Chapter 1

Creating Value in Financial Services

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1.1 Introduction

Financial services firms everywhere have undergone major changes over the last several decades. These firms include retail commercial banks, investment banks, insurance companies, mutual fund companies, securities brokers, and credit card companies. The decade of the nineties has witnessed a significant number of mergers among these firms worldwide. Some mergers were intended to achieve economies of scale from greater size and geographic diversity, e.g., the merger of Chase and Chemical. Some mergers were intended to establish a bridge between different financial services in the hope of creating synergies e.g., the merger of Travelers Group with Citicorp.

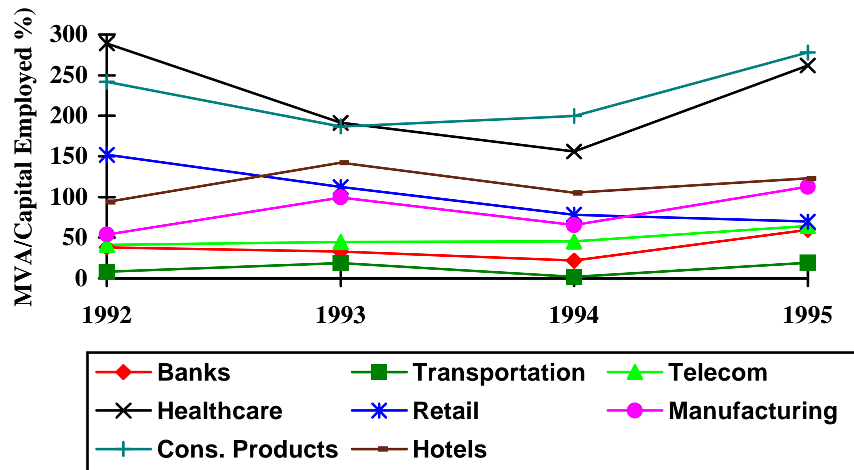
Simultaneously with consolidation in the financial services sector, many new financial services have also been introduced: cash management accounts, mortgage backed securities, and index funds. The decade has also witnessed many new technologies coming to fruition, especially in computers and communications. These new technologies, especially the Internet, have spawned new firms such as the E*Trade Group, Inc. and TeleBanc Financial Corporation, while also changing the ways of doing business at established companies, e.g., Charles Schwab and Merrill Lynch. The goal of all these new developments in strategy, services, processes, and technologies was to create value.

There is little data comparing the impact of these innovations on value creation by the financial services sector with value creation by other industries. What

little evidence there is suggests that the financial services sector has not created as much value as it should have. At the outset, it is important to recognize that value creation varies across industries as well as within industries. And, value creation varies across time. To put value creation by financial services firms in perspective, consider Figure 1 below. One measure of value created by a firm is Market Value Added (MVA), defined as the difference between the market value of a firm's equity and debt and its economic book value, which is the amount that is invested in the firm. To calibrate MVA, it is useful to compare it with the Capital Employed by a firm. A ratio above 1 indicates that a firm has created value. A ratio below 1 indicates that it has destroyed value.

Using Market Value Added divided by Capital Employed as a measure of value created by firms, Figure 1 shows that some financial services firms (in this instance, banks) have performed rather poorly over the period 1992 to 1995 in comparison with other industries. In particular, during these years banks' MVA/CE hovered in the 50% range. During 1992-1995, banks were unable to even recover the capital invested in them! Only transportation destroyed more value; while manufacturing struggled to stay above water; hotels were barely breaking even and retail firms were experiencing a spectacular nosedive. In contrast, firms in industries as diverse as healthcare and consumer products created large amounts of value during the same period.

Figure 1. Value Creation and Destruction *Across* Industries



Sources: Smith Barney, Stern Stewart, *Business Week*

One implication of these data is that financial services firms may benefit from studying the value-creating practices employed by firms in industries as diverse as healthcare and consumer products. These two industries showcase two very different practices. Healthcare firms have relentlessly pursued cost control while consumer products firms have single-mindedly focused on customers and consumers to understand their wants and needs and then designed and delivered well-suited products efficiently. Could financial services firms emulate such practices?

In particular, could a bank intent on improving itself learn anything from other banks? Figure 1 suggests that this is a rhetorical question and one not even worth addressing. However, Figure 1, tells only part of the story. Consider Figure 2 that shows variations in value creation within four industries. Now we find that there is at least one bank that creates significantly more value than other banks. How? What does this bank do that creates so much value? Figure 2 also shows that there is at least one retail firm and one telecommunications firm that create more value than even the best-performing bank. How? What do this retail firm and this telecommunications firm do that creates so much value?

