Do We need a Bad Bank?
The Interplay of Cultural Intelligence and IT Project Management in IT Offshore Outsourcing
Hot or Not?
Usage of Web 2.0 Applications by Retail Banking Customers
Changing Role of Chief Financial Officers in the Current Crisis
The pressure to create a bad bank becomes stronger every day. For many bankers, a government sponsored bad bank seems to be the ultimate solution to the crisis. After selling (at book value) the loss making “toxic” securities to the bad bank, the selling bank would be relieved from further losses stemming from these assets and it is thus expected that both credit worthiness and share prices of banks could resume to pre-crisis levels. The transaction also prevents – to some extent – the stigma of using public support as there is no obligation to publicly disclose transactions with the bad bank. It is not surprising that even sound banks find this solution attractive as it promises public subsidies to every bank with toxic securities – and that is virtually every bank.

Unfortunately, government has good reasons not to follow these arguments:

- The capital market does not know the amount of toxic securities on a bank’s balance sheet – neither before nor after selling the securities to the bad bank. Thus intransparency and distrust in the capital markets would remain.
- Scarce public money is not used where it is most urgently needed: on those banks that would collapse without help and that may cause systemic risks.
- Government does not have the necessary organizational capabilities to refinance, manage and hedge a complex portfolio of structured credit products held by the bad bank.

Banks would receive cash or government securities in return, but they do not get what they need most urgently: equity capital.

The federal finance ministry is currently working on a revised scheme called “bad bank light”, where the state takes over future losses from toxic securities and in return receives a share of future profits over the next 40 to 50 years ("Ausgleichsforderung"). Nice idea, but it can be easily improved by changing the terms slightly. Why not increase the maturity from 40 or 50 years to infinity? In this case the "Ausgleichsforderung" becomes a capital increase and gives banks what they need most urgently: a strong capital base. This solution could become the silver bullet to resolve the crisis: Government takes over (a large fraction of) the downside risk from "toxic" securities portfolios and is paid for this by new equity. The fair price of a guarantee could be determined in market auctions and government should improve the auction price in a transparent way in order to provide real support to the banks. The auction could work as follows: First a bank specifies a “toxic” securities portfolio and the type and level of protection it desires. In a next step, market participants like large international banks and private equity houses are asked to submit binding bids for selling a fraction of the desired protection. The protection seeking bank would then select the best bids and acquires e.g. 20% of the protection from the bidding group. The remaining 80% of protection would be provided by government in return for new shares whose value should be (100-X)% of the auction value of its own protection stake. X denotes the price improvement provided by government and might be set to 50%.

This scheme strengthens the banks by curbing out the toxic risks and at the same time by improving their deteriorated capital position – and it does not violate one basic principle of government subsidies: if taxpayers’ money is spent for saving banks, this should not happen behind curtains but needs to be made transparent to the public.
Research Report

The Interplay of Cultural Intelligence and IT Project Management in IT Offshore Outsourcing

HOW A ‘NEGOTIATED CULTURE’ EMERGED IN THE CASE OF A CORE BANKING SYSTEM REENGINEERING PROJECT WITH INDIA

Robert Gregory
Roman Beck
Michael Prifling

Is the World Really Flat?
In a recently published international bestseller, Thomas Friedman suggested the world is ‘flat’ in the sense that globalization has leveled the competitive playing fields between industrial and emerging countries (Friedman 2005). One of the mentioned ‘flatteners’ is IT offshoring outsourcing, the sourcing of IT-related products and services from low cost countries such as India. At first sight it seems as if the world became really ‘flat’ and distance (e.g., geographic, temporal, historical, political, cultural, language) does no longer matter. However, in reality firms are having a hard time when it comes to IT offshoring due to various obstacles. Empirical research in this area has emphasized on the critical success factors such as coping with differences in culture or social behavior (Dibbern et al. 2008). The question is, how managers can reduce these “extra costs” and manage the risks of client-vendor distance, and a less developed physical work environment. On the other hand, it was critical for the vendor staff to understand the client’s business and functional environment. What at first hand does not seem to be important for cultural adaptation, proved to be critically for the success in our case analysis in a way that project members learned to tease out their interaction partner’s culture-specific and non-cultural aspects of behavior. Besides cognitive understanding, the motivation for cross-cultural interaction was crucial. For example, in our case study the perceived non-fulfillment of expectations hampered the motivation of both client and vendor personnel to collaborate effectively. Client staff expected a higher level of service quality in the beginning while vendor staff expected a more open attitude of their German colleagues towards the sharing of critical functional and business knowledge. Over time, client and vendor staff learned about each other and developed a

The Emergence of ‘Negotiated Culture’
For IT offshore project members with diverse socio-cultural backgrounds to interact effectively with each other, a cognitive understanding of the other person’s behavior is needed. Apart from understanding the social and cultural background of the interaction partner (also called ‘subjective’ culture), the individual must also be able to carefully and delicately elicit the objective cultural elements of behavior. Culture is thereby defined as having subjective (rules, norms, roles, and values) and objective components (legal, economic, political, religious, and educational systems) (Ang and Inkpen 2008). For example, in our case study client project members needed to learn about the economic environment in India, mainly characterized by higher staff turnover rates than in Germany, a different approach to career development, and knowledge management, expressing itself in more frequent job rotations within the company.

Since 2007 we have been analyzing a large-scale IT project where a core banking system of a European bank had to be reengineered together with a contracted IT vendor from India. For a first version of the case study, please refer to (Beck, Gregory & Prifling 2008). Meanwhile we have conducted 30 additional interviews both in Germany and in India. In total, we have conducted 46 qualitative expert interviews including additional field observations in India at the end of November 2008.

Adapted Behavior for Cross-Cultural Interaction

Cognitive Dimension
- subjective cultural understanding
- objective cultural understanding

Motivational Dimension
- personal goals
- curiosity
- fulfillment of expectations
- self-efficacy

Figure 1: Cultural Intelligence and Negotiated Culture
The interplay between cultural intelligence and IT project management, indicating that IT project managers can positively influence the emergence of negotiated culture and a shared understanding. In particular, the adapted use of formal project management techniques was driven by the cultural intelligence of the responsible project managers by stimulating the development of new ideas for offshore-specific techniques and methods. One example is the so-called ‘replay sessions’ where vendor project members were asked to present what they had understood on a given subject after a knowledge transfer session had been carried out previously by client members. On the other hand, informal project management and team building techniques, i.e. cross-cultural training, project manager coaching, and client-vendor project manager interaction, stimulated the accumulation of cultural intelligence by individual project members. Hence, cultural intelligence and project management reinforced each other. In this way a cycle of continuous improvement and learning was created to overcome the problems of cultural distance between client and vendor. More than just a single-loop learning process, the analysis also shows that joint reflection was important, both in interpersonal meetings as well as during cross-cultural workshops and site visits in the home country of the foreign partner. Hence, joint reflection helped to stimulate a double-loop learning process where problems due to socio-cultural differences are continuously tackled and overcome, both by the means of individual adaptation as well as offshore-adapted use of IT project management techniques. In doing so, “hidden costs” in offshore IT projects can be reduced or avoided to fully benefit from a “flattened”, global market.

**References**


Research Report

Hot or Not? Usage of Web 2.0 Applications by Retail Banking Customers

The term Web 2.0, coined for a variety of recent web applications, resounds throughout the land and fires online marketers’ imagination in many industries. We examine empirically how far those applications are used by retail banking customers and which role they play in the retail customers’ purchase process.

Christian M. Messerschmidt
Bernd Skiera
Sven C. Berger

Introduction

Promising something new and innovative, the term Web 2.0 arrived in mass media as well as literature, replacing the ‘old Internet’. A vast array of (sometimes contradictory) definitions has been published, but there is an emerging consensus that user-driven and interactive applications with a certain degree of social functions, such as online communities, weblogs, and review websites, qualify as web 2.0 applications. In contrast, ‘traditional’ web applications and the ‘old Internet’, which have arrived in the financial services markets a long time ago, are primarily applicable for passively retrieving and consuming information.

With web 2.0 applications, beyond mere retrieval of product offers, consumers perform more complex steps when using the Internet as part of their financial service purchase process – facing the financial service providers’ need for individual and customer-centric, yet cost-efficient, solutions. In terms of Web 2.0, there might be something in for both sides of the counter.

We examine whether, when and which consumers use typical web 2.0 applications for online buying of financial products. Our results indicate that many web 2.0 applications fulfill information purposes and therefore find primary use in the pre-purchase stage. The online activity and the financial knowledge of the consumers are identified as the main influencing factors on the usage of web 2.0 applications.

We distinguish online communities into those with a general interest and those with a special interest community where the consumer can learn how to trade with stocks or how to optimize his trading behavior. The stocks used at Tradingbird.com are connected to real market incidents but they only exist virtually. Another very interesting online community in the financial sector is Wesabe.com, which is a money management tool on the one hand and a community on the other hand. The intention is to form a collective intelligence in money management where all members can benefit from.

Virtual sales assistance covers the communication via chat/instant messenger or voice-over-IP. During complex online transactions the consumer favors to have real time contact to an advisor, other applications cannot provide these features sufficiently.
Audio- and videopodcasts are verbal or visual contents to which the user can subscribe to and consume them on personal computers or mobile devices like portable mp3-video-players. Scottrade, an American discount brokerage firm, uses videopodcasts to train its customers in the handling of their online banking and -trading tools. Audiopodcasts with latest market news are provided twice a day on the website of Financial Times Deutschland. Experts’ comments on latest market developments via videopodcast are available on the worldwide web presence of the Financial Times.

Widgets are small windows which can be implemented on websites, on the pc desktop (windows vista sidebar) or even in a user’s protected personal area of his online community account. Widgets display userselected content from other websites which will be constantly and automatically updated with the origin. The functionality ranges from newsfeeds (for example latest market news of the Wall Street Journal Online) to more complex services like bank account management. With the mymoney widget, which is supported by a variety of financial institutions in the United States, a Facebook user can manage his bank accounts without leaving Facebook.com.

Status Quo: Consumer Usage

We collected data in 2008 from over 1,500 German online users to analyze the current use of web 2.0 applications for online buying of financial products (response rate: 26%). Figure 1 shows the results for each application in the three stages of the buying process of financial products. In the pre-purchase stage review websites and wikis are the applications that are used most often. About 20% of the respondents gather information via these applications. At least 12% of the consumers cover their information needs by participating in online communities or reading and interacting in weblogs.

Widgets, audio-video-podcasts and virtual sales assistance do not reach more than 10% of the respondents by now.

The usage of all applications for executing a product purchase is rather small and is rarely above the 5% hurdle. Reasons for that outcome may be a lack of trust in security and privacy of transferred information (during a transaction on these platforms) or the habit to buy financial products via the financial service provider’s own website or even by visiting brick-and-mortar branches.

In the post-purchase stage, only review websites are used by more than 10% of the respondents. After buying a financial product the consumer now returns to the review website to post his personal experiences with it. Only few other applications reach more than 5% of usage in this stage.

In summary, we found that in the pre-purchase stage only two applications are used by more than 20% of the respondents, review websites and wikis. There are two potential interpretations for these results: (1) consumers are just not interested in using web 2.0 applications for financial products by now or (2) they cannot use them because of scarce offerings of German financial service providers. Due to our prior research we consider scarce offerings as the most likely explanation for the low usage.

Characteristics of Financial Web 2.0 Application Users

To characterize the consumers that are using web 2.0 applications for online buying of financial products we analyze which factors influence the consumers’ usage behavior in the three purchase process stages.

Regarding the demographics we analyze income, the degree of education, and the age of the consumers. The online behavior consists of activity (the time the consumer spends online), experience (5-point scale ranging from novice to expert), general online buying behavior (how often the consumer buys products online) and the online buying behavior concerning financial products (has the consumer ever bought a financial product online?). Additionally, we take the financial knowledge into account, which measures in how far a consumer feels familiar with financial topics.

Table 1 displays the results separated in the influence factors, the web 2.0 applications, and the three purchase process stages.

The analysis identifies online activity and financial knowledge as the main factors that influence...
the consumers’ usage of web 2.0 applications. Regarding these two factors we observe a pattern in table 1. Whereas the financial knowledge primarily influences the usage of the applications on the left hand side (review websites and wikis) the consumers with a distinct online activity are primarily using the applications on the right hand side (especially online communities, weblogs, widgets, and virtual sales assistance).

The online buying behavior in general as well as concerning financial products also shows a strong influence especially on the usage of review websites and wikis. Online experience plays a very limited role.

Among the demographic factors, income and education significantly influence usage. A higher income drives the transactions via review websites and wikis in the purchase stage. In the pre-purchase stage widgets and virtual sales assistance are often chosen by consumers with a higher income. In a few cases the factor education shows a significantly negative impact. A lower education leads to a higher usage of review websites, wikis, weblogs, and virtual sales assistance in the post-purchase stage. An explanation for that rather surprising outcome may be that lower educated consumers need more customer support which they primarily obtain via these web 2.0 applications.

Conclusion

Web 2.0 retail banking applications can support consumers when they are about to gather information and interact with other consumers who already made experiences with specific financial products.

We learn from our empirical study that German retail banking customers are mostly using such applications in the pre-purchase stage. Only a few established applications like review websites and wikis show distinct usage within the purchase process. The consumers who currently use the applications are those who feel familiar with financial topics or spend a lot of time online anyway.

Despite the low current usage, we observe examples in foreign countries we described in the beginning of this study where web 2.0 applications are successfully introduced and adopted by the consumer (for example the financial community Wesabe.com), allowing the conclusion, that in the future Web 2.0 will play a considerable role for German online customers in financial services particularly in the pre-purchase stage.

<table>
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<tr>
<th>Application</th>
<th>Review Websites</th>
<th>Wikis</th>
<th>Online Communities</th>
<th>Weblogs</th>
<th>Videopodcasts</th>
<th>Widgets</th>
<th>Virtual Sales Assistance</th>
<th>Audiopodcasts</th>
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<tbody>
<tr>
<td>Financial Purchase Process Stage</td>
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<td>P2</td>
<td>P3</td>
<td>P1</td>
<td>P2</td>
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<td>Demographic Factors</td>
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<td>Online Behavior Factors</td>
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<td>Financial Buying Behavior</td>
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Table 1: Analysis of Influence Factors on the Usage of Web 2.0 Applications in the Financial Purchase Process.
What are the key implications for the CFOs in the current crisis managing the company?
Within the context of the current crisis the CFO plays a critical role in managing the company through rising challenges: Some experts expect several quarters of negative earnings after a unprecedented boom within the last 5 years, volatilities of key profit drivers like commodities, FX or interest rates are expected to be much higher than in the past, demand in many business models is expected to further shrink and last but not least funding/refinancing sources will be scarcer and more expensive. In short: CFOs are really in the eye of the current storm!

Which concrete levers should CFOs pull in the current environment?
Key is to have a clear contingency plan in place, based on different scenarios, what could happen within the next 24 month. Given that the average performance of companies in 2007/2008 in terms of profits and return on capital was much higher than at any time in the past 40 years, cash flow and liquidity projections that really taking into account, how bad things could get, are from utmost importance. This extreme crisis planning exercise should throw out the traditional planning mode and should strictly focus on free cash flows and liquidity needs, actually broken down on a daily, weekly and monthly basis. These scenarios should take into account different macroeconomic scenarios plus company specific risks. Based on that the CFO should be the driving force in developing a contingency plan (see exhibit) in the event, that these scenarios should actually come to pass.

What are the key success factors in developing such a contingency plan?
In the best-run contingency planning efforts, the CFO manages the work in a centralized approach, assembling a cross-functional taskforce that includes managers from production, distribution/sales and supply chain. They assess not only the cash and liquidity needs on a daily, weekly and monthly basis, but also all levers to create short-term liquidity. These levers include a short-term working capital optimization program, a capital expenditure (CAPEX) streamlining program and a short-term cost-hunt program. For example, by optimizing working capital by billing earlier, enforcing payment terms, reducing safely stocks, and improving production planning, additional one-off cash can be generated, which is in some cases higher than the current annual operational cash flows. In addition, reevaluation of the portfolio and extracting value from suppliers should be part of that a contingency plan.

Thank you for this interesting conversation.
Infopool

News

Awards
Effective Jan. 1st, 2009, Prof. Dr. Andreas Hackethal (co-chair of cluster 4 of the E-Finance Lab) was appointed as member of the Expert Advisory Committee of the German Federal Financial Supervisory Authority (BaFin). This 24 persons institute comprising representatives from sciences, credit business and insurances as well as consumer protection associations and the Bundesbank supports the BaFin concerning its tasks and its further development of supervisory policy. Congratulations!

Robert Gregory, Roman Beck, and Michael Prifling (cluster 1) have received a Best Paper Award at the 42nd Hawaii International Conference on System Sciences with their paper “Breaching the Knowledge Transfer Blockade in IT Offshore Outsourcing Projects – A Case from the Financial Services Industry”. Congratulations!

Björn Imbierowicz (cluster 4) was awarded an outstanding paper award in empirical finance at the Southern Finance Association annual meeting 2008, for his paper “How efficient are Credit Default Swap Markets? An empirical Analysis of Capital Structure Arbitrage based on Structural Pricing Models”, joint work with Balázs Cserna. Congratulations!

Research assistant Katharina Vogt (cluster 1) was granted a month-long research fellowship at Baylor University’s Hankamer School of Business. During her stay in March 2009 Katharina will work with Prof. Dorothy Leidner to bring forward her research regarding IS nearshore outsourcing projects in the financial services industry.

Team Members
Since 01.01.2009, Dipl.-Kfm. Bernd Mack from Deutsche Börse Group is supporting the team of cluster 5 as a research assistant in the cooperative Ph.D. program. In his research, he will focus on the impact of technology-enabled advances in derivatives trading and clearing.

Since 01.01.2009, Dipl.-Kfm. Sebastian Müller joined the team of cluster 4. He is a first year Ph.D. student of the graduate program “Finance and Monetary Economics” and has recently finished his diploma thesis on the effects of owner-occupied housing on the portfolio composition of households.


Selected E-Finance Lab publications


For a comprehensive list of all E-Finance Lab publications see: http://www.efinancelab.com/publications
In retail banking and financial services customer base analysis is receiving more and more attention and academics are increasingly interested in the development and implementation of stochastic models for this purpose. Using the information these models provide, customer managers should be able to i) distinguish active customers from inactive customers, ii) generate transaction forecasts for individual customers and determine future best customers, and iii) predict the purchase volume of the entire customer base. This paper compares the quality of these models when applied to managerial decision making with the simple heuristics that firms typically use. Results show that the simple heuristics perform at least as well as the stochastic models with regard to all managerially relevant areas, except for predictions regarding future purchases at the overall customer base level. The implication for financial service institutions is that they do not have to invest heavily into complicated models to distinguish active from inactive customers and to identify their best customers.

Wübben, Markus; Wangenheim, Florian v.

**RESEARCH PAPER: INSTANT CUSTOMER BASE ANALYSIS: MANAGERIAL HEURISTICS OFTEN ‘GET IT RIGHT’**

The E-Finance Lab conducts two kinds of newsletters which both appear quarterly so that each six weeks the audience is supplied by new research results and information about research in progress. The focus of the printed newsletter is the description of two research results on a managerial level – complemented by an editorial, an interview, and some short news. For subscription, please send an e-mail to eflquarterly@efinancelab.com or mail your business card with the note “please printed newsletter” to Prof. Dr. Wolfgang König

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The Internet-type newsletter uses short teaser texts complemented by hyperlinks to further information resources in the Internet. To subscribe, please send an e-mail to newsletter@efinancelab.com.

Further information about the E-Finance Lab is available at www.efinancelab.com.

RESEARCH PAPER: COMPETITION FOR ORDER FLOW AND SMART ORDER ROUTING SYSTEMS

In European equity trading, market fragmentation is currently triggered by the emergence and relevant market share gains of new execution venues like BATS, Chi-X, Turquoise or Equiduct. Although institutional investors can benefit from this increased competition, their trading can suffer from the fragmentation of liquidity that comes along with new execution venues. Based on the entry of the London Stock Exchange (LSE) to the Dutch equity market the authors analyze potential effects of market fragmentation empirically as well as theoretically. Their results are twofold: First, they show that fragmentation of order flow can enhance liquidity supply as the consolidated limit order book is deeper after the entry of the LSE. Second, they outline the importance of protecting limit orders from violations of price priority which might happen in fragmented markets and which could lead to trade-throughs, i.e. transactions occurring at a price that is higher than the best posted offer or lower than the best posted bid while orders at these better prices are not included in the transaction.

Foucault, Thierry; Menkveld, Albert J.
The E-Finance Lab is a proud member of the House of Finance at the Goethe University, Frankfurt. For more information about the House of Finance, please visit www.houseoffinance.eu.

THE E-FINANCE LAB IS AN INDUSTRY-ACADEMIC RESEARCH PARTNERSHIP BETWEEN FRANKFURT AND DARMSTADT UNIVERSITIES AND PARTNERS ACCENTURE, BEARINGPOINT, DEUTSCHE BANK, DEUTSCHE BÖRSE GROUP, DEUTSCHE POSTBANK, DZ BANK GRUPPE, FINANZ.IT, IBM, T-SYSTEMS, DAB BANK, AND INTERACTIVE DATA MANAGED SOLUTIONS, LOCATED AT HOUSE OF FINANCE, J. W. GOETHE UNIVERSITY, FRANKFURT.