of sale (EPOS) systems. These appear to be no more than electronic cash registers, yet they offer a great potential to the retailer. They are powerful information systems, which enable the identification and exploitation of fast-selling lines. These systems are an undoubted success. It is estimated that by the end of 1988 over 140,000 terminals existed in the UK, with British retailers expected to invest almost £1 billion before the end of 1989.[29]

In spite of the above, it would appear that EFTPOS UK Ltd have developed a totally separate terminal for their trial service. Most retailers are working on the basis of one terminal per point of sale, which leaves no room for an EFTPOS device where EPOS is already installed. In the future compatibility will be achieved and it is likely that a retailer will order an EPOS system which supports EFTPOS functionality.

EFTPOS UK Ltd did not initially allow retailers to be members of the company. With hindsight, they have admitted that this was a mistake and now hope to liaise further with retailers - it may be too late. Indeed, this poses the question as to why a company set-up with the specific
objective of introducing an innovative payment media within retailers' premises did not include active retailer participation?

One of the reasons for EFTPOS introduction is the time saving for both the customer and the retailer. It is estimated that EFTPOS will operate at twice the speed taken by a cheque payer or plastic user, when a voucher is involved. On average each EFTPOS transaction should save 25 seconds (although Sainsbury's report a one minute saving over cheques and that the system is as fast as cash).\[29\] However, it is the time saving to the customer that is critical. For the system to be a success the customer will have to perceive this to be a significant area of added-value. Quicker service will improve customer loyalty and satisfaction, a Gallup Survey of a sample of UK consumers commissioned by International Computers Limited\[19\] shows that quicker service at tills and checkouts is the improvement in retailing that is most wanted by customers (71% would like to see this change). Secondly, customers who use EFTPOS don't have to carry much cash around. At three UK EFTPOS trial locations, this was rated as the biggest benefit (55% of EFTPOS users).\[19\]

16.6 CONCLUDING REMARKS

The development of EFTPOS is a further polarisation between branches and customers. Hence, the banks will find themselves with yet another major challenge to maintain their visibility. Accordingly, the marketing of the bank, through direct mail and advertising, may become increasingly crucial to its long-term survival. Current branch banking structures (including ATM installations) will have to be re-thought if substantial substitution of cash and cheques due to EFTPOS takes place. It is only
when the full structural re-organisation has taken place that the full benefits of EFTPOS will be realised by the banker.[6]

To the outside observer, it may appear that EFTPOS is very much a bank (and technology) led initiative. Individual members of EFTPOS UK Ltd have undertaken their own market research into the level of customer demand, but the results have been kept confidential and not disclosed to EFTPOS UK Ltd. There has been substantial press criticism of this fact, however, it should be remembered that EFTPOS UK Ltd is only the enabling structure for a national system. They are not providing a direct service or product to the customer. Market research details are a competitive issue, although the general results have been implied to EFTPOS UK Ltd.

It may be that EFTPOS development is not the result of rational cost/benefit evaluation, rather the realisation that the technological capability exists and hence, should be exploited as on the continent.[21] The potential investment in EFTPOS is not small; it has been estimated that the expenditure will be equivalent to a £20 contribution from every man, woman and child in the UK[29].

The main criticism of the project revolves around the lack of retailer involvement. As previously mentioned, no retailers are allowed to join the scheme until the inaugural year has been completed, additionally plastic cards issued by retailers will be excluded from the trial and only those issued by financial institutions will be allowed. This would appear to make a nonsense out of a trial that will be conducted in locations where the use of a retailer card will be a natural choice for many consumers.
In 1987 "spontaneous" non-cash payments to retailers in shops accounted for over 2 billion transactions, one third of the total of all non-cash money transmissions. Of these, three quarters were made by cheque and the balance by credit card; only 5% are currently processed electronically[1]. The Retail Consortium (which represents virtually every store in Britain) has estimated that by the year 1995 there will be 2.2 billion EFTPOS transactions per year. By the end of the century it is likely that EFTPOS will become the preferred payment method for this type of transaction and a terminal population of over 300,000 handling some 10 million transactions a day is forecast.[29]

It is hard to imagine that some of the more dynamic retailers and building societies will wait quietly in line until they are allowed to participate under the national scheme. Indeed the delays in implementation of the national system have led banks to place more and more emphasis on their own autonomous EFTPOS schemes which are already operational and this may well undermine the national scheme.

EFTPOS can be regarded by banks as a means to an end - namely that of reducing costs by lessening the amount of paper in the system. With the UK-wide network set to devolve into a competitive free-for-all after the initial trials prove successful, Lloyds admit that competition will be fierce and that a price-war could break out in the absence of a pricing standard.

The Arthur Andersen report[2] indicates that by 1995, EFTPOS is expected to rise to more than half of all customers. However, the report is slightly more reserved than some bankers, as it points out that the banks will lose commissions and have to take on major new responsibilities and risks. One predicted consequence of the rise in
EFTPOS networks, is that the banks will lose absolute control of money transmission. Retailers are expected to own up to 25% of such networks by 1995 and only a small proportion of bankers expect money transmission to remain the exclusive preserve of the banks.