More recent data suggests that financial services firms, including banks, have improved their record of value creation. To see this and also to get a longer-term perspective on value creation across industries, consider the data in Table 1 below excerpted from the Stern Stewart & Company's list of the top 1000 firms based on market value added as of December 31, 1998. Table 1 lists in descending order the 5-year average return on capital divided by the 5-year

Figure 2. Value Creation and Destruction *Within* Industries

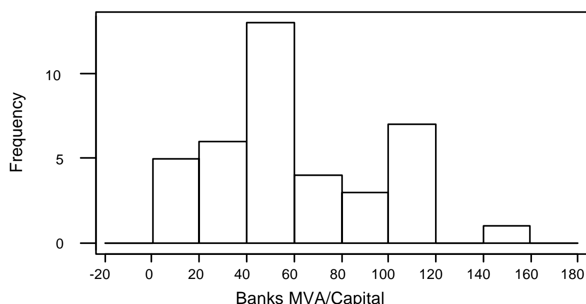
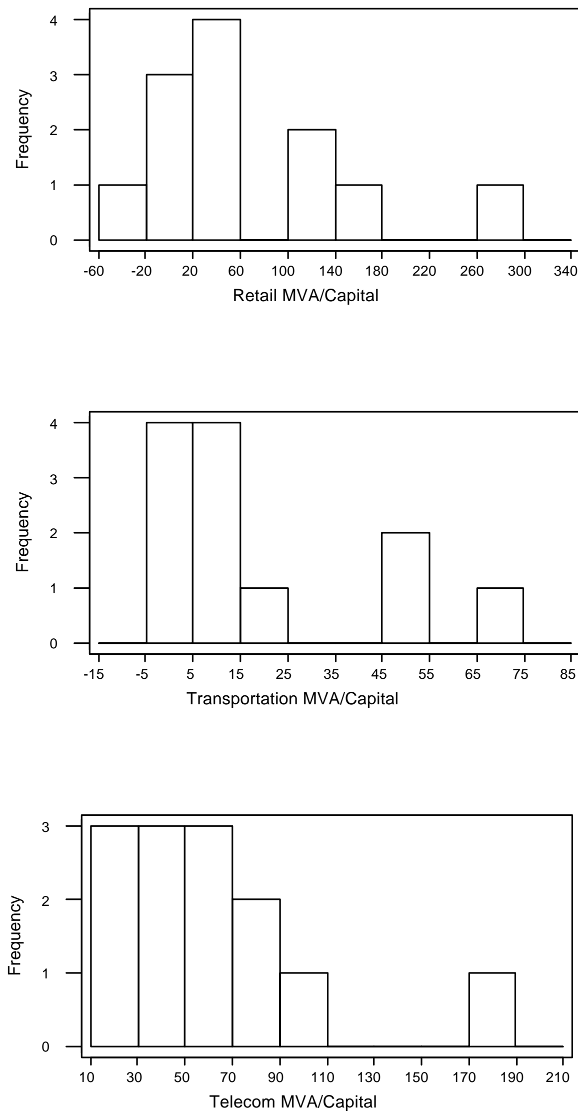


Figure 2. Value Creation and Destruction *Within* Industries



Sources: Smith Barney, Stern Stewart, *Business Week*

average cost of capital for banks, retailers, transportation firms, and telecommunications firms. A number greater than 1 indicates that a firm is creating value. Most of the financial services firms listed in Table 1 created

value. Moreover, the best to worst ratio for financial services firms (in this list) is not as high as is the same ratio for retail, telecommunications, and transportation firms. It should be noted that this result might be an artifact of this list because financial services is a more fragmented sector than the other sectors. Thus, many financial services firms are not represented on this list although most of the firms in the other industries are included. Despite this limitation, the fact remains that the worst financial services firm listed in Table 1 has a long way to go before catching up with the value creation effort of the best firm on the list. A similar conclusion is reached by perusing the credit ratings of insurance firms.

1.2 How Does A Financial Services Firm Create Value?

For long it was thought that functional excellence created value. Thus, a bank that excelled at, for example, origination, distribution, servicing, bundling, intermediating, or making markets was considered likely to succeed in creating value for its customers and ultimately in creating shareholder value. But, customers did not really care about functional excellence. Further, functional excellence could be easily imitated. This view was replaced with the view that unique resources controlled by firms helped create value for customers. Thus, a bank that was large in scale and scope, or one that possessed vast amounts of information, or one that had the greatest reach or best-risk customers was considered most likely to succeed. However, customers did not really care about size or information or reach or risk exposure. And, banks with narrow spheres of operation were better able to serve their local markets than their larger counterparts.

More recently, strategists share the view that a focus on customers in terms of anticipating, understanding and responding to their needs rapidly and efficiently, and ultimately establishing enduring relationships between service providers and customers, creates value that is sustainable and often difficult to imitate. How does that happen? Certainly not by functionally specialized hierarchies, but rather by designing and managing customer-focused processes. For example, Merrill Lynch long held out against Internet trading. Instead, it chose to focus on leveraging existing unique resources and functional excellence embodied in its large brokerage sales force. Its customers, however, began to migrate to Internet trading. Recently, Merrill Lynch gave in and announced that it, too, will join the Internet fray to be able to better meet its customers' needs. Citigroup attributed its recent boost in second quarter earnings to greater customer focus that enabled it to complete 67 fees-based investment banking transactions made possible by the combined efforts of the former Travelers Group and Citicorp units acting in unison to meet customer needs (*New York Times*, July 20, 1999).

