



Retail Banking in the Contemporary Financial Environment

Karaoulanis Andreas MBA, MScEng

Blekinge Institute of Technology, SE- 37179 Karlskrona, Sweden

andrekaroul@gmail.com

Abstract

Which challenges does the retail banking industry face nowadays? Walking on the path of M. Porter's theories, the author tries to open a window in the retail banking's present and future, the challenges the industry faces, the main forces that shape the competition, the strategies deployed in order to create a competitive advantage for the industry players, and a short prognosis for the industry's future.

Keywords:

Retail; Banking; competitive strategies; Porter; Main forces; Prognosis.

Academic Discipline and Sub Disciplines:

Economics; Strategy; Market- based management.

Type (Method/Approach)

Literary Analysis



Council for Innovative Research

Peer Review Research Publishing System

Journal: Journal of Social Sciences Research

Vol. 9, No.1

jssreditor.cir@gmail.com

www.jssronline.com



INTRODUCTION

By the term retail banking, we mean that area of banking which is primarily focused on individual customers, and is usually made available by commercial banks. Savings and checking accounts, bill paying services, credit and debit cards, mortgages and personal loans, even different kinds of insurances and retail brokerage are some of the products the retail banking usually offers to its customers. The retail banking is well addressed to every consumer.

Retail banking is an industry which one can argue that is a sub division of the whole banking industry. The retail banking profitability which springs from the profits that gives to the bank mainly the difference between the deposits and the loan's rates of interest, can bring to the bank further profitability via the investments' department. In simple words, this means that the bank invests the money it earns to other markets in order to gain more money and to be able to pay its customers' interest.

THE MAIN FORCES THAT SHAPE COMPETITION-STRATEGY IN RETAIL BANKING

The main forces that shape competition, thus strategy in retail banking industry, according to Porter (2008) are: threat of new entrants, rivalry among existing competitors, bargaining power of buyers, threat of substitute products or services.

Threat of new entrants

The retail banking industry has not been disrupted in the past by new entrants. A big barrier to new entrants was the "capital requirements" (Porter, 2008, p.81) Due to its nature the banking sector is very costly for new entrants who have to spend a lot of money in order to get into business. This is a deter paragon for them. In addition, many retail banks have the tendency to create loyal customers. When a new entrant attempts to get into business, he must gain a market share which is very difficult especially in the beginning, because customers don't have the tendency to trust their money to newcomers. In this difficult first period new entrants have to overcome the expenses that will arise from the operation of the bank. This customers' tendency to trust banks which others customers patronize is called "network effect" (Porter, 2008, p.81) and is another deter paragon to new entrants.

It is very important for one to notice that the last years due to the expansion of internet the threat of new entrants has rapidly increased in the retail banking. These new entrants although they may not be banking institutions, are making their first step into retail banking business by using online banking as a platform for achieving their goals. These companies are some of the globally leading ones and the most well- funded, such as Wall Markt, which offers a growing array of financial products including small business and consumer credit. (banking2020, 2011, p.3)

Rivalry among existing competitors

Another important factor which modifies the retail banking strategy, is the "rivalry among existing competitors" (Porter, 2008, p.85). This rivalry takes many forms some of which are the introduction of new products, the improvements in customer service, the advertising campaigns and even higher rates of interests in deposits and lower in loans.

Almost every retail bank the last years have introduced many new customer service approaches, such as the internet banking, the phone banking, the smart credit cards, the ATMs etc. Furthermore, retail banking, especially the last years, got involved into many new categories of customers' needs, such as insurance and health care. The last years, especially the years within the large financial crisis, many retail banks focused in increasing their deposits due to lack of liquidity. In these terms, they decreased the interest in an intense rivalry between them, in order to gain a bigger market share in capital adequacy.

Due to the large number of global competitors, the rivalry intensity grew up to extreme levels. The slow growth of the industry the last years, especially after the financial crisis, made the big players of the industry and not only to give an everyday fight in order to maintain or to grow their market share (Porter, 2008, p.85).