The benefits to all parties are clear: customers get a faster service and retailers get a guaranteed payment system. But the banks have the most to gain. In addition to saving money by reducing fraud, they will make large administration savings as the amount of paper to be processed diminishes. On the other hand, there are substantial costs associated with installing EFTPOS, such as telecommunication networks, terminals at every check-out and large central processing computers. The key to its widespread implementation will always be deciding who shoulders these costs.[29] EFTPOS history in the UK shows how difficult it will be to achieve an all-party agreement. Success will lie with those institutions which sell them most effectively while heeding the established requirements of retailers and consumers. The key to the success of EFTPOS hangs on two critical factors. They are; that the time saved on payment is of value to the customer and retailer, and that the banks will be able to cut back on their costs as the volume of paper transactions declines. Without these benefits occurring simultaneously it is unlikely that the inaugural service will spread to a full national coverage. [17]

Note: Subsequent to the completion of this thesis, it was publicly announced that the National EFTPOS system, under the auspices of EFTPOS UK Ltd, was to be abandoned. Consequently, the inaugural scheme was terminated in April 1990. Apart from technical problems the primary causes of failure were attributed to the delays caused by attempts to implement a central clearing system and the adoption of the principle of
open membership to qualified financial institutions. These delays enabled institutions to develop and install their own modest but, nevertheless, successful schemes which would appear to guarantee the future of EFTPOS as a concept.
17. DIRECT ELECTRONIC BANKING

17.1 INTRODUCTION

For some time, direct electronic banking (in the form of home banking and tele-banking) has been considered by parts of the financial press as an excellent way for banks to reduce their costs and at the same time to increase their cross-selling opportunities. Customers would remain at home, yet be able to carry out simple banking transactions via keyboard and terminal or by telephone, thus eliminating a significant amount of paper from the banking system. With the former method, promotional messages could be sent directly to the customers' home which would facilitate cross-selling of other financial products.

Despite these advantages, in the main, bankers in the UK have remained sceptical and home banking systems that are in existence are on a small scale and backed by limited resources. As a contrast resources have been plentiful in trying to initiate home banking in the US. There are estimates that US financial institutions have already invested $600 million[25] into home banking and significantly, not one has yet earned a profit. Even though one American consultancy had predicted in the early 1980s that by 1985, home banking would be accepted by 45% of all US households - today there are only just over 100,000 people who bank by home computer.[25] Telephone banking, which can be regarded as a lower technology derivative of home banking peaked at an acceptance level of 2.5% of New York households in 1981.[25]

The evidence from surveys would suggest that these low figures are not surprising. Of those questioned in a 1987 MORI poll on the possible impact of home banking: 80% said that they would use such systems. If a
bank other than their own were to offer the service, 13% said they would move all their accounts to the bank offering the service whilst another 21% said they would open an account with the new bank whilst retaining their existing arrangements.[20] Another important issue probed by the survey was the likely effect on people's savings arrangements given the opportunities to transfer money easily between deposit and savings accounts. Of those surveyed, 60% didn't have a savings or deposit account with a bank, only with a building society. Of these, 38% said they would be likely to open such an account with their bank given the funds transfer facility. The effect on building society deposits of such a move would clearly be very damaging and the acquisition of additional funds to the bank would probably justify installing the system.

This forecast of a dramatic change in people's banking habits contrasts sharply with the empirical evidence of existing schemes (see 17.2 below). Previous market research into home banking indicated that while it was of some interest to a small number of people, it did not have mass market appeal. In the Arthur Andersen survey "Strategic Issues in Banking"[3] the consumer respondents were asked if the availability of home banking systems would be an important criterion in their decision to select a bank, both now and in the future. Fewer than two out of every ten stated that the existence of home banking systems is of importance now. But more than five out of ten stated that it will be a more important criteria in the future. This view was acceded to by the interviewees.
On the other hand, the largest banks believe that only about 12% of consumers will be using home banking by 1990. One negative factor often cited in support of such views is the availability of home computers, but by 1990 it is estimated that more than 20% of homes will have one.[2] Arthur Andersen[2] believe that by 1995 between 15% and 30% of all retail customers will subscribe to a home banking system.

American financial and retail organisations have noted the opportunities for marketing products directly to the consumer through home banking terminals. If the banks do not invest in home banking through such organisations as COVIDEA (the joint venture between AT&T, Bank of America, Chemical Bank and Time), it is likely that retailers will.[20] The TRINTEX joint venture of CBS, IBM and Sears could make an aggressive move into home banking, which would mean a primary banking delivery channel beyond the control of the banks.