Table 1: Index of Value Creation and Destruction, 1992-1997			
Financial Services Firm	**Index**	**Retail Firm**	**Index**
MBNA Corporation	2.76	Dollar General	2.46
Merrill Lynch & Co., Inc.	2.26	Autozone	1.94
Star Banc Corporation	2.18	Home Depot	1.55
Allstate Corporation	2.17	Wal-Mart Stores	1.28
American Express Company	1.85	May Department Store	1.28
Morgan Stanley, Dean Witter	1.83	Costco Companies	1.15
National Commerce Bancorporation	1.82	Limited	1.12
First Tennessee National Corp.	1.64	Kohl's	1.07
Comerica Incorporated	1.63	Consolidated Stores	1.05
Norwest Corporation	1.58	Dillard's	1.05
SunTrust Banks, Inc.	1.56	Toys "R" Us	1.01
Synovus Financial Corp.	1.54	Dayton Hudson	1.00
Summit Bancorp	1.53	Sears Roebuck	0.89
Citicorp	1.46	Staples	0.87
Northern Trust Corporation	1.46	Nordstrom	0.87
BB&T Corporation	1.42	Kmart	0.85
BankBoston Corporation	1.38	Federated Department Stores	0.77
State Street Corporation	1.38	J.C. Penney	0.76
Firstar Corporation	1.38	Pep Boys	0.70
Union Planters Corporation	1.37	Loews Corporation	0.43
First Commerce Corporation	1.37		
Old Kent Financial Corporation	1.36		
Fifth Third Bancorp	1.35		
First American Corporation	1.34		
Mellon Bank Corporation	1.33		
SouthTrust Corporation	1.33		
AmSouth Bancorporation	1.31		
Fleet Financial Group, Inc.	1.30		
Huntington Bancshares, Inc.	1.30		
Bank of New York Company, Inc.	1.29		
First Union Corporation	1.28		
First of America Bank Corporation	1.26		
Chase Manhattan Corporation (The)	1.25		
Associates First Capital Corporation	1.25		
National City Corporation	1.25		
J.P. Morgan & Company, Inc.	1.23		
Bankers Trust New York Corp.	1.21		
NationsBank Corporation	1.20		
U.S. Bancorp	1.19		
Regions Financial Corporation	1.18		
Wachovia Corporation	1.16		
Mercantile Bancorporation, Inc.	1.13		
Republic New York Corporation	1.13		
BankAmerica Corporation	1.09		
First Chicago NBD Corporation	1.05		
CoreStates Financial Corp	1.01		
KeyCorp	0.99		
Hibernia Corporation	0.99		
PNC Bank Corp.	0.98		
Bank One Corporation	0.96		
Wells Fargo & Company	0.91		

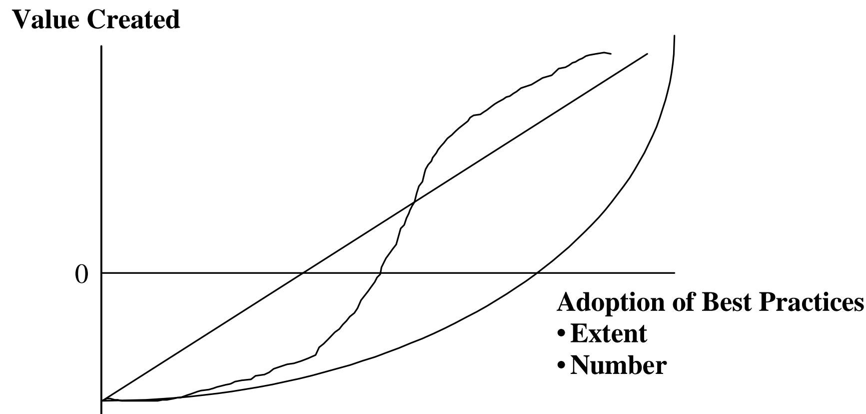
Table 1: Index of Value Creation and Destruction, 1992-1997 (contd)			
Transportation Firm	**Index**	**Telecommunications Firm**	**Index**
Apollo Group	2.56	Tellabs	3.19
Continental Airlines	2.55	SBC Communications	1.73
Northwest Airlines	1.59	Bell Atlantic	1.39
Airborne Express	1.48	Ameritech	1.19
UAL Corp.	1.36	GTE	1.19
Delta Air Lines	1.32	Alltel Communications	1.15
CNF Transportation	1.30	BellSouth	1.14
USAir	1.29	Frontier	0.97
Trinity	1.22	US West	0.89
Budget Group	1.17	Sprint	0.82
AMR Corporation	1.13	AirTouch Communications	0.79
Rollins Truck Leasing	1.10	AT&T	0.57
Ryder System	1.07	MCI	0.42
Southwest Airlines	0.98	Nextel Communications	-1.11
Burlington Northern Sante Fe	0.86		
FDX Corp.	0.83	Qwest Communications	N/A
CSX	0.81		
Brunswick	0.80		
Atlas Air	0.80		
Norfolk Southern	0.72		
Alexander & Baldwin	0.72		
GATX	0.63		
Overseas Shipping	0.54		
Union Pacific	0.53		
AMERCO	0.49		
Newport News Shipbuilding	-0.42		

The index is defined as the 5-year average return on capital divided by the 5-year average cost of capital.
Source: Stern Stewart & Co.