The retail banking industry is one of the most competitive industries globally. It is a global industry which is active in almost every country in the world. The big players in retail banking industry worldwide and especially in the European Union are inter alia large national and international commercial banks, savings banks, cooperative banks, and a growing array of other financial and non-financial institutions. (Gardener E., Howcroft B. & Williams J., 2006) The dominant players, and big rivals in retail banking business, globally are: Deutsche Bank, HSBC, BNP Paribas, Industrial and Commercial bank of China, Mitsubishi FJ Financial Group, Credit Agricole, The Barclays Group, The Royal Bank of Scotland, JP Morgan chase, Bank of America.

Bargaining power of buyers

Retail banking industry structure is an important paragon in terms of defining the gap between revenues and costs (Porter, 2008, p.87) which means that the intense rivalry between retail banks reduces the loans' rates of interest and increases the deposits' rate of interest. Also customers, especially the period after the financial crisis, can bargain better rates of interests as the demand for capital has increased among retail banks. Customers of today are very stickler for new sophisticated products and transaction systems, such as the internet, mobile banking etc. In order for retail banks to meet their customers' needs, they must invest a large amount of money to new technology and to maintain equilibrium between customers' needs and profits. (Porter, 2008)



Threat of substitute products or services

Another important factor that shapes the retail banking industry competition is “the threat of substitutes” (Porter, 2008, p.84) Although in retail banking there are no substitutes, (by the term substitute we mean products or services which perform the same or similar functions as another industrial product but with different means (Porter, 2008, p.84)) the last years through the evolution of the internet a potential substitute arose. The bitcoin is a new way of transactions via the internet. In some countries there are even ATM machines that can execute transactions with this new kind of currency.

Of course this new product is in its beginning phase but it attracts more and more consumers who are willing to change their traditional point of view of the retail banking system. Industry's profitability is not threatened, for the time being, from this substitute product, because it is in its early stage, but in the future, due to the expansion of internet, this potential threat can create many profitability problems to the retail banking industry.

COMPETITIVE STRATEGIES in RETAIL BANKING

It is widely accepted that there are three distinct competitive strategies in retail banking, cost, focus and differentiation leadership (Porter, 1980, cited in Howcroft, 1991, p.1) Cost leadership is a structure concerned with producing lowest possible cost structure in order to expand the profit margin. Focus strategy involves the production of specific products which address to specific categories of consumers and aim in prevailing in a specific segment of the market. Differentiation strategy aims in offering a unique product or even one product in a unique way (Howcroft, 1991, p.1)

In today's markets the strategic goals of the retail banking industry involve cost leadership and primary differentiation leadership in terms of providing services in a unique way, in order to achieve the best possible customer satisfaction. The purpose of the adaptation of such strategic goals is based upon two factors. In terms of cost leadership, retail banks had to decrease their expenses in order to widen their profit margins by following a more austere way of budgeting. In terms of differentiation leadership, retail banks made the last years a turn in their strategy philosophy by focusing primary on customers. This kind of attitude must be considered as a differentiation strategy (Howcroft, 1991).

As Dawar N. (2013, p.102) indicates, “the strategic question that drives business today is not “what else can we make?” but “what else can we do for our customers?” This point of view, which is mainly the idea of contemporary retail banking strategy, is underlining that the strategic goals of today's retail banking is focusing on customers' needs and their purchasing criteria which can drive the pace of the market evolution thus becoming the strategic goals of the retail banking (Dawar N., 2013, p.102) It is thereby assumed from the above that downstream activities, such as delivering products for specific consumption circumstances (Dawar N., 2013), are the field in which retail banks have to gain their competitive advantage by emphasizing in influencing their customers' purchasing criteria by focusing on them and innovating, in order to solve any potential problems their customer have, in order to deliver a better thus antagonistic customer satisfaction (Dawar N., 2013, p.103). This has become the main retail banking strategy nowadays.

Retail banks of today are providing multichannel environments. They try to approach their customer's needs via multiple channels, such as internet, branches, phone banking, ATMs etc. These multiple channels provide big opportunities to retail banks, as they can enhance their customer's satisfaction (Rangaswamy & Bruggen (2005), cited in Klaus & Nguyen, 2013, p.431)

Another competitive advantage retail banks try to acquire is the linkage between them and their customers. Retail banks need to create a kind of bond with their customers in order to make them remain “loyal” to the brand name of the bank. This is quite difficult as antagonism nowadays is very tight in terms of costs and rates of interests. Many customers tend to be clients in more than one bank. Others, feel comfortable to be linked to only one bank in order to cultivate a more intimate relationship with just one bank, as that fact makes them feel more trust. It is very important, and this is one big bet for the retail banks, to create loyal customers. This turns out to be a great competitive advantage (Dawar N., 2013, p.103).

