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Financial Services

# Thriving in the new economy: perception vs. reality

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# Executive summary

The new economy is with us. The dramatic growth globally in Internet-based transactions – up more than 300% in the past year alone – is the reality. Yet many established financial services companies are not taking on board the real implications of eBusiness for their business. eBusiness is not only rewriting the rules of distribution within the financial services, it is reshaping the way companies go to market, the way customers buy products and services, and the way that success will be achieved in this century.

We surveyed 200 leading companies from across the financial services sector to find out how they are perceiving – and responding to – this revolution at the heart of the industry. What we discovered were some striking – and concerning – mismatches between the reality of eBusiness today and the reaction of the industry to its potential:

It's all about facade.
The perception is that the Internet is a shop window rather than a store whose doors should be wide open to the marketplace. Few respondents saw the potential for eBusiness to provide a broad-based business platform, either internally or via alliances.

The reality is that the success of eBusiness will depend on having sites that provide a range of attractive products and services. The pervasive nature of eBusiness will affect the entire organization and will involve the creation of strategic and tactical alliances across each industry, but especially outside it.

It's all about one-way communication.
The perception is that the Internet is wonderful for giving information to the customer, rather than getting information from or vigorously interacting with the customer. Very few respondents focused on the importance of getting close to the customer, aggregating customer data, and creating value-added relationships.

The reality is that managing customer relationships, customer information and customer retention are critical to future survival. New and deeper forms of relationship management are in the offing. They are essential to creating value that is more than just a rehashing of past products and services on a new electronic platform.

It doesn't involve much change.
The perception is that existing platforms, marketing approaches and organizational structures are adequate to meet the challenges of the eBusiness environment.

The reality is that almost nothing within existing business models can survive without comprehensive re-examination, retooling and redirection – from physical capital to intellectual capital, from human resources to strategic direction. Hierarchical organizations simply do not fit in the unforgiving rules created by the Internet.

It won't alter industry structures.
The perception is that the way the industry goes to market by segment will continue.

The reality is that, for those who want to seize the future, existing industry boundaries are history – as indeed are the boundaries between the financial services and a host of new entrants coming from outside the sector.

It will only enable, not transform, business.
The perception is that eBusiness will enhance existing models of customer interaction, organization, management and performance measures. eBusiness is seen as less important than consolidation, diversification and efficiency.

The reality is that eBusiness is not only reshaping each of these areas, it is the means by which change is occurring at an accelerating rate.

## Key findings

- Current strategic challenges
  Businesses rank a number of strategic issues as more important than eBusiness, despite the fact that eBusiness is reshaping these issues – and can provide a solution to them.

- Drivers and barriers to the adoption of eBusiness
  Customer acceptance will be the main driver of eBusiness growth. But transaction security and the fear of making the wrong choices are top-of-the-mind issues for business leaders.

- Marketing approaches to eStrategy
  Companies see eBusiness as a marketing rather than a transactional platform, as a way of communicating to, rather than interacting with, their customers.

- Outsourcing
  The potential costs of making the wrong technology choices are beginning to reshape business attitudes to outsourcing technology solutions.

- Organization of eBusiness
  Business wants to integrate eBusiness into current management structures, rather than create stand-alone operations or use eBusiness as a platform for reshaping their existing organization.

- Taxation and regulation
  Respondents believe over-regulation on certain products and cross-border activities will hamper eBusiness growth.

- Future eBusiness directions
  Despite their own general caution, respondents are enthusiastic about the Internet generating significant levels of growth in the coming years.

This Arthur Andersen survey was developed to assess perceptions of eBusiness among professionals from both established players and new market entrants within the financial services community. It covers the customer facing segments of the business in both highly developed as well as developing economies in the eBusiness world.

Our goals were to identify the gaps between market perception and reality, the supports for and barriers to developing effective eBusiness operations, the implications for existing business models and the challenges that tomorrow's successful companies must address.

Our objective was to uncover the rationale for a persistent gap between the industry's acknowledgement of the power of eBusiness and its preparedness to invest in developing an eBusiness solution.

# Thriving in the new economy: perception vs. reality

In the last five years, eBusiness has moved from being a facilitator of traditional business to a transformer of business in its entirety. It has achieved this in three dimensions:

- Transforming established businesses through the restructuring of distribution, customer management and transaction processing
- Transforming non-financial services companies into highly successful entrants in a very competitive industry
- Transforming the relationship between customers and producers to create a genuinely consumer-driven marketplace.

The measure of this success can be seen in the overall growth in Internet transactions, which have soared from virtually zero six years ago to an expected $400 billion in 2000. The impact of eBusiness in creating new business models can be seen in the phenomenal growth of new entrants who are wholly web-based, such as E*Trade, or the web-based operations of established institutions such as Charles Schwab, which radically changed its business model and saw stunning growth in the past year alone, and offshoots of established institutions, such as Egg, an Internet-only bank that is a subsidiary of UK Prudential.

While eBusiness is attracting a phenomenal amount of attention and revolutionizing the marketplace, its capacity to transform business and to rewrite the relationship between customers and suppliers or producers in the financial services industry remains barely realized. Why is this? Our survey sought to surface the attitudes and perceptions of both traditional and new market participants on the transition of eBusiness from potential to reality.