Much of the recent wave of improvement in performance of financial services firms in terms of creating value could be the result of the adoption of, so called, "best practices". Together with the ever-present comparisons made across industries, across firms within industries, and across time, the adoption of best practices is often considered as a means to improve value creation. Lest the quest for identifying and adopting best practice go too far, consider Figure 3 below. Figure 3 is a speculative figure. On its horizontal axis is the extent to which an organization has adopted best practices. For example, this could be measured by the number of best practices adopted, such as Total Quality Management, Just-in-Time materials management, straight-through processing, and Benchmarking. Or, it could be an index created to measure the coverage of best practices within an organization. On its vertical axis is a measure of value created by the adoption of best practices. It would be very useful to know the relationship between the extent of adoption of best practices and value

creation. Is this relationship linear? Does it have a threshold? Is it asymptotic to some limit? Does it exhibit increasing or decreasing returns? Unfortunately, to the best of our knowledge, this relationship of best practices to value created is unknown. Is it unknowable? We think not.

Figure 3. Do Best Practices Always Create Value?



As an example, consider the data in Table 2. It shows the change in stock market value of firms that announced changes in the level and kind of customer service they provide. (For more details see Nayyar, 1995.) One would expect that increased levels of customer service would be positively valued while decreased levels would be negatively valued. In many cases this general expectation is true as indicated by the percent positive and percent negative columns respectively. Of all customer service increases 67% were positively valued while of all decreases 82% were negatively valued. Conversely, 33 percent of *increases* were *negatively* valued and 18 percent of *decreases* were *positively* valued (there were no zero-valued changes). Why did the stock market act in this seemingly perverse manner?

Nayyar (1995) speculated that there might exist optimum levels of customer service beyond which customers and the stock market do not reward firms. In effect, adopting best practices beyond a certain point destroys value. These findings also suggest many other possibilities including decreasing returns and threshold effects. This is but one example of attempts to understand the relationship between adoption of best practices and value creation. The chapters in this book rise to the challenge of connecting best practices to value creation in financial services.

Table 2. Adopting Best Practices and Creating Value: The Case of Customer Service

Stock Market Reaction

3-Day Market-Adjusted Cumulative Abnormal Returns (%)

	Customer Service			
	Increases		Decreases	
Actions	Mean CAR	% Positive	Mean CAR	% Negative
Purchase Risk	0.62	65	-0.43	88
Purchasing Cost	0.58	67	-0.20	82
Ease, Convenience & Cost of Use	0.30	65	-0.23	92
Personalization	0.28	76	-0.09	67
All Actions	0.46	67	-0.22	82

A 1% 3-day abnormal return is equivalent to an annual return of 137%. A 1% abnormal return for an average firm on the *Business Week 1000*, with a market value of $3.8 billion on March 5, 1993, results in an increase in market value, after adjusting for overall market movements, of $38 million in 3 days. (Source: Nayyar, 1995.)

1.3 Beyond Best Practices: The CVFS Engine

What lies beyond best practices? Of course, the creation of value! How then is value created? We suggest that firms must not merely focus on customers. Instead, we advocate that firms must be Customer Value Focused. The difference lies in the explicit attention to creating value for customers. Creating value for customers, in turn, creates value for employees and shareholders.

Once a firm becomes customer value focused, it immediately realizes that it is not only best practices that help it create value. Many other factors affect value creation in financial services firms. Some factors, such as globalization, deregulation, maturing and efficiency of financial markets and changing customer needs and tastes, may be external factors outside the control of individual firms. Others, such as scale and scope of product portfolios and operations, product designs, process designs and technological choices and deployment, are internal factors within the control of individual firms. It is this latter type of factors that this book addresses. Of course, the two sets of factors are not independent. Their interactions must be considered as well.

Furthermore, beyond these two sets of factors are the multiple dimensions of organization design, risk taking, innovation, social awareness and responsibility that can be used to partly explain success and failure in value creation efforts. In fact, financial services, more so than many others, are integral to both the local and global communities within which they operate. Different clients, different regulations, different economies, different employees, might elicit a different response.

Value creation is both an outcome and a process. Value creation is the result of a smoothly running engine that we call the CVFS Engine. It has four key elements—strategies, services, systems and measures of success—that must be carefully designed and meshed to create customer focused value. We extend the notion of customer focus to one of customer value focus. This subtle distinction, we believe, provides the necessary focal point for all of a firm's efforts at understanding the needs of its customers and delivering appropriate services to them at the right time, at the right place and at the right price. Each element of the CVFS Engine and, by extension, each element of all firms, must contribute to customer value. We espouse the view that value is created through the design and operation of the CVFS Engine comprising the following four elements:

