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DISASTER RECOVERY

Hurricanes Katrina and Rita reverberate in Q3 US results

As the Gulf Coast tallies the awesome damage of one of the worst hurricane seasons on record, the aftershocks of the disaster are shaking bank balance sheets.

Hurricanes Katrina and Rita conspired with a flat yield curve, increased credit costs and a shaky macroeconomic picture to drag down many US banks' third-quarter earnings, as the effects of the storms were felt thousands of miles from Louisiana and Mississippi.

Banks with heavy loan exposure in the Gulf Coast predictably faced the brunt of the storms, but the question is whether third-quarter losses represent the worst of the news or just the tip of the iceberg.

The region's leading banks all took a hit. According to the Federal Deposit Insurance Corporation, there were 343 financial institutions directly affected by hurricanes Katrina and Rita. Among the hardest hit banks – measured in terms of branch closures as of early October – were New Orleans-based Hibernia National Bank, which was forced to close 52 of 300 branches, and Whitney National Bank, which was forced to close 31 of 139 branches.

Hibernia recorded a net loss for the third quarter of \$58.1 million, compared with net income of \$76.5 million for the same period one year earlier, reflecting the impact of the hurricanes. For the first nine months of 2005, net income was \$107.1 million, down from \$215.8 million one year earlier.

Costs incurred in the third quarter relating to the hurricanes totalled approximately \$197.7 million, including a charge of \$175 million to provision expense directly related to the hurricanes. Loan delinquencies increased to approximately \$300 million, or almost 2 percent of loans at 30 September 2005, compared with \$60 million, or 0.4 percent of loans, at 30 June 2005.

Hibernia has made significant progress in reopening locations and restoring services in areas affected by the two hurricanes. Of Hibernia's 326 locations in Louisiana and Texas, only 37 remained closed as of late October. Of those 37 locations, 26 remained closed primarily due to varying degrees of damage from the hurricanes. Most of the

bank's locations in Jefferson Parish, which borders New Orleans to the west, have now reopened. Offices are also now open in the French Quarter, Uptown and Algiers sections of New Orleans.

Hibernia's progress bolstered Capital One shareholders, who finally approved a deal to acquire the New Orleans-based bank in November – after completion of the deal was postponed twice after Hurricane Katrina struck and the merger price was reduced.

Capital One felt the effects of the hurricanes as well, reporting third-quarter earnings that included a \$44 million loss related to Gulf Coast hurricanes. The credit card company reported third-quarter net income of \$491.1 million, or \$1.81 a share, up marginally from \$490.2 million, or \$1.97 a share, one year ago.

International players too

The effects of the hurricanes were felt in bank boardrooms across the world. HSBC, the world's second-largest bank, announced a \$206 million provision for hurricane-related loan losses in its US operations. HSBC, which bought Household International, a subprime consumer finance company, in 2003, reported that third-quarter net income in the three months ended 30 September fell to \$688 million, from \$755 million in the same period one year ago.

Household International, which specialises in offering mortgages and unsecured loans to people on low incomes, has about \$1.4 billion of consumer receivables outstanding with customers living in the affected area, including \$1 billion in real estate.

RBC Royal Bank appears to be the only big Canadian bank to take a charge for expected claims from damage caused by the hurricanes. RBC said it would take an after-tax charge of \$130 million in the third quarter for expected claims from damage caused by the two hurricanes.

The third-quarter effects of the hurricanes – namely added operating costs and lost revenue from branch closures – were anticipated by analysts and generally met expectations. The longer-term prospects are far murkier, but doubtless there will be huge increases ▶

NON-BANK COMPETITION

Former Sumitomo Mitsui chief to head up Japan Post

The Japanese government has appointed Yoshifumi Nishikawa, the former president of Sumitomo Mitsui Banking, to head the holding company that will oversee the privatisation of Japan's postal system.

Japan Post will be split into four main units, covering mail delivery, banking, insurance and counter services, under a holding company from October 2007. The privatisation process is scheduled for completion by 2017.

Japan Post, which has savings deposits and insurance funds of ¥350 trillion (\$3 trillion) – equating to one-third of the country's personal sector savings – and 260,000 staff, is the world's largest saving bank.

Nishikawa is highly respected in Japanese banking circles, having successfully steered Sumitomo Mitsui through Japan's recession in the late 1990s. He also served twice as chairman of the Japanese Bankers Association.

Tough competition

"We're heading into an era of tough competition in financial services," Nishikawa said at a press conference to announce his new appointment earlier this month. "I want the employees of Japan Post to understand that it's the firms that succeed in taking risks that will be profitable."

Nishikawa, aged 67, joined Sumitomo Bank in 1961 after graduating from Osaka University. He became president of the bank in 1997 and of Sumitomo Mitsui Financial Group in 2002, after Sumitomo merged with Sakura Bank.

Nishikawa stood down from Sumitomo Mitsui in June, after the bank lost out to Mitsubishi Tokyo Financial Group in the bidding for smaller rival UFJ Holdings.

