



Innovation in Retail Financial Services – Value Creation and Value Capture - John Lawrence

AIM Presentation, June 2005

Lawrence Somerset
Growth through Innovation

Agenda

- Objectives
 - Innovation - is there any?
 - Key considerations
 - Examples of creation and capture
 - Future?
 - How do we work with clients?
-

The Financial Services Sector is on a journey, and has not yet arrived

A lot of progress...

1965 ish	2005
<ul style="list-style-type: none"> • Branch, the 'Man from the Pru' / brokers 	<ul style="list-style-type: none"> • Phone, ATM / debitcard, internet, IFA, brokers, branch, employer
<ul style="list-style-type: none"> • Cheque, cash 	<ul style="list-style-type: none"> • Automatic payments, SO, DD, Debit card, credit and charge card, micro, Paypal, smartcards,
<ul style="list-style-type: none"> • Beg building society to lend money 	<ul style="list-style-type: none"> • Beg them to stop!
<ul style="list-style-type: none"> • Weeks to get a loan decision 	<ul style="list-style-type: none"> • Minutes to get a loan decision
<ul style="list-style-type: none"> • 2% directly invested in equities 	<ul style="list-style-type: none"> • 22% UK adults directly invested in equities
<ul style="list-style-type: none"> • Most on state pension, some with SERPS, few affluent 	<ul style="list-style-type: none"> • 55% of adult population has a PP / GPP / SIPP plus housing equity

...but still a long way to go...

Demand

- £1tr + debt, with rising bankruptcy and repo
- 2m 18-64 year olds are without a bank account
- 57% can't define APR *(Source: NOP, 2004)*
- 50% have less than £1000 financial assets

Supply

- 3 day clearing
- Misselling: PP, precipice bonds, splits, MPPI
- 'Utility' thinking eg, Life Assurance
- The 'BID' model

Financial services present a complex context for innovation – our interest is in disruptive innovation

Companies share clients:

- Average customer has **7** products
- Average firm has **2** products per customer
- So, ...average customer has **3.5** 'relationships'

The regulator and government interventions encourage a utility mentality:

Products....

- PP
- PEP
- TESSA / ISA
- Stakeholder
- Sandler Products
- Child Trust Fund

Taxation, rules and reserving...

- MIRAS
- Polarisation / depolarisation
- Means testing
- Kite marking
- Equity exposure
- Pension fund taxation

Markets present challenges:

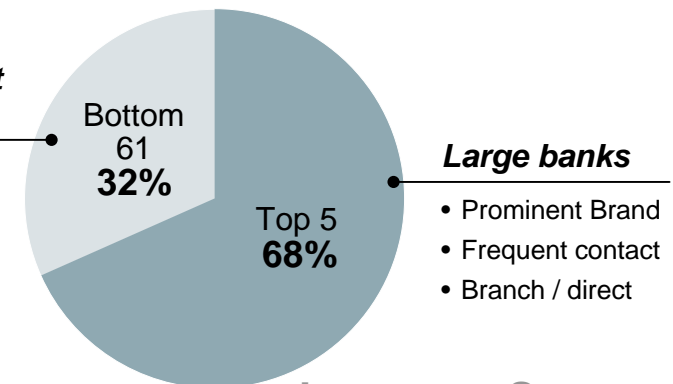
- Underlying cyclicalality of markets
- Manage stock (assets, debt) for fees and compete for flows of new business
- Indifference to deferred gratification
- Ignorance of many of the basics

Industry structure leads to many innovations sustaining the status quo:

