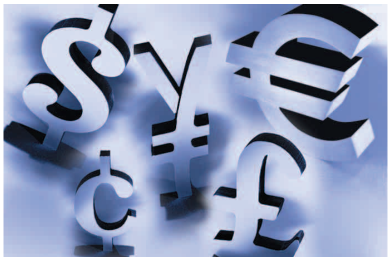
IBM Global Services



Financial services

Competing for customers in an era of change

Introduction

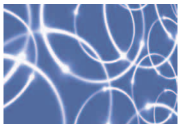
The financial services industry is undergoing sweeping change in virtually every area — from the kinds of products and services customers are seeking to the ways those offerings are delivered. As executives confront these shifts and chart their path for growth in this new environment, they must ask themselves a key question: *What do our customers pay for now, and what will they pay for in the future?*

While management comes to grips with this issue, corporate leadership will be called upon to determine the following:

- What are our core strengths?
- Do these strengths put us in a strong position for the future?
- Do we need to develop (organically or through acquisitions) new competencies for leveraging opportunities in a changing marketplace?
- Is the technology in place to manage these changes?

Addressing these issues effectively and expeditiously can help ensure alignment with marketplace trends, while providing customers with the goods and services for which they are willing to pay.

e business



The pressure is on

Although managers across industries must face a similar set of issues, the pressure is clearly on the financial services sector, an environment in which many companies pursue short-term gains in lieu of longer-term growth strategies. Currently, the industry has a number of compelling opportunities to use technology to exploit competencies and serve a larger number of customers. Today's leading-edge financial firms understand the importance of capitalizing on this opportunity and are learning to balance short-term financial performance with long-term approaches for maximizing their portfolio of businesses.

IBM research indicates that over the next five to ten years, market factors will force most traditional lines of business in the financial service industry to reinvent themselves. This will result in dramatic shifts in revenue sources and market share. Our research shows that:

- The Web and its related technologies will significantly impact virtually every aspect of brokerage, banking, insurance and trading — both institutional and retail.
- Traditional delivery systems will give way to new models that leverage technology to reduce costs, improve customer service and maximize efficiencies.
- Multiple points of access and service will be increasingly key to enhancing and maintaining customer relationships.
- Companies in other industries will use their brands, capabilities and customer bases to expand into the financial services sector, creating a new breed of potent competition (and, in many cases, driving the need to build new competencies).

As a financial services executive, you are responsible for building a comprehensive, long-term strategy for thriving in the new economy. This means asking difficult questions about customers' needs, your company's ability to meet them, your competitors' strategies and your firm's core capabilities. It also means intelligently incorporating next-generation technologies, and preparing for an inevitable shift in business models that can strengthen your value proposition, sharpen your competitive edge and increase profitability.

Where do you stand today?

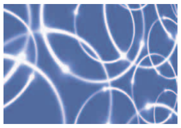
IBM has developed a "three-wave" model that demonstrates how various e-business dynamics combine and interact.[1] This model is part of a larger analytical framework that strategists can use to understand how e-business is evolving within a particular industry.

In the financial services sector, the factors associated with evolution are forcing companies to abandon traditional organizational silos built solely on relationships, products, portfolios and processes. This in turn is prompting a shift to business models and core capabilities designed to improve end-to-end business performance.

Today, the financial services industry functions within distinct business clusters that reflect limited and diminishing value propositions. The first wave of e-business has seen financial institutions effectively employ technology to enable new operating efficiencies, enhance distribution systems and improve customer service — all while leaving the business model intact.

A second, e-business centric wave has also emerged, with dot-coms and new-media units competing against traditional entities. Players in this wave have ushered in new business models and value propositions that focus on creating online brands and employing new forms of customer acquisition and service. While many dot-coms have failed recently, the need for business-model reinvention has not disappeared. Casualties uncovered the inefficiencies of traditional structures and opened the door for well-established brands to reinvent their businesses and revitalize their relationships. A hybrid model of waves one and two — one which leverages both physical and virtual businesses for the benefit of the customer — has also surfaced.