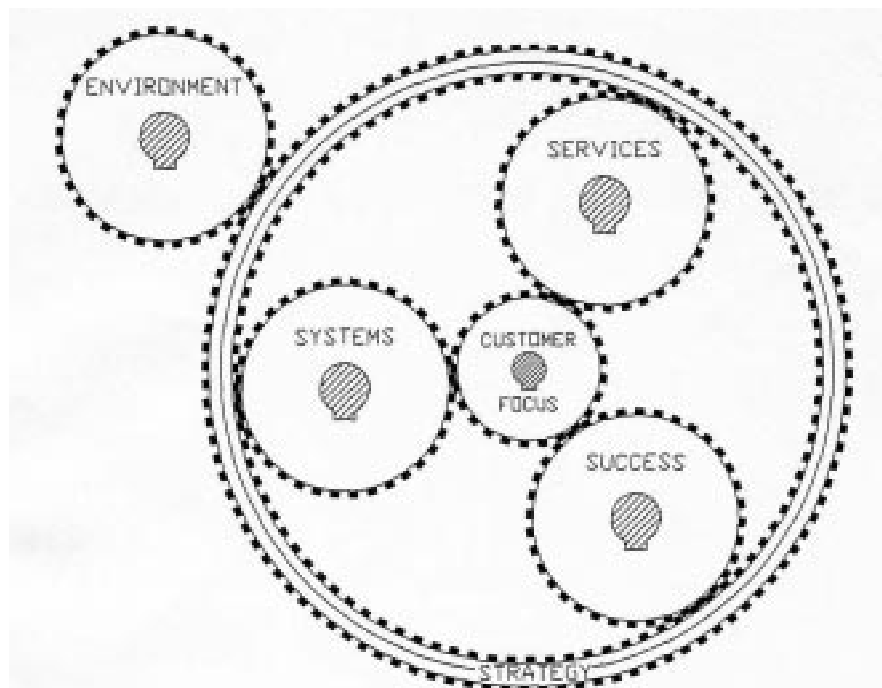
- Customer Value Focused Strategies
- Customer Value Focused Services
- Customer Value Focused Systems, and
- Customer Value Focused Measures of Success.

These four elements are neither independent of one another nor independent of the external environment. This is depicted by the intermeshing gears in Figure 4. And, if the rotation of the gears is not perfectly synchronized the whole system grinds to a halt! This book focuses on each of the four elements.

The need for perfect harmony among the four elements of the CVFS Engine may be illustrated by a few examples of what happens when the gears do not mesh properly. If a large insurance firm that primarily uses independent agents to sell products and services to affluent clients installs a web based process for selling products over the Internet, it would generate conflicts with its existing customer base and may create conflicts in the distribution system of agents. If the measure of success in a bank is defined as the efficiency with which applications are processed, to the extent that such a measure increases the exposure of the bank to the risk of loan-defaults, existing customers who enjoy a relatively low borrowing rate will eventually feel the effects of such a change and will not be quite satisfied. If a competitor introduces technology that significantly lowers costs without reducing quality, the focus may shift from

cost reduction to providing additional information services. A firm in response to this move may have to change its strategy, services, systems and success measures rapidly to stay in business.

Figure 4. The CVFS Engine: Creating Value in Financial Services



The CVFS Engine evokes an image of a precision machine, such as a finely crafted watch, in which every part is precisely designed to fulfill a specific purpose that has value only as a part of a much greater whole. By itself, each element of the CVFS Engine is important but it cannot act alone to create value.

The CVFS Engine also evokes an image of motion. An engine at rest does not create any output. Similarly, the CVFS Engine at rest does not create customer value. It must be in motion to work. Each element must also be able to shoulder its share of the load on the engine in order for the four elements acting together to develop and deliver the desired power to the central drive shaft. If the four elements do not carry the apportioned load, one or more of the elements could be strained beyond breaking point resulting in the total loss of power. If that happens, value cannot be created.

The CVFS Engine meshes smoothly with its environment. It uses inputs from the environment to regulate the rate at which it rotates. It also attempts to "push" the environment to adjust its speed, if necessary, to stay synchronized with the increasing rate of change needed to deliver customer value. Thus, the CVFS Engine both works with and works on the environment in the interest of its customers.

The chapters in this book offer a rich and varied collection of ideas to design and operate the CVFS Engine. Although we have collected the chapters into four sections—strategies, services, systems, and measures of success—this does not imply that each chapter is somehow restricted in its applicability to only one element of the CVFS Engine. On the contrary, every chapter paints a wide canvas. We invite you to see the whole picture by sampling from the book as you like. In this way, each reader will paint her own mosaic. And, each financial services firm will find a unique way to create value.

We do not attempt to offer generally applicable prescriptions for all financial services firms. Instead, this book contains a menu of options that financial services firms could consider. Many options will, if adopted, need to be adapted to suit the particular circumstances of a particular firm. It is our hope that the chapters in this book provide sufficient detail to begin the task of exploration within financial services firms as they determine how best to prepare for, create and exploit future opportunities.

The remaining chapters in the book are organized into four sections. Section 1 contains broad-perspective discussions of customer value focused strategies—both corporate and competitive—for financial services firms. Section 2 discusses customer value focused services using examples from four very specific financial service types. Section 3 highlights various customer value focused systems—technology and process design—that financial services firms need to consider going forward. Section 4 discusses customer value focused measures of success at both the macro- and micro-level to help financial services firms better calibrate the results of their efforts at improving performance.