Market cap of FS cos in Top 500

Insurers, and Asset Managers

- Some Brand
- Infrequent contact
- Intermediated



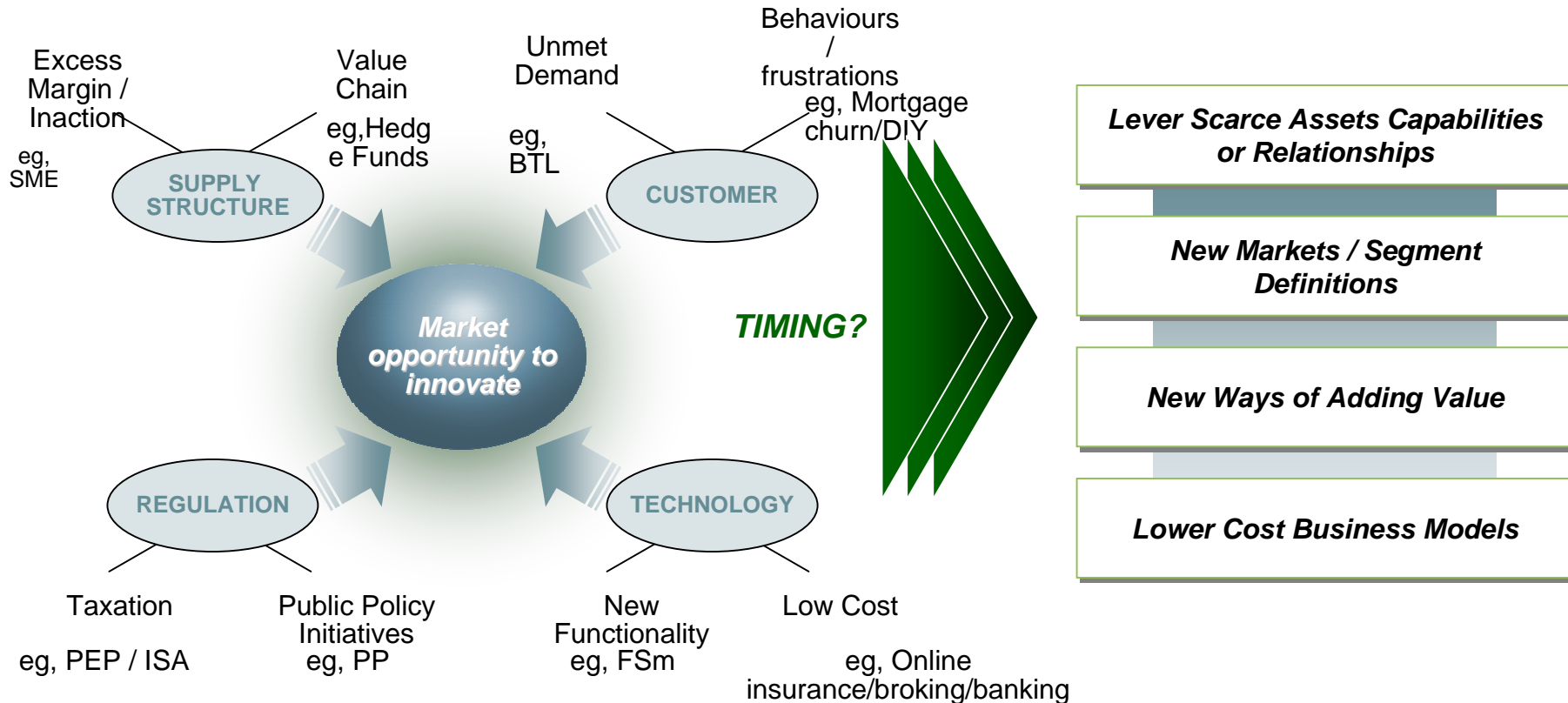
Large banks

- Prominent Brand
- Frequent contact
- Branch / direct

Innovations must be reflected in the business system to capture value, product alone is not enough

Response to market opportunities.....

.....Must be embedded to be sustainable



Alternative, low cost (?) business models and clear proposition

Pre 2002

Borrowing customers

Banks, building societies
150-250bp Cost

Saving customer

2002

ING Direct
30bp cost

Customer Value?

- Clarity
- Better interest on large deposits

UK

- 1m customers
- £7.5bn est. UK deposits
- 8 countries

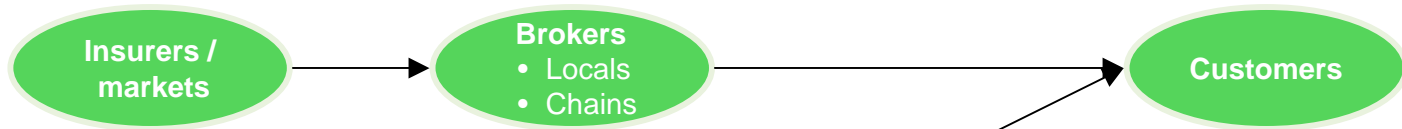
But

- Sustainability??
- Real Cost??
- What's next??