In order to evolve the business structure as a whole, financial services executives must first identify where their business is currently positioned on the continuum of technology waves. Then they can determine which new business models should be leveraged as the foundation for each operating unit.



Where will you stand tomorrow?

As the balance of power shifts from producers to consumers, the next wave of e-business will surface, characterized by the realignment and redefinition of entire industries. In wave three, enterprises will attempt to build dynamic e-businesses capable of rapidly accommodating and participating in a range of value chains with a variety of new partners. In the process, organizations will face a series of challenges centered on what customers will pay for and how best to align the business to meet their changing demands. This will require launching some significant initiatives, including:

- Migrating existing businesses and operating models to a defensible competitive position
- Applying brands across multiple businesses and industries
- Assessing prospective economic opportunities (and threats) from emerging technologies
- Leveraging next-generation technologies to create competitive advantage
- Gaining customer acceptance and loyalty.

Four "centric" business models

Successful financial services enterprises will go to market armed with a combination of four new "centric" business models that will empower management to:

- Replace the traditional product-based value proposition and compete on the basis of core capabilities (customer point of contact, fulfillment, production or market knowledge). As management engages in this process, it is important to avoid segregating the business. Although one model may be selected as the primary approach, leaders will weave together key elements from each centric model to achieve maximum results.
- Leverage next-generation technology platforms that allow management to focus on core capabilities, outsource non-essential functions and align all lines of business in a given enterprise.
- Identify new revenue sources that map to the company's core competencies (both existing and acquired).

As you explore the four centric models, it is important to view them not as precise paradigms in which to structure and manage your business, but as symbolic of the options you have at your disposal. By doing so, you can realign your company to address a changing marketplace and position yourself to provide "what your customers will pay for".

Customer-centric

Businesses operating under the customer-centric model have a pervasive influence on the customer relationship. By providing customers with a gateway to a network of industry-relevant product and service vendors, these entities act as an agent — controlling the point of customer interaction and empowering customers through education, knowledge and convenience. Figure 1 outlines some of the key competencies and success metrics that characterize this model.

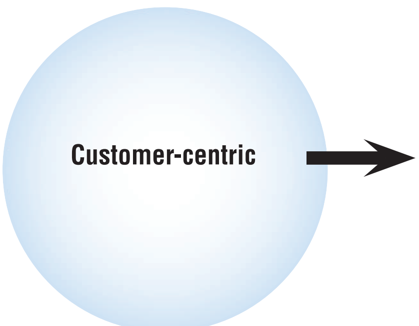
By honing in on a specific customer base and providing access to a tailored set of financial planning products and services, myCFO has adopted an early form of the customer-centric model. The company, which affords customers convenient access to personal financial management via online interaction, is currently developing brick-and-mortar locations across the U.S. to offer in-person service delivery to those who prefer that option. Although the financial services giants may view myCFO as a niche player in a highly targeted market, the business has a proven track record, and has invented a business model that promises to be a harbinger of the future.

This model puts your business in a strong position to offer customers precisely "what they are willing to pay for", even as their demands evolve with the marketplace. More often than not, they will turn to you to explore and acquire new offerings. The customer-centric model often appears to be the most natural —everyone knows that building on customer relationships is a key to further success. It is also likely to attract the greatest numbers of competitors.

Sony, a long-established manufacturer and marketer of high-end electronic products, recently announced plans to open an Internet bank in the Asia-Pacific market. Working with J.P. Morgan to provide personal financial tools and with Sakura Bank for industry expertise and access to the latter's ATM network, Sony is leveraging its capabilities to exploit a new market. This move represents a threat to traditional financial services companies as a new breed of competitor — with roots remote from this market — enters their space.

