E-Commerce Strategies in UK Financial Services

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Introduction

The dramatic increase in awareness of the World Wide Web has brought the internet to centre stage in many of our conversations with clients, who are rapidly realising the fundamental impact which it will have on their markets and their businesses.

Whilst there is now a general acceptance that the web will have a significant effect on the way financial services are delivered, there is as yet very little consensus on just how profound the effect is likely to be and on how best to respond.

Our own work over the last two years suggests that the potential disruption of the web could be enormous and that in a relatively short timeframe, established businesses will be under pressure to offer improved services at lower costs in a way that can only be realised through the web.

However, established companies have a number of internal difficulties to overcome in order to respond fully to web-based opportunities. These include Y2K, protection of existing profit streams, failure to create the circumstances for innovation at the right level in the business, and insufficient critical mass of people who are web-literate. In the short term this will slow down the rate of introduction of new business systems, and ultimately, will leave incumbents vulnerable to new entrants or others prepared to 'slaughter the sacred cow'.

We have prepared this paper in the interests of stimulating debate and have set out some of our thinking under four questions:

- Will web use continue to grow?
- What new business models are emerging?
- How will financial services be affected?
- How should senior management respond?

* * * * *

The material contained in this paper was the subject of a series of seminars run through the summer and autumn, and attended by over seventy senior executives from the financial services industry.

If you would like to discuss any aspects of this paper, or would like information on future seminars, please feel free to contact the authors.

Growth in use of the Web

Internet use has grown almost exponentially in the last 2-3 years: there are now over 10 million people on-line and the revenues from e-commerce are approaching £3 billion.

There are strong arguments to support the view that use of the web will continue to grow, and quickly become part of our lives in the way that other powerful technologies have.

There are drivers of increased penetration under both demand and supply.

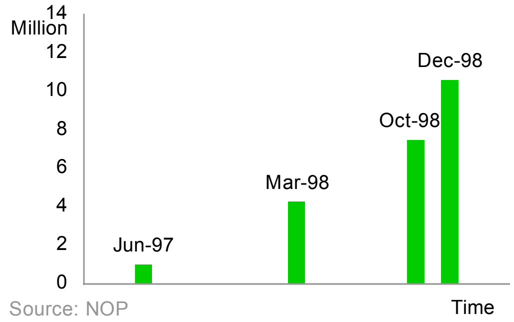

Exhibit 1 Number of people online in the UK

Demand will be stimulated by four factors:

- **Decreasing costs of computers and connection**. Computing costs are decreasing rapidly: it has been estimated that functionality doubles every 18 months at a given price level. Last week, a Keele University professor announced the launch in 2001 of a storage device that will hold 2,300 gigabytes of data in the space of a credit card for £35. Free ISPs are now the norm, and telephone charges are also declining.

- **Education**. People are learning how to use the web, and the more people using it, the more pressure there is on non-users to get online.

- **Digital TV**. The advent of DTV will extend web access to a large part of the population although there is still debate about whether this new constituency will represent a fundamentally different market from the current one.

- **Low prices and convenience.** Many services are more easily purchased on the web and there is already a strong expectation that people will get a fair deal, if not always a bargain.

Supply will be stimulated by three factors:

- **Y2K.** Systems people are already coming off Y2K projects and their energies are being redeployed into web development. This will only intensify in the new-year. It is likely that much of this new energy will go into value chain restructuring and business-to-business web development, as well as new client propositions.

- **Education.** As with users, senior executives will learn about the web and develop more sophisticated visions of how the web can influence their businesses. At present, there is a noticeable gulf in knowledge between younger middle management and older senior management.

- **Competition.** There is definite fear factor inherent in some web developments as companies realise that they must take action before others do so.

Both **demand and supply** will also be stimulated by **increasing bandwidth** and the improvements in functionality that this will bring. The costs of telecommunications plays a major role in the development of the web – one recent study has attempted to correlate telephone charges using the US as the benchmark, with penetration of internet use. In the UK, the introduction of ADSL has been held up by 'profit-taking on the narrower bandwidth, more expensive ISDN lines.

So far, the impact of e-commerce has been most noticed in retail and consumer markets, but the next surge is expected to be in business-to-business markets and in restructuring the value chain with browser technologies.

New business models on the web

Successful web propositions

The internet is a startling area for business innovation, and it is worth establishing some parameters to define what success could mean in this context. We are all no doubt familiar with the widely publicised success stories: Amazon, E*Trade, eBay, Freeserve, Mutual.com. etc. Despite recent falls in stock market valuations, these companies have created an enormous amount of shareholder value in a very short timeframe. Market capitalisations have been created in 2-3 years which had taken 20 + years to create in terrestrial businesses.

	Market cap.	Number of clients	Client asset portfolios	1998 revenues	1yr growth rate
Amazon	$17.8bn	10 million	_	$610m	236%
Yahoo!	$33.1bn	60 million	_	$203m	185%
eBay	$17.0bn	2.1 million	_	$47m	_
E*Trade	$8.5bn	1 million	$2bn	$245m	63%
Charles Schwab	$36.5bn	2.5 million (online)	$221bn (online)	$2,736m	57%

Exhibit 2 Successful e-business models

Are these valuations robust in any economic sense? Or are they merely an artefact of the army of day-traders that has emerged in the US? Most importantly, what can be learned from them to help established financial institutions seeking to have a web presence?

Typology of web propositions

In order to understand these phenomena, Lawrence Somerset recently carried out research that has enabled us to define three broad 'types' of business proposition that differ in terms of the underlying business model, economics and the degree of success that is available.

