

Competing without boundaries - the new market space

The financial services industry in
Ireland

August 1998

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We would like to thank all those companies that participated in this research.

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Introduction

Introduction

This is the fifth survey of the financial services industry in Ireland to be conducted by Prospectus. In this year's survey, we look across the entire spectrum of financial services in Ireland.

Rationale for the study

The rationale for this study is to:

- Identify the main trends and issues emerging from this and previous reports
- Assess and compare the preparedness of various sectors, within the industry, for what we perceive to be the major strategic changes in the financial services sector.

The trends and issues are considered under the following main headings:

- Executive summary
- Issues relating to growth
- Business strategy
- Organisation and people
- Distribution
- Branding
- Internationalisation

Research Methodology

Questionnaires were sent to senior executives in all sectors of Financial Services in the Republic of Ireland and Northern Ireland. The entire survey was conducted by post during December 1997 and January 1998 and 57 responses were obtained.

Respondents

The industry sectors represented by the respondents include:

Retail banking	Stockbrokers
Building societies	Treasury
Credit unions	Asset finance
Life companies	Financial administration
Non life insurance companies	Semi-state
Non traditional entrants	Direct banking
Investment banks	Corporate banking
Corporate finance	

A list of the companies which responded is given in Appendix 1.

About Prospectus

Prospectus is an independent strategic consultancy established in 1991 with substantial international reach. The company provides consulting and research services across a range of industries. Prospectus has worked in the following sectors: financial services, information technology, public sector, healthcare, utilities and manufacturing.

Prospectus bridges the gap between strategy development and implementation and specialises in putting strategy to work. The company brings an extensive range of specialist skills, in-depth industry knowledge, and international experience to our clients, helping them to:

- Identify areas of opportunity
- Develop plans to exploit these opportunities
- Put these into practice

Our approach to consultancy differs from that of many of our competitors. By working very closely with our clients, we achieve tangible and realisable results.

Relevant experience

- Strategy development
- Industry, customer, supplier and competitor research
- Market and customer segmentation
- Market entry
- Organisational redesign
- Benchmarking
- Human Resource management
- Strategic assessment
- Process improvement
- Strategic management

Prospectus is part of the Cobra Alliance, a dynamic group of strategic consultants, covering Europe, North America and Asia, committed to sharing knowledge, experience and skills for the benefit of all our clients.

Introduction

Executive summary

Executive summary

Introduction

This section highlights some of the main findings, how existing key success factors are being eroded, potential market developments and what these mean for the financial services industry in Ireland.

Main findings

- Traditional boundaries to competition will disappear

Increased competition is expected from companies within EMU participating countries, due to greater price transparency, no exchange risk and greater industry consolidation as a result of offshore activity. In addition, US firms and potentially some UK firms are likely to view Ireland as an ideal springboard into the markets of EMU participating countries.

Due to the success of non-traditional brands entering the financial services market in the UK, it is expected that they will soon offer similar products in the Irish market.

We can also expect to see an increase in the number of specialist single product providers who will target the high margin sectors.

- The new market space

While the traditional distribution channels are expected to remain the most popular, channels such as the Internet, the telephone, and retail outlets of non traditional financial services companies, combined with the increased internationalisation of competition, will create the new market space in which financial services providers will compete.

- Technology

Technology is recognised as a key enabler in providing a greater customer focus and improved service. Developments, such as Computer Telephony Integration (CTI) and Internet banking, offer convenient access and the potential to customise, at low cost, the services offered to customers. The danger and opportunity from these newer channels to market comes from their global reach, doing away with the need for a local physical presence.

Paradoxically, technology was also rated as a threat to future success, mainly due to the limitations of the legacy systems which many financial services companies operate.

Executive summary

- Quality of Staff

Quality of staff was quoted as one of the main factors contributing to a dominant position. The key skills that employers will require include IT-capable staff, languages, and experience in customer service. However, these skills will become increasingly more expensive to acquire.

- Customer Focus

In an increasingly competitive environment, value for money is seen as the most important customer expectation. Convenience and ease of access are seen as the main requirements. The non traditional entrants' experience in collecting and analysing customer information effectively is one of the main reasons they pose such a threat.

Erosion of the status quo

The table below summarises some of the radical shifts affecting the key success factors of today's financial services industry in Ireland.

Today's key success factors	Change eroding the status quo
Trust and security (key brand attributes)	<ul style="list-style-type: none">• Recent media revelations
Market place protected by small scale and remoteness	<ul style="list-style-type: none">• EMU• Non traditional entrants
Distribution	<ul style="list-style-type: none">• New technologies, e.g. CTI, Internet• Strategic alliances
Relationship management	<ul style="list-style-type: none">• Non traditional brands with the expertise and technology to manage customer information
People	<ul style="list-style-type: none">• Expected shortages of skilled staff
Range of products	<ul style="list-style-type: none">• Non traditional brands cherry picking the high margin products

Executive summary

Potential market developments

- Pan European branding

The response of the large players in financial services, to EMU, may be to create a European brand. Whilst Ireland itself may not be an individually attractive market due to its scale, the costs of extending the brand to Ireland will be minimal in terms of Europe as a whole. The media images of UK brands already reach Ireland indirectly. Pan European branding may be an extension of a global branding policy of US firms. Examples, such as Merrill Lynch and Citibank, already exist in the corporate financial services market.

- Sky Bank?

Examples of non traditional brands providing financial services are already with us. The development of a strong pervasive brand, e.g. Sky TV, providing front end financial services only, seems plausible. The sales and marketing expertise of these types of companies, supported by a group of traditional suppliers providing sales fulfilment and back office activities, would pose a challenge. Innovative new channels, such as interactive TV, would provide significant competitive advantage to such competitors.

- Virtual Competitors

Increased use of the Internet will mean that new entrants can reach the Irish market without a physical presence. Whilst Irish consumers may currently be reluctant to purchase financial products and services from, for example, a US company, the speed with which Internet technologies are developing, and the increase in usage, suggests that it may soon become a practical option.

So what does all this mean for the Irish market?

- New entrants

The first move is expected to come from non traditional brands which already have established a presence here in their core business, such as Tesco. Other product specialists are expected to follow the example of MBNA.

- Pace

The new entrants and new channels will all gain ground, and the frequency of merger activity means that the profile of competitors will constantly change. The pace of change is likely to continue to increase and large cumbersome organisations will struggle to keep pace with the new competition. New entrants will imitate the successful products already available in the Irish market, but provide them in an innovative way, with the emphasis on customer focus and value for money.

- Move from ability to activity

The results of the survey indicate that many financial services companies have difficulty implementing strategy. In order to compete successfully in the new market space and capitalise on new opportunities, companies must become better at rapidly harnessing the abilities of their organisation.

- Lack of long term strategic thinking

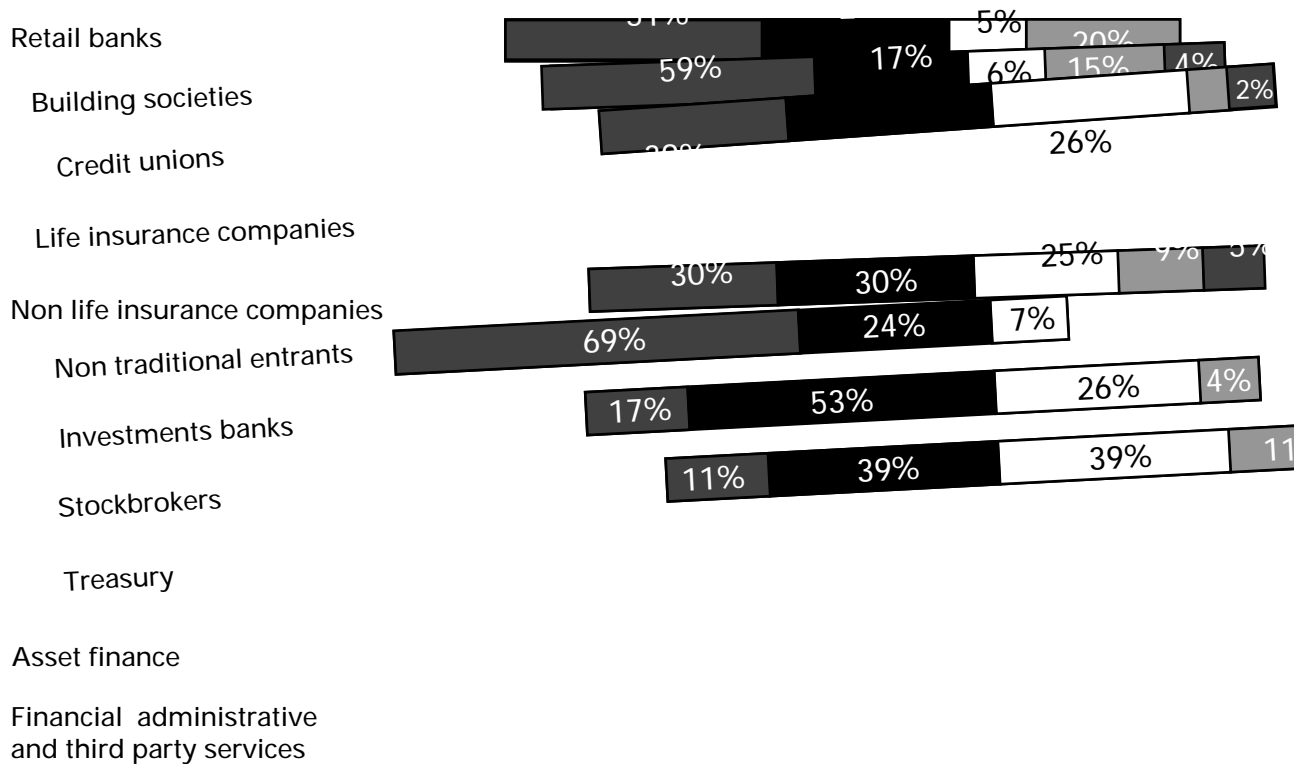
We believe that the shifts in the industry are already starting to happen. Unfortunately, we see little evidence in the responses to our survey of an understanding of the scale and pace of the changes. There are clear indications that respondents are aware of the developments and that the issues are being discussed, but a comprehensive strategy to take advantage of the new market space appears to be lacking.

Executive summary

Issues relating to growth

Issues relating to growth

Figure 1.1 - Expected rate of change in financial services



Question 1.1 What will be the rate of change in financial services over the next five years?

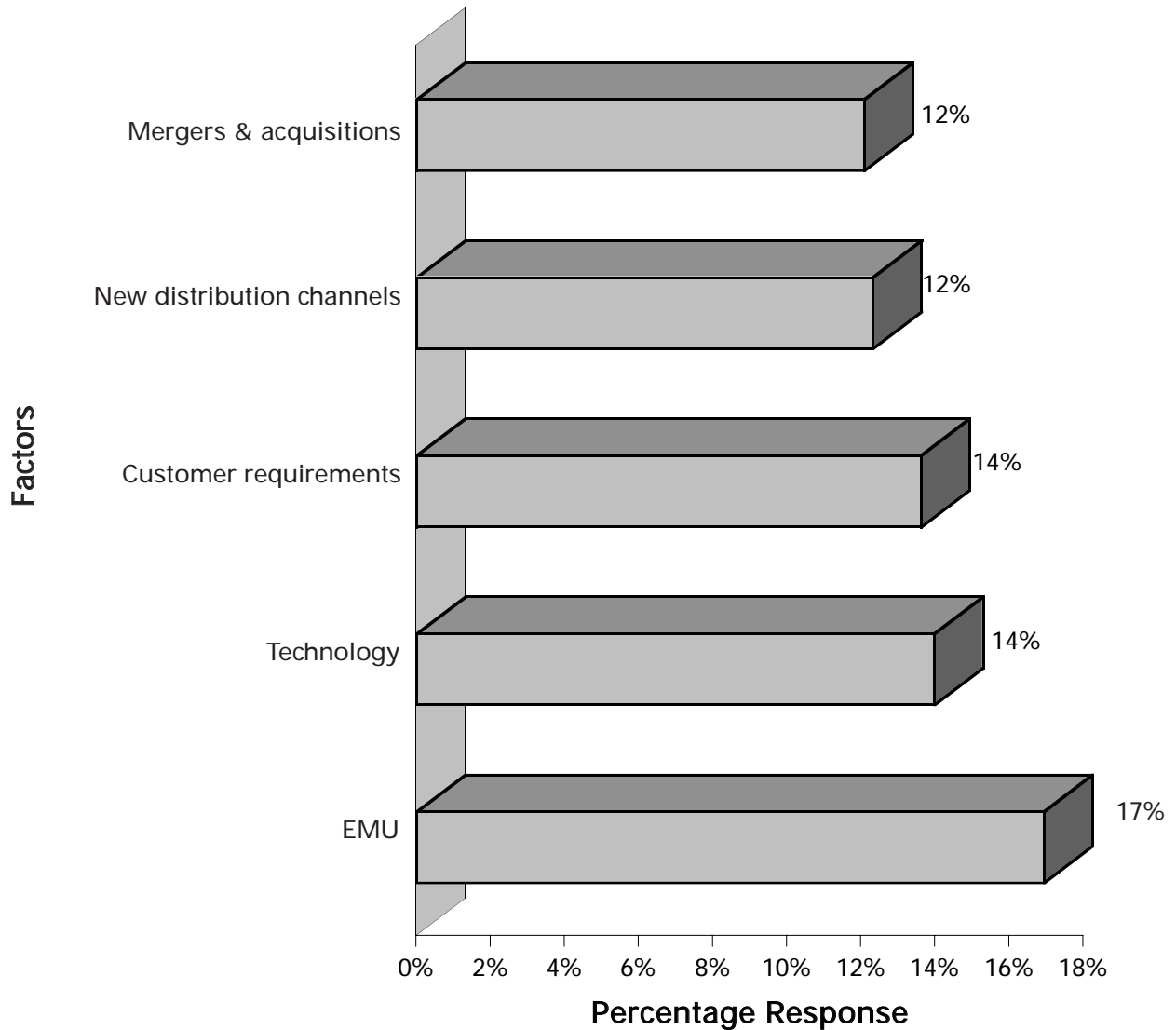
Issues relating to growth

Non traditional entrants are most likely to influence the rate of change in the market place.

- Whilst non traditional entrants to financial services in the UK in recent years have been from the retailing sector, the scope now extends to other industries such as airlines and utilities. For example, in the UK, British Gas have recently launched a credit card. Some of the non traditional entrants offering financial services in the UK have already established a retail presence in Ireland and the industry is expecting financial products to follow shortly.
- Building societies continue to face an increased rate of change. The change which was also recognised in the previous survey, is driven by the need for building societies to increase their range of products and services to compensate for the declining mortgage margins.
- Retail banks are rated third in the rate of change of sectors. This is up considerably from our previous survey. This is indicative of the need for retail banks to respond to changes happening in other sectors of financial services and the advent of non traditional entrants, as these companies begin to encroach on the traditional areas of retail banking. For example, Friends Provident have publicly stated that they want to be a full service provider. Tesco's purchase of Quinnsworth may see them enter the financial services market in Ireland. They currently offer a range of financial products in the UK including savings accounts, loan products, credit cards and home insurance, and they expect to offer a mortgage product shortly.
- In addition to their need to respond to changes in the industry, retail banks are in an ideal position to capitalise on their customer base and retail distribution networks to offer an increased range of non banking products to their customers.
- Respondents expect the least rate of change in stockbroking.
- Irish investment banks are more likely to focus on the Irish SME market, as global players, such as Merrill Lynch, will dominate the capital markets. This is reflected in the responses which do not anticipate much change in the investment banking market.

Issues relating to growth

Figure 1.2 - Factors likely to affect structural change in financial services over the next five years



Question 1.2 What factors are most likely to affect structural change in financial services over the next five years?

Issues relating to growth

EMU is the most likely factor to affect structural change (17%). Customer requirements and technology rank joint second as in our previous survey.