Customer-centric virtual agency offerings will provide significant customer value through "peace of mind" creation, enabling defensible positions of market advantage

Figure 1



Description

- Offers Virtual Agency, acting on behalf of customer and representing their wants and needs in marketplace
- Manages aspects of a customer's life and/or 'spend' in accordance with pre-agreed rule sets and level of delegated authority
- Provides personalized advice and counsel regarding alternatives via an ongoing dialogue with customer, capturing decisions and preferences
- Enterprise economic interests are exactly aligned with / centered on customers' interests

Revenue sources

- Customer fee for services
- Percentage of customer's savings

Core competencies

- Understanding, anticipating and reacting to customer needs
- Acting as customer advocate with access to the total marketplace, independent of specific product providers
- Continuous learning about customers, markets, and providers
- Ability to build strong and loyal customer relationships by providing "peace of mind"
- "Segment of one" personalization / customization, while upholding the highest standards for privacy and security
- Providing full customer access, wherever and however they want to interact
- Key partnerships with fulfillment organizations

Success metrics

- Customer profitability
- Percentage of customer spending and/or selling
- Customer referrals
- Customer acquisition costs
- Satisfaction indicators:
  Retention / loyalty
  Increased delegation
- Supplier / fulfillment effectiveness ratings

Production-centric

Production-centric players either meet customer needs directly, or serve as a resource for companies adopting other centric models. These businesses compete on the basis of price, quality, and/or convenience. Figure 2 outlines some of the key competencies and success metrics that characterize this model.

Folio FN enables investors to choose their personal investing preferences (risk, industry, etc.), then directly invest in portfolios that match those selections. Folio FN's value proposition is in helping clients eliminate the unnecessary risk, cost and guesswork inherent in investing in one stock at a time.[2] *Folio FN takes advantage of the fact that investing in a portfolio of stocks can provide investors with a lower level of risk for the same expected rate of return, or the potential for a higher expected rate of return for the same level of risk. Because Folio FN investors directly own the stocks in their portfolios, they can avoid the high fees often associated with mutual funds. And unlike mutual fund investors, Folio FN investors always know exactly which securities are in their portfolio, and can customize and tailor these holdings to reflect their preferences and values.*

Since the production-centric model involves intense competition on price, financial services firms should continue to look for ways to offset any potential revenue loss by turning their core "production" capabilities into new revenue streams.

The Royal Bank of Scotland Group plc (RBSG) outsources its backend banking functions to companies wanting to offer banking services without engaging in the logistics of operating a bank. RBSG furnishes its back-office capabilities as a production-centric line of business. RBSG is now engaged in such a transaction with Commercial General Norwich Union plc (CGNU). As part of this arrangement, the two businesses will seek to further their commercial cooperation by identifying opportunities to develop their respective businesses.

Production businesses will optimize market and financial performance through "perfected" traditional and hybrid business models, most of which will compete on scale and unique capability

Figure 2

Production-centric

Description

- Cost-efficient manufacture of products & services
- Advantage based on scale and process excellence / capability
- Ability to sell into the marketplace or direct to customers
- Ability to create unique / differentiated value via customized product sets

Revenue sources

- Product / service sales

Core competencies

- Streamlined business processes
- Supply-chain integration / virtualization
- Understanding, anticipating and reacting to intermediary needs and end customer needs
- Portability of operation to compete on a global basis
- Development of strong relationships with selling partners
- Dynamic pricing
- Collaborative demand planning / forecasting

Success metrics

- Customer satisfaction
- Quality control
- Inventory analytics
- Activity costs / return on capital
- Product profitability
- Process efficiency
- R&D analytics
- New product introduction
- Supply chain efficiency
- Revenue by channel / partner

Market-centric

Market-centric lines of business offer buyers and sellers value-added services that provide a context in which both parties (or their agents) can conduct commerce. Figure 3 outlines some of the key competencies and success metrics that characterize this model.