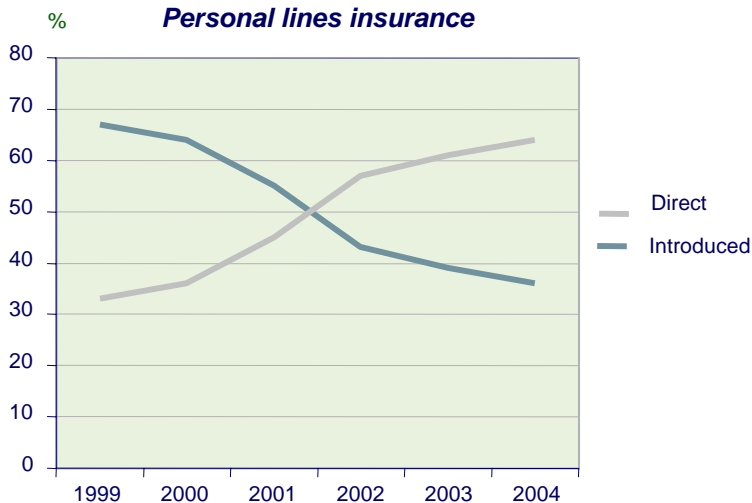
Proposition Comparison		
<p>ING</p> <ul style="list-style-type: none"> • Headline 5% <p>But...</p> <ul style="list-style-type: none"> • Applies to ALL deposits • Can invest large sums • Low service level 	Vs	<p>ANO</p> <ul style="list-style-type: none"> • Headline 8% <p>But...</p> <ul style="list-style-type: none"> • Requires regular saving • Applies to only £1500 avge. • Rest is at 3.45%

Technology and behaviour driving new channels

Pre 1990



Now



Telephone

Internet
Direct writers

- Price and service based competition
- Not yet STP
- RBS (Direct Line, Churchill)

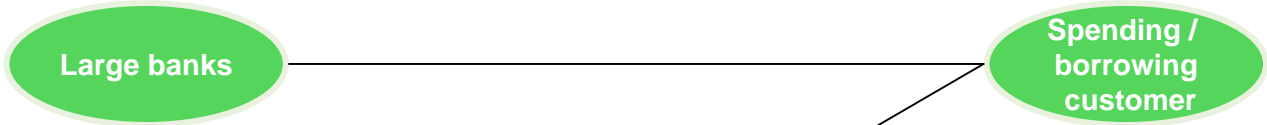
Supermarkets?

Customer Value?

- Cheaper insurance
- Better access

Innovation around pricing and proposition

Pre 2000



2000 - 2005

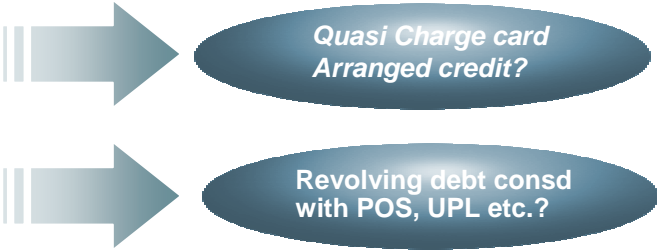
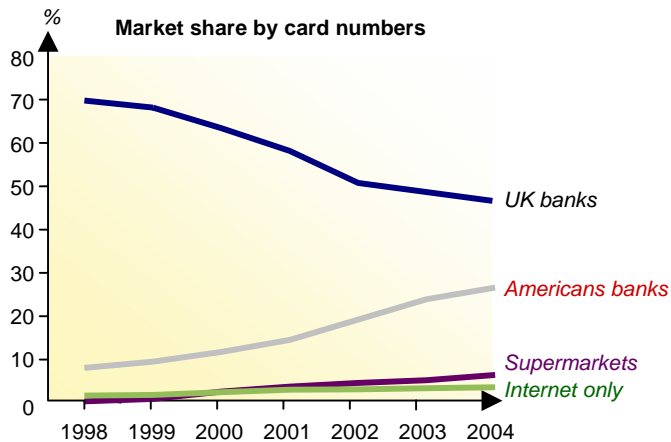


• Price-based competition (0% transfers, cheques..)

Customer Value?

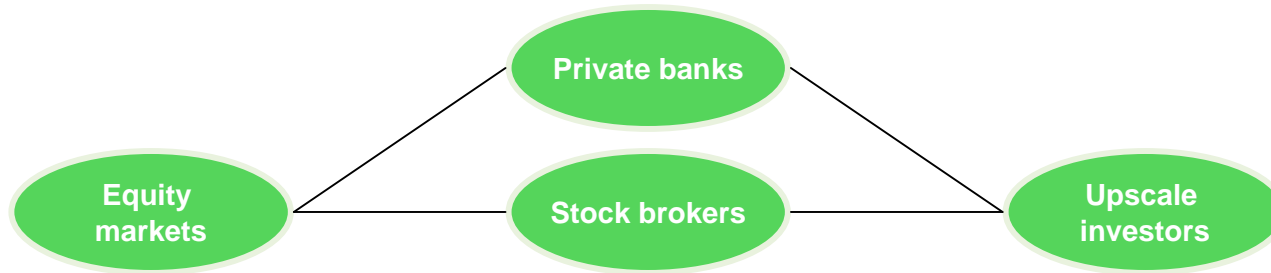
- Cheaper Credit, but...
- Deeper in debt

Now



Disruption from online services and explosion in demand

Pre 1995



1995

Huge growth – dot-com bubble

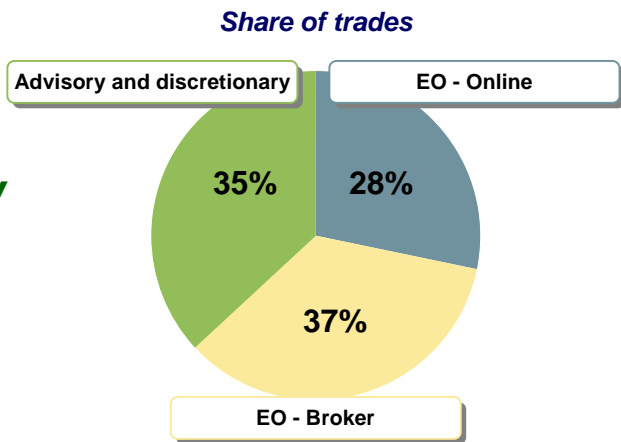
Online trading

Emerging Affluent / Mass Affluent investors

Foreign entrants - Charles Schwab, TD Waterhouse, Venture funding - ETrade, Incumbent - Stock Trade (Brewin Dolphin)