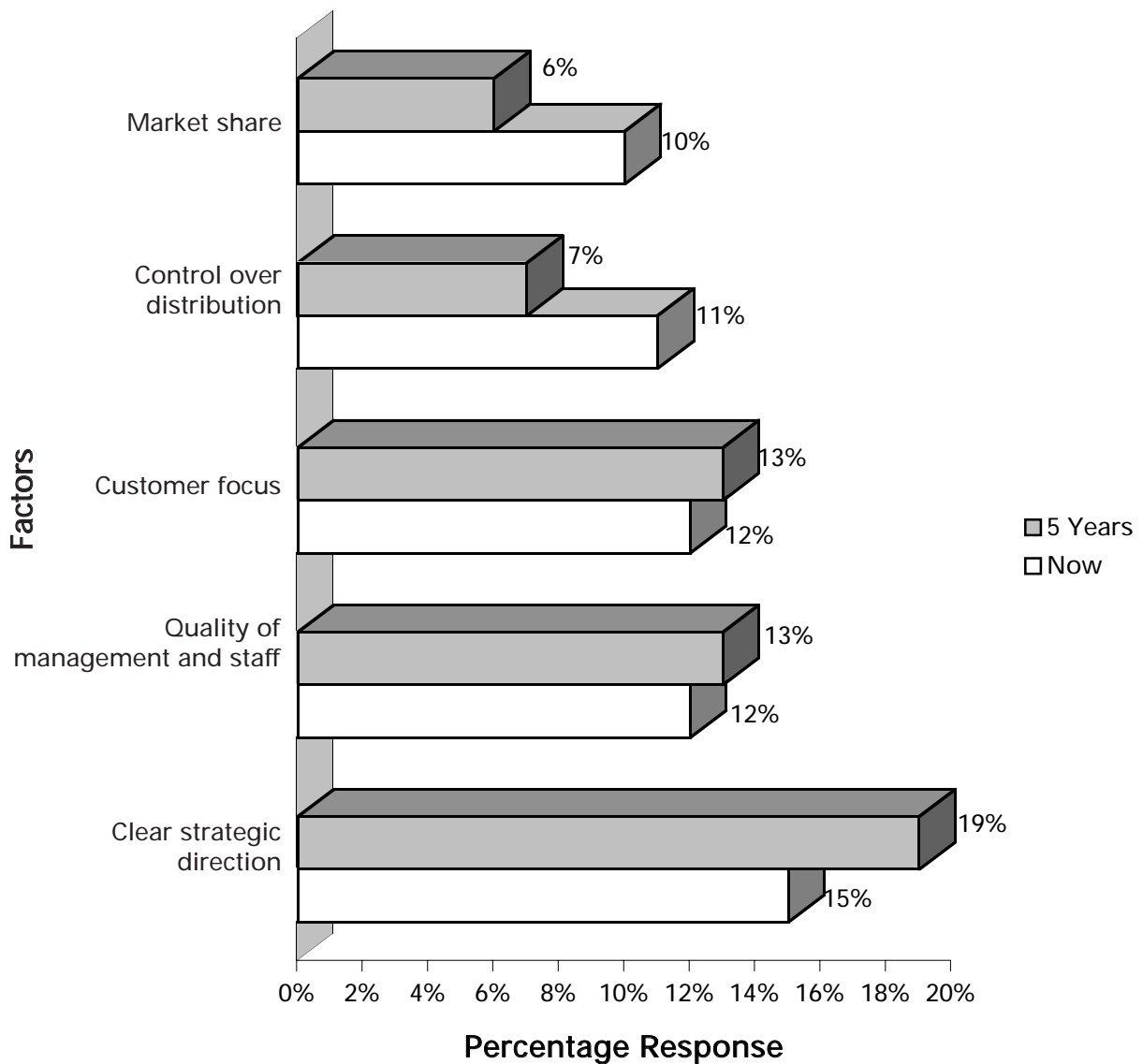
- Although EMU is acknowledged here as the most important factor affecting structural change, there is little evidence, in the responses to other questions, of a proactive strategy being developed by companies to take advantage of the changes.

The main changes as a result of EMU will be a reduction in the number of foreign exchange transactions and the removal of exchange rate risk as a barrier to competition. Most financial services companies see this as a threat rather than an opportunity.

- Customer requirements still ranks as a key issue across all sectors.
- Technology and customer requirements are seen as equally important in affecting structural change. This is an exciting result as it illustrates effectively that a balance needs to be struck between taking advantage of new developments, such as Internet banking, and yet still remaining in touch with customers' needs. It appears that the successful financial services company will not allow technology to determine the service provided. Instead, the successful company will use technology to deliver the service required by customers.
- Distribution channels was ranked first in the previous year and is now ranked fourth. This is indicative of the globalisation of the market. New distribution channels such as telesales and the Internet are a great leveller of distribution capability.
- Mergers and acquisitions received double the rating than in the previous survey. This is not surprising given the unprecedented level of international merger activity in a number of sectors, including financial services, during 1997. For example, Merrill Lynch's £3.1bn acquisition of Mercury Asset management, the UK's largest international fund holder. Merger activity is driven by deregulation and globalisation of mature industries. It is therefore likely that the approach of EMU will provide a further catalyst to merger activity in the financial sector. In banking, the focus is expected to be on domestic consolidations in overbanked markets such as Italy and Germany. For example, there is mounting speculation about the merger of ICI and San Paolo in Italy and attention continues to be focused on Germany's Commerzbank.

Issues relating to growth

Figure 1.3 - Factors contributing to a dominant position in the marketplace



Question 1.3 What are the main factors contributing to a dominant position in the marketplace both now and in five years time?

Issues relating to growth

Clear strategic direction is seen as the most important factor contributing to market place dominance.

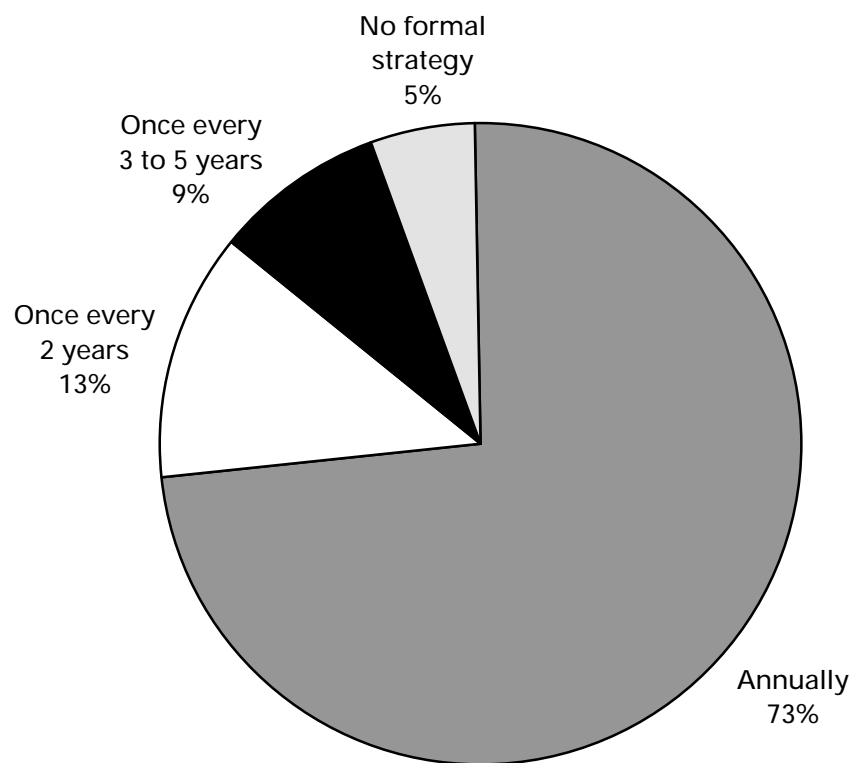
- In five years time the top three factors remain the same, i.e. clear strategic direction, quality of management and staff and customer focus. However, a competitive cost base replaces the control over distribution in fourth place. Given the level of change anticipated in the industry, it is not surprising that clear strategic direction is given such a high ranking both now and particularly in five years time.
- In the environment of increased competition, meeting the customer needs repeatedly emerges as one of the most important differentiating factors.
- Quality of staff moves up to joint second from fifth in our previous survey. The increasing importance of quality of staff is interesting in light of the buoyant employment market. Increasingly, employers are beginning to realise that investing in key staff is a much more efficient and economical method of maintaining and building knowledge and skills in the organisation than replacing personnel. Skill shortages are most evident in the IT departments of financial services companies. The set up of a significant number of new companies in the IFSC can also create shortages, particularly in technical/specialist areas such as custodial and trustee services, and stockbroking.
- Control over distribution has fallen in ranking steadily, from second place in our previous survey to fourth in our current survey, with an expected sixth place in five years. This decrease in importance was foreseen in the previous survey's estimate for five years time. As anticipated, key changes in distribution have already started to occur. For example, electronic commerce on the Internet and increased use of telesales.
- Despite scoring a consistently high factor affecting change, technology continues to score a surprisingly low rating for contribution to market dominance both now and in five years.

Issues relating to growth

Business strategy

Business strategy

Figure 2.1 - Strategy revision



Question 2.1 How often does your company revise its strategy?

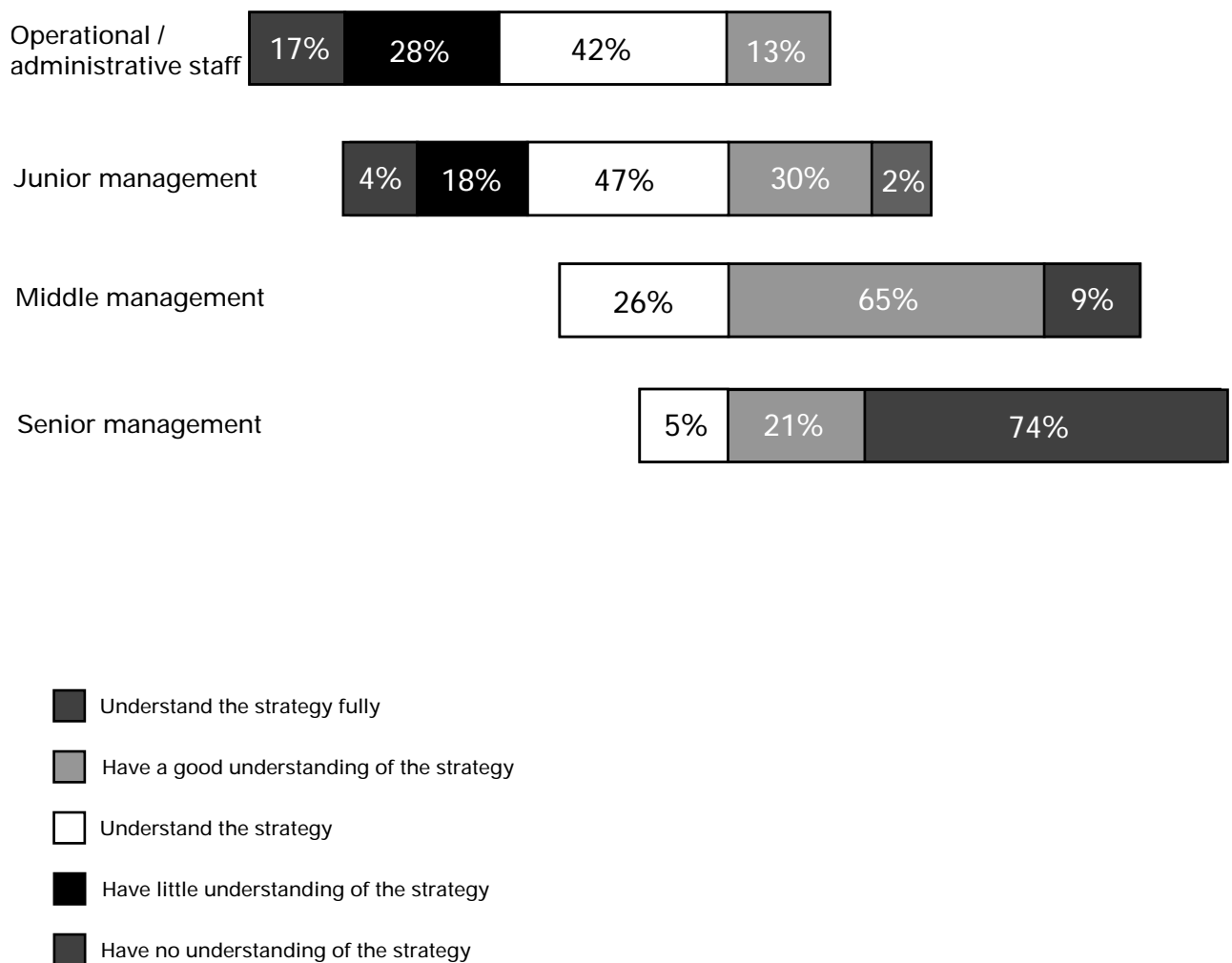
Business strategy

73% of companies stated that they revise their strategy at least annually (up from 68% in the previous survey).

- The overall responses indicated that, on the whole, more companies are revising their strategy on a more frequent basis.
- It is encouraging to note that the 23% of previous respondents who only revise their strategy every 3-5 years or have no formal strategy, has reduced to 14%. This is not surprising however due to the rapidly changing environment in which most financial services companies operate. The rate of change is expected to continue to increase with developments in customer requirements, non traditional market entrants, technology, the impact of EMU, etc. creating the need for more frequent reviews of strategy.
- However, an astonishing 5% of respondents stated that they had no formal strategy. They included companies in corporate finance and treasury. This is especially alarming, given that the main structural change, EMU, will impact these types of companies directly.

Business strategy

Figure 2.2 - Level of understanding of company strategy



Question 2.2 What level of understanding of your company's strategy is there among your staff?

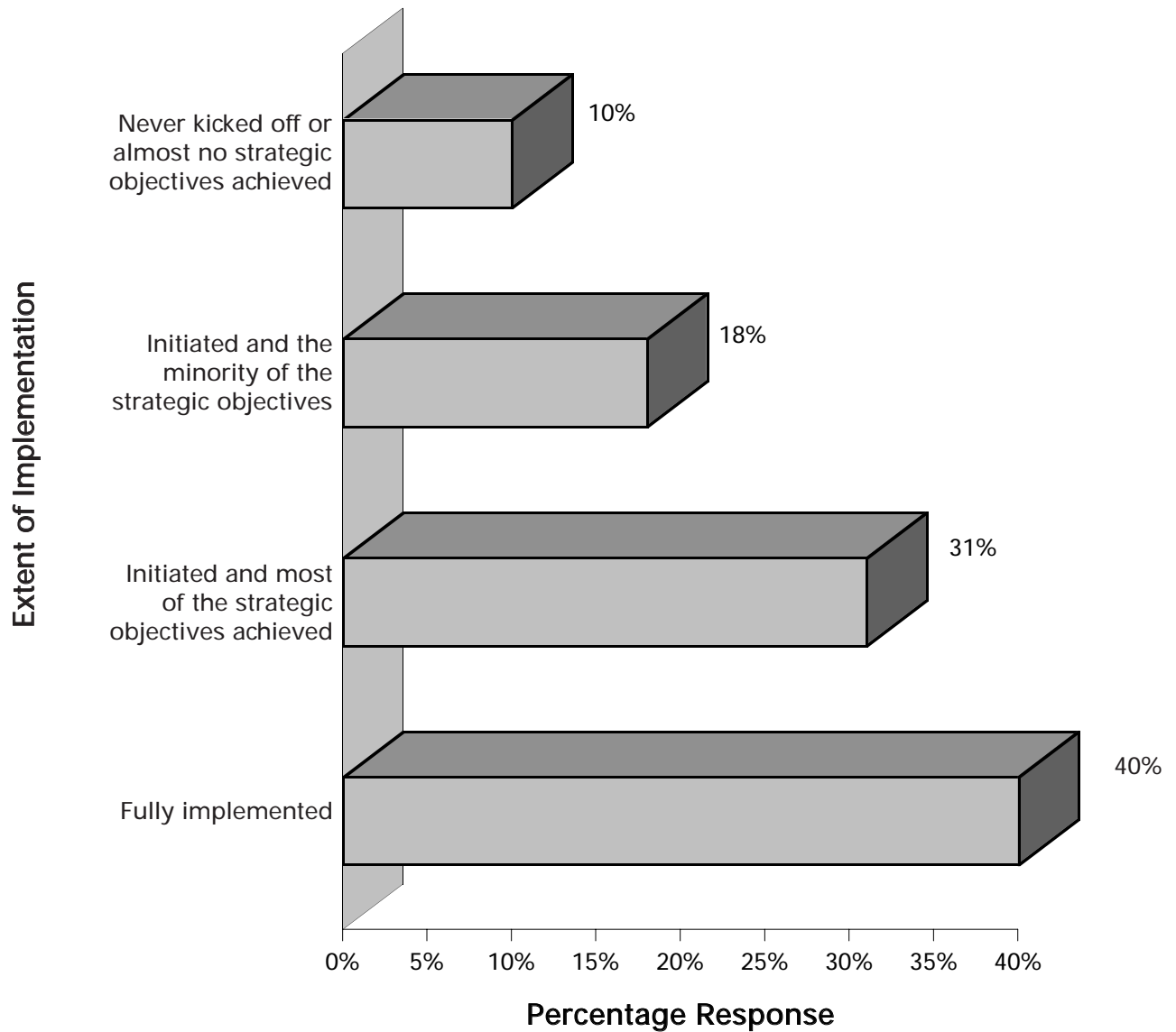
Business strategy

Only 9% of middle management and 2% of junior management fully understand the strategy in financial services companies.

- No operational / administration staff fully understand the strategy, and 45% still have a poor or no understanding of the strategy. This continues to be the main obstacle in successfully implementing strategy. A company cannot attain "clear strategic direction", quoted in the responses to question 1.3 as being the main factor contributing to a dominant position, unless the whole company understands the strategy and what is required to deliver the strategy.

Business strategy

Figure 2.3 - Percentage of strategic initiatives achieved



Question 2.3 What percentage of your strategic initiatives are implemented?