In general, however, no-one on either side of the Atlantic can claim that home banking has been a major success. It is believed that one of the reasons for its failure is that fees are excessive for the little value that is added. Home banking can only truly succeed when it represents a truly innovative payments system, providing real value both to account holders who make payments and to the organisations that receive them.[20] In contrast to ATMs and EFTPOS, home banking is an area of development that relies almost entirely on customer demand for its growth. The argument is that as long as customers must visit ATMs to receive cash and make deposits, then there is little reason for them to make enquiries and transfer funds on expensive home banking equipment.
17.2 SYSTEMS IN OPERATION

Home banking originated in the UK with the Nottingham Building Society service which became operational in 1983. "Homelink" was introduced by the society to widen their customer base and to enter the market "south of Peterborough", without the need for a costly expansion of their branch network.[5] Seven years on, the society claim a complete success, with over 50% of their customer base "beyond The Wash". The system requires either a videotex terminal or a television with keyboard for access. The Bank of Scotland was the first clearing bank to invest in home banking technology, offering a similar system shortly after the Nottingham initiative, their reason for introduction also being a desire to break into new markets. At the time it had 373 branches of which only 17 were in England, a market it was actively looking to enter.

Lloyds Bank are currently running an extended trial Autophone voice response home banking service which customers access with a card swiped through a terminal attached to the phone. There are currently 700 users of this £1 million system (August 1989).[6] Lloyds believe that further refinement of the system is required before it is offered to a more substantial portion of their customer base. They are persevering as they believe the home banking future is bullish. This view is evidently also shared by Midland Bank who are planning to launch their own home banking service in the near future.

The interviewees from the TSB believe that they have the most successful system the UK. Speed1ink telebanking service has been in operation for 18 months and has 160,000 regular users (from a total customer base of 6 million), both personal and commercial, and the numbers are increasing by 3,000 per week (of which 1,100 are commercial users). It is one of the most technically impressive systems: taking on average 3 minutes 40
seconds to receive a fax of a statement from initial dialling. An interviewee from TSB confided the belief that customers' reactions to telephone banking will follow that of ATMs; initial mystification, rapid acceptance, and eventually ultimate addiction. The same interviewee also admitted that as yet, tele-banking has not reduced the money transmission costs of the bank.

17.3 TELEPHONE VERSUS SCREEN-BASED SYSTEMS

Bankers now generally accept that for personal customers, home banking by telephone is more appropriate than screen-based systems and it now seems as though the telephone is becoming an accepted delivery mechanism in retail banking.[20] In May 1989, National Westminster became the first of the large clearers to announce a nationwide telephone banking service with the extension to all customers of ActionLine. This is the fourth system to become generally available. TSB's Speedlink and Nationwide Anglia's home banking were launched in 1987, while Clydesdale launched its TeleBank service last August. The recently launched scheme from the National & Provincial Building Society is more limited in that it only applies to specific account holders. Additionally pilot schemes are still running from Lloyds Bank and Royal Bank of Scotland.[5]

Leaving aside the cost of the keyboard to the customer, screen-based services can offer a far superior presentation to that provided by telephone, allowing more information to be provided and a more complex range of services offered. For example, the French home banking service, provided by the Minitel network supplier, provides twelve banking services including balance information and portfolio and investment trust valuation. In addition, Minitel allows users to access a whole range of other services such as travel agents, theatres and
restaurants. Thus, screen-based services can provide a ready interface to other systems. In addition high levels of security can be added. However, when the total cost for such a system is considered, it is likely that the real market for screen-based electronic banking is in the commercial sector.

More recent home banking systems have tended to favour the telephone (The first two schemes from the Nottingham Building Society and the Bank of Scotland were screen-based), using either tone input and voice response like TSB Speedlink, or speech recognition and voice response like Clydesdale, Royal Bank of Scotland, and now National & Provincial. The advantages of the telephone over screen-based services are its wide availability, low cost and ease of use. None of these benefits are true of screen-based systems.

In deciding which is the best method of delivery, the best answer is probably a combination of the two. By approaching direct electronic banking in a strategic way, financial institutions can decide to target a particular market and provide their financial services using the most appropriate method; the telephone for personal customers and, for example, perhaps personal computers or videotex terminals for their business customers. Of systems now installed in the UK, only Clydesdale can claim to support screen and telephone banking on the same system.

17.4 CONCLUDING REMARKS

Home and office banking, or more accurately direct electronic banking, has a lot going for it. From the customers' viewpoint, there is the convenience of conducting personal financial transactions at a time and location of their choice. This is an important aspect in the choice of
branch, but whether customers are prepared to pay highly for it must remain doubtful. It is perhaps significant that Prestel, a service initially aimed at the personal sector, now has more than 60% of its terminals in the corporate sector. \[5\] While for retail financial institutions, it provides an ideal marketing tool for accurately targeting and cross-selling personal financial services.

One result of introducing direct electronic banking is that people make fewer visits to their branch and when they do it is generally to withdraw cash which could be done via an off-site ATM. On the surface, the decline in branch visits may be a negative aspect for the banks. Judging by the number of banks and especially, building societies offering home banking, this does not appear to be the case. The reason for this apparent contradiction lies in the current thinking among the major retail financial institutions that profitability can be increased by removing the simple transactions from the branch altogether and dedicating the space to the selling of more lucrative services. This was a view acceded to by all of the clearing bank interviewees.