In October, Japan enacted legislation to privatise Japan Post after the country's Prime Minister, Junichiro Koizumi, won a September general election centred on this issue (see RBI 538). Privatisation will enable Japan Post to diversify into other areas of financial services, but it will also put an end to privileges, such as its current exemption from paying corporate taxes. ■

The retail evolution in banking

Recognition of the similarities between retailing and consumer banking, and transfer of knowledge, skills and practices from the former to the latter, commenced some 20 years ago. **Linda Lockhart**, director of business development at performance management specialist Cohen Brown, tracks progress to date

The retail evolution in consumer banking began 20 years ago. Bankers everywhere were looking for creative and innovative ways to leverage their retail branches, in the same way that traditional retailers leverage their retail stores to increase sales per square metre. Banks had retail floor space occupying prime locations, repeat retail customer footfall and predictable traffic patterns.

Prior to the retail evolution, bank branches were not designed to promote sales-based activities. The financial service industry knew that dramatic change was necessary. Above all, it was clear that the mentality and attitudes of front-line employees had to change. Terms such as 'cultural transformation' and 'paradigm shift' were used to describe the magnitude of change needed to happen, and happen quickly.

Before the evolution, it was acceptable for bank executives to say "it is going to take time", or "our employees did not enter banking to be sales people", or "we have to change the profiles and hiring criteria of our employees to successfully institutionalise a proactive sales culture".

Today, when discussing why their branches are not producing higher sales revenues, it is not uncommon to hear the same excuses from executives. Are they still talking about the employees who were on their payroll 20 years ago?

Perhaps the financial services industry has procrastinated on institutionalising the more difficult components of a proactive sales and service culture, while spending too much time and money on easier initiatives like new branding and new branch designs.

The retail evolution had two distinct phases. The first phase, which began in the mid-1980s, could be characterised as 'Hey, we are in the retail business too!'. This was a period of reinvention and experimentation in a quest to transplant traditional retail practices into financial services.

The second phase, which occurred in the mid-1990s, brought with it 'the experience economy', a period of expanded awareness of the total customer experience, comprising everything the customer sees, hears, feels

and, ultimately, does with the bank.

The desire to create the ideal financial retail store or ideal customer experience led to endless branch transformation projects worldwide. Very few of these new concepts made it to network roll-out.

In too many cases, banks did not start with a differentiated strategy. Instead, bank executives travelled the globe, visited other banks and copied concepts that appealed to them, regardless of whether or not the concepts supported their delivery strategy.

However, banks which put strategy first were in a position to map out the desired actions and behaviours of their employees (the sales and service choreography) and the desired actions and behaviours of customers, and design a stage to support the enactment of scripted and rehearsed scenarios – scenarios that supported a profit-driven delivery strategy.

Banks which had existing branch networks in place invested in only a few elements of the new concepts, as opposed to a total transformation. A business case-driven partial roll-out plan turned out to be the best implementation strategy to follow.

A new concept that worked

ING Direct is a good example of a differentiated retail strategy that connected the business proposition to delivery channels in a very creative and highly-branded manner. ING Direct branches are designed to reinforce the brand's delivery proposition of easy access through 'click, call and face'.

Many bankers still do not understand the business intent behind the ING Café. The primary purpose of it is not to open new accounts, although the café can facilitate this it is to build brand awareness and drive new business to the bank's convenient direct channels. This physical representation of the brand presence was necessary because, before ING was a known brand, many doubting customers wanted to actually see an ING office and some went so far as to drive to ING's operation centres to personally hand a member of staff their deposit.

Today, there is a hint of a backlash concerning the merits of the retail evolution,

mainly because of highly publicised follies, where strategy was not at the forefront of a new concept, or lost direction along the way. However, if bankers had not upset the apple cart 20 years ago, they would not have developed their thinking about what it means to be a retailer.

Retail thinking brought about significant changes in retail banking. The following concepts are taken for granted today, though 20 years ago they were considered forward thinking:

- The branch is a service space and a sales space: this new way of thinking about sales per square metre shifted the standard 80 percent back-office floor space allocation to an 80 percent customer floor space allocation.

- Sales people should be visible and accessible: sales offices were moved out of discrete locations and positioned in open platform environments with appropriate privacy solutions.

- Merchandising is a retail science that can be applied to all retail spaces: professional merchandising practices replaced the haphazard placement of communication collateral in bank branches. Marketing departments added merchandising as a new function and a new position appeared on retail banking organisation charts, the merchandising manager.

- Retailers spend the majority of their time in the field – smelling the soil: this revelation forged a movement from central to local marketing structures.

- Customers appreciate feeling welcomed: the greeter concept is now common in bank branches.

Bankers also learned invaluable, albeit costly, lessons when applying retail concepts and ideas that were not closely aligned to a supporting strategy, namely that customers do not visit a bank branch to browse.

There was a period of time when many bankers wanted to believe customers would think of the bank branch as a destination point, a place to come and learn about financial solutions. Once again, without a sound strategy, this wishful thinking led to complicated and costly branch zone strategies, whereby branches had zones dedicated

to market segments such as seniors, young professionals, home-buyers, travellers and college students.