New 'Low End', and Private, Professional Markets

Now

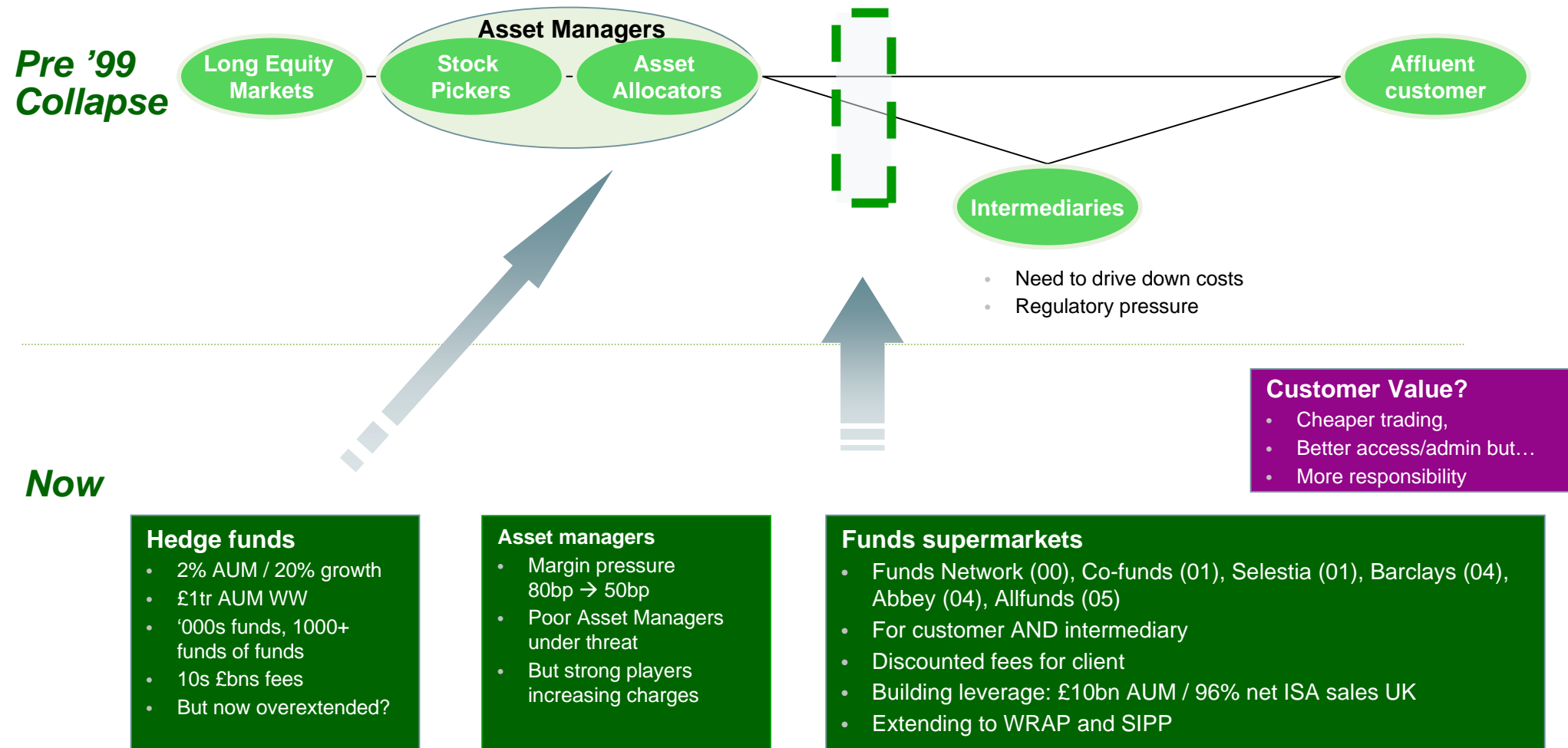


- Online trading**
- Reduced trading / cost
 - Collapse / consolidation of several (50+) brokers (esp Barclays)
 - Adoption of wealth management business model (%AUM)
 - Advice?
 - Other online instruments (option, spread-betting, poker)

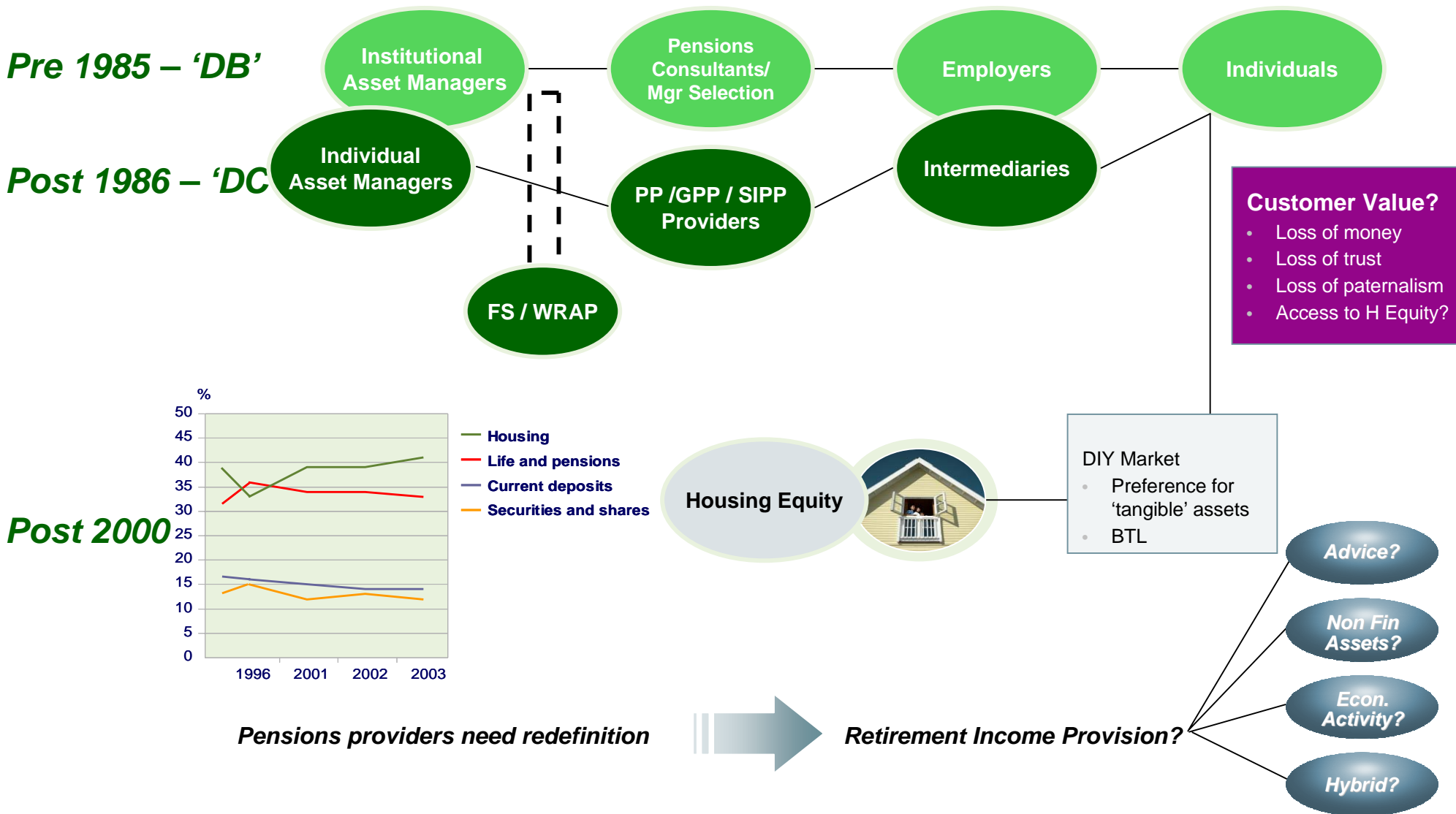
Customer Value?