Type I and II initiatives are about taking existing business formats (or parts of them) into a web or browser environment. Depending on the specific product market context, these sorts of initiatives are not likely to be very successful in terms of building competitive advantage and creating long-term value. Type III initiatives are about transforming businesses and markets and creating huge value.

Type I

Type I initiatives may be necessary, but serve only to 'keep you in the game' by e.g. providing a web presence, or by streamlining processes. While a Type I may cut costs and release value, your ability to hold on to that value is weak: the value will most likely go to customers in the way of lower prices.

Type II

Type II initiatives are more ambitious. A Type II will most likely be a re-expression of an existing business model adapted to the web with a marginal degree of re-design. Key processes on parts of the business system are migrated to the web or another browser-based

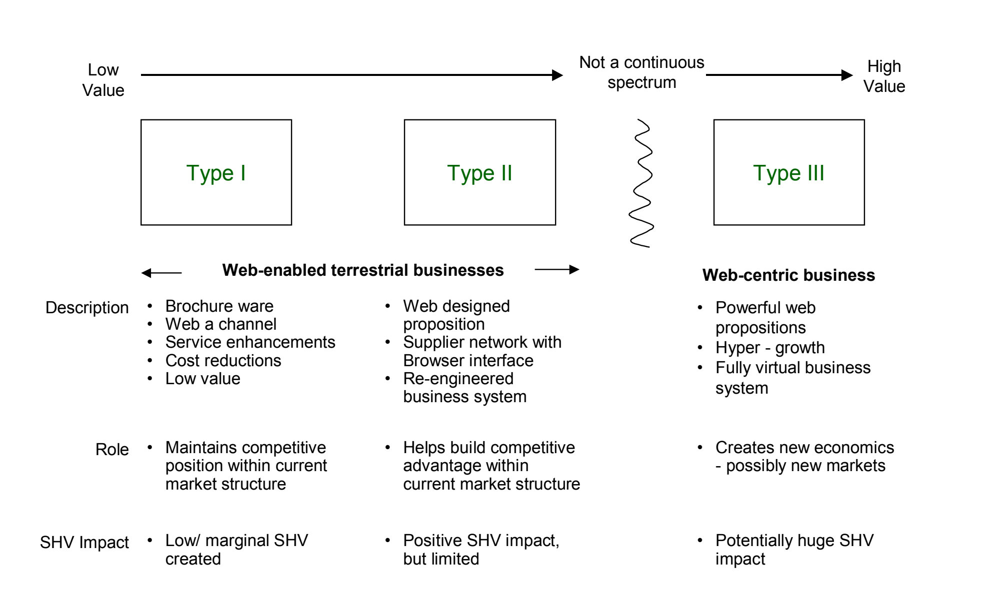

Exhibit 3 Typology of web propositions

environment and depending on how fast and well this is done, could lead to some market advantage. Within Type II, there are a number of permutations determined by the nature and extent of the application of web technology and, in practice, this will be driven by the type of business in question. We have worked with five in particular.

- **Sales process.** This is the 'shop-window' model that has been explored by the 'bought' product suppliers viz. personal lines insurers and, increasingly, retail fund providers. While product information is plentiful, full cycle transaction capability is still relatively uncommon and is giving certain companies a small first mover advantage. Execution-only services may also be bought on-line, by knowledgeable investors who are self-directed or who know what they want.

- **Service process.** This would refer to banking and other service intensive services such as group personal pensions, where the customer, or an intermediary or introducer requires frequent information that can be provided automatically. There are significant rewards if activity can be shifted out to customers and **if internal costs can be avoided, while** simultaneously improving the overall service quality.

- **Relationship enablement.** In some contexts such as private banking or stock-broking, personal relationships are valued, and the people in these roles can be made much more effective if they are supported by large information resources. The challenges here are to be sure that the personal relationship is still required, and continues to add value

- **Back office.** Legacy systems are a major problem for most institutions, and browser technology can be used in conjunction with middleware to provide better management information systems and customer database access.

- **Supply chain.** Out-sourcing can be made very much easier using browser technology to provide greater, more flexible connectivity. It can also reduce the costs of and barriers to switching service providers. This has wide application from out-sourcing funds to risk-bearing services.

Type IIs create value, but in much the same way and in much the same magnitude that other good strategic initiatives have in the past: incrementally. A company with a Type II may be able to retain much of the value created, in the short term at least, but this will depend on the potential for price competition in the sector. These various uses of web technologies, either singly or in combination, can have a significant impact on costs and functionality, but they will not transform the business system or its fundamental economics.

Type III

Type III initiatives are fundamentally different from Types I and II because they **reframe markets and design new kinds of business systems that more fully exploit the new media**. As a result, Type III businesses have enormous value creating potential - orders of magnitude greater than what is possible with Type II initiatives.

Type III businesses are distinct for three reasons:

- First, because they operate virtual business systems which are heavily automated and heavily outsourced and this leads to **'flywheel economics'**
- Second, because they enjoy increasing returns to scale and (thus) potentially high levels of defensibility from **' network effects'**
- Third, because they use the inherent characteristics of the web to create new **'demand models'** which often create entirely new markets.

Flywheel Economics

Type III business have economic characteristics that contribute to huge potential for growth. These are: virtual business systems and negative working capital.