The home-banking experiments of the mid-1980s would suggest that at present the UK customer is not prepared to pay significant amounts for his banking services. This implies that screen-based home banking is an uneconomic prospect, whereas the considerably cheaper tele-banking is a viable alternative that is gaining in popularity.

It is suggested that true home banking will, in most developed countries, need to become part of a large range of home information services, to which the individual will have access on payment of an appropriate fee. \[25\] Bankers must, therefore, prepare for a future in which their services will be sold, and in some cases delivered, on
television sets side-by-side with a large range of other goods and services. The marketing and cross-selling implications of this situation are wide-ranging and need to be addressed as part of the long-term strategic planning process.

The success of screen-based home banking may well be dependent on the overall level of computer literacy within society. It is probable that the demand for such services may well dramatically increase after 1995, especially if cable and satellite links are extensively used. The Japanese obsession with computer games means that effectively one-third of households are computer literate, accordingly Sumitomo Bank was the first to launch home banking services based on video game machines. Nomura is intending to take this a stage further, by devising software which will enable the purchase or sale of securities through these machines.

Although tele-banking has experienced a certain degree of success in the UK, pure pay-by-phone services are not likely to develop in the UK and in Europe to the same extent as they have in the US. This is because European customers can already pay their bills by standing order or direct debit, which are even more convenient than pay-by-phone, or by postal giro credit transfer services. The best chance of success would appear to lie in telephone banking systems that offer a balance enquiry feature. Now that there is an increasing number of multi-frequency phones installed in the UK, there may be a real market for relatively unsophisticated home banking by telephone.

No research has really examined whether the need for home banking services is perceived rather than actual. Although about 90% of Nottingham Building Society's Homelink transactions are made outside
normal banking hours this could just as well be an indication that phone
bills at this time will be cheaper, as an indication that a genuine need
exists.[5] If the volumes of home banking transactions become large, it
could be that the transactions would be best handled by a national
EFTPOS system. Such transactions are more likely to take place in the
evenings when EFTPOS usage is at a low level, thus leading to greater
utilisation of the network.

Banking literature often draws comparisons between home banking and
ATMs; initially ATMs were distrusted by customers, but were soon
welcomed as convenient, quick and labour-saving, money access devices.
However, home banking systems were first seen in the UK in 1983, and if
they are to emulate ATMs, progress has to be rapid in the next three or
four years. As yet it only has minority interest status. France is the
only country to have anything like a national homebanking network, and
that is based around the free distribution of 3.5 million Minitel
screens by the French telecommunications company.

There are still less than 250,000 users of home banking systems in the
UK, at present it is very much an area of experimental exploration and
expenditure.[5] In the meantime, banks that have decided to introduce a
home banking service for their customers, stand as innovators and their
experiences as lessons to those who are thinking of investigating the
same areas. Unless financial institutions have a particular strategic
objective to be met, such as the expansion of the customer base, that is
best facilitated via a homebanking service, there seems at present no
necessary reason for its introduction. Indeed, the head of Information
Technology at National Westminster is still unconvinced that home
banking will be a success, believing that there is insufficient
underlying demand.
PART III - REFERENCES


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PART IV - FUTURE, PERSONNEL IMPLIC.
18. FUTURE OF RETAIL BANKING

18.1 BUSINESS STRATEGY

As the business and competitive environment has grown more sophisticated, strategic planning has become an increasingly vital function of the organisation. A need exists for structured planning and implementation so that profitable markets are identified and exploited. Improved communication of management's goals to lower levels of management is required if plans are to be brought into effect. The following requirements were identified by Arthur Andersen:[1]

- To be successful strategic planning needs to be 10% planning and 90% implementation.
- The process of preparation of plans and their application requires visible active involvement of senior management.
- The planning system should be moulded to match the business ethos and management style of the bank.
- Integrating technology planning (with its long lead-time) into the corporate plan is difficult yet essential.

As the competitive strategies of institutions change in reaction to a more dynamic marketplace, the organisational form of the institution must also respond. Increasingly, there will be a need to plan exit strategies in addition to growth and investment strategies.
A major strategic decision that faces the banks concerns the size of their branch networks. In a traditionally oligopolistic industry such as banking, the main way to build market share is via number of outlets. However, in a climate of rising operating expenses and money transmission costs, the clearing banks have had to reassess the number, size and function of their branches. Extensive branching has been criticised as wasteful competition and as an undesirable alternative to price competition.\[13\] To be set against this, is the fact that location of branch is still the most important criterion in branch selection.

Many of the threats to branch banking were identified in the US as banks were prevented from branching across state boundaries. The larger and more aggressive banks needed to innovate constantly in order to sell their services outside the physical catchment area of their branches. As the reliance on the branch network to sell services, declines in the UK, a commensurate rise in innovation should follow replicating the situation in the US.