- Cheaper trading, but...
- More responsibility/exposure

Disruptive new roles in value chain



Innovation driven by economics, public policy and technology



Progressive innovation leading to sector collapse

Pre 1980s



80s, 90s Innovations

- Globalisation
- Automatic trades
- Increased volatility
- 99 / 2000 collapse

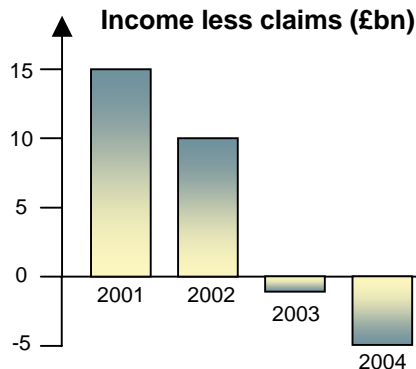
- Unit linking competition
- Unitised with profits
- Low cost / guaranteed endowments
- Plus
- Mortgage collateral growth

- Customer Value?**
- More exposure
 - Loss of money
 - Loss of confidence

20s Interventions

- FSA: 40% equity

Now



- Brands lost
- Equitable
 - Save and Prosper
 - GA Life
 - Albany
 - Pearl
 - Allied Dunbar

Providers need redefinition



Innovation around customer experience

Pre 1995



1995 – 2000

- Offset (10% share)
- Flex (20% share)

- Fast growth in demand

2000 – 2005

- Penalty removal
- 2yr discounting
- Decline in SVR
 - 2004 – 26%
 - 2005 – 19%

- Pressure to churn
- Zero sum
- Now regulated

- Fast growth in demand
- Low persistency / loyalty

Future?

- Need better relationships
- Customisation?

- Partnership?

- Use Mortgage/Equity as financial planning tools
- Invest value thro' use

What does the future hold?

Value chain

- Continued outsourcing of non-core activities, but reappraisal of boundaries
- Value continuing to migrate towards customer
 - Advice and sales processes
 - Customisation and creating value
 - Channel management/Workplace

Industry structure

- Continued dominance of large banking conglomerates, via cross-selling
- Life sector/Pensions sector shakeout
- Opportunities for niche, new business model, cherry pickers

Market specific

- Debt management/Protection
- Housing equity/Retirement income
- Payments/Marketplaces
- SME Banking

Customer

- Big challenge of mobilisation around retirement income



John Lawrence

TEL 020 78132197 07971 559 564

jlawrence@l-s-l.com

www.l-s-l.com

Lawrence Somerset
Growth through Innovation