- Type III businesses operate **'virtual business systems'** which are highly automated and heavily outsourced (Exhibit 4. We have recently prepared a paper on virtual insurance business systems and this can be obtained via our web site). Aside from being extremely efficient, virtual business systems allow for near-immediate scalability with minimal up-front investment in rigid physical infrastructure or assets. Significant investment may still be required, indeed entry costs are rising daily but much of this investment, however, is related to customer acquisition with immediate pay-off.
- Many Type III businesses enjoy **'negative working capital'**: the larger they get the more cash emerges from the trading activity because they hold no physical inventory and receive payments before they pay suppliers. Amazon and other virtual businesses derive a great advantage over terrestrial businesses because they do not need to carry large inventories, with the associated investment, financing costs and risk of redundancy. In some cases, they have prepaid web advertising in advance of revenues. These cash flows do not show on the profit and loss account but on the balance sheet – all helping to finance growth but not appearing as conventional earnings.

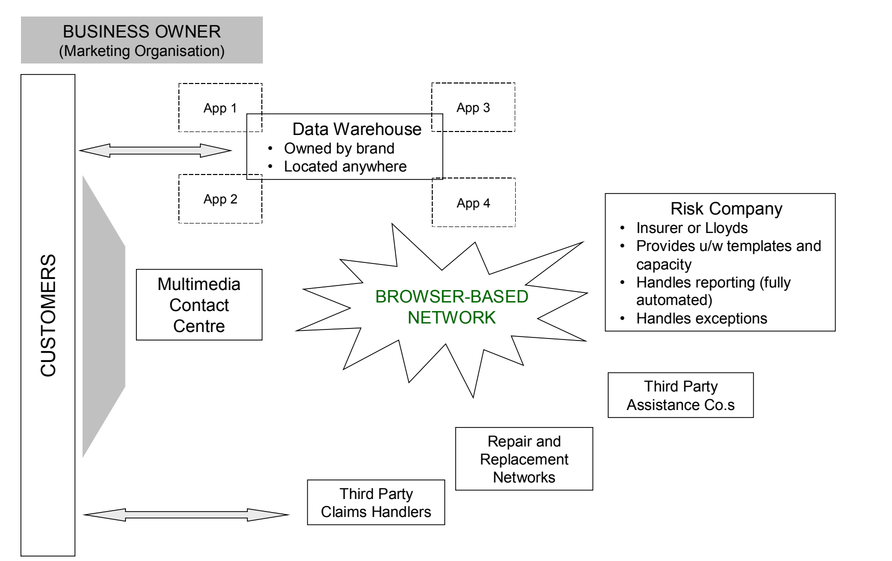

Exhibit 4 Virtual business system in insurance

Financial services propositions are unlikely to generate incremental negative working capital from product sales, because they neither hold stock nor extend credit.

Network Effects

Network effects refer to the process of interaction between people when considering using or when using a service. Positive network effects occur when the value to the customer of a particular service increases with the number of customers buying or using the service. This can ultimately lead to increasing returns to scale and a highly defensible business: the bigger you are, the easier it is to get even bigger.

The network effect is seen in a variety of contexts, from telecom networks to brands to celebrities (fame spiral), and can be extremely powerful in conferring oligopolistic, if not monopolistic, benefits to first-moving companies. Historically, the realisation of network effects has required huge amounts of investment in physical infrastructure, brand, etc. over long time scales. Now the internet is providing a new (and in many instances superior) medium for this kind of connectivity and is set to host the networks of the future.

The network effect can operate both at the customer acquisition level to promote trial and subsequently at the customer retention level to improve the functionality of the service.

- **Promoting Trial.** In this context, the network effect means that the more people using a service, the easier it is to acquire new users/customers. This operates in at least two ways:
    - First, awareness of the service spreads exponentially in relation to the number of people using it
    - Second, the risk of trial reduces due to the endorsement of others who already use the service

  Both of these mechanisms are currently levered by terrestrial branding to promote trial, and they will be equally if not more powerful in the digital economy where networks can form more freely. Awareness of a new internet service, for instance, can spread much more quickly, broadly and inexpensively by 'digital' word of mouth than through traditional awareness building activity such as terrestrial advertising.

- **Improving Functionality.** This happens when increased numbers of users leads to increased opportunity for interaction amongst them that adds value to the overall proposition. This phenomenon is common with E-businesses because the web provides an excellent context and medium for user interaction and community formation. Amazon.com, for instance, goes beyond simple online book selling and encourages their 'members' to post their own book reviews so that others in the community can benefit from their experiences. Once this kind of interaction is established, it can be extremely difficult for competitors to replicate.

Implicit in the functioning of the network effect is a model for how to initiate and develop online relationships with clients. Our research shows that there are three stages of relationship development and that successful Type III propositions are good at all three!

The key stages are:

- **Initiation.** Successful web propositions must have a clear 'hook' to attract new clients. For new entrant start-ups like Amazon and E-bay this often relies on some combination of innovation, low cost, relative convenience and clever marketing.

- **Retention.** Clients must stay once they have tried a service. To achieve this the service must be very effective and at the simplest, it must work. Initiation can be significantly easier for launching, incumbent web business on the back of a large existing client base. (e.g. Schwab)

- **Extension.** To build an effective on-line relationship, and to defend against rivals, the proposition must allow the client to meet additional needs. Peripheral services, sub segmentation and community building are all effective ways of doing this.