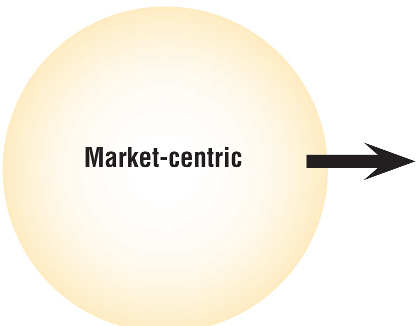
Their capabilities include:

- Mechanisms for price discovery
- Functionality to enable transaction settlement
- Mechanisms to mediate risk
- Orchestration of necessary fulfillment
- Collaboration features.

E-Bay, the popular online auction house, is moving towards the market-centric approach by understanding the needs, concerns and relationships among buyers and sellers, and utilizing next-generation technology and partnerships to create a loyal community of users. To address its growing number of customers and the resulting fulfillment tasks, E-Bay created an option so customers can shop within their local market using the site's advanced search option. This gives buyers peace of mind knowing that they can personally examine the item for sale, as well as reduce shipping costs and delivery time. E-bay patrons are also given the opportunity to rate the seller. This model helps create a sense of loyalty to E-bay on the part of online buyers — and a new form of customer relationship management.

Next generation market-centric models will reach further into buy and/or sell business functionality to secure customer relationships

Figure 3



Description

Provides the context for buyers and sellers (or their agents) to conduct commerce including:

- Mechanism for price discovery
- Functionality to enable transaction settlement
- Mechanisms to mediate risk
- Orchestration of necessary fulfillment
- Collaboration features

Revenue sources

- Transaction fee / percent
- Fees for value added services

Success metrics

- Buy / sell business process outsourcing revenue
- Number of qualified active buyers / sellers
- Volumes (bids/ transactions)
- Risk measures (e.g., losses)
- Customer ratings/ feedback

Core competencies

- Attracts qualified buyers and suppliers, locally and globally
- Provides robust commerce infrastructure and matching engine
- Truly understands needs and processes between buyers and sellers
- Focused on understanding product, the related integrated supply-chains and environment within which the product is positioned to provide collaboration and integration services
- Maintains neutrality between buyer and seller
- Functionality to interact with virtual agents
- Understands complexities of differing geographical ‘end points’ for fulfillment
- Risk management to fully understand risk and its mitigation as part of buy/sell transaction process
- Understands who fulfillment partnerships are and gauges their performance

Fulfillment-centric

Fulfillment-centric businesses create economic value by identifying and fulfilling the needs of buyers and sellers. They achieve this through:

- Distribution conveniences, such as geography and availability
- "Fair" price relative to speed of delivery
- Reliability and dependability
- Post-fulfillment services.

Figure 4 outlines some of the key competencies and success metrics, which characterize this model.

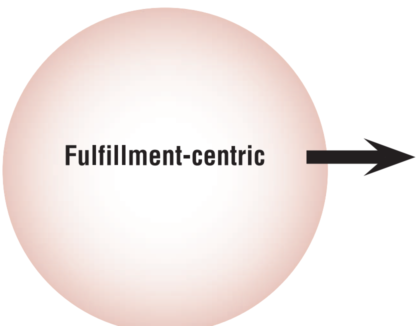
This model requires — at minimum — superior physical and virtual fulfillment capabilities and the necessary infrastructure. Key differentiators will be the degree of supply chain and infrastructure efficiencies and the intelligent use of next-generation technologies to enable enhanced payment and transaction processes.

As one of Japan's largest retailers, Ito-Yokado operates about 8,200 7-Eleven stores in Japan and more than 400 other businesses that include superstores, supermarkets, discounters and specialty stores. The company's new venture, IY Bank, will enable customers to deposit or withdraw funds to IY Bank and other financial institutions at ATMs installed in Ito-Yokado stores — 24 hours a day, seven days a week. Customers will also be able to settle transactions for their securities accounts, pay credit card and utility bills and make insurance payments. What's more, IY Bank will provide small lines of credit for customer purchases at its stores. Since IY Bank will only offer small loans for shopping and will borrow space from Ito-Yokado group retail outlets, it will operate with little additional assets.