The innovations the retail banking has introduced the last years, such as internet banking, phone banking etc. can be called as downstream innovations (Dawar N., 2013, p.107) as they can reduce cost and risk for customers and gain them time as much as they can give them the flexibility needed in modern times. This is creating a downstream value which can outcome a competitive advantage. It is very important to notice that this is not always the case, as technology although it is a necessity, is not a panacea in the market evolution (Dawar N., 2013, p.108). This is why retail bankers tend to focus more and more on customer's satisfaction as a strategic goal.

EXTERNAL FORCES THAT INFLUENCE THE RETAIL BANKING INDUSTRY

The strategy, thus the growth of the industry, is highly influenced by governmental interventions. (Porter, 2008, p.86) Governments can create circumstances due to which the retail banking sector must differentiate its strategic goals in terms of antagonism or products and interests. Many of these decisions are usually coming when difficult situations in local or global level occur, such as the financial crisis which brought many new laws -policies in terms of guarantee of the deposits of retails customers up to the limit of 100,000 euros per person etc. Such laws -policies can make customers deposit their capitals or on the contrary, if we have laws that do not guarantee their deposits, to make them take their deposits from the banks. This inevitably can lead the retail banking industry to increase the deposits' rates of interest in order to attract new or to maintain its existing customers. Government operates at many levels and can affect the structure of specific industry such as retail banking in many ways. (Porter, 2008, p.86)



Also, the retail banking business can be influenced from many other external factors such as social problems, monetary crisis, natural disasters and anything else that can affect financially its customers.

Finally, one can notice that many organizations follow the industry closely. The stock exchange, many investors, banking analysts etc.

RETAIL BANKING THE LAST YEARS and PROGNOSTICS FOR THE FUTURE

Internet banking has been one of the most significant innovations in retail banking industry the last 10-15 years. The last ten years (2000-2010) the volume of transactions done through branches has decreased. The expansion of electronic channels such as internet banking, mobile phone banking, automatic transactions and ATMs has absorbed a big number of the total transactions which in the past mostly occurred via the branches. (Infosys.com, 2011)

The big change in retail banking strategy occurred the last years when the retail banks changed their point of view by focusing now not on their products but on their customers (tellervision, 2011). This customer- centric approach became the vehicle for the leading retail banks in order to set themselves apart from other institutions and achieve their profitability goals. In the future, retail banking will focus on quite different approaches in order to achieve profit and retain a high market share (PWC-retail banking2020, n.d.):

1. Developed markets' populations are ageing, which means that their focus will be rather on investment and savings than on credit and consumption.
2. In the next 30 years almost 1.8 billion people will move into cities notably in Asia and Africa creating a big potential population of customers to which retail banks can sell new financial products.
3. In both developed and emerging countries customers focus more and more in financing their well- being in lifelong basis. This will bring wealth management in the frontline of the products offered by retail banking.
4. Fee- based revenues will increase as a percentage of total in developed markets and China.
5. The internet banking will be a major pillar of the retail banking, although cyber insecurity is and will be a threat to the internet retail banking business.

CONCLUSIONS

Retail banking has a global presentation with a huge number of present and potential customers. The industry has set its strategic goals mainly by focusing on customer satisfaction. Digitalization is going to play an important role in the competitiveness and strategic formation of the industry in the future. Innovation is very important although it is not the only way to bring involvement and profitability. Competition in retail banking industry is very tough, but as Porter indicated (1979, p.79) "the job of the strategist is to understand and cope with competition". In this essence, retail bankers have to have a vision and to be ready to cope with competition in order to maintain or even increase their market share.

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Andreas Karaoulanis is currently working in Alpha Bank Greece. He has an MBA degree in Industrial Management and Economics from Blekinge Institute of Technology Sweden and a MSc in Engineering from Aristotle University of Thessaloniki. He is very experienced after 25 years of working in several industries like engineering, banking, retail and consulting. He is a Linked In blogger with many managerial posts.