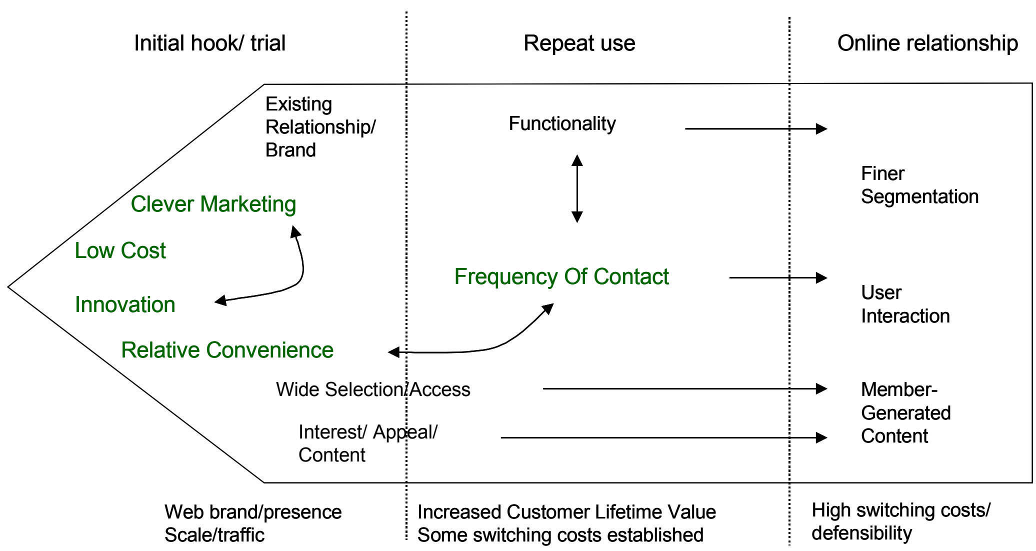

Exhibit 5 Initiation, retention, extension

Demand models

These cash flow advantages are not reflected in profitability but are critically important in financing the rapid growth of Type III propositions. Web-centric businesses take advantage of the peculiar characteristics of the web that puts a great deal of power on the demand side of a commercial relationship, i.e. it gives power to buyers. What does this mean in practice and how are these new models possible?

Several new models are emerging based on a combination of factors:

- Price setting mechanisms; live bidding processes or reverse auctions
- New relationships with and between clients
- New forms of service development
- New forms of dis-intermediation of service or information
- New forms of intermediation, or market making
- New forms of service bundling and unbundling
- New ways of constructing supply chains

A major factor inherent in these models is that they are **demand driven,** i.e. they place the buyer in the driving seat and enable the buyer to find their way to realising their needs. I use the term buyer earlier to indicate that these processes operate throughout the value chain – not just in an end-customer context. This has major implications for suppliers of 'sold' products because they have much less traction with clients' attention.

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The combined effect of these three factors is significant.

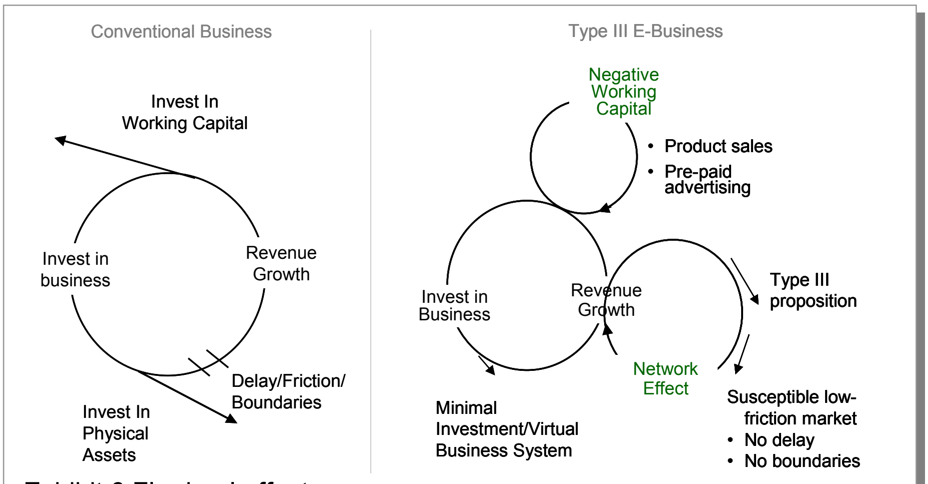

Exhibit 6 Flywheel effects

A conventional business can be characterised as a continuous flow of funds, as shown in the exhibit. The flow is topped-up by investment, but depleted by the need to continually invest in working capital and physical infrastructure. Relieved of these constraints, with the benefits of negative working capital, and on a growth trajectory stimulated by the network effects and the use of demand oriented business models, the Type III has enormous potential.

Impact on financial services

Market context

Product market context sets the pre-conditions for Type III businesses and determines (broadly) the level of friction and the potential for network effects, the potential for flywheel economics and the opportunities for new demand models.

	Good potential			Less obvious potential		
	Broking	Banking	Credit Cards	Packaged Savings/ Investment	General Insurance	Mortgages
Nature of Purchase Decisions	• Large 'bought' E.O. segment • Multiple purchases • Direct (E.O.) • High transaction value but low fees (£20)	• Bought - everyone needs a bank account • One-off decision (supplier selection) • Direct • Low cost/low ticket	• Bought • Multiple - credit cards - transactions • Direct • Relatively low ticket	• Historically sold • One-off (e.g annually) • Highly intermediated (80%) • High ticket	• Bought • One-off • Increasingly direct • Medium ticket	• Bought • One-off • Increasingly direct, except high value mortgages • High ticket
Nature of Ongoing Contact	• Frequent price checking • Positive associations recently in bull market	• Frequent balance checking/ transaction execution • Neutral association	• Frequent contact • Negative associations	• Infrequent especially for trackers • Positive associations in bull market, but vulnerable to suing	Infrequent • Negative associations of claims	• Frequent contact • Negative/ neutral associations

Exhibit 7 Market context

The more 'bought', low ticket, branded, direct or frequently purchased/ used a product or service, the easier it will be to create a frictionless trial process and stimulate the network effect to create growth. Broking and banking are both frequently used, sometimes low-ticket services, which are 'bought'. Unsurprisingly they are at the forefront of web adaptation.

The more 'sold', high ticket, un-branded, intermediated or one-off the purchase decision, the more difficult it will be to build scale traffic quickly as these factors create friction. Moreover, service tails with infrequent or negative contact allow less scope for building traffic and relationship. Many insurance and investment products are poorly placed to become central to a web proposition, although ongoing service relationships in certain markets may become web-based.

In any case, it is likely that it is in those markets where the context is not as suited to the web with **existing** business models that we can expect to see **new models emerging**, for example, in insurance

- New market-making mechanisms
- New forms of underwriting
- New claims restitution processes

Success will be determined by the extent to which the new propositions exploit the ability of buyers to be self-directing and in control of the pace and form of the interaction.

In the meantime, it is in these markets that the implementation of Type III propositions will be most crucial to maintain competitiveness.

Economics

Web technology will affect conventional business economics by impacting both revenue generation and cost structures, and the timescales over which these are considered.

- **Revenues.** The challenge to revenue generation is that the sources of revenues are likely to change**.** A common feature of web businesses is that they offer services free or at a great discount. In addition, the web forces much greater transparency in pricing and challenges common tactics to hide charges or to charge percentages instead of flat fees. Lastly, new sources of revenues such as banner advertising can play an important role.

- **Costs**. Cost structures are also changing because browser-based processes cut out unnecessary steps, e.g. re-keying data and letting customers or intermediaries self-administer. In some cases**,** costs can be **reduced to one tenth or less.** Aside from saving money, browser based processes also often improve service levels by being faster, more comprehensive, and offering greater functionality, convenience or range.

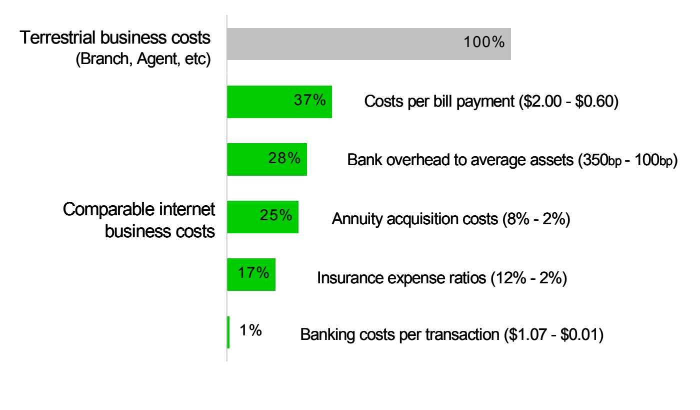

Exhibit 8 Internet business cost savings

These factors combined will make it harder to earn the kinds of returns that many financial institutions have become used to.

Culture

As a result, web-centric management are adopting a number of approaches to managing these new economics. These new approaches, combined with the need to develop innovative propositions in a new environment amounts to a **new culture.**
Already, this is being experienced in a number of tangible ways.

- **Timescales.** A race is on to stake out territory in the new economy, which means that timescales **for everything** are collapsing. The digital markets are moving fast and internal processes must accelerate commensurately.

- **Accounting.** Profit and loss accounting is no longer sufficient to capture the true performance of Type III businesses, and so a cash flow focus must be adopted.

- **Measurement and control.** As a result of collapsing time scales, the nature of successful web businesses is one of near instant feedback, experimentation and fast response. These factors require a new style of management information system (Bill

Gate's Digital Nervous System), and a new style of manager who is data driven but able to take informed risks and work on very short timescales.

The perceived seriousness of this is revealed in a recent survey which reported that 85% of European executives do not believe that their company has the skills required to exploit e-commerce successfully and, perhaps more seriously, 83% **do not believe that their company has the culture necessary to adapt to the electronic marketplace.**

New Entrant Advantage

New entrants, whether from other sectors or territories have an inherent advantage for three reasons:

- First, **they are more able to think of new, mould-breaking initiatives** because they are not tied to pre-conceived notions of how a business should operate. They can be more inventive or import ideas that have worked elsewhere. The classic example of this is 'Don't upset the brokers'. While insurers struggle with channel conflict issues new entrants are not hesitating in slaughtering these 'sacred cows'.

- Second, **they are more likely to implement them aggressively**, because they have little to lose. From a commercial perspective, there is only upside (albeit shareholder value). Incumbents have existing sources of revenues to lose and existing cultures that defend themselves, and so cannot take such bold action as new entrants. This is evident in the major banks' approach to on-line banking. For the most part, banks are offering on-line (not PC) banking passively to protect existing customer relationships and revenues. In some cases they are even charging for the privilege

- Third, they are more likely to move directly to virtual business systems, and so their **time to market is greatly reduced** and their business system is designed to purpose.

Against this, existing companies can lever existing relationships. In the case of on-line banking, banks can afford to offer their service passively because they can rely on a large proportion of potential switchers looking for on-line services referring to their existing bank first. One high street bank, with a vanilla service is attracting 10,000 clients per week, and so the scale of potential demand is clear. This is reinforced by the difficulties perceived in switching accounts – a friction factor likely to be reduced in the near future if Don Cruickshank's taskforce reviewing competition in banking has its way.

Passivity is not likely to be a viable strategy going forward. Our own research reveals that once a person or company has moved accounts, particularly if they have on-line banking, they are more likely to move again.

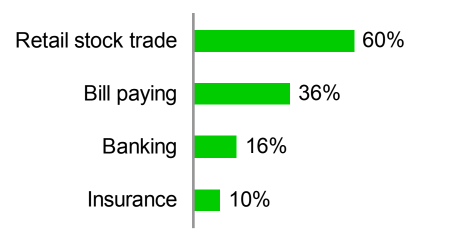

Exhibit 9 OECD estimate of proportion of business moving online by 2005

Current UK situation

We have recently carried out research into the current state of development of the web presence of UK financial services companies as one insight into their overall strategies. The detailed findings are the subject of another paper (available shortly via our website). The key conclusions are that the majority of the UK companies are engaged in Type I and II behaviour and few bold moves are, as yet, apparent. The Halifax and Cooperative Bank have emerged as notable exceptions.

Overall stage of development

The majority of major financial services players now have some web presence, although insufficient effort has often been made to ensure that these sites are easy for first time users to find.

Development of web propositions is currently embryonic. Brochureware predominates, with description of company non-interactive contact information easy to find. Sites are, handsome and easy to navigate, however, product information of any depth is largely lacking and few financial services sites provide dynamic rather than static information. The web propositions are clearly not client-centred and really only the banks have begun to provide transactional ability. Only a handful of sites, such as Prudential's Egg service, would qualify as Type II propositions, and as yet there are simply no Type III offerings in this sector.

Our hypothesis is that the gulf between feel and functionality is a symptom of web-strategy falling under the remit of IT or, at best, marketing departments rather than being addressed as a serious strategic issue.

Differences between sectors

At this stage there is little differentiation. Transactional ability provides the broadest spectrum of offerings – several of the banks and building societies offer account access, bill payment and even one-off BACS payment through their websites. The insurance sector is lagging behind, although several sites are able to accept payments into ISAs online.

Comparison with US

The US has been consistently two years ahead of the UK in terms of Internet development. The financial services offerings currently available on the web clearly indicate that such a gulf persists. In the US banks such as Net.B@nk and Security First Network Bank, brokers such as E*Trade and Charles Schwab, and a variety of credit card providers have designed or redesigned their business propositions for the web, passing on hitherto unavailable functionality and reduced costs.

The UK has been very slow to follow suit. Products and services have largely been sold through the web rather than being designed for the web. As an indication of the pace at which this must and now will change, during this September alone Egg has launched a potentially Type III credit card proposition, First-E has arrived as 'Europe's first true internet bank', and both the Halifax and Cooperative banks have announced bold new propositions. However, one may observe that even these offerings are emulating US models, rather than being truly innovative.

Scenarios for the future

Speculation on the future may be risky because there are so many variables at work. However, it is useful to construct scenarios because the focus of attention is on the drivers of change and their interrelatedness.

One such is sketched out below. We have concentrated on the relative competitiveness of web-centric propositions, and we have considered three timescales. The drivers of change have been discussed already.

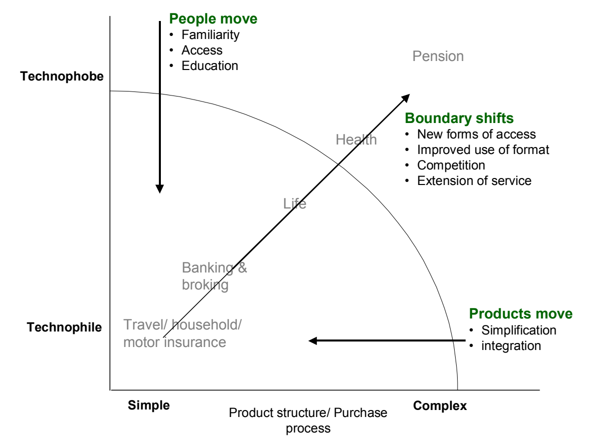

Exhibit 10 Drivers of change

- **From now to early 2000**. The environment will continue to be characterised by ambivalence of the major players as senior management seek to overcome their lack of hands on expertise. The preponderance of initiatives will be Type Is, some IIs, and with new entrants seeking to launch Type IIIs in some markets – notably execution-only broking and perhaps banking.

- **1-2 years into the new millennium.** Post Y2K, resources and commitment will emerge, and web access and use will have grown significantly with DTV. The shortcomings of Type I will be evident and the effort will be focussed on developing web-centric propositions, i.e. Types II and III. This will occur in the less obvious markets where new business models will be developed to meet needs, relate to buyers, or web-enable key staff members. Many of these will be seriously compromised by the influence of people wedded to old models. Competition will intensify and lead to price and margin erosion.

- **2002 onwards.** This period will be characterised by **consolidation** amongst the most successful companies. Type IIIs will extend their reach to related product markets to lever their ability to manage web traffic. Many successful Type IIs will exist, most likely on reduced margins, and may be vulnerable to Type III encroachment. Compromised Type II and those companies that did not get beyond Type I will be losing ground and contribution and will need to undertake enforced re-engineering perhaps following acquisition.

This is only one scenario of many possible, and we invite you to suggest your own. The crucial point is that this thinking should be carried out for sectors and product markets as well as at this broad level in order to inform strategy formulation for individual businesses.