1.4 Customer Value Focused Strategies

Value creation begins with strategy. A carefully crafted strategy that appropriately addresses customers' needs and wants is a prerequisite for success. The chapters in Section 1 consider customer value focused strategies for financial services firms. Rinnooy Kan (Chapter 2) presents a perspective on the future of global financial services. He sets a stage upon which the ideas contained in this book must play their part in helping to create value in financial services.

The financial world has changed dramatically in only a few decades. Rinnooy Kan considers three main categories of changes: in the market place, on the demand side and on the supply side of the financial services industry. The first category includes developments such as the globalization of financial markets, the changed role of governments and the revolution in the field of information technology. On the demand side, financial services companies have to satisfy more demanding and less faithful consumers who live longer and who expect higher returns on their savings. On the supply side, banks and insurers face competition not only from each other, but also from new suppliers such as supermarkets with banking outlets and providers who know their way on the Internet. Rinnooy Kan argues that although capital and know-how will continue to be crucial for financial services companies, distribution will be the main key to success.

One form of distribution is universal banking. Rogers (Chapter 3) and Walter (Chapter 4) discuss whether and how universal banks create value. Rogers discusses the characteristics of high and low performing commercial banks. Drawing on eight analytical case studies on U.S. and British banks, other case materials and industry statistics he addresses the question of what mix of strategy and organization infrastructure is particularly associated with rising and declining performance. Rogers concludes that although a strategy of growth-by-diversification has met with only equivocal success, forces such as unreflective herd instincts, behavioral contagion, and the diffusion of managerial fads drive managers to nevertheless pursue such strategies.

Since universal banks supply a collection of financial services, Walter suggests that shareholders, in essence, own a "closed-end fund" of assets intended to maximize risk-adjusted returns and hence the market value of the enterprise in relation to its book value. He traces the various sources of value-creation and value-destruction that ultimately explain market capitalization, including a survey of the main empirical findings in the literature. He then suggests alternative ways of enhancing market value of universal banks.

Across all segments of the financial services industry and across all markets, the development and sustenance of enduring multi-product relationships with consumers remains the most hallowed strategic objective. Monahan (Chapter 5) notes, however, that research conducted by The Executive Board Company identified a growing current of dissatisfaction with the payoff from "traditional" relationship strategies (defined as the cross-sales of proprietary products). Despite major investments in more detailed customer knowledge and the growing freedom to sell additional types of products, most institutions reported wide skews in customer profitability, increasing consumer price sensitivity, and greater consumer reliance on multiple providers. Increasing pressure on the traditional relationship suggests a deeper, structural change in retail financial markets caused by falling barriers to entry, decreasing search and switching costs and the rise of advice and consolidation "pure plays". He concludes that this evidence of the rise of buyer power in consumer financial services points to the emergence of a newly powerful customer that has driven pioneering institutions to rethink all the components of their relationship strategies, including deployment of staff, branding, product design, and delivery channels.

Relationships with customers often result in financial services firms offering multiple services as a part of their product-mix. Nayyar (Chapter 6) notes that most such diversifying moves are motivated by expected synergies from either reduced costs or increased revenues. However, cost-reduction is seldom achieved and revenue-enhancement is extremely difficult to accomplish because it requires substantial changes in the way businesses are organized and managed. Nayyar's examination of the performance effects of cost-reduction and revenue-enhancement driven diversification strategies in service firms revealed that revenue-enhancement strategies created value while cost-reduction strategies destroyed value. These results depended upon the type of service involved. The revenue-enhancement strategy was particularly valuable for firms offering services whose quality cannot be determined until after purchase and, even then, with some difficulty such as asset and risk management services. For services whose quality can be determined prior to purchase such as tax return processing, consumer finance, and mortgage lending, cost-reduction strategies could marginally create value.

Nayyar also discusses appropriate organization design—structures and processes—to help attain the desired benefits from diversification by service firms. Since each source of benefits is based on different underlying mechanisms, attaining each benefit relies on the adoption of appropriate organizational structures and processes. For example, attaining cost-reduction benefits requires structuring organizational units based on the particular resources shared between different services. In contrast, attaining revenue-enhancement benefits requires structuring organizational units based on the particular customers shared between services.

Contrary to the view that banks serve narrowly defined market niches, Bhargava (Chapter 7) argues that banks entering emerging markets succeed by building capabilities to serve many markets otherwise they cannot develop any sustainable competitive advantages in the face of fierce competition from well-entrenched local banks. He offers a framework to evaluate and choose business strategies for entry and competition in commercial banking in emerging markets. He argues that global commercial banks have inherent advantages in expanding their operations into emerging markets. However, in the corporate and institutional marketplace, this often does not translate into sustainable competitive advantage because of an inappropriate fit of the product delivery strategy with the overall business strategy for the bank. He illustrates this phenomenon for the transaction services business using the cash management product family as an example. He argues that the only tenable long-term proposition for a global bank is timely investment in delivery capability to serve multiple non-traditional segments in emerging markets.