A need for rationalisation of the network undoubtedly exists as technology has questioned the role and necessity of branches, at least on the present scale of over 13,600.\[3\] From the interviews conducted there is undoubtedly a consensus on the need to exploit these distribution outlets for a wider range of sales opportunities and a better and more personalised quality of customer service. There is the possibility that further aspects of basic banking may move from clearing bank branches into department stores, building societies and other
outlets. [19] Additionally, the branch network is no longer an effective barrier to entry. [15] Technology has reduced the need for an extensive branch network system for effective collection of deposits and money transmission. Different financial institutions can now provide these services more efficiently and more cost effectively. Some major retail chains have the infrastructure and image to provide a limited range of basic banking services in addition to their own-brand charge cards.

Review of the branch network organisation will also encourage a re-examination of the roles and functions performed within that network. The following changes were generally perceived as likely by the financial managers interviewed:

- "Processing factories" will be established to perform many of the routine back office operational processing functions. This has already been instigated by Midland Bank.
- Specialist product functions will be located centrally or regionally.
- Administration and account management/maintenance will be increasingly centralised.

The interviewees from TSB expressed the opinion that their branches are their "display shelves". They are inspected frequently by existing customers and attract potential new customers to the product range. The branch will be regarded as a profit centre in the future and in time this may lead clearing banks to follow other retailers in quantifying the success of their outlets in profit per square foot rather than by existing criteria (this is already used by American retail banks such as Wells Fargo). The branch of the future will not only reflect a retail
image within a "high-tech" environment, but will also have to be sufficiently flexible to accommodate new product lines as they are introduced.

The decline in the number of branches need not be dramatic, indeed between 1987 and 1988 the number of bank branches in the UK fell by only 400. Indeed, a contrary body of opinion believes that banks which successfully identify and market a good range of ancillary services may need to expand their networks. The belief that the days of the branch are numbered would, therefore, seem to be inconclusive and certainly premature. If technology is going to dominate, there are many retailing operations that will disappear before bank branches. In the future, however, differential pricing will undoubtedly result in less individuals using paper-based methods of payment. The unit cost of processing the remaining items will, therefore, increase dramatically resulting in the possibility of some institutions exiting the paper processing market altogether. At this point, the very purpose of branch networks will, once again, be called into question.

Market structure tends to dictate distribution channels which eventually determine organisational form. The operation of the branch network produced rigid, formal and hierarchical management structures. Therefore, clearing banks had a tendency to recruit and train their staff to coincide with the requirements of the branch, rather than with the requirements of the organisation as a whole. Clearing banks now need to be market and customer orientated, which requires dynamic and flexible reactions. The threat of the future demise of the branch network, may be the catalyst required to improve management's responsiveness to market changes.
We have already witnessed a move to "hub and spoke" branching. This is a system whereby a core branch offers a full service with satellite branches offering a more limited, highly automated service. Implicit in this method is the removal of the processing function to a centralised department. However, the need to retain some form of in-branch processing may be desirable to maintain the traditional banker/customer relationship.

18.3 MARKETING

The interviewees agreed with the Andersen report that marketing is the most critical planning issue currently facing the clearing banks. The predicted sharpening focus on marketing strategy will have its effect on bank organisational structures. On the one hand there will be a requirement for a much greater degree of co-operation between the various operations of the bank which are related across market sectors - many banks will go further in actively re-organising themselves along market sector lines to provide the necessary degree of focus to the organisation. On the other hand, sharper definition of the clearing banks' products and service lines will be called for, with more formal product co-ordination to conduct both development and marketing of products more effectively.[1]

In formulating strategic decisions it is essential to know where profits are coming from, whether by service line, market segment or probably more importantly, by customer relationship. A growing number of decisions will, therefore, be initiated by management information systems, potentially giving rise to tensions between the new breed of management and the more traditional form of intuitive decision making.
Management information systems will increasingly depend on automation to provide accurate and timely information on market, product and customer profitability as a critical support for both planning and monitoring market strategy. For those institutions offering a wide range of financial services through multiple distribution channels (which will become increasingly essential), such developments as automation of direct marketing and sophisticated sales monitoring and MIS will be major areas of focus. The Andersen report[1] confirmed this view - 83% of respondents to the questionnaire believed that product profitability systems would be vital to a bank's survival.

Generally speaking marketing of products has moved on from the stage where its attributes are emphasised. Now we have reached the stage of marketing by image, notable examples being Halifax CardCash and most of the Midland Bank range. Although very much suited to an age where the advertising agency is all-powerful, this form of marketing incurs the danger of becoming increasingly uninformative and not encouraging the banks to produce innovative products - rather there may well be a tendency to simply rely on the most arresting advertising.

18.4 TECHNOLOGY

The consensus of opinion amongst the interviewees was that innovations in banking will be increasingly dependant on technology and that new products will increasingly involve the integrated packaging of financial services. As product life-cycles are becoming shorter constant innovative substitution and change will have to become more commonplace.
An underlying theme of the Arthur Andersen survey[1] is that technology issues can no longer be addressed tactically, on an ad hoc basis, but must be incorporated into the bank's strategies for the 1990s. Their findings stress the future importance of technology.

- 97% of respondents believed that technology will be important in maintaining or increasing competitive advantage.
- 98% believed that technology leadership will help a bank's image and be an advantage in attracting new customers.

The key to the future of retail banking, therefore, lies in what might be termed "technological liberation" - that is the freedom that technology will give banks to offer the services their customers need, rather than the services that are technologically possible. This is in direct contrast to the criticism levied at marketing departments in the past, who have given the customer what is technically possible rather than finding out exactly what the customer wants.

The reduction in paper processing and the instant sanctioning of loan applications by computer (it has been estimated that the typical bank loan in America involves between 50 and 80 internal communications, and that inefficient banks may use three or four times as many)[4] these, are all developments which are beginning to emerge throughout the financial services industry and which will come to re-define the branch of the 1990s. The changes are indicative of the general trend towards a more service-based philosophy supported by an increasing level of automation.
Increasingly computer firms are forming strategic alliances with financial services companies, to exploit the potentially huge market for information technology systems and training among intermediaries in the financial services sector.

18.5 CONCLUDING REMARKS

In practice, the most successful challenges to clearing banks are likely to come from institutions which attack a particular segment of the market, in terms of either customer or product, rather than pursue a wide-ranging attack on the entire market. A focused attack on any class of consumer, or product which is involved in subsidising other customers or service is, therefore, a distinct possibility. In the future, banks may well need to reconsider their universal approach to the market - high-volume, low-price and clearer differences between the institutions may consequently begin to appear.

A fully electronic banking system has interesting implications for the mobility of money, which will enable customers to open a new account with an institution and move funds across immediately. Cost pressures and competition will require clearing banks to make better use of technology. They will need to use technology to project an image that is positive and attractive. The Andersen report[1] predicts that network sharing will be a widespread practice among financial institutions in the basic bank markets by 1995, as they are a sensible means of reducing technological development costs. The main retail banks in Europe have agreed to make their cash and credit cards compatible within three years, so that holders of any one card will be able to obtain access to the facilities of other card systems.[11] These
developments mark an important step towards the integration of international payments systems, however, there may be delays due to technical incompatibilities and rivalries between systems.
19. PERSONNEL IMPLICATIONS

19.1 INTRODUCTION

In a increasingly competitive environment, the calibre of bank staff will need to be improved throughout the whole organisation. This has implications for recruitment, selection and training.[8] Accordingly, personnel policies are now receiving greater attention. Marketing experts need to be recruited as a priority so that bank marketing departments can compete with the new competition, many of which have a long tradition of marketing in a highly competitive market.

Arthur Andersen[1] unreservedly predicts a future increase in the number of jobs in marketing and systems development and a fall in the number of jobs in domestic branches, bank operations and accounting. The prediction however is that there will be little or no overall change in bank employee numbers, but those employees will be able to add more value through the increased use of technology.

Personnel change is also needed at the top of financial organisations, especially clearing banks, which need to bring in more "outsiders" to challenge the established ideas concerning their business. The most severe skill gap is in people with both marketing imagination and technological understanding. The key to future financial performance is to identify and use those people who know how to relate technology to customer desires.[8]

Management quality has been identified as the most critical success factor for future banking operations. Management will need to become
less risk averse and emphasis will switch from technical abilities to marketing and selling skills. This could possibly result in a further increase in the mobility of senior management between financial institutions.

None of the changes and improvements previously outlined can be implemented without the full cooperation of the financial institutions' personnel. Banks are notoriously labour intensive. National Westminster was the UK's biggest private sector employer of school leavers in 1988 - it needs 59,300 people to look after its 3,200 domestic branches and assets of £71 billion.[13] However, it is unlikely that staff numbers will be lower by 1992 than their current levels. Even though rationalisation of branch networks and automation of clerical tasks are possible causes of personnel reduction, these are not new priorities. A drop of more than 1,100 in the number of clearing bank branches between 1970 and 1984, was accompanied by a growth of 35% in staff numbers.[5] However, it is even more unlikely that the expected growth in transaction volumes will result in an increase in staff numbers - as the current environment is one where the cost/income ratios of the banks must be reduced if they are to stay competitive.

Changes will occur, however, in organisational structure and the type of work that an individual performs. These will be as a result of the increased use of technology and the shift to a more market-orientated strategy.
19.2 THREATS FROM INCREASED TECHNOLOGY IMPLEMENTATION

It is probable that failure to introduce new, innovative technology and to respond to competitive threats would provide a greater threat to long-term employment levels than would the introduction of technology.\(^5\) There is a dual purpose for the introduction of technology into banking - to reduce costs and secondly to give a more efficient service and, thereby increase revenue. The benefits of its introduction will accrue to both the customer and the institution. However, technology must provide greater flexibility for the organisation and it is through this flexibility that the impact on staff will be made. There are opportunities for patterns of work, career paths and the location of work, all to be effected.\(^{12}\)

Six out of every ten people in UK retail banking are employed handling paper and every day there are 12.4 million paper transactions passing through the clearing system.\(^{10}\) The removal of much of this paper processing, through the possible implementation of a national EFTPOS system has lead to estimates of a threat to more than 200,000 employees currently working in the industry.\(^{10}\) The assumption that staff liberated from such mundane processing tasks will be automatically re-deployed on the selling and advice side of the business, however, is not necessarily a foregone conclusion.