<table>
<tr><th rowspan="2">Timescale</th><th rowspan="2">Characteristics</th><th colspan="3">Locus of Business Models</th></tr>
<tr><th>I</th><th>II</th><th>III</th></tr>
<tr><td>Now (pre Y2K)</td><td>• Ambivalence of majors
• Lack of hands-on</td><td>• Main focus of web applications
• Marginal impact</td><td>• Virtual companies emerging
• Some re-engineering
• Relative competitive advantage</td><td>• Few radical propositions in suitable market contexts</td></tr>
<tr><td rowspan="2">Y2K + 6 - 18 months</td><td rowspan="2">• More resources
• Internet use widespread</td><td rowspan="2">• Continued as above</td><td colspan="2">• Main effort to develop web centric proposition</td></tr>
<tr><td>• Poorer market contexts
• Compromised solutions
• Successfully enabled relationship business</td><td>• Especially new entrants or new brands reframing markets</td></tr>
<tr><td>Y2K + 18 - 48 months</td><td>• Competitive impact now significant</td><td>• Enforced BPR/ Cost reduction
• Industry consolidation</td><td>Shake out
Either
• Community development
• Sub-segmentation
or
• Deterioration
• Industry consolidation</td><td>Consolidation amongst leaders
• Networks
• Broader offerings</td></tr>
</table>

Exhibit 11 Scenarios for development

Issues for management

We do not wish to pretend that the issues raised by the web for business strategy are easy to resolve, quite the opposite. However, companies are not only wrestling with the **external** issues, they appear to be weighed down by **internal** processes, people and mental frameworks that are not suitable to the new environment.

Indeed, one can view the opportunities created by the web as catalysing competition between cultures: the old and the new.

For companies to compete in the new medium requires a change of approach, yet in many companies we see existing cultures subtly, or not so subtly, eroding the potential of new ideas. This is not always deliberate, but arises because structures used hitherto to evaluate new ideas do not serve well for web initiatives.

	Spectrum		
Framing the opportunity (or threat)	• Existing margin erosion • Opportunity to skim	vs	• Pursuit of risky opportunity
Focussing the effort	• Re-engineering	vs	• New Web-centric virtual, digital, self-contained
Approach to work	• Grand Slam • Committees, PERT charts • Technology	vs	• Nimble project team • Thinking process • Behaviour
Assigning responsibility – Decision making – Executing	• IT Departments • Operating companies	vs	• Board level • Separate team
Length of chain	• Insufficient radicalism • Excessive radicalism	vs	• Autonomy

Exhibit 12 The internal dilemmas

Assigning responsibility

An important consideration in taking forward a new initiative is where to assign responsibility.

The most appropriate locus of responsibility is the operating board because of the potential impact decisions about web strategies will have on the existing business, and the need to take informed risks regarding the future of the terrestrial business.

However, the dilemma that companies face is that frequently, senior executives lack the hands-on knowledge and experience to lead such an initiative, and do not wish this to be exposed. Some may not wish to tackle such major issues because of the potential exposure to censure if things do not turn out well, or lead to a great deal of conflict with long-standing colleagues. They therefore delegate the thinking to people who are thought to be more knowledgeable. Two obvious homes would be the IT or marketing departments. Both could lead to problems because of vested interests. Alternatively, they delegate to people who are more web-literate, but who may lack the maturity to structure arguments around such major issues.

The answer will differ for each company depending on the available people and their capabilities, but is likely to involve the following:

- Clear operating board sponsorship
- Operating company leadership for Type II initiatives
- Non- operating company leadership for Type III initiatives, with….
- Central co-ordination across any Group, both to act as a centre of excellence and to coordinate practicalities e.g. web-site format, branding, connectivity, and compliance

Establishing a project

It is crucial to establish the appropriate form of project to evaluate e-commerce opportunities, because the wrong brief or structure can lead to a poor result.

Often, companies are used to running projects that have tight briefs, concerned with product-market strategies or systems and operational implementation. The emphasis of these projects is often on task management, scheduling, resource management and deadlines.

E-commerce projects, whilst still needing these disciplines, require more emphasis on **developing a thinking process in a fast changing environment, in which the team will be learning as they go**, and in which the benchmarks of success are less easy to define. In particular, it is very difficult to forecast financials in an environment in which the sources of revenues and margins are very different, and where volumes can have very large upsides. Also, it is often advisable to implement early, before all the details are worked out in order to build essential experience.

Companies that have well disciplined product-development processes can be better placed because they are more used to redundancy, but still struggle with the way web projects can, and indeed should, stray across previously established boundaries based on conventional thinking.

Reporting to the conventional project steering group is also more challenging when many of its members are not web-literate and derive confidence for their decision taking from the conventional trappings of a 'well-managed' project in an area with which they are familiar.

Agreeing the imperatives for using browser technologies in your business

From the discussion so far, it may be clear that our view is that there will be an imperative in all financial services businesses to adopt browser technologies. It is likely that in a 2-3 year time frame all sectors that will be affected significantly by the web, and newly competitive businesses will be stealing a march on sluggish rivals relying on old formulations of competition.

In any market, it is likely that there will be a range of web-based plays ranging from Types I and II, perhaps a little later on, to Type III. The strategic consideration should be **what is possible in a given market as defined by a given group of buyers**, not according to existing product definitions.

The challenge for management is to identify the likely types of propositions that will be viable in a given market and the speed with which these will be introduced. This means making a judgement about two related and disruptive factors.

- The nature and extent of the electronic relationship with buyers, which will disrupt existing market linkages

- The degree of virtuality and digitisation in the business system, which will disrupt the relevance of existing capabilities.