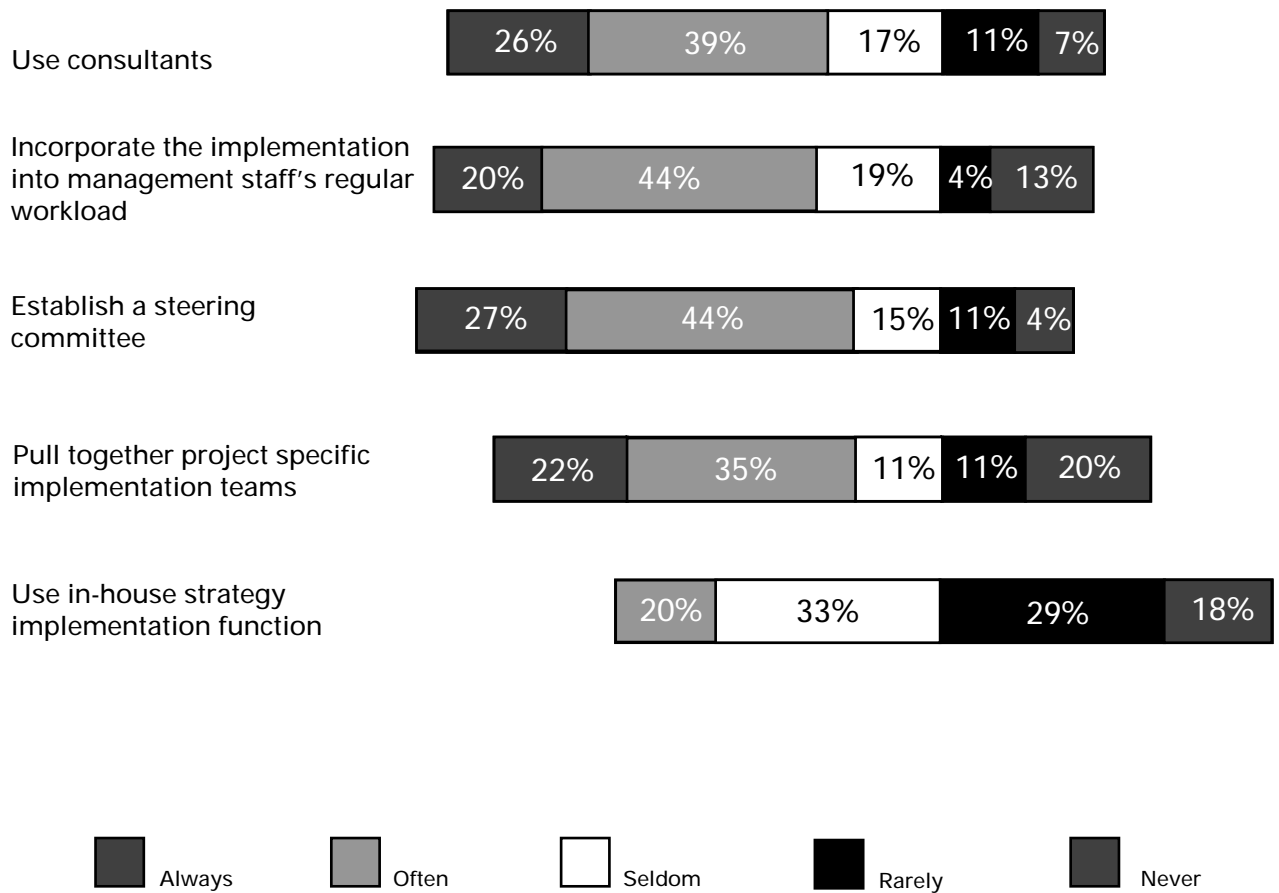
Business strategy

The majority of strategic initiatives are not fully implemented.

- However, the number of strategies fully implemented has increased encouragingly from 16% in our previous survey to 40% in the current survey
- 90% of strategic initiatives are kicked off. The problem seems to arise in communication and implementation of strategy. This is consistent with the poor levels of understanding of strategy by middle and junior management recorded in the previous question.

Business strategy

Figure 2.4 - Implementation of strategic initiatives



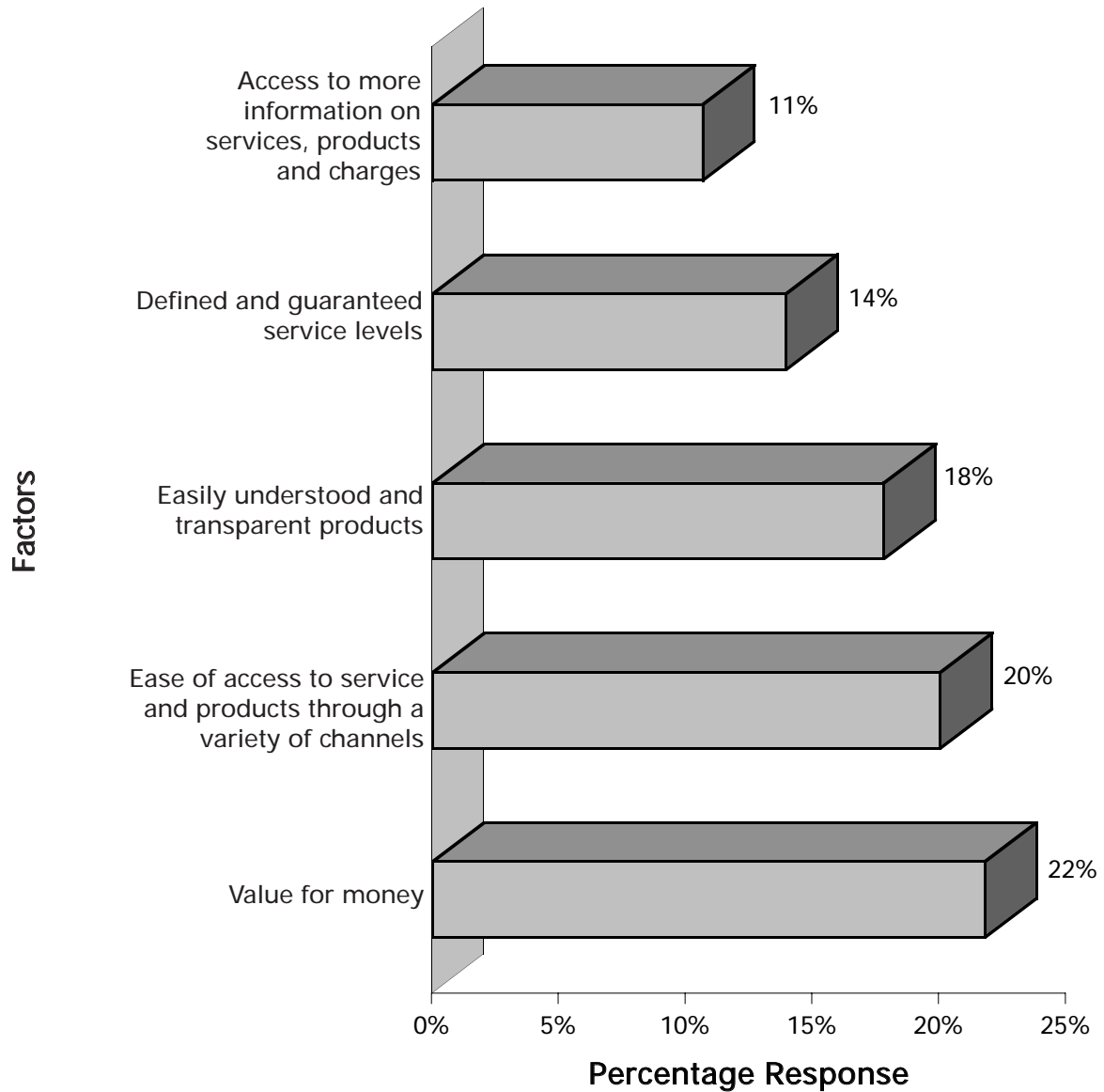
Question 2.4 Typically how do you implement strategic initiatives?

Almost two thirds of respondents will try to integrate strategic initiatives into employees' regular workload.

- A combination of techniques appears to be popular with over two thirds of the respondents using project specific implementation teams, establishing a steering committee, and incorporating implementation into staff's regular workload.
- The least popular method was use of an in-house strategy implementation function. This indicates that strategy implementation is still dealt with in an ad hoc manner rather than with dedicated tools and resources. For example, it is rare that a company would try to develop a new IT system without dedicated resources assigned to the project. Yet when it comes to implementing strategic change, those who are responsible for ensuring that the benefits are realised, often have to do so without any reduction in their regular workload.

Business strategy

Figure 2.5 - Top five future customer expectations



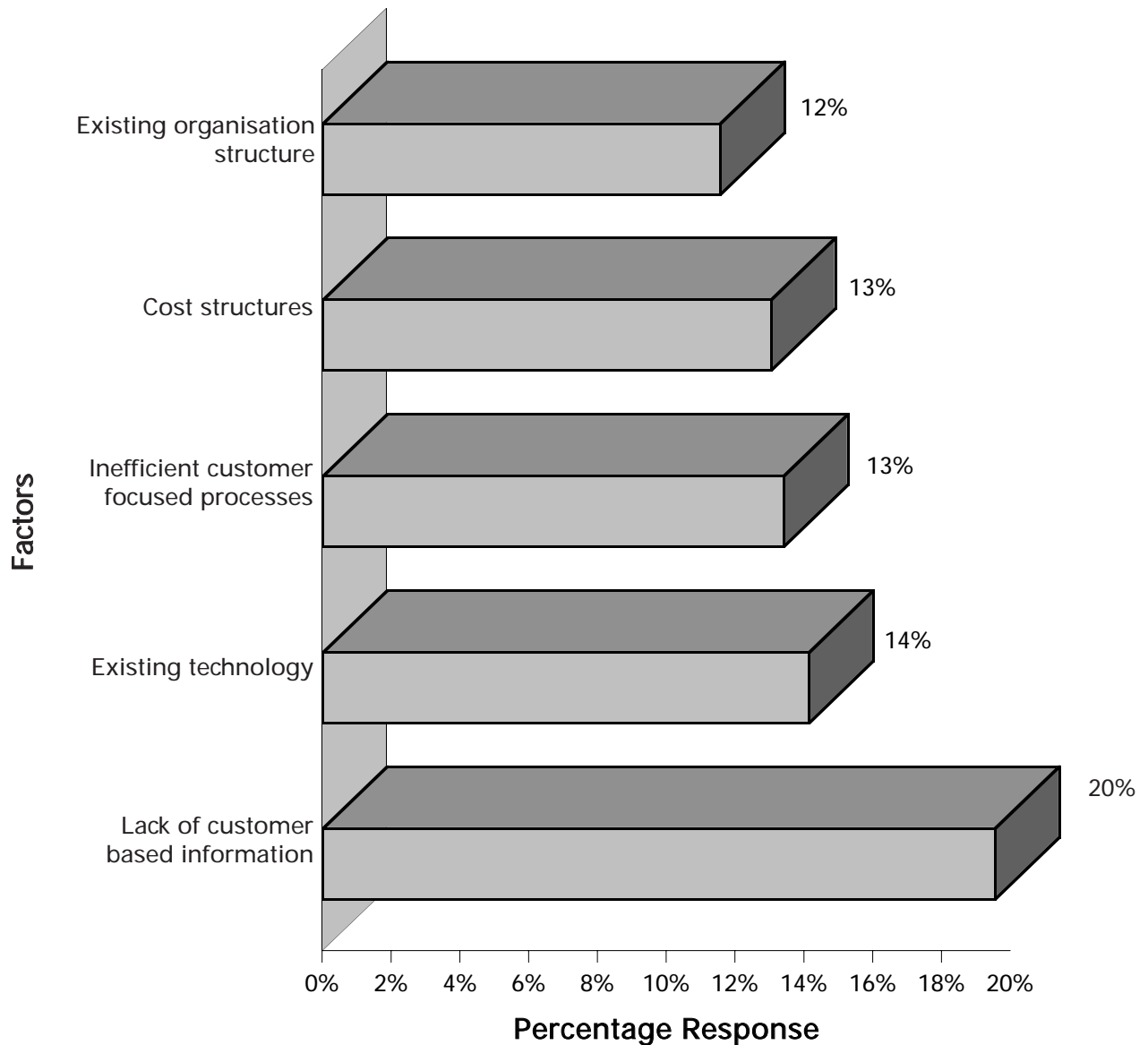
Question 2.5 What will the customer expect in the future?

Value for money remains the most important customer expectation in the future.

- Ease of access to service and products through a variety of channels was rated as the second most important customer expectation. Irish financial services companies, especially retail banks, are already starting to respond to this customer expectation with the provision of 24 hour banking, Internet banking and pilot branches which are open shop hours, e.g. the AIB branch at Bloomfield shopping centre.
- Easily understood and transparent products was rated third overall. As increasingly innovative new products are offered by financial institutions to differentiate themselves from the competition, sufficient and easily understood information becomes more important to the customer. As the information age progresses, consumers are becoming increasingly sophisticated and expect to be able to compare information about products and services. Distribution channels such as the Internet allow such information to be easily disseminated at low cost and is a useful tool for customers who wish to browse available products. Personal contact, however, remains the most popular method of clinching a deal.
- There has been little change in responses since we first asked this question in our 1994 survey. The top four in 1996 were, value for money (26%), easily understood products (17%), ease of access (16%), and transparency (14%).
- A greater range of products and services remains the least important customer expectation. Product enhancements and new products, however, are often seen as a method of creating competitive advantage.

Business strategy

Figure 2.6 - Major internal impediments to meeting future customer expectations



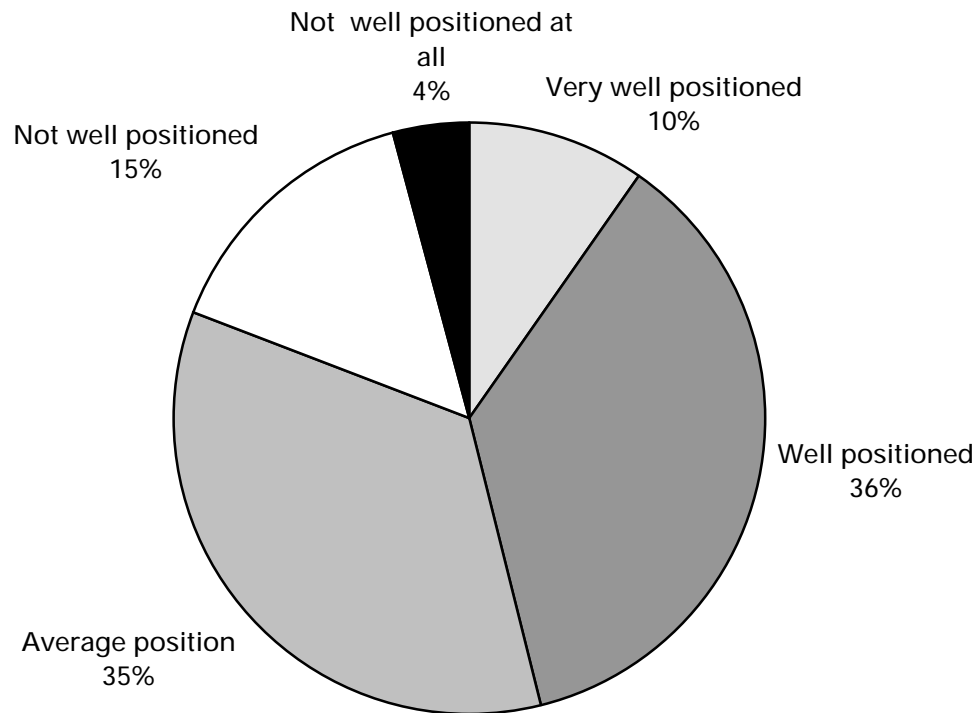
Question 2.6 What are the major internal impediments to meeting future customer expectations?

Lack of customer based information, existing technology, inefficient customer focused products and cost structures are seen as the major impediments to meeting future customer expectations. This is symptomatic of the way systems and processes have been developed over time, i.e. from an operational perspective rather than from the customer perspective.

- Customer based information has taken a leap from fifth place in the previous survey to first place in the current survey. This is likely to have been prompted by the recent entrance of non traditional financial services providers. The UK industry has seen retailers such as Marks and Spencer, who have experience in gathering and analysing customer information, use this knowledge to successfully enter the financial services market. The complexity of customer relationships is greatest for large multi-channel financial institutions with a large portfolio of products and services. However, it is these organisations that would benefit most from consolidating customer based information.
- In our previous survey, which included UK respondents, customer based information was already rated the most important factor by the UK respondents, yet at that time ranked only fifth by Irish respondents. This is an interesting illustration of the gap in the UK and Irish markets. The impact of non traditional entrants and their effective use of customer based information, was evident in the UK market before the Irish market.
- Existing technology was rated the second major impediment to meeting customer expectations. This is an alarming statistic given the speed with which technology and electronic commerce is developing. The main threat with Internet based financial services is that the user is not limited to the local geographical market. This fact, combined with the approach of EMU in 1999, means that European financial services companies with more advanced technology, such as ING Group who have a joint venture with PTT, the Dutch equivalent of Telecom Eireann, will be well positioned to poach customers from Irish companies lacking the technology to compete.
- There is some evidence that while financial services companies are investing a lot of technology resources in resolving the problems posed by EMU and the Year 2000, they are reluctant to invest in or try new technologies. However, this may result in loss of market share, as more innovative companies embrace the new technologies to gain competitive advantage.
- Processes need to be redesigned in conjunction with customers to ensure that the appropriate levels of customer focus are built into the process.

Business strategy

Figure 2.7 - The position of the financial services industry to meet future customer expectations



Question 2.7 How well positioned is the industry sector in which you operate to meet future customer expectations?

Business strategy

Overall, the industry expressed confidence that it would be fairly well positioned to meet future customer expectations.

- Stockbrokers, Life assurance companies and building societies gave themselves the least vote of confidence, in their ability to meet future customer expectations.
- Over half the respondents from retail and investment banks believe their sectors are well positioned to meet future customer expectations, although 8% of the retail bank respondents rated their sector as being not well positioned at all.

Business strategy

Figure 2.8a - Top five key threats

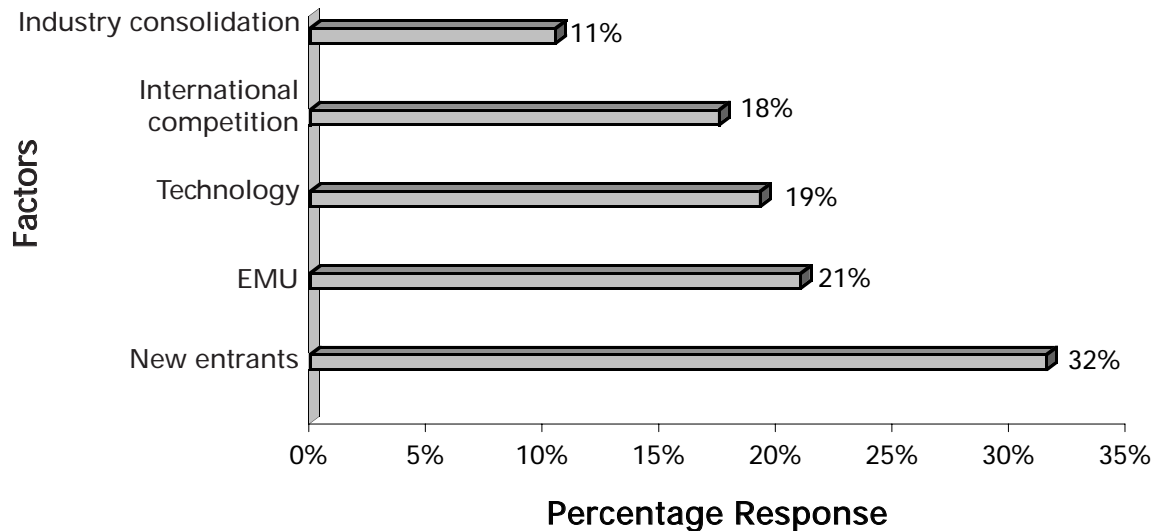
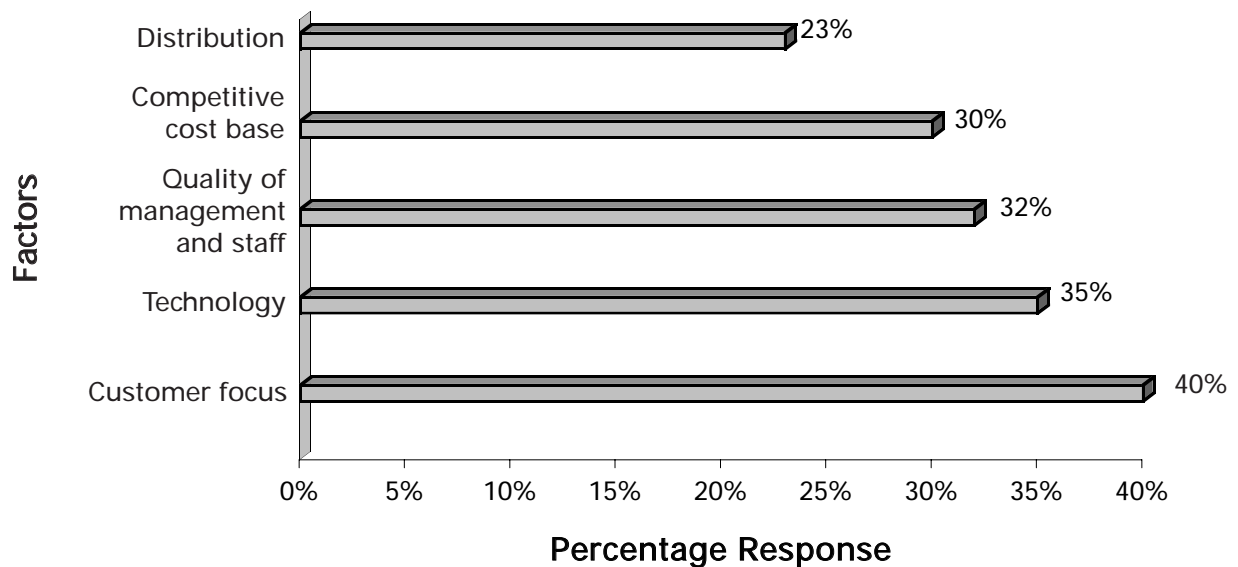


Figure 2.8b - Top five key success factors



Question 2.8 What do you see as the key success factors and key threats to be addressed which will allow companies in your sector to prosper in the 21st Century?

Business strategy

Customer focus and technology are the key enablers, and new entrants and EMU are the main threats to the industry. It is interesting to note that the responses to this open-ended question confirm very strongly the messages from the earlier questions.

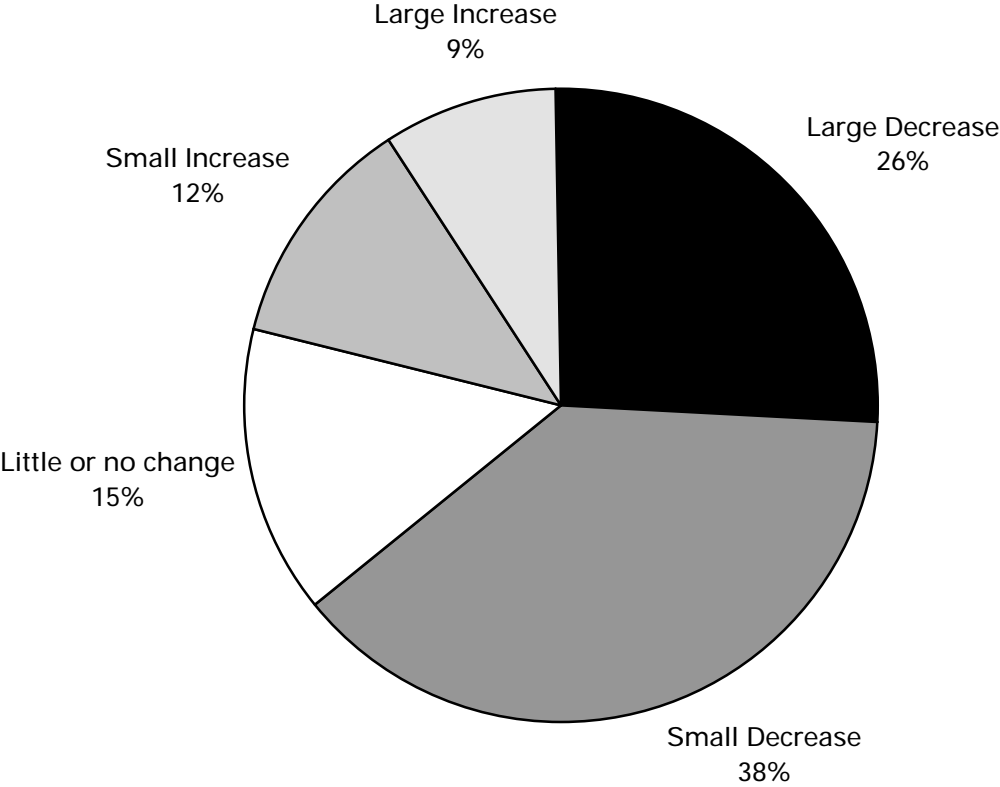
- New entrants was seen as the main threat, closely followed by EMU. In addition to new entrants from non traditional markets, it is likely that EMU will facilitate the entrance of new competitors to Ireland from existing financial companies in Europe and the US. US banks have always viewed Europe as one market and the introduction of the Euro will make the market more attractive. The 1996, GDP of the 11 countries set to enter EMU was US\$6,623bn compared to US GDP of US\$7,263bn. Europe, therefore, represents a large market to the US financial services sector with low saturation levels. The additional threat for Irish companies is that Ireland, as an English speaking country, represents an attractive springboard for US, or potentially UK, companies to enter the pan European market of EMU participating countries.
- Interestingly, whilst EMU is perceived as one of the top threats, it was not mentioned by any respondents as a potential opportunity or success factor. This suggests that Irish financial services companies will be adopting a defensive strategy to the European market rather than an offensive one. This view is supported by the rating of international competition as a top five threat.
- Technology is seen as a critical issue, both as a potential success factor and threat. As technology is perceived as a key enabler, this may raise other strategic issues, such as adaptability of HR policies, in light of the scarcity of IT resources.
- It is worthy to note that a successful technology strategy, rated second as a key success factor, can be used to deliver the top key success factor, customer focus. Developments in technologies such as Computer Telephony Integration (CTI) allow financial services companies to deliver better customer service. For example, First Direct in the UK recorded a 92% satisfaction rating with their new direct banking service compared to 50% for traditional banking customers. On the other hand, many traditional banks are encumbered with legacy systems which inhibit new applications such as consolidating customer data.
- Customer focus was mentioned the most as a key success factor. This corroborates the message from question 1.3 where customer focus was ranked second in factors leading to dominant market position.

Business strategy

Organisation and people

Organisation and people

Figure 3.1 - Change in staffing levels for the financial services industry



Question 3.1 What do you predict will be the change in staffing levels for organisations operating in your specific sector and in financial services as a whole over the next five years?

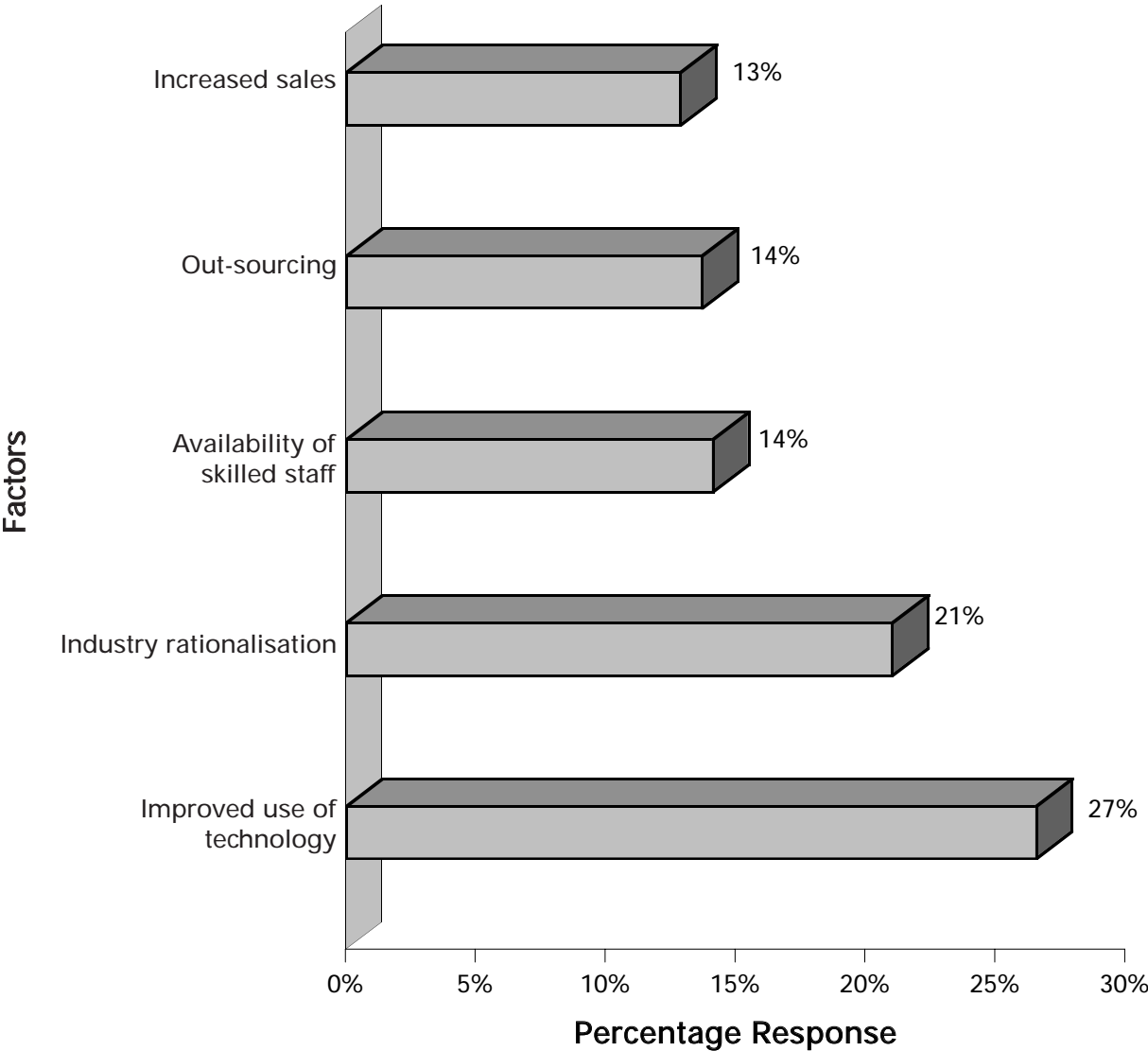
Organisation and people

More than half of the respondents predict a decrease in staff levels with 26% anticipating a large decrease.

- More than half the respondents from life insurance companies predict a large decrease in the number of staff. 38% of non life insurance companies predict a large decrease in staff and 31% a small decrease. This is indicative of the degree of consolidation we have seen in the insurance industry in recent years.
- Job insecurity continues across all sectors, except treasury, financial administration and corporate finance companies. However, the decreases in staff levels predicted are not as large as in the 1996 survey when 79% of Irish respondents predicted a decrease in staff in retail financial services. This is probably due to some industry rationalisation already having taken place.

Organisation and people

Figure 3.2 - Top five key drivers affecting change in staffing levels



Question 3.2 What are the key drivers affecting the change in staffing levels in your sector and in financial services as a whole?

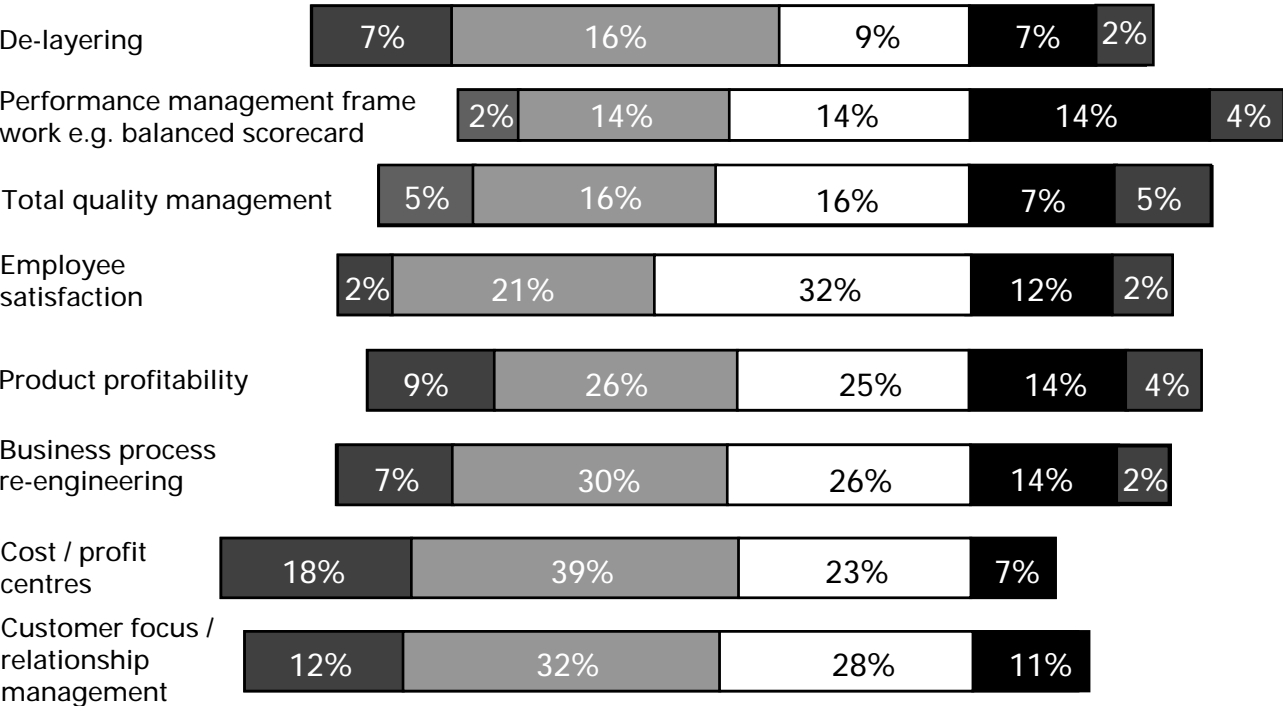
Organisation and people

Improved use of technology is the main driver affecting change in staffing levels for the industry as a whole.

- Industry rationalisation was quoted as the top reason in the retail banking sector, building societies and credit unions. Given that the combined market share of the two leading retail banks is approximately 70%, it would appear that there is little scope left for major rationalisation.
- The availability of skilled staff is an increasing issue for many financial services companies.
- Outsourcing appears to be an increasingly attractive option for semi-state, corporate and retail banks, financial administration and life insurance companies. However, it is also interesting to see that some financial services companies are starting to look at insourcing, reversing decisions made in the 1980's and early 1990's.
- The skill mix of staff is changing. The shortages tend to be in areas where a sophisticated skill level is required.

Organisation and people

Figure 3.3 - Effectiveness of managerial concepts



-  Used very effectively
-  Used effectively
-  Used satisfactorily
-  Not used very effectively
-  Not used effectively at all

Question 3.3 How effectively are these concepts being used within your company?

Organisation and people

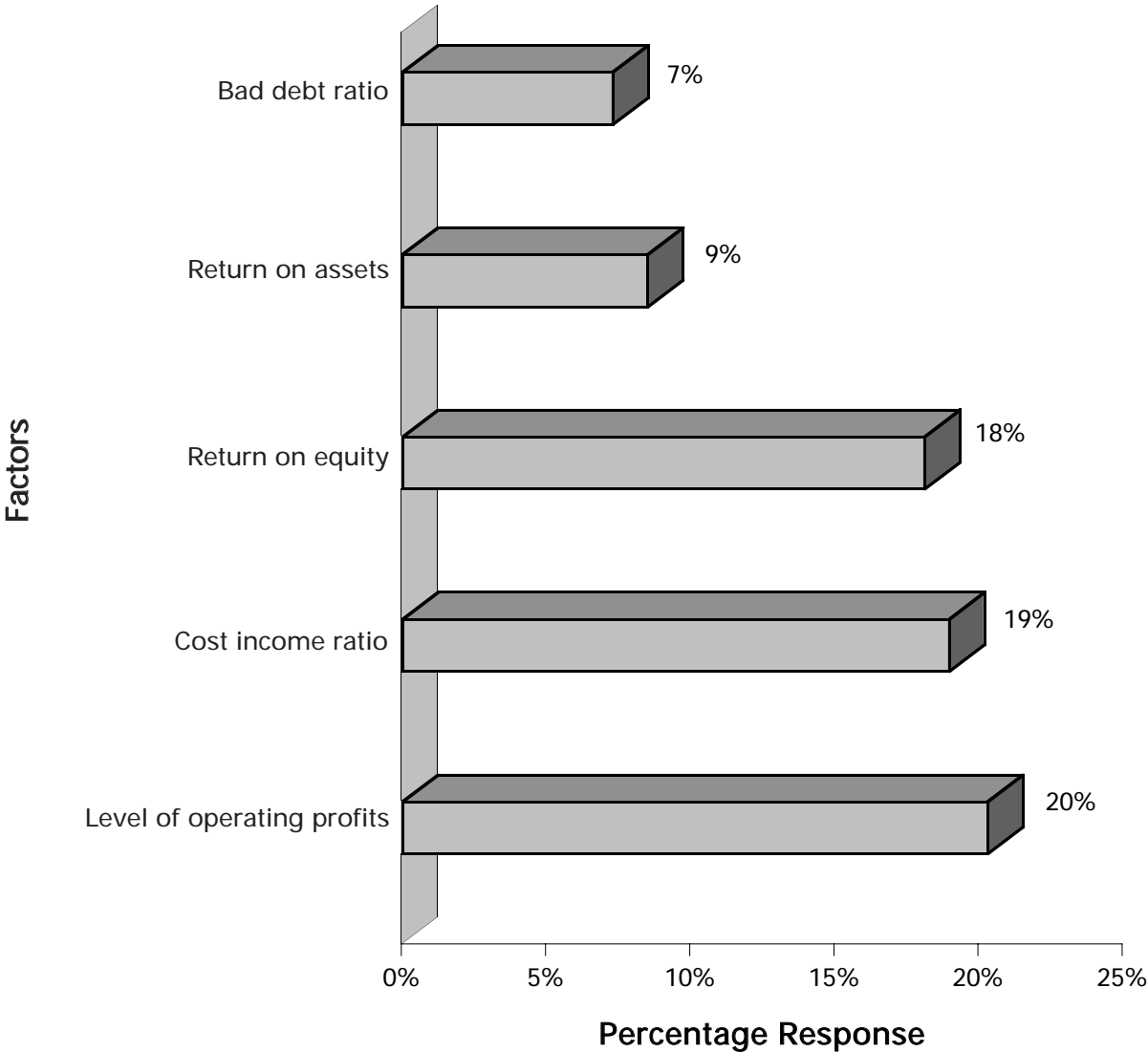
Cost / profit centres, customer focus / relationship management and business process re-engineering were the most frequently used managerial concepts

- As expected, cost / profit centres remain the most frequently used managerial concepts, with 87% of respondents making use of the technique in 1998.
- Customer focus ranks second and has consistently featured in the responses to this survey as an important factor in gaining a competitive edge.
- Interestingly, although quality of management and staff was considered a main factor contributing to a dominant position, employee satisfaction measures are only used by 69% of respondents and only 23% of respondents ranked it as being used effectively.
- Product profitability, relationship management and customer focus and employee satisfaction are managerial concepts which have increased in popularity in recent years.

Clearly, many companies are having difficulty in realising the benefits from the concepts. All managerial concepts, except the traditional areas of cost / profit centres and relationship management are used effectively less than 50% of the time. When managerial concepts are positioned within an overall strategy, their purpose tends to be more clearly defined and therefore understood. The information generated from the managerial concepts can then be analysed within the context of the overall strategy rather than considered in isolation.

Organisation and people

Figure 3.4 - Top five financial performance indicators



Question 3.4 Which financial performance indicators do you consider important in your organisation?

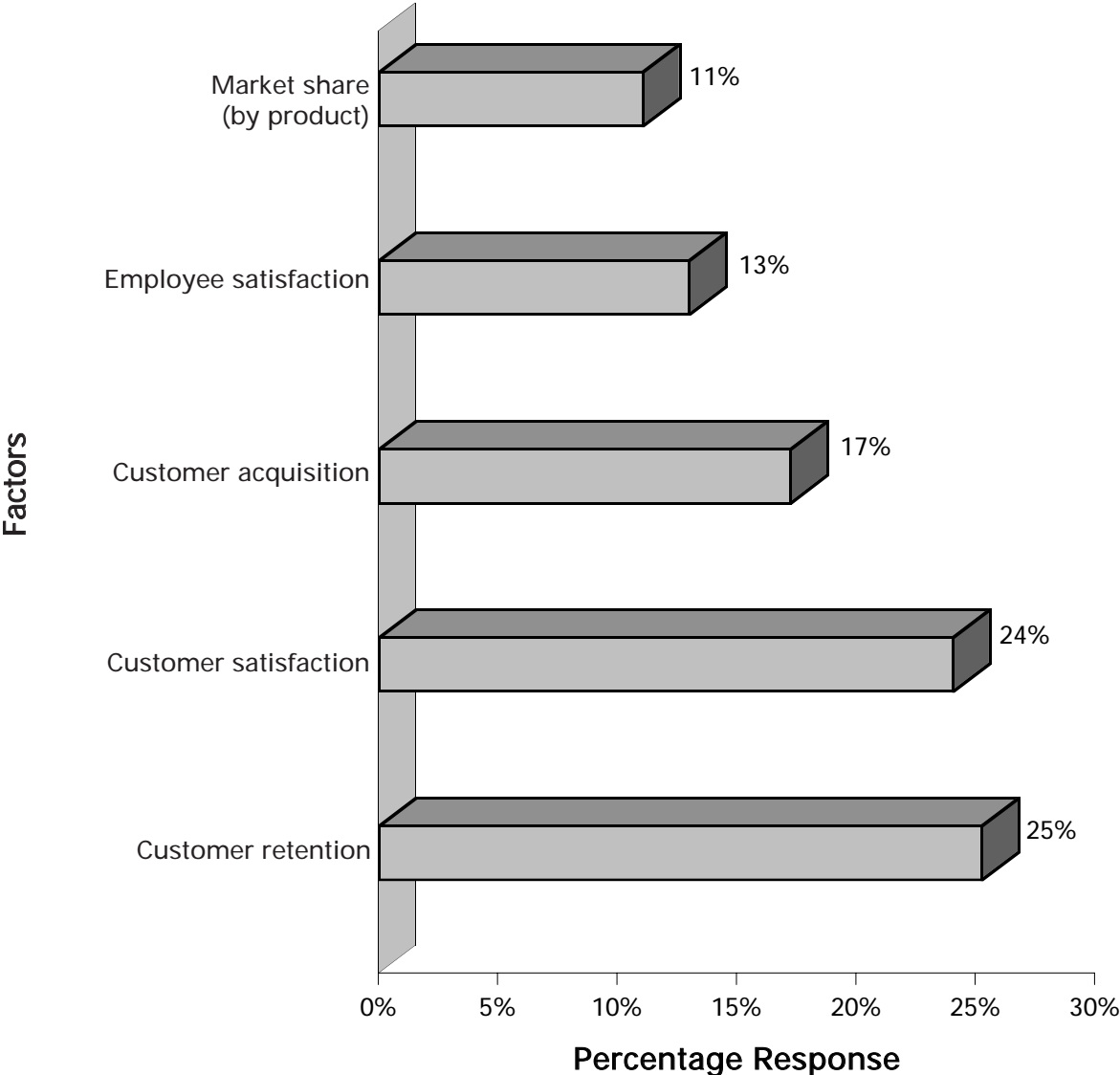
Organisation and people

Not surprisingly, level of operating profits, cost income ratio and return on equity continue to be the most important financial performance indicators

- Despite a rapidly changing market, the top three financial indicators remain the same with a margin of 9% between third ranked return on equity and fourth ranked return on assets. The same top three responses were given in the Prospectus 1994 and 1996 financial services surveys.
- No change is expected in the top three financial performance indicators over the next five years.
- Whilst such financial indicators are historic and companies measure their performance against their own historical indicators, an eye should be kept on the performance and financial ratios of new entrants to the market, in particular non traditional entrants.
- With the approach of EMU the financial ratios, such as ROE, of companies within the EMU will become much easier to compare, providing greater transparency for potential investors.
- Currently Irish retail banks rank high along with the UK, on the European profitability league. Irish retail banks enjoy an average ROE of 21.5% compared with an average 11.4% for the rest of Europe, excluding the UK.

Organisation and people

Figure 3.5 - Top five non financial performance indicators



Question 3.5 Which non-financial performance indicators do you consider important in your organisation

Organisation and people

Customer retention, satisfaction and acquisition are considered the top three non-financial performance indicators

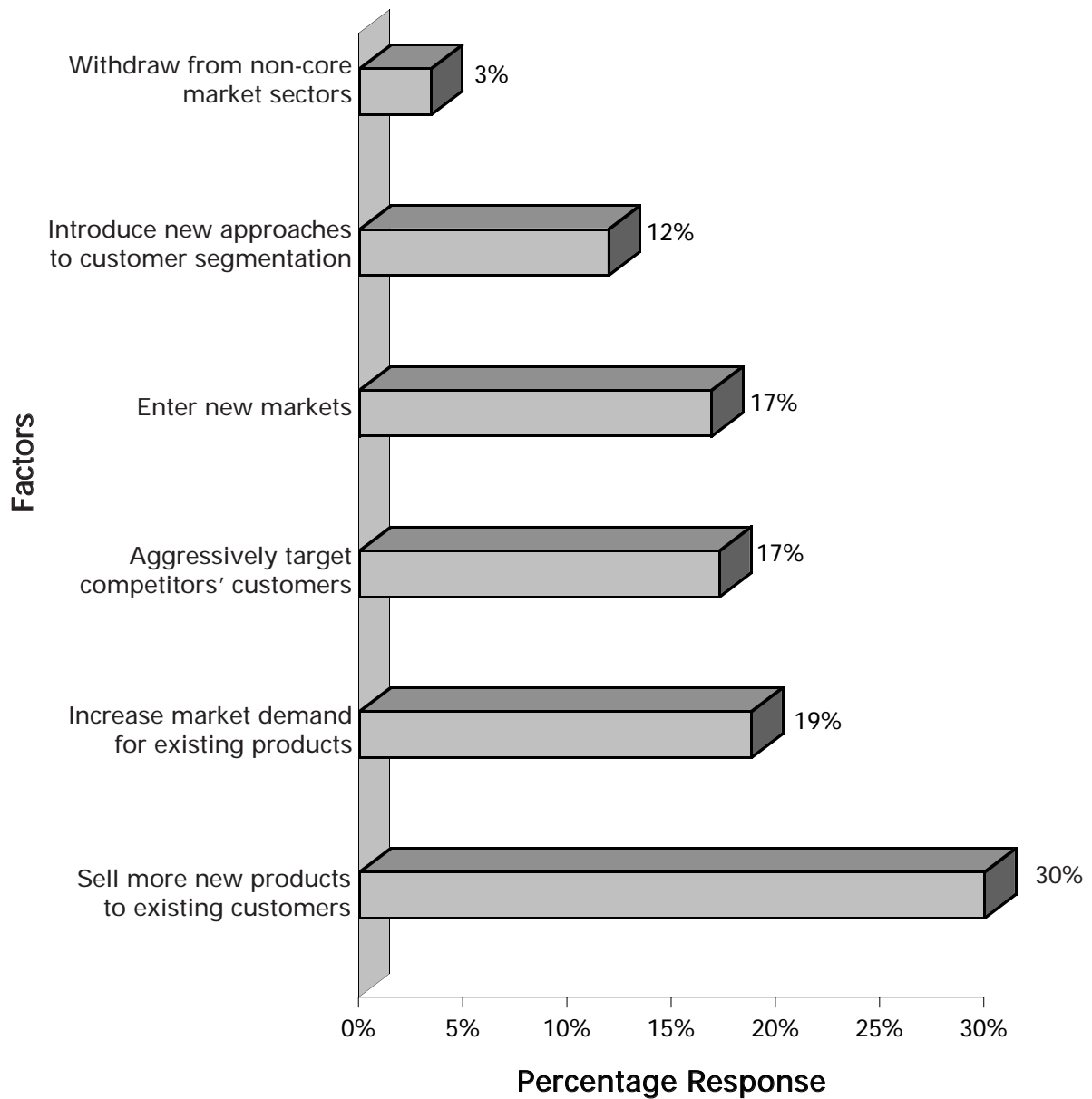
- Customer retention has become the number one non financial indicator for the first time in the history of our surveys. The focus by financial services companies is to retain the most attractive portfolio of customers. It is a well established industry fact that the cost of acquiring new customers is significantly greater than the cost of selling new products to existing customers.
- The importance of customer satisfaction can be interpreted as a tool in the customer retention battle. In a recent survey of US credit card customers, 44% of customers who had defected from one provider to another, did so because of poor service.
- Employee satisfaction is rated fourth, an increase from sixth place in the previous survey. This increase reflects the increasing importance that employers are placing on retaining key staff, as they now see them as a main factor contributing to market dominance. However, the results from question 3.3 suggest it is being used less than effectively.
- The importance of market share has fallen dramatically from first place in our previous survey to fifth in our current survey. This is possibly as a result of most financial services companies realising that not all customers are equal, and the profitability of different customer segments can vary enormously. The result is that overall market share ceases to be as important a performance indicator as it used to be. It will be interesting to see if return by segment gains greater emphasis in future surveys.

Organisation and people

Distribution

Distribution

Figure 4.1 - Market strategy for achieving growth



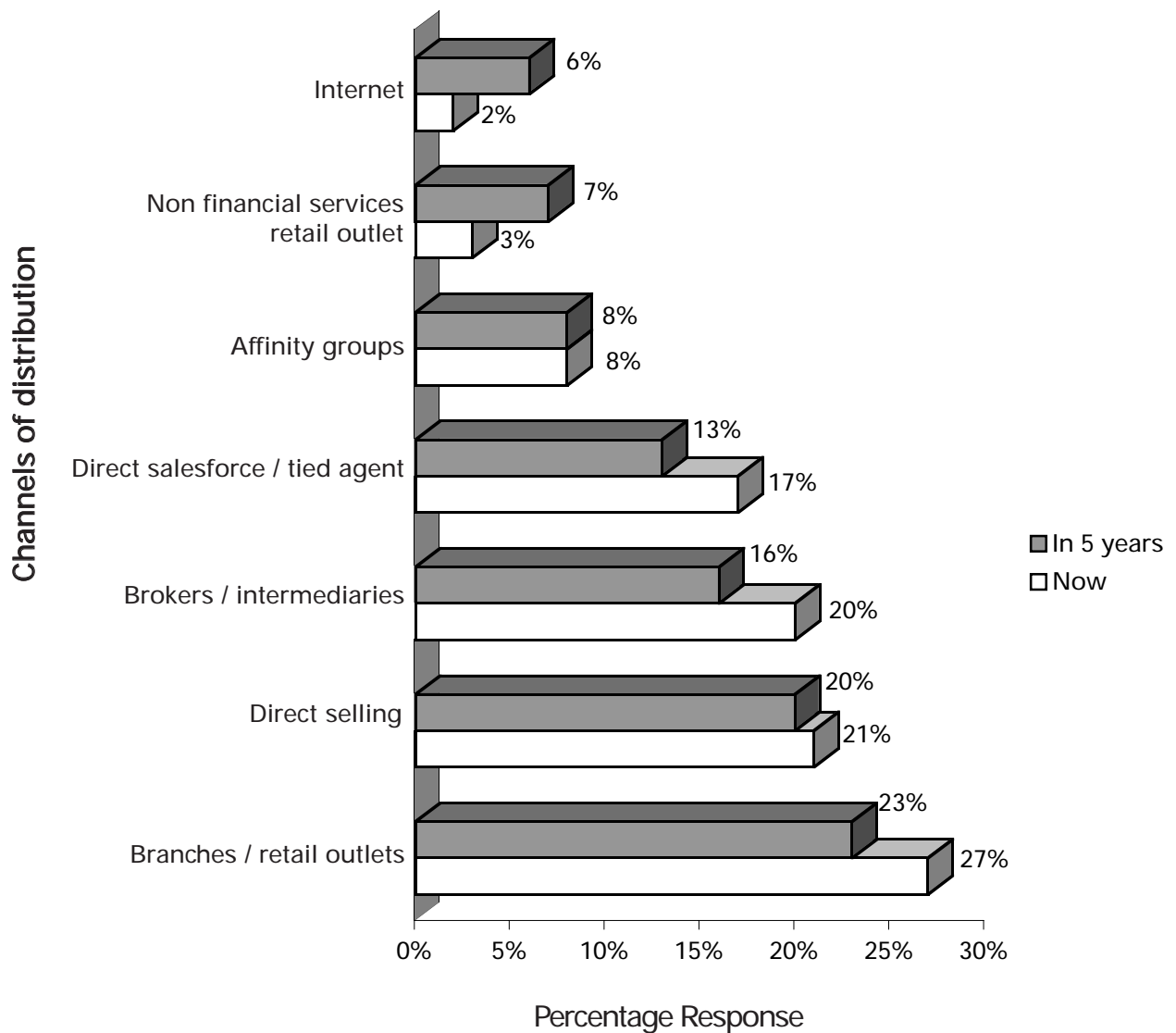
Question 4.1 What will your market strategy be in achieving growth over the next five years?

Sell more products to existing customers was the overwhelming reply to this question on growth strategy.

- The most popular response to this question, selling more products to existing customers, is consistent with the customer retention strategy outlined in question 3.5
- The importance of increasing market demand for existing products as a strategy, would suggest that financial services companies intend to increase the promotion of their product portfolios. Direct marketing companies are most likely to benefit from this move.
- It is extremely interesting to note that respondents from all sectors indicated that they plan to aggressively target competitors' customers. While the Irish market is competitive, we have yet to experience the competitor wars such as those experienced by UK mortgage lenders and US credit card lenders in recent years. While the proposed competitive strategies of the respondents will lead to further declines in industry margins, it is probable that declines in margins are inevitable given the anticipated level of new market entrants. In the short term, we believe the arrival of MBNA is likely to stir up the credit card market.

Distribution

Figure 4.2 - Main distribution channels now and in five years time (top seven)



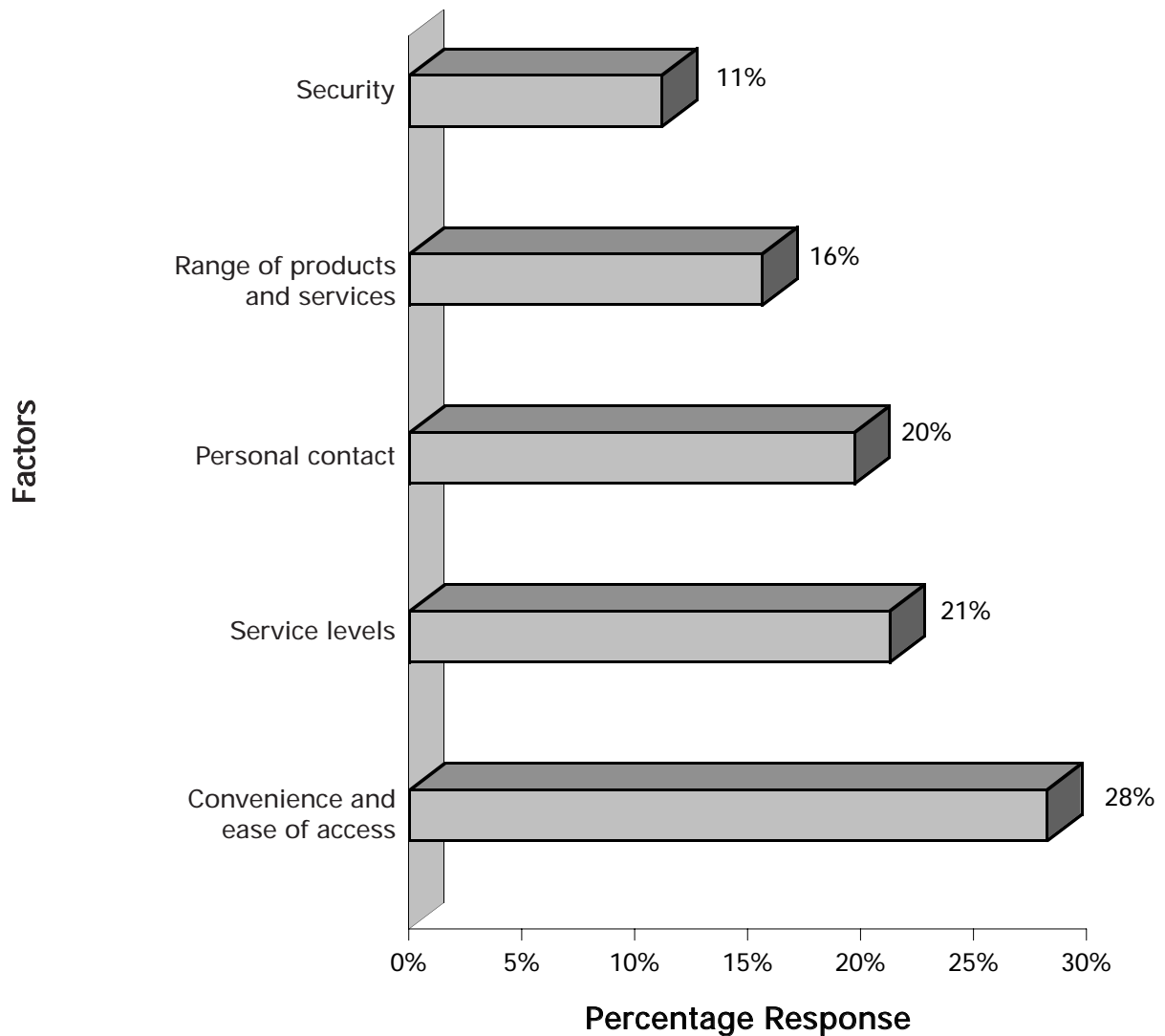
Question 4.2 What are the main distribution channels in your specific services sector and in financial services as a whole, both now and in five years time?

Branches / retail outlets, direct selling, and brokers / intermediaries are the top three distribution strategies, now and in five years time although they all drop a few percent in their share of the distribution channels, in five years time.

- The traditional channels, therefore, are expected to remain the most important channels.
- The main growth area is the Internet and non financial services retail outlets. With the increase in Internet usage, home PC ownership and shopping patterns, the Internet usage is estimated to triple, however it is not yet perceived as a threat to traditional channels.
 - As with all areas of the Internet, the US leads the way in Internet banking, both from established banks and new purely on-line banks. Wells Fargo, Bank of America and Huntingdon Bancshares lead the way in the established market. Ohio based Huntingdon will allow you to open, manage your account, pay your bills and transfer money between accounts online. The only current restriction for a non US citizen to open an account is the need for a US social security number. This, however, is not a legal restriction, just common practice among US banking institutions. Virtual banks in the US include Security First Network bank, which was set up to illustrate that the software worked. (The company's primary activity is software.)
 - Other developments in the US include the joint venture between Microsoft and First Data Corporation, a US credit card processing giant. Together they offer an easy to use electronic bill presentment and payment service, through banks, directly to consumers.
- The sectors which envisage the biggest increase in the use of Internet banking are stock brokers and financial administration. It is not surprising that stockbrokers envisage an increase in the use of Internet as many US brokers already provide an electronic trading service to their customers.
- Affinity groups were seen as being important for direct banking, moving from third place to first, in five years time, for this sector.
- Although it is difficult to estimate the speed with which the consumer will become comfortable with electronic commerce, from our observations of the market, we believe that the Internet will become an increasingly important channel. Currently, the market does not appear ready to take advantage of this change.
- The growth in new channels is driven by customer preference. In the US, between 1985 and 1992, the compound annual growth rate was 5% for ATM transactions, 15.5% for EFTPOS transactions, i.e. debit cards, and 57% for telephone banking transactions. This is an interesting illustration of the growth in demand for new channels which focus on customer convenience.

Distribution

Figure 4.3 - Top five factors consumers consider in selecting a distribution channel



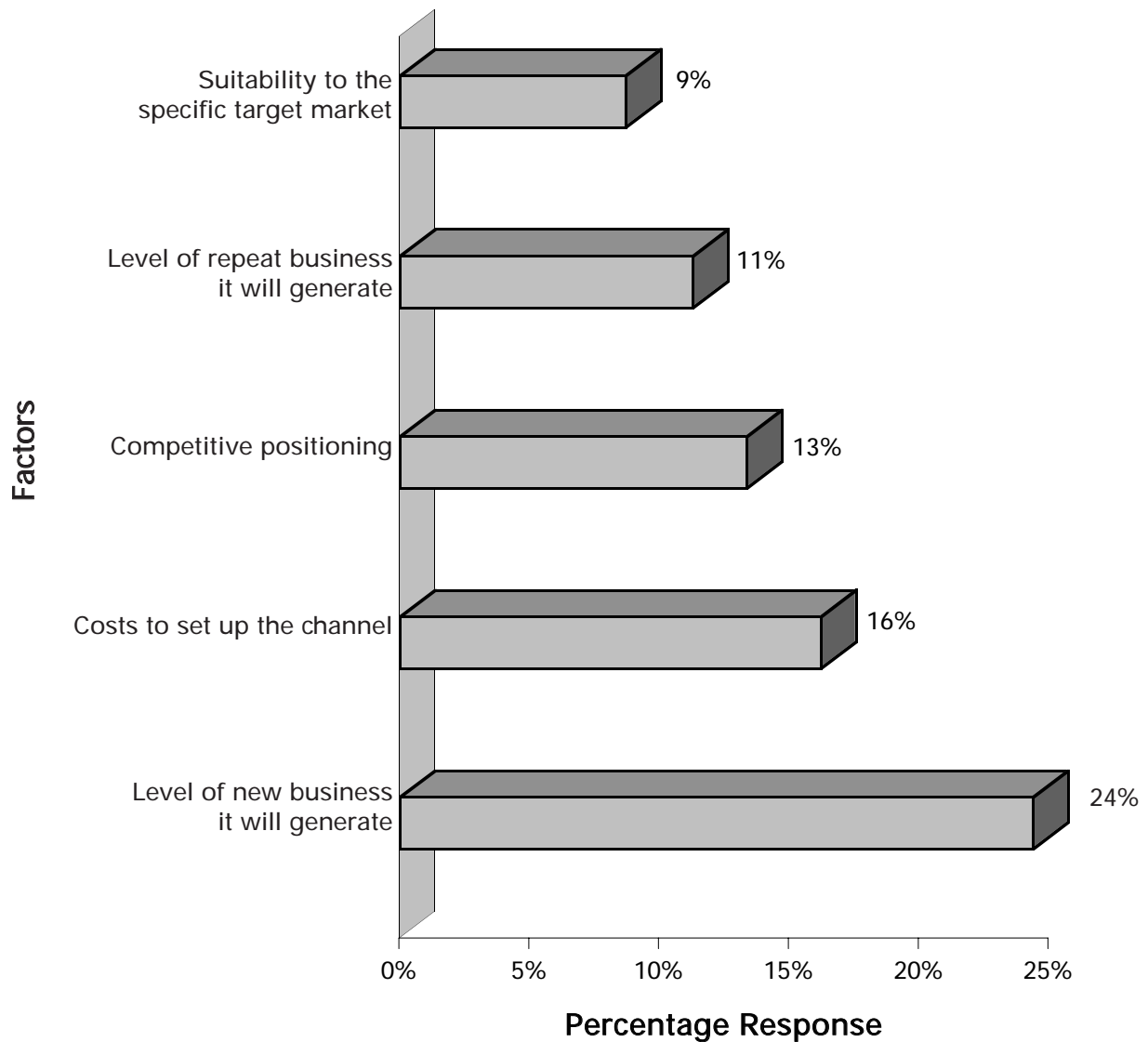
Question 4.3 What are the factors which consumers consider in selecting a channel?

Convenience and ease of access is perceived as the number one factor customers consider when selecting a channel

- The message is clear, customers will want to be able to transact business with financial services companies when it suits them. Retail banks have come a long way from the restrictive opening hours of the early 1980's. Branches are now open during lunch and later on Thursdays and Fridays. 24 hour telephone banking is increasingly popular and Internet banking is starting to emerge. It will be interesting to note if brands such as Tesco will use opening hours as a differentiating factor when entering the financial services market.
- Service levels and personal contact come second and third. Regardless of the channel, customers will demand good service. Customer expectations of service levels are getting higher and higher. Therefore, financial service providers must ensure that the overall customer relationship is not damaged as a result of poor service in one of their channels.
- Despite the proliferation of new electronic commerce channels, financial services companies still believe that they have to serve the customers' need for personal contact. This may explain the reluctance to embrace new channels such as Internet electronic commerce.
- Surprisingly, the complexity of product offering is not rated highly as a factor to be considered in choosing a channel.

Distribution

Figure 4.4 - Top five factors to consider before adding an additional channel of distribution



Question 4.4 What are the factors you consider before adding an additional distribution channel?

Level of new business it will generate, costs to set up the channel and competitive positioning are the top three factors considered when setting up a new distribution channel.

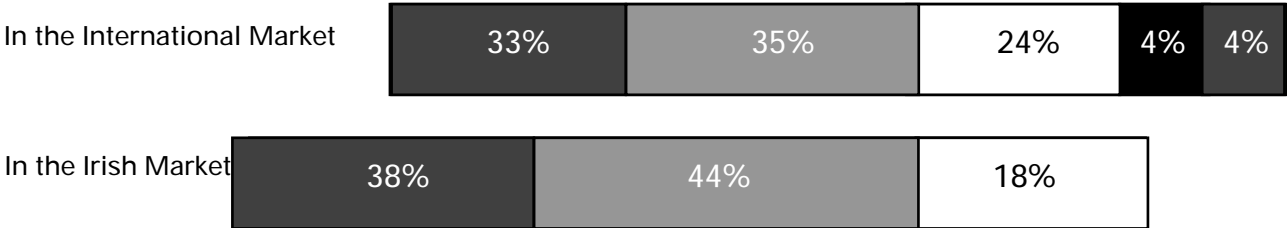
- Level of new business is the key factor considered due to the fierce competition in existing channels. Despite this, in other responses there is little interest in the Internet as a new channel even though this represents the largest untapped market available to financial services companies today.
- The high ranking of competitive positioning highlights the potential danger of "me too" strategies. Examples of this include web sites being set up just because a competitor has established one. However, a poorly designed and serviced channel can be more damaging than not having one at all.
- Suitability to the specific target market only ranks fifth, indicating that distribution strategies are not being matched with customer segments. Despite the level of importance that was attributed to customer segmentation as a performance indicator, it is not being exploited via integration with other strategies.
- "Fit with corporate image" was given a low rating, which suggests that financial services companies are increasingly likely to update their image with new channels that have proven to generate new business.
- Despite the most popular growth strategy, highlighted in 4.1, being "sell more to existing customers", the level of repeat business generated by a new channel was only ranked fourth, as a factor to be considered in adding a new distribution channel. This may indicate that new channels, such as the Internet, are seen as a new business opportunity rather than an integral part of the existing business strategy.






Distribution

Branding

Branding

Figure 5.1 - Importance of brand name to customers



-  Very important
-  Important
-  Average importance
-  Little importance
-  No importance

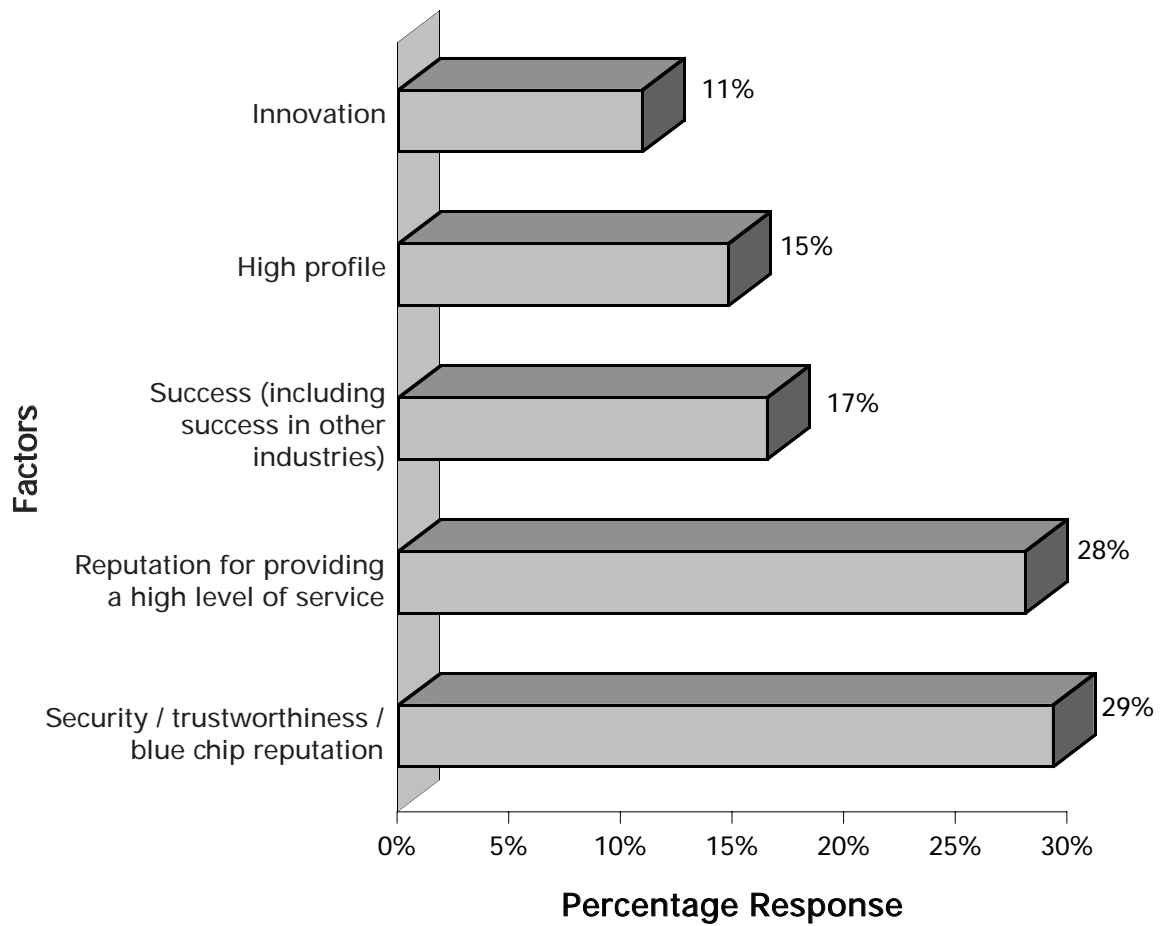
Question 5.1 How important do you think brand name is to customers?

Over one third of respondents believed that brand name is very important in the Irish market.

- On average respondents believed that brand name in Ireland was more important than in the international market.
- All respondents claimed brand name was at least of some importance.
- On the international front it is interesting to see that ABN AMRO have decided that their brand has global appeal in the investment banking business. While local market brands such as Riada are being absorbed into the overall brand, other international brands, within the group, will still be kept on, e.g. ABN AMRO Rothschild and Hoare Govett Corporate Finance.

Branding

Figure 5.2 - Top five qualities consumers look for in a brand name



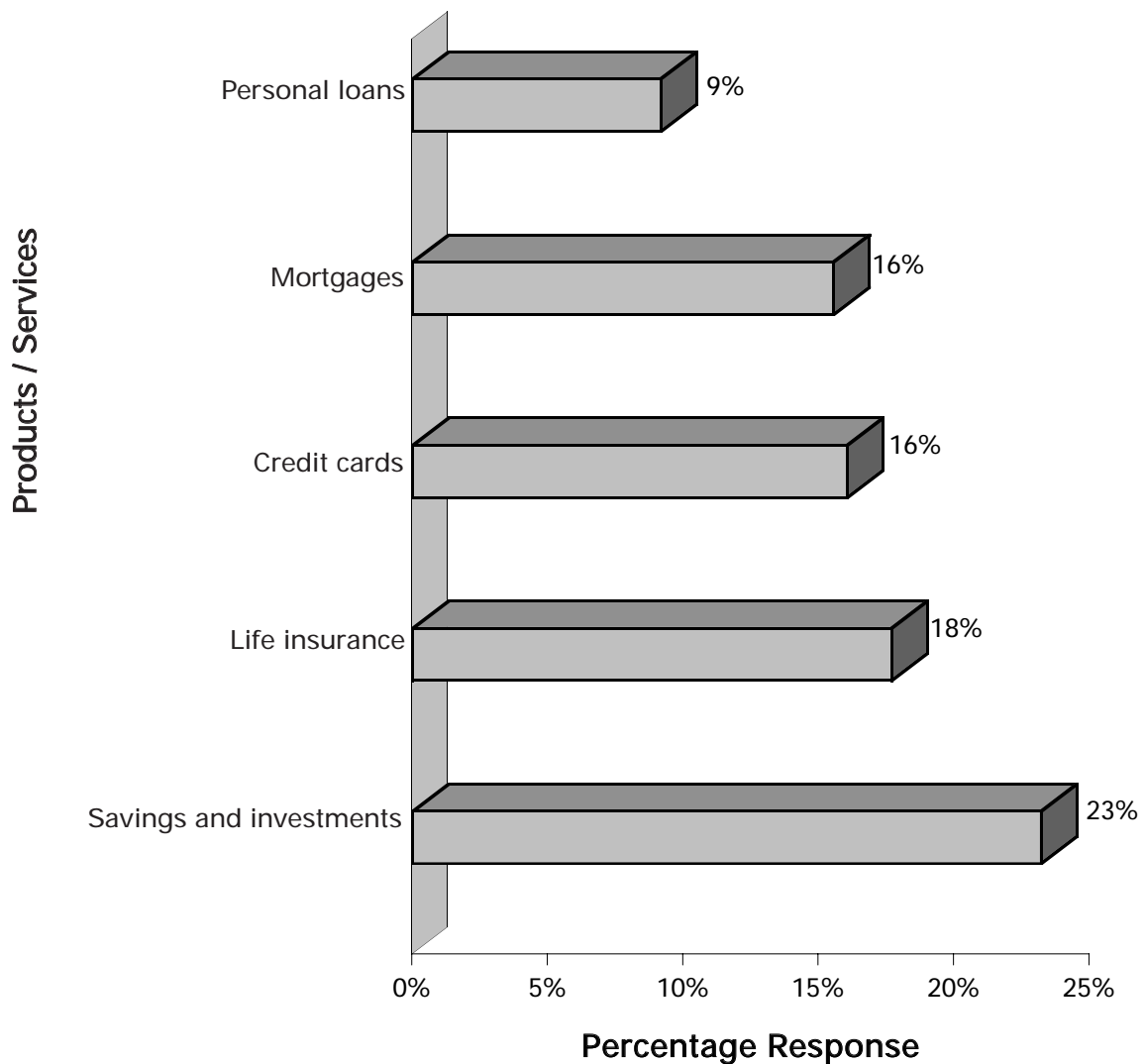
Question 5.2 What qualities do consumers look for in a brand name?

Not surprisingly, security / trustworthiness / blue chip reputation and reputation for providing a high level of service were considered the top qualities a consumer looks for in a brand name.

- The importance of security / trustworthiness in a brand name may explain the reluctance of larger established brands to be innovative in developing new products, services and channels. New entrants are more likely to be innovative as they do not have an established brand name to damage.
- The results to this question tend to reflect the traditional view of financial services.
- The proven success in transferring brand name from other sectors into financial services has led to a diverse range of new players in the UK market. They include companies such as Tesco, Shell, BT and BMW. More recently British Airways announced its aim "to become as successful in the global financial services market as we are in world travel". BA as a brand will be able to cherry pick by targeting its niche upmarket customer base. Similarly, Boots, the high street chemist, is moving into the travel and health insurance market in the UK, with off-the-shelf products aimed specifically at women and families. Royal Sun Alliance is taking on the risk, providing an underwriting and claims service on behalf of Boots.

Branding

Figure 5.3 - Top five products / services likely to be dominated by strong brand names



Question 5.3 Which products / services are likely to be dominated by strong brand names in the next five years?

Branding

Savings and investments, life insurance, mortgages and credit cards were identified as target products and services for strong brand names.

- Savings and Investments were the clear leaders with an average of 23% of responses indicating that they would be dominated by strong brand name. This represents high volume, low risk and is an attractive entry market.
- There has already been considerable market penetration in the area of personal loans by brand names such as Marks and Spencer.
- The success of MBNA in the US would suggest that brand in the credit card market is not as important to customers as respondents have suggested. Similarly with mortgages in the UK, while the market is dominated by big players such as the Halifax, there are a large number of successful niche product providers. These providers tend to be centralised lenders who use the capital markets to fund the mortgages.

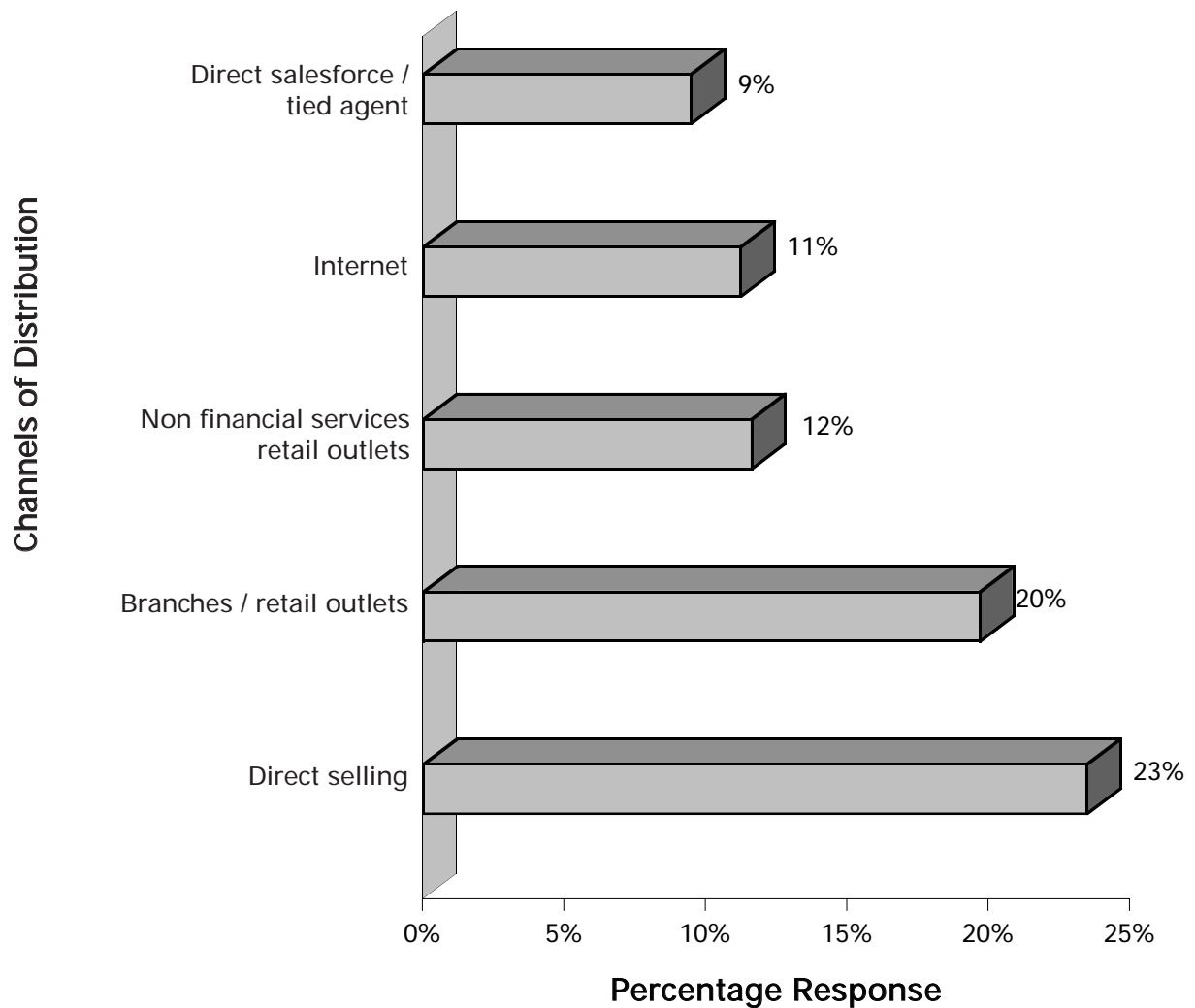
The table below is an illustrative list of the type of products available from the non traditional financial services providers in the UK.

Type of product	Provider		
	Tesco	Virgin	Marks & Spencer
Credit cards	✓	*	
Charge card	✓		✓
Savings accounts	✓	*	✓
Loan products	✓	*	
Insurance	✓		
Life assurance			✓
Pensions			✓
Mortgage	Planned	*	
PEPS		✓	✓

- * Incorporated into the Virgin One account, which offers one account for mortgage, credit card, personal loans, current account, overdraft and deposit account transactions.

Branding

Figure 5.4 - Top five channels most likely to be dominated by strong branded distributors



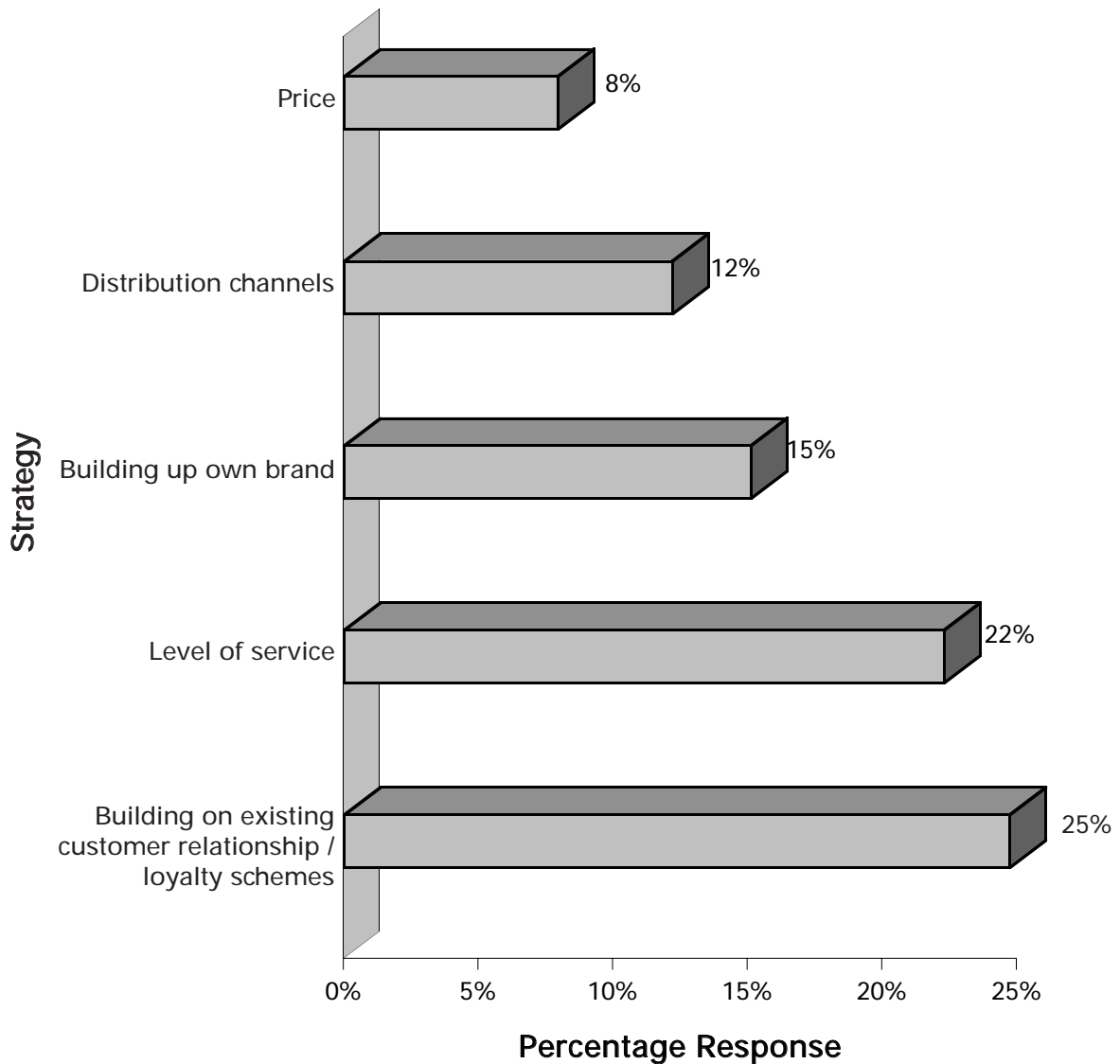
Question 5.4 Which of the following channels are most likely to be dominated by strongly branded distributors in the next five years?

Direct selling and branches / retail outlets are anticipated to be the two main distribution channels dominated by strong brand names.

- Retail outlets are currently used by a number of supermarkets in the UK such as Marks and Spencer. While Marks and Spencer do not have a substantial retail network in Ireland, new entrants such as Tesco are well poised to enter the financial services market.
- Non financial services retail outlets may be a determining factor for strong brand names in gaining market share, mainly because they are likely to serve the customer needs by providing services outside the normal banking hours.
- Internet was ranked fourth which was higher than the overall anticipated use of the Internet for financial services. This suggests that the industry believes consumers may feel more comfortable with strong established brands on a new distribution channel. It is easier for non traditional entrants to offer new channels as they have less risk of alienating their existing customer base. The traditional banks' move toward customer focus appears to be linked with personal contact, whereas the younger customer base targeted by the non traditional entrants are more disposed to non personal channels which offer speed and convenience.

Branding

Figure 5.5 - Top five strategies for competing against new entrants with strong brand names



Question 5.5 What is your strategy in competing against new entrants with strong brand names?

Building on existing customer relationships / loyalty schemes and level of service are the main defence strategies against brand names.