- If eBusiness is the future, what is really stopping institutions from seizing the opportunity?
- Is there a future outside the Internet? Will ‘chips-and-clicks’ fully replace ‘bricks-and-mortar’?
- Will today’s cannibals become tomorrow’s conquerors? In the new economy, does fortune favor the early entrant or the cautious late-comer?
- How will tax and regulation shape the eBusiness landscape?
- In a world without boundaries, where do today’s players see tomorrow’s successes?

While eBusiness is revolutionizing the marketplace, its capacity remains only barely realized.

While ‘true’ eBusinesses such as E*Trade or SoftBank dominate the headlines, the majority of financial services companies remain uncertain as to their strategic or tactical response.

A clear majority of our respondents still rated consolidation and cost reduction as strategically more important than eBusiness – while apparently not realizing that eBusiness provides a solution to both.

Industry studies, including our most recent asset management survey[1], consistently show that top executives in the financial services industry, as well as others, regard eBusiness as enormously important – except when it comes to committing to an investment. Generally, surveys conducted in the past 12 months indicate that only 20-25% of respondents among top executives are actually prepared to translate a professed strong faith in eBusiness into investment. Our survey clearly shows a lot of ambiguity when it comes to taking decisive action. If eBusiness is the future, what is stopping institutions from seizing this opportunity? Do they see a great risk in making the first move, or are there other areas of concern?

### Seeing opportunity is different from seizing it

There is no conventional business model for the eBusiness world. The explosion in market valuations, online users and business volume has no parallel in industrial history. It is tempting to say that the virtual nature of the financial services industry makes it a more natural ally to the non-physical universe of eBusiness. But as our survey shows, this is not quite the case. While ‘true’ eBusinesses such as E*Trade or SoftBank dominate the headlines, the majority of financial services companies remain clearly uncertain as to their strategic or tactical response.

### Drivers and potential advantages in using eBusiness for financial transactions (chart 1)

This uncertainty cannot persist, if only because the rate of change and transformation is rapidly accelerating. Despite the swift changes in the eMarketplace, a recent survey by Interbrand and IBM identified only a handful of banks qualifying as fully Internet in their operations. These included three from the US, three from the Nordic region, two Swiss institutions and banks in the UK and Germany. There is clearly a long way to go for financial services firms to embrace and capitalize on the eBusiness phenomenon. Web-based transactions in the most web-advanced economies still account for a low overall percentage.

### Importance of eStrategy relative to other strategic company issues (chart 2)

For many of our survey participants, eBusiness remains a passive or background factor, rather than a positive strategic initiative. A clear majority of our respondents still rated consolidation and cost reduction as strategically more important. Similarly, they ranked diversification in both the product and market mix, as well as delivery platforms, as more important in their strategic considerations than eBusiness. What is interesting is the implied absence of linkage between the tools offered by eBusiness and many of these factors. eBusiness growth is not only directly contributing to creating these strategic pressures, it also provides a powerful platform for addressing them. Indeed, eBusiness pressures companies to decrease costs while at the same time offering the means to do so. The substantial impact on transaction costs alone (a decrease of 89%)[2] has forced banks to look at their cost base with even greater intensity.

What is preventing companies from either making this connection or acting on it? Certainly transaction security is in everyone’s thinking as we discuss this platform. Tied to this issue is respondents’ concern that a major barrier to the development of eBusiness lies in the danger of making the wrong decisions. Among these wrong decisions, of course, could be the real danger that by choosing to do nothing, institutions may well see their market share eroded by aggressive new competitors.

[1] Asset management: challenging strategic perceptions of tomorrow’s markets, Arthur Andersen Global Financial Services research papers, June 1999.

[2] Organisation for Economic and Cooperation and Development (OECD), The economic and social impacts of electronic commerce: preliminary findings and research agenda, 1999, page 14.

1
## Drivers and potential advantages in using eBusiness for financial transactions

| | % spontaneously mentioned |
|---|---|
| Customer acceptance/eBusiness culture | 48 |
| Reduced costs of accessing Internet | 25 |
| Increased security of transactions | 24 |
| Increased access to Internet/Cross-border deregulation | 22 |
| Evolution of payment system | 12 |
| Speedier access, faster responses | 9 |
| Increasing dialog with customers/Improving customer services | 9 |
| The need to be competitive | 9 |
| Ease of use | 8 |
| Better communications, more interfacing, easier access to information | 7 |
| Improving efficiency | 6 |
| Establishment of eBusiness tax haven | 4 |
| Development of digital TV as an alternative media platform | 2 |
| Development of alternative media platforms | 2 |
| Others | 15 |
| Don't know | 8 |

2
## Importance of eStrategy relative to other strategic company issues

| | % less important than eStrategy | % more important than eStrategy | Mean score |
|---|---|---|---|
| Consolidating, cost reduction, streamlining | 18 | 49 | 3.53 |
| Diversifying products/markets | 24 | 46 | 3.38 |
| Multiple delivery platforms | 20 | 39 | 3.37 |
| Strategic partnerships | 23 | 39 | 3.27 |
| Tackling threat of disintermediation | 20 | 32 | 3.27 |
| Globalizing operations and/or brands | 27 | 36 | 3.18 |

Industry respondents were also less sanguine about two other internal factors – calculating the return on equity of eBusiness investment and, more importