

Cluster 4 in 2007: Reshaping the Banking Business

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Project Summary

The banking industry has undergone tremendous change over the last decade. New technology standards are evolving, regulation is becoming more and more complex and competition is intensifying among banks and non-banks. Banks have reacted to these challenges by breaking up their value chains and by focusing on core activities. However, by non-financial industry standards banks are today still highly vertically integrated. Change will therefore also occur in the future resulting in our overarching research question: "How will the banking industry develop over the next ten years?" Given the broad nature of the research topic, we have rephrased the question to guide our activities over the next two years: "What are the evolving, optimal boundaries of banking firms and how should banks design the interface to its customers?"

Our research projects focus mainly on bank strategies that aim to reshape the organizational structures of institutions. Thus we will address innovative and new topics and trends of practical relevance in the financial services industry. We look at the banking organization, its core and non-core processes, and pioneering products that will help institutions to gain competitive advantage in the market. Ultimately, managers as well as researchers shall be provided with a better understanding of how exactly and to what extent value will be created in reshaped banking organizations of the future. We aim at our results being guidance to senior management of banks on strategic issues while at the same time having the potential for publications in top finance journals.

We have subdivided our research activities into three work streams.

Work stream 1 ("Managing the banking value chain") focuses on those activities that most banks do not consider to constitute core competencies, namely administrative, back office, and IT functions. We investigate optimal sourcing strategies for these functions that enhance overall efficiency and allow banks to free up resources for their core activities. Furthermore, we want to analyze the impact of regional diversification on bank's success. In addition we focus our research on the efficiency of firms acting as service provider in the financial services industry.

Work stream 2 ("Credit business excellence") aims to generate a detailed perspective on one of the core activities, namely the lending business and on innovative credit products to be developed in response to the changing environment. We will analyze the implications of Basel II, securitization technologies, process automation etc. on business models.

Work stream 3 ("Innovative Financial Services Sales & Distribution Strategies") deals with the revenue-growth agenda of banks. Proceeding from a better understanding of customer needs and customer behaviour we will investigate how banks should design and price their market offerings and organize their sales and distribution function.

Motivation

Over the recent past banks started to break up their value chains. Although the technological means to unbundle highly vertically integrated banking firms were already available in the late 1980s, it took yet another decade until German banks started to actively search for new ways to restructure and reorganize their operations. Bearish capital markets, decreasing margins, lower entry barriers for new competitors and low customer loyalty were putting enormous pressure on banks. In combination with new legislative and regulatory requirements such as Basle II, MaK, SOX, and MIFID credit institutions are forced to cut costs and look out for new revenue opportunities.

Hence, we now observe a situation in which sophisticated IT solutions and the mergence of large service providers coincide with the need to radically rethink the way banks operate their business in a more cost-efficient manner. As evidenced by recent transactions by major players, banks indeed start to concentrate on their core competencies and to outsource non-core activities.

The banks' credit business will be influenced by the development of new kinds of products and a rapidly changing regulatory environment. Credit institutions will thus have to adjust their core processes and product portfolio to succeed in a market characterized by an intensifying competition. Because German firms are still heavily reliant on bank loan finance, we consider an in-depth analysis of how banks will perform their credit business in future as essential.

The adverse capital market environment of recent years has not only revealed the structural efficiency problems that many German banks have been facing but has also lead many banks to seek for income streams that are more stable than those from capital market oriented, fee-based activities. This in turn has been reinvigorating large banks' focus on their retail banking operations. Many banks are reconfiguring their service offerings to better meet the needs of selected customer segments. At the same time banks are enhancing the skills of their client-facing staff and are redesigning incentive systems to proactively sell these services to existing and new customers. Given that the management of the retail sales function is high on the bank management agenda and given that the academic literature is relatively silent on these topics we have decided to establish a new work stream that covers the sales and distribution of retail financial services.

Objects

Our overall goal is to develop clear-cut scenarios of how the European banking business will evolve in the next years. The focus will be on the German banking market. Methodologically, we aim to derive positive as well as normative assessments on the likely developments in the banking business by building upon prior own research and by means of reviewing the literature, expert interviews, theoretical model design and empirical analysis.

Between 2003 and 2006, we laid the foundation for achieving the overall goal by screening existing work, by doing primary empirical research, by conducting interviews

with experts from sponsor firms and from external institutions and by theoretical reasoning. We sent out various empirical questionnaires and published first results of our work in several journal publications and conference presentations. Building on the results achieved in previous years, we will continue to diligently produce relevant and novel research output in 2007.

As was the case in the past, we will continue to involve representatives from sponsor firms into insight derivation through joint studies and workshops and through the supervision of dissertation theses of external PhD students.

Projects

We divided our work in three working packages with each addressing one selected aspect of value creation in banking. While work streams 1 and 2 concentrate on the cost side of banks and possible improvements of the processes including the extent to which the service is produced internally, work stream 3 has a clear revenue focus.