Staff will need to be fully at ease with this new technology and not feel threatened by its introduction - this may well require a certain degree of staff education. Computer operations and new ways of processing and presenting information will be so vital to the day-today bank operations, that the present division between data processing
skills, banking skills and management skills will become less
delineated.[6] Present day observation already bears testimony to the
increased importance of the technologist within the banks - a view
supported by much of the empirical work behind this thesis. The
recruitment of specialist staff has and will continue to increase as
will the number of staff employed mid-career.[5] Often these people
will be new to banking and they will be able to provide a view of the
situation that is uninhibited by banking traditions. The recruitment of
specialists will particularly apply to those organisations entering new
markets as existing management expertise may be insufficient.
Ultimately, technologists (who can cut costs) will be superseded by the
marketeers (who can increase revenues).[13]

19.3 IMPLICATIONS OF NEW MARKETING STRATEGIES

The current need is for banks to cross-sell lucrative services to their
existing customers or to new customers. This requires bank staff to
sell bank services rather than merely provide them. As selling has been
a concept that many bank staff have traditionally dissociated themselves
from, this will require a certain degree of education and cultural
change.[6]

Organisations need to be much more market and customer-orientated.
Accordingly, management and staff must be more responsive to customer
needs. Adopting the marketing concept was viewed as a form of
enterprise differentiation by Tarver.[12] Bankers must differentiate
their organisation by the quality of its personnel, the ultimate aim
being to use personnel as a means of obtaining comparative advantage.
This advantage would be sustainable in a way that product
differentiation never can be. Consequently, management must pay as much attention to their staff as they do to their customers and product ranges.

As the staff have a much greater degree of contact with customers, managers may well have to involve staff more closely in the strategic planning process. This will allow the corporate mission statement to be in tune with market sentiments and requirements.

19.4 ORGANISATIONAL AND STRUCTURAL CHANGES

Organisation structure and management will need to become more flexible to compete effectively in the increasingly competitive marketplace.

Bureaucracy must be reduced and the hierarchical structure of bank management ideally needs to be flattened. Atkinson[2] envisages a situation where a small, numerically stable group of employees will be supported by a larger number of employees who may well be employed on a contractual basis. Naturally, this will impact heavily on bank management and one result may be the abolition of life-time employment.

The Royal Bank of Canada is a good example of how changing market conditions alter the structure of the organisation. They previously had a vertical, multi-tiered organisational structure which is typical of so many banks. However, they recognised that the President was at least eight layers away from the customer. Consequently, they restructured by cutting out unnecessary layers and putting the customers on top. Each manager has now been given a great deal of freedom to change their delivery system, training programmes and marketing techniques to meet
local market demands. The area manager has effectively become a general manager of a franchised banking operation.\[13\]

As the banks become less hierarchical organisations, their corporate cultures must change. The removal of management tiers will hopefully lead to a more open culture that enables more efficient communication between different parts of the organisation. Depending upon the success of this organisational change, banks will become more flexible organisations, better able to respond to the changing market environment.

19.5 THE IMPORTANCE OF TRAINING

Cowan\[6\] pointed out that changing market conditions will impact on job content. Accordingly, career planning will be more difficult and less predictable than at present. It is likely that financial institutions will have to review their management development programmes to ensure that the training is still relevant. As organisations diversify away from traditional lines of business, training will take on added importance as staff will need to be educated in products and services that are new to them.

Pressures on training resources will increase in the future and it is likely that banks will spend increasingly heavily in this area. Stonier argues that organisations must move away from the training of line managers who are imbued with traditional values and look to produce the "professional generalist, capable of organising along horizontal lines."\[11\]
Training is likely to be the most effective source of productivity improvement for employees with functional responsibilities. Training will continue to place less emphasis on traditional technical skills and more upon general management qualities, particularly, selling. Indeed, overall resource management and people management will be highly sought after qualities. As an example, National Westminster (group) are currently spending £50 million and devoting more than one million man-hours per year to training their staff. They believe in the recruitment of staff in mid-career and additionally that there is a need to buy-in specific technical expertise. Both viewpoints are quite revolutionary in banking.