Melnick (Chapter 8) develops a model that may be used to help financial services firms determine their product portfolio for emerging markets. Using multi-objective optimization, he describes a methodology for determining the location of facilities to serve a spatially dispersed population. The technique is suitable for emerging markets because it combines ideas from the design of experiments with techniques for updating that will suggest modifications as environmental factors change over time. Melnick describes an example of a financial institution considering expansion into an emerging market and at the same time attempting to maximize its customer base. The decision variables he uses are the number and location of branches and the percent of activities that will be dedicated to low-income customers. This approach can be extended to analyze the effects of other policy variables of relevance to a financial services institution.

1.5 Customer Value Focused Services

Firms must design and deliver appropriate products and services[*]. The chapters in Section II discuss customer value focused products and services for financial services firms. Financial services are becoming more complex and the rate of innovation of complex products is increasing as firms attempt to stay ahead in the commoditization race where new products are rapidly imitated. Rapid innovation of financial products creates problems for firms due to a lack of standards, a lack of clearly defined responsibilities in the management of new

[*] The term "products" includes goods and services. In practice, however, "products" refers to specific service offerings such as CDs, derivatives, mortgages and insurance.

financial services among end users, and a lack of definition of clearly defined responsibilities of dealers to end users.

As one example of how to develop and implement customer value focused services, Matthews and Rusinko (Chapter 9) examine two sets of solutions to these problems: standards and the use of specific risk management techniques. These solutions have improved the management of financial derivatives for U.S. financial services firms. Further, they suggest that financial services firms benefit from organizational learning to change strategic direction, organizational structure, deployable technologies, and information management systems when introducing new financial services.

Hosking, Kambil and Lister (Chapter 10) examine trends in electronic brokerage and how major brokerage firms are adapting to an online market place characterized by low transactions costs and margins. They examine strategies of incumbents and new entrants and outline the future of electronic brokerage. They also discuss the relationship between various electronic agents for brokerage and new forms of exchange.

The Internet is transforming the delivery of financial services, and the Charles Schwab Corporation is among the firms at the forefront of this revolution. Dewan and Mendelson (Chapter 11) use Schwab as a case study of the use of the Internet channel. They show how the Internet has come to occupy a place at the core of Schwab's business strategy. They draw lessons from the Schwab experience to shed light on the broader impact of on-line trading on the brokerage industry.

There is a large and growing need for sophisticated analytical software and high-powered computers to evaluate risks associated with complicated securities. Battifarano (Chapter 12) uses the experience of developing The Yield Book, a new product at Salomon Brothers, to draw some critical lessons for conceiving, designing, introducing and growing a new financial service. He argues that broker-dealers, in general, are highly qualified to develop analytical software and manage hardware to satisfy their own internal needs as well as those of the financial community at large. He also suggests that the key to good customer service is providing not only information but also tools to deliver information directly and efficiently to customer's desktops.

1.6 Customer Value Focused Systems

The chapters in Section III consider systems—technological and process design—for financial services firms. Regulatory and technical changes occurring in the financial services and information technology sectors of the

economy are driving a revolutionary convergence of hitherto vertical market segments. Squeezed between these revolutions on its demand and supply sides, McGilloway (Chapter 13) argues that corporate information technology departments will also undergo a profound revolution in the way they are organized and in the services they provide. He suggests that the open nature of standards in the financial services and information technology arenas offer tremendous scope for Chief Information Officers (CIOs) to shrink (cut costs) and link with users (collaborate). Therefore, he expects that the role of the CIO will shift to Chief Integrator or Coordinator.

Karmarkar (Chapter 14) suggests that access is a key aspect of competition in financial service markets. New technologies for information collection and distribution are altering the costs and value structures associated with access to information intensive services. As a result, significant changes are occurring in the configuration of service systems and in industry structure. Karmarkar discusses the role of access in service competition and the effect of technological changes on access, location and configuration. These effects are most visible today in transaction-intensive financial services such as retail banking and brokerage. He argues that they will increasingly affect all financial services and indeed all information based industry sectors.

Dunbar and Garud (Chapter 15) examine the implementation of virtual office technologies in financial services firms. Virtual office technologies are of interest to firms in financial services because of the real estate cost savings and increased productivity that such strategies offer. They argue that it is not clear which functions in financial services are most suitable for implementing such virtual office technologies. They use case experiences to develop a conceptual framework for assessing the value likely to be added by making different functions virtual.

Fan, Stallaert and Whinston (Chapter 16) examine the emergence and growth of electronic financial services such as Schwab and E*trade. The growing popularity of Internet-based transactions is radically transforming long-established business paradigms in every sector of the economy. They focus on the market mechanisms in use in the financial system to explore the implications of a shift to open electronic networks on the traditional relationships between financial institutions and their clients, both household investors and corporate borrowers. They present a design of an Internet-based marketplace where individual investors trade financial assets directly with each other and settle transactions instantaneously. Such systems, they suggest, will render mutual funds and other pooling mechanisms obsolete.