However, even today the branch visit is still viewed as a task and the main objective of most customers is to get in and out as quickly as possible. Customers do like to browse and learn about financial options and opportunities, but they like to do this through books, journals and the internet, not in a bank branch while other customers are stealing their place in the queue.

Once successfully migrated to self-service channels, most customers have little desire to enter a bank branch again. Banks which led the e-centric charge are now back-peddling to get their customers to come back to the branch for discussions. They have learned that technology, typically, cannot build the same level of personal relationship as a human can.

So what has the financial services industry learned from the retail evolution? A significant breakthrough is a new appreciation and understanding of how to transform the branch experience without transforming the entire branch.

Knowing that, on average, 80 percent of branch traffic flows to transaction points and 20 percent flows to sales and service points, transforming the branch visit has become a retail science. Solutions are now focused around leveraging all transaction visits to turn qualified leads into sales and leveraging all sales and service visits to maximise total customer value.

Leveraging transaction visits

Selling is a numbers game; the bigger the pipeline, the greater the probability of leads. In addition, the more qualified the leads, the greater the probability of a close. Cashiers should be the bank's most significant source of qualified leads to sales. Proactive engagement skills and the ability to listen are being added to cashier profile recruitment requirements worldwide.

If a branch has only one merchandising element, the optimal placement of that element is on the wall behind the cashier counter, where 80 percent of branch traffic has an opportunity to see it.

Is seeing a merchandising message enough to move awareness to intent-to-buy? Seeing a message does create awareness and does improve the probability of a sale, if the customer is proactive. However, when a bank takes a more holistic approach and manages a sales and service choreography designed to connect promotional messages with proactive employee engagement and intervention, the probability of driving qualified leads to sales increases exponentially.

Branch employees and merchandising working in concert is rapidly becoming a best practice retail strategy. Imagine the impact on a bank's return on investment if 10 percent of the 80 percent (the transaction traffic) be shifted into the sales pipeline could.

Annual merchandising spend is a significant budget allocation at most banks. It is being underleveraged unless it is carefully integrated with proactive employee behaviours. Merchandising exists to ensure that sales discussions happen.

On average, banks with merchandising systems in place spend between €10,000 (\$11,779) and €20,000 per branch annually on in-branch merchandising. This figure includes the amortisation of the system and the communication content (posters, brochures and the like). A bank which has 1,000 branches spends between €10 million and €20 million a year to leverage the 'privilege of the moment'.

The 'privilege of the moment' is the privileged and opportunistic moment when a banker is face to face with a customer who has a financial need. The total costs associated with creating these moments are astounding. A reactive banker's lack of reverence and appreciation for the privilege is sometimes astounding as well.

Leveraging sales and service visits

Although reported to be more profitable, successfully migrated customers visit the branch less than customers who are not migrated. As a result, improving branch sales per square metre is challenged by lower footfall rates. The 'privilege of the moment' is no longer being left to random behaviours and actions in the branches.

The behavioural science of orchestrating a purposeful sales and service choreography is gaining momentum. After 20 years of procrastination, bankers are finally focusing on the hardest part of managing a commercially successful customer experience, ie, embedding the right sets of skills and behaviours in their organisation – skills and behaviours that impact the bottom line most.

The majority of financial services executives are in agreement about the skills that most impact their bottom lines. They agree on the critical importance of listening, probing, profiling, closing and follow-up skills among front-line sales and service employees. They also agree on the critical importance of having emotional retail intelligence and knowing how to really coach management teams.

When a manager has emotional retail intelligence, smelling the soil tells more than counting the beans. Knowing how to really coach means knowing how to validate good sales and service skills in addition to the

THE SEVEN-STEP PROCESS

Transforming the branch experience, not the entire branch

1. Start with a strategy.
2. Map the strategy to the sales and service choreographies that produce the most desirable commercial outcomes.
3. Distil the right behaviours and skills that impact the bottom line most for each step in the choreographies.
4. Measure the skills gaps between what is being practised today in the branches and what is needed to support the new sales and service choreographies, and progress with a process for institutionalisation.
5. Design the ideal retail stage set to support the choreographies and the performance of the right behaviours and skills.
6. Determine what parts of the ideal retail stage provide the greatest return on investment and progress with a partial roll-out plan for the entire network.
7. Implement an in-branch communications discipline, based on integrating the bank's promotional/brand messages (merchandising) with proactive employee engagement and intervention to support the bank's branded customer experience. ■

number of products sold.

Because up-skilling is a process that takes place over time in the everyday work environment in the branch, a management-led process versus a one-time training blitz is needed to ensure the right skills and behaviours are consistently practised in all branches, at all times, by all employees.

Having friendly employees is no longer a competitive differentiator. Friendliness has become a non-negotiable hygiene factor to stay competitive. Friendly without purpose, without commercial purpose, is a waste of everyone's time and in the end does not serve the best interest of the customer.

The retail evolution focused bankers on their customers. Through trial and error, band-aid retail solutions were separated out and discarded from sustainable ones. Exorbitant branding spends proved that employee actions, not tag lines or written promises, became the customer experience. In addition, financial services retailing, like traditional retailing, became a retail science, highly dependent on the seamless integration of place, product, promotion and people. ■