It is likely that, in any large business there will be a number of possible initiatives with varying degrees of radicalism including both Types II and III. The Type III initiatives are difficult for two reasons:

- First, because they cannot be achieved through incremental or organic development, either from the terrestrial business or from a Type II. They therefore require a more explicit, and more difficult decision to be taken.

- Second, because a Type III is likely to compete with the existing business with a different brand, which will create a significant reaction from heads of terrestrial business units.

These factors combined will muddy the waters considerably. At best, matters may be delayed, but at worst, a long series of compromises will lead to a less powerful initiative.

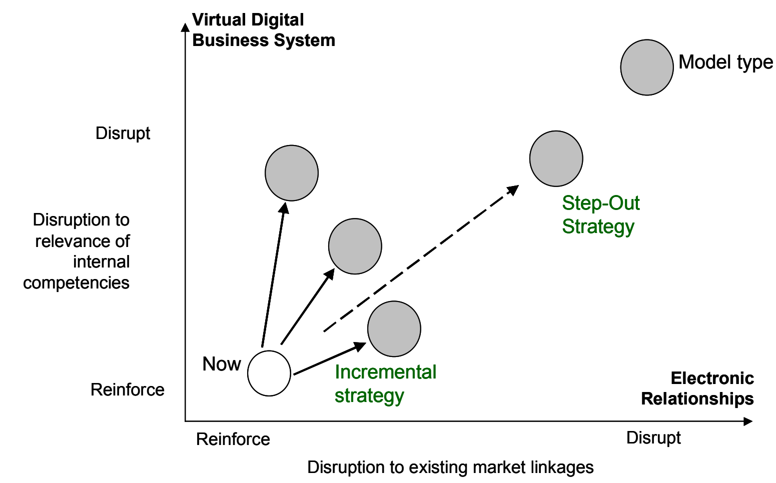

Exhibit 13 Approach to strategy

Getting the timing right

The timing dilemma is that to launch a successful web-centric proposition, a company must move very quickly to avoid pre-emption by competitors, but it may be tempting to delay in order to persist with existing sources of revenues.

If a very competitive proposition is possible in a given market, then eventually someone will do it – if not an incumbent then a new entrant. And so companies must move very quickly – many virtual technologies can be made available in a matter of months.

Delaying an initiative can be very tempting especially if new business models offer lower margins or uncertain revenue sources. It may make sense to offer new services when clients demand them. On-line banking is an example of this, in which new services have been offered passively on the assumption that customers wanting on-line banking will ask their existing bank first, so there is no need to speed up the process. Essentially, this is a form of price skimming, i.e. taking margin while you can, and while it **may be** the optimal short-term tactic, it will not be sustainable for much longer.

It is perhaps to be expected that people running existing businesses will be protective of the existing revenue streams, but in our opinion this should be reflected in the overall strategy, not in protectionism among business units.

Being prepared to invest

Companies are used to business development programmes that take years to unfold and where investment decisions are made every few years. Web businesses have the potential to evolve quickly and require additional tranches of funding both sooner and in larger increments than conventional businesses.

Migrating the existing business

A crucial issue that concerns most financial institutions is how to migrate the existing business to the new models. In some cases, it may not be possible to do this because the skills and staff numbers required in the new business models are so radically different that physical migration will not be viable. In addition, the culture required to run an aggressive Type II or Type III business will be very different from that in the existing business. Under these circumstances, it may not be possible to change an existing culture sufficiently – especially if people are seeking to retain it!

Ultimately, the extent and nature of change will depend on the portfolio of initiatives that are pursued and the nature and timing of these.

From a strategy perspective, a more useful notion is that of **migrating shareholder value**, from terrestrial to web-enabled businesses. If a company launches a successful web-business, it is likely that more value will be created in shareholder value to signify expectation of future earnings, than will be apparent from near-term earnings statements. Shareholder value will shift towards the new activity. This could occur either as a result of an increase in existing share values arising from successful web strategies, or from the creation of new businesses.

This can have implications for the corporate structures used. In many circumstances it may be better to establish a new company rather than trade under the existing structures.

It is, perhaps, early days to suggest that there may be a conflict of interest between shareholders and management but this could be a hot debate in the near future.

Conclusion

We have described a set of developments over the next few years, which we believe will severely challenge the management teams of most financial institutions. Markets, technologies, competition and economics are in an unprecedented state of flux and will combine to create a tougher, more volatile commercial environment in which margins will be slimmer and harder to secure.

However, there is an unprecedented opportunity for incumbents to lever their assets, in particular their existing customer, supplier and intermediary networks, to stake out territory in the new economy. Speed is critical, however, as are original strategies which play on the peculiar economics and network potential of the web.

The authors

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Lawrence Somerset

Lawrence Somerset is a UK-based management consultancy firm with a strong market research capability which specialises in advising senior management of financial and other service businesses on issues of strategic importance. In the past five years we have worked for over 50 clients in the UK, and several others from elsewhere in Europe and the United States.

Our work is to design actionable and robust solutions to commercial problems, with an emphasis on how they may be implemented. Solutions are, therefore, custom-built for specific clients and particular situations. Solutions can be offered “end-to-end” as we have strong working alliances with e-commerce technology providers and outsourcing companies.

The issues addressed cover most aspects of business strategy but we have a particular focus on the interface between technology and markets. We have invested substantially in understanding how new media and technology will affect market behaviour, business competitiveness and cost structures. We are currently engaged in translating this into novel financial services business formats.

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