Fulfillment-centric models offer compelling advantages. They can help assure access to the customer while exercising a high degree of control over which products and services they offer—and the terms upon which they will do so. The more robust their fulfillment capabilities, the more they can strike favorable distribution agreements.

Fulfillment businesses are capital intensive and leverage their scale to provide an optimal combination of virtual and physical "delivery" for their customers, based on the product/service being delivered

Figure 4



Description

Enterprises focusing in this strategic model will perform one or more of the following:

- Provide the necessary physical infrastructure to deliver products & services between buyers and sellers
- Provide the necessary technology-based infrastructure to enable the interaction between buyers and sellers in the marketplace
- Provide the necessary capabilities, process functionality, and information to enable transaction completion and settlement

Revenue sources

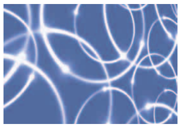
- Delivery fees (transportation, related services)
- Fees for customization / packaging / information services
- Fees for business processes performed for customers

Core competencies

- Leverage of capital investments and physical infrastructure
- Capable of full integration into buyer / seller supply-chain management
- Robust infrastructure (24x7x365)
- Providing a two-way interchange between the buyer and seller (delivery and return)
- Fully understands the dynamics of channel integration
- Provide 'perfect' visibility / trackability of orders
- Value-added information services
- Global scale capabilities / operations

Success metrics

- Return on infrastructure costs
- Customer ratings / satisfaction
- Delivery time / channel performance
- Inventory levels / turns
- Supply chain efficiency



Are you ready?

To survive in the emerging e-marketplace, financial services enterprises will need to plan and manage a “business portfolio migration”. To do this, executives must be ready to ask themselves some difficult questions:

- What are my revenue streams? What sources can I maintain, and which ones will disappear or change?
- What are the strengths and weaknesses of each business within the organization?
- What are the potential e-business opportunities and threats?
- Which lines of business lend themselves to reinvention?
- What are the possible unique value propositions?
- What is the current maturity profile of each line of business?
- Who are our competitors and how can we position our company strategically to gain more market share?
- What are the needs of each of the target customer segments?
- What offerings can be crafted to meet those needs?
- How can we leverage next-generation technology to deliver those offerings?
- What will be our best marketplace position? What will be the best processes and structure to effect these changes? How can we reorganize business capabilities to meet the new offerings and marketplace position?
- What current and new business capabilities and assets can be leveraged to generate new synergistic revenue opportunities?

Preparing for the future

As you begin to plan your long-term strategy, getting where you need to go can be intimidating. IBM has identified a process that can help you understand where you are and how to take the first step toward transforming your business model. We can show you how to:

Build a comprehensive "franchise profile"

- Take a snapshot of where each business unit is now (in terms of maturity)
- Identify which businesses will be subject to reinvention
- Define target customer segments that require an alternate strategic position. (i.e., customer-centric)
- Evaluate existing processes, plus the strengths and weaknesses of each business line.

Plan the transition

- Make decisions regarding the market position, target customers and core capabilities of each unit
- Identify the architecture, processes and core capabilities that will be needed to meet customer needs.

Execute

- Generate efficiencies in core processes through next-generation technologies and outsourcing of all non-core processes
- Leverage combined skills and assets to create new revenue streams.

The challenges you will face as you seek to transform and align your company to "what customers will pay for" will be complex. Channel conflict, structure development, integration of culture and management models — all must be addressed as your business evolves and adopts new business models. But the advantages of change far outweigh the risks of doing "business as usual". New market entrants, the expansion of existing companies and growing customer empowerment are compelling reasons to apply fresh and creative thinking (and the execution that follows) to assure a vital future for your company.

At IBM, our financial services consultants would welcome the opportunity to assist you in revamping your business strategy — and implementing the organizational and technological changes your new strategy dictates. To explore how we might help you position your company to offer what customers will be willing pay for, please contact us at *insights@us.ibm.com*. To browse through other resources for business executives, we invite you to visit:

ibm.com/services/insights

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