19.6 CONCLUDING REMARKS

The move towards a more dynamic management style reflects the more open and flexible organisational structure of the future. Increased competition has already resulted in a shift from a self-determined to a more market-determined organisational form. The constant need to provide what the customer requires, influences not only the services/products of an organisation, but also the internal structure of that organisation. A combination of marketing and technology strategies must be found which coincides with the organisational fit of the bank. Clearing banks are seeking to group their operations in such a way as to focus more directly on the requirements of particular customer segments, rather than on particular types of banking operations. They are also looking to increase the number of these requirements that can be seized from a single "delivery point" within the group. To take an extreme view, clearing banks will have to choose what businesses they wish to
specialise in. Those areas that they cannot make money in may well be sub-contracted to other organisations.
20. THESIS CONCLUSIONS

20.1 CONCLUSIONS

The thesis has examined the dynamics of competition within the UK basic bank markets. It has indicated a marketplace where the traditional players, the clearing banks and building societies, have been joined by new entrants such as foreign banks and retailers. These newcomers have carefully targeted the niche markets they perceive to be most lucrative within the total market. Consequently, the traditional players have seen a relative reduction in their total market share, but more importantly, a migration of some of their most profitable customers.

Quality of service has been identified as a prime way of gaining competitive advantage over one's rivals. As the financial institutions become more market-orientated, increasingly the standards for product and service quality will be customer-defined. The move from organisations being internally-driven to ones which are more responsive to outside forces, will be difficult for some financial institutions.

Cost pressures and competition will require players in the basic banking markets to make better use of technology. They will need to use technology to project an image that is positive and attractive to the marketplace in general and also to their own staff.

From the response of the interviewees, it is clear that customers want to be informed; they equate knowledge with financial power and sophistication. Product value can, therefore, be added by the inclusion of an information component. These financial service providers must
create value that customers are prepared to pay for. A major step in achieving this is through the individualisation of product service provision. The thesis identified that the customer database is key to the accurate targeting of potential cross-selling opportunities. The banker must know details of existing product relationships, potential needs and customer product profitability.

The institutions' success in achieving the changes of emphasis outlined in this thesis will ultimately be dependent on the quality of its staff. These institutions must differentiate their organisation by the quality of its personnel, the ultimate aim being to use personnel as a means of obtaining comparative advantage. This advantage would be sustainable in a way that product differentiation never can be.

Implicit throughout the whole of this thesis, has been the need to service the market to a high standard. Institutions can no longer expect to be able to provide the required level of service over a wide range of services. Accordingly, the total market will be segmented and an institution will look to focus its resources in the provision of services to the sub-group that it is best placed to serve. Products will be designed, priced and delivered in such a way as to appeal to that specific target market. No longer will total market share and mass-market appeal be a priority, but rather the pursuit of a differentiated corporate strategy that focuses on specific, lucrative market segments.
20.2 FURTHER RESEARCH

The initial objective was to take an essentially broad based view of the problems and challenges in the basic bank markets. By necessity certain areas are only briefly considered. Quality of service has already been identified as a future area of competitive advantage. This is an area that will undoubtedly lend itself to further examination. It may be worthwhile evaluating whether any financial institution should pursue a low-cost strategy, as opposed to differentiated or focus strategies which are the current convention. Further study in this area will be productive and challenging, reflecting the dynamic changes occurring in the marketplace.
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WORLD ATM POPULATIONS
(JANUARY 1987)

SOURCE: Battelle International Research
High Street Banks

Growth in ATMs

SOURCE: Banking World
NUMBER OF ATM CARDS
BANKS AND BUILDING SOCIETIES

Millions of Cards

SOURCE: APACS / Bank of England
NUMBER OF ATM WITHDRAWALS

UK BANKS

Million Withdrawals

0 1 2 3 4 5 6 7 8 9
1 1 1 1 1 1 1 1 1 1
9 9 9 9 9 9 9 9 9 9
7 7 7 8 8 8 8 8 8 8
7 8 9 0 1 2 3 4 5 6
9 9 9 9 9 9 9 9 9

SOURCE: APACS
CASH WITHDRAWAL COMPARISON

BY CHEQUE AND BY ATM

(EXCLUDING BUILDING SOCIETIES)

Millions


[Bar chart showing cash withdrawal comparison by cheque and ATM by year from 1976 to 1987.]

SOURCE: APACS
NUMBERS OF BRANCHES / ATMs
HIGH STREET BANKS
As At 30 June

SOURCE: Banking World
HIGH STREET BANKS
COMPARISON OF BRANCHES AND ATMs
July 1988

SOURCE: Banking World
NUMBERS OF BRANCHES / ATMs
BUILDING SOCIETIES
As at 30 June

1986
1987
1988

ATMs
Branches
GROWTH IN CREDIT CARDS
UK CARDS IN ISSUE

SOURCE: Abstract of Banking Statistics
CREDIT CARD MARKET SHARES

UK BANKS
1987 ACCOUNTS

SOURCE: Euromonitor
PAYMENT INSTRUMENTS

RELATIVE IMPORTANCE 1987
(EXCLUDING INTERBANK TRANSFERS)

- CHEQUES: 57.0%
- DIRECT DEBIT: 11.0%
- ELECTRONIC TRAN: 13.0%
- PAPER TRANSFERS: 9.0%
- CREDIT CARD: 9.0%
- POSTAL ORDERS: 9.0%

SOURCE: CLSB