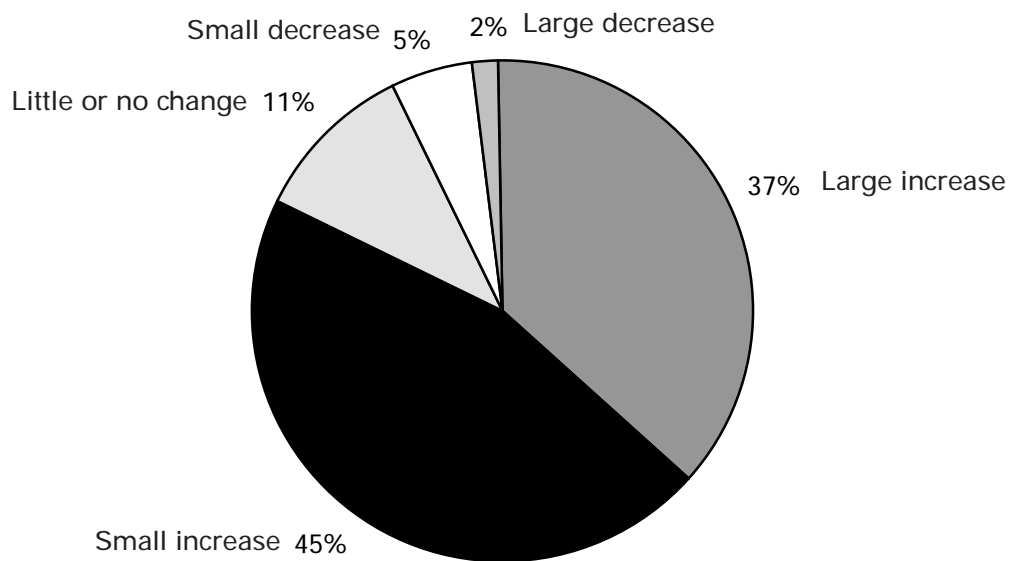
- Interestingly, loyalty schemes were first introduced by non traditional financial services companies such as Tesco. Their already established expertise in analysing and segmenting customer information means that they will get first crack, from a marketing perspective, at the consumer loyalty schemes. This may reduce the impact of traditional players' customer loyalty schemes. Financial services companies must be prepared to look at the overall profitability of a customer in order to successfully implement loyalty schemes through relationship pricing.
- Level of service to the customer again rates highly and is an indication of the customer focus strategies being adopted by the industry.
- Building up of own brand was ranked third. This strategy needs to be proactive rather than reactive to be effective, i.e. promoting and reinforcing brand name prior to new entrants targeting the market. The recent revelations about National Irish Bank will probably have a knock on effect on the brands of all of the existing retail financial services providers. In light of these recent events, being proactive about building brand has taken on even greater significance.

Branding

Internationalisation

Internationalisation

Figure 6.1 - Increase in new entrants post-EMU



Question 6.1 What do you predict will be the increase in new entrants to the financial services sector post-EMU?

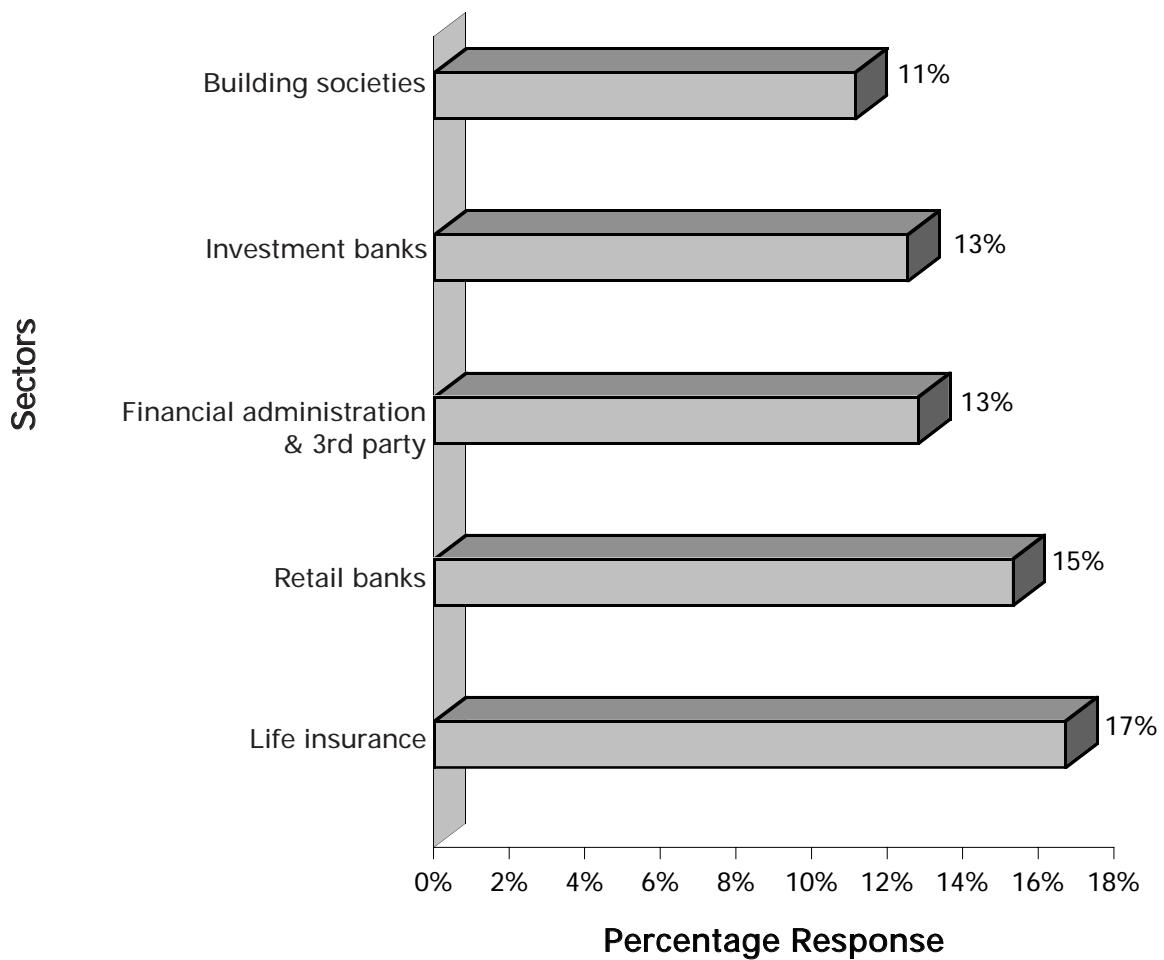
Internationalisation

37% of respondents predict a large increase and 45% predict a small increase in new entrants.

- Despite the overwhelming opinion that EMU will lead to an increase in competition in Ireland, responses to previous questions suggest that Irish companies do not anticipate moving into foreign markets. The view of EMU only as a threat and the lack of interest in electronic distribution strategies, suggests that Irish financial services companies, while expecting an increase in competitors post EMU, do not have a strategy to take advantage of the change in the market.
- It will be interesting to see if the increased competition comes from US firms, who may use Ireland as a springboard for their activities in Europe. New entrants from the US are likely to be product specific.
- The Irish retail banking sector will be especially attractive for potential new entrants due to the high ROE it currently enjoys compared to the rest of Europe, (excluding the UK).

Internationalisation

Figure 6.2 - Top five sectors expecting an increase in new competitors



Question 6.2 In which sectors, if any, do you expect an increase in new competitors?

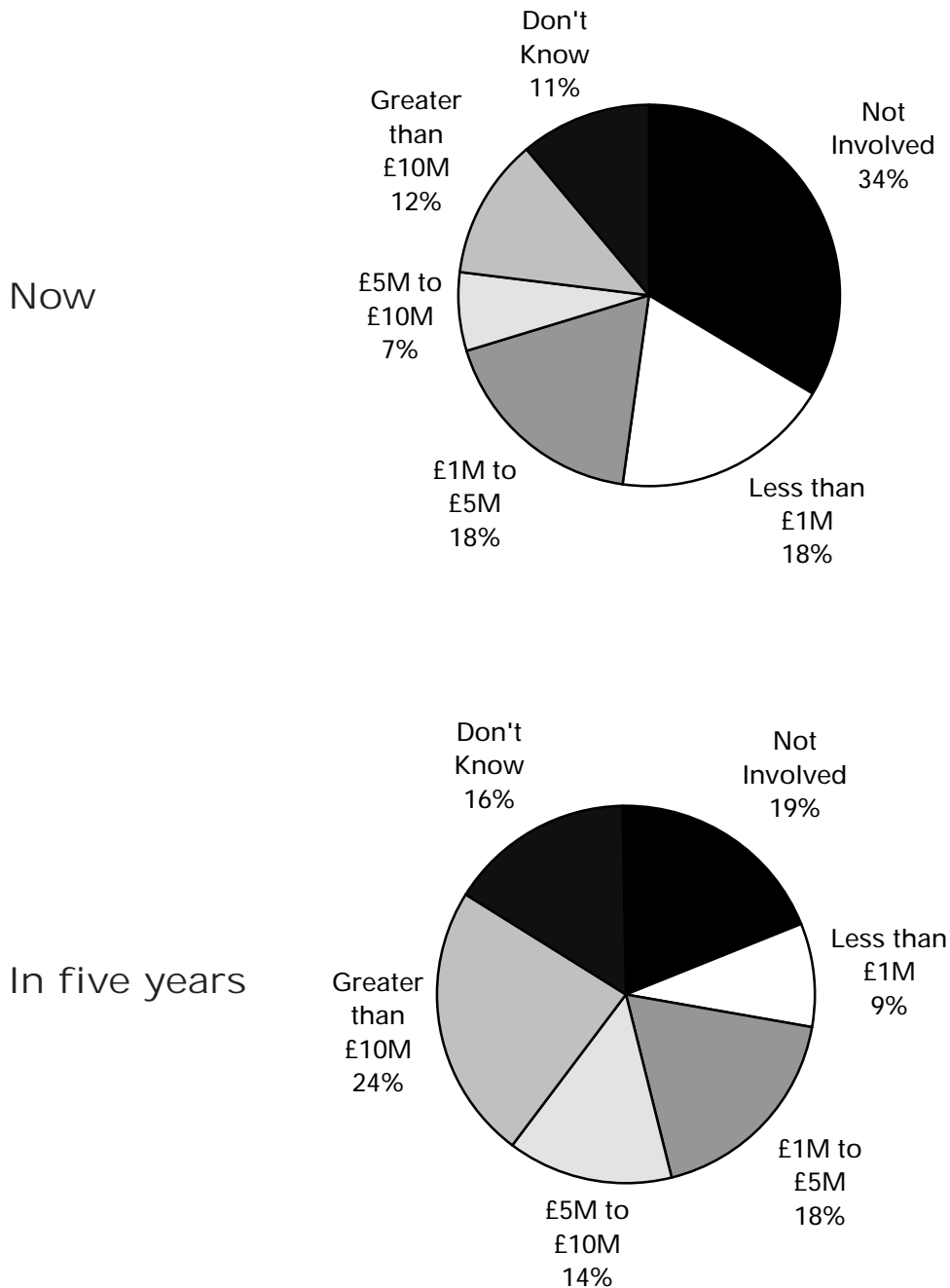
Internationalisation

Life insurance companies and retail banks are considered to be under the greatest threat from post EMU competition.

- Pensions is the key growth market throughout Europe, driven by tax incentives, greater awareness of the need to provide for retirement and competitive investment returns. The new entrants to the life insurance market are likely to be through mergers and acquisitions, via electronic distribution channels and possibly through supply to private label distributors.
- Retail banks see themselves as being the full service provider to consumers. This trend is not confined to retail banks. For example, the pending demutualisation of First National is being driven by the desire to offer more products. This trend provides further opportunity for niche single product providers.
- Increase in competition in the credit unions and stockbroking markets was perceived as minimal.

Internationalisation

Figure 6.3 - Level of exports now and in 5 years time



Question 6.3 What level of export of financial services is your company involved in and how do you expect that to change in the future?

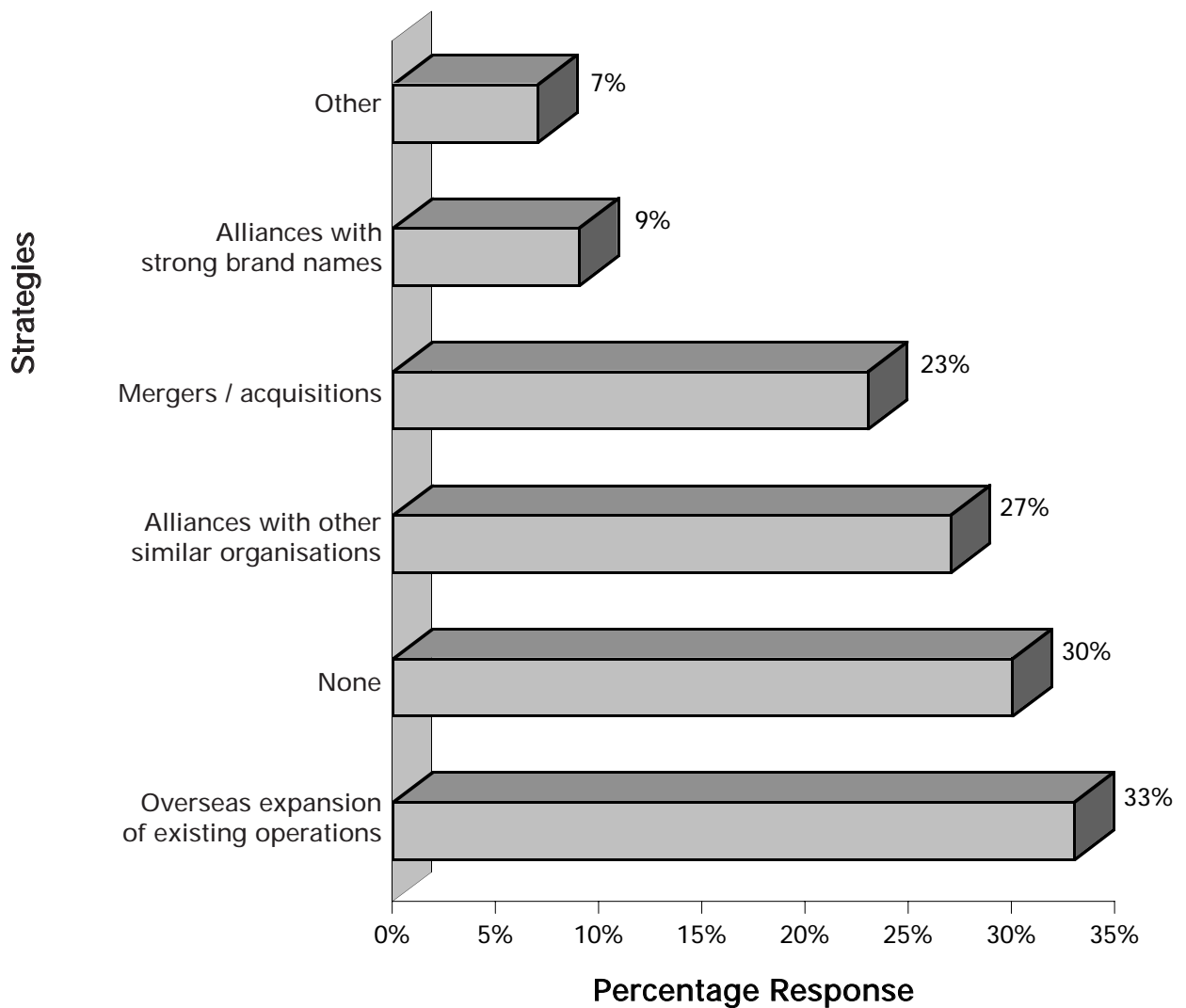
Internationalisation

The overall trend appears to be an increase in the level of exports, particularly at the larger end of the market.

- The statement that companies expect to increase exports is not supported by any evidence of an international expansion strategy. The previous responses suggest more of a defensive strategy to EMU.
- Although brand name is considered important in Ireland, it appears that Irish companies foresee a problem transporting Irish brand names into the European market

Internationalisation

Figure 6.4 - Growth strategy outside the domestic market



Question 6.4 What is your growth strategy outside the domestic market?

Internationalisation

One third of respondents said they planned to expand outside the domestic market by expanding existing overseas operations.

- A number of companies indicated a multi-strand approach, selecting several strategies.
- 9% of companies indicated that alliances with strong brand names were being considered as possible methods of expansion into Europe.
- Growth strategies outside the domestic market were least popular with the retail banks and non life insurance companies. This is understandable due to the lower ROE experienced by retail banks in the rest of Europe and because most non life insurance companies operating in Ireland are subsidiaries / branches of multinational insurance companies, with the main exception of Hibernian.

Internationalisation

Appendix

- List of companies which responded

Appendix

Appendix -: List of companies which responded

ACC Bank	Guardian Insurance
AGF Irish Life Holdings	Guardian Life
AIB	Hibernian Group
AIB Capital Markets	ICC
AIB Investment Managers	ICS Building Society
An Post	Irish Permanent Plc
Anglo Irish Bankcorp	L&P Financial Trustees of Ireland
Ark Life Assurance	NCB Stockbrokers
Bank of Ireland	Northern Bank
Caradas Ireland	Norwich Union Building Society
Celtex Futures Ltd	Premier banking
Cornhill Insurance	Progressive Building Society
Coyle Hamilton	Riada Stockbrokers
Eagle Star Insurance	Royal Sun Alliance
Eureko Ireland Holdings	Scottish Amicable
FBD Holdings	Sedgwick Dineen
FBD Insurance	Standard Life Assurance Company
Fexco	TSB
First National Building Society	Ulster Bank
First Trust	Ulster Bank Markets
Friends Provident Financial Services	VHI
Goodbody Stockbrokers	Woodchester Investment Broker