Financial services institutions are providing a rapidly expanding variety of products and services; technology is making customers more mobile, and delay is

unacceptable in financial transactions. These attributes of the financial services sector mean that firms must provide effective, efficient and reliable service or quickly lose customers to competitors. To avoid huge labor costs, financial services firms must develop innovative approaches to managing their workforces and their service delivery process. Larson and Pinker (Chapter 17) outline and provide examples of effective techniques for managing part time and flexible personnel in back room operations, bank teller scheduling and management, improving customer queuing experiences, and the design and operation of call centers to take into account cross-training, learning and cross selling.

Call centers are becoming more important in financial services. They are of importance to retail banking operations, credit card operations and mutual fund organizations. A significant part of the dynamics of call centers in financial services is similar to call centers in other industries. Analyzing both static and dynamic aspects of managing call centers, Pinedo, Seshadri and Shanthikumar (Chapter 18) discuss necessary service, security, and database requirements for call centers in financial services firms. They also analyze the differences between call centers in financial services and call centers in other industries such as airlines. These differences center around the more extensive database requirements necessary to handle each call, as well as the fact that customers of financial institutions tend to be more captive than customers of airlines.

Alouisa, Anderson, Castro, Ennis, Gevarter, and Pandolfo (Chapter 19) discuss Prudential's solution to complex call center problems. Since Prudential is a service oriented business, its success and competitive advantage lies in its ability to give customers the highest quality of service possible, "wherever and whenever" they want it. Managers at Prudential determined that without the proper tools to do the job, service quality would be diminished. PruServ™, a powerful call center application, effectively solved the business problem by providing users with a robust and exciting application that resulted in "world-class" customer service. This translated to the firm capturing an increased percentage of clients' assets and generating incremental revenues.

1.7 Customer Value Focused Measures of Success

Cost, quality, time, productivity and satisfaction are often good broad themes around which performance measures can be developed. However, when it comes down to actually defining and measuring performance there can be large gaps between what was originally meant to be measured and achieved versus what gets measured and the actions taken. Two reasons for the distortion or myopia of measures are lack of foresight and excessive internal focus. The chapters in this section consider several important antecedents and

consequences of customer value focused measures of success for financial services firms.

Patel (Chapter 20) posits that the quality movement in the financial services industry stalled in the mid-1990s after tremendous momentum in the mid-1980s. Significant factors in the failure of the movement include the measures and measurement processes used to evaluate the progress of quality programs and to construct product or process enhancements. Patel calls for financial institutions to employ more sophisticated measurement tools to focus quality efforts on those areas with the greatest impact on customer behavior and tangible financial outcomes. He discusses four statistical methods for linking quality outcomes to financial returns, concluding that, to the average practitioner, the best choice is one that achieves the best blend of accuracy, ease of use and ease of interpretation. From a broader perspective, however, he argues that no matter how sophisticated the measurement processes are, institutions hoping to differentiate themselves need to focus less on incremental improvements in individual metrics and more on wholesale process change.

Chase, Roth and Voss (Chapter 21) compare service practice and service performance of financial services with that of other major service sectors in the U.S. They found that financial services lag hotels, which is the exemplar service sector in both practice and performance. Several practice drivers separated financial services from exemplar counterparts. Relative weaknesses of the financial services sector were seen primarily in the areas of service quality and customer growth, which was ascribed to financial services' improper management of "moments of truth" (the encounters) with customers. They suggest that this is a result of financial services personnel management practices emphasizing cost cutting re-engineering while not emphasizing quality leadership and employee empowerment.

Frei and Harker (Chapter 22) suggest that the development of total quality management, reengineering, and other tools have led organizations to focus on the design and management of production processes. In services, and in particular in banking, this process orientation deals directly with customer interactions with the organization. This focus raises two important questions: (a) does such a process-orientation matter to the overall efficiency of an organization? and (b) what are the characteristics of effective process management in financial services firms? They summarize a four-year research effort to understand the role of process performance in the overall efficiency of banks. They recommend effective approaches for designing and managing key service delivery processes for financial services firms.

Cutler (Chapter 23) suggests that, for at least the past decade, banks have made three promises with regard to improving productivity. First, that new technology will reduce the workforce size. Second, that closing branches and migrating customers to lower cost distribution channels will increase productivity. And third, service levels (i.e., greater convenience, zero defects, and expanded product sets) will rise leading to higher customer satisfaction. Research conducted at Booz, Allen and Hamilton, a management consulting firm, reveals some alarming insights into the true productivity trends of the major banks in the U.S. Notwithstanding this, he argues that there are some institutions that are achieving superior productivity by focusing on instilling disciplined operations management capabilities.

Presenting a macroeconomic perspective on productivity growth in services, Solow (Chapter 24) discusses important issues in productivity definition and measurement for services. Highlighting some particularly vexing problems in measuring productivity in service industries, he suggests that the financial services sector, in collaboration with business schools or other interested research agencies, could make a valuable contribution in developing ways to define and measure the real output in this and similar service industries.

1.8 Conclusion

We believe that the CVFS Engine is an effective and parsimonious framework for designing and delivering financial services in an increasingly competitive global economy. It evokes images of precision, motion and oneness with its ever-changing environment. Every chapter in this book assists financial services firms to design and operate their own CVFS Engine—one that uniquely addresses the needs of customers to create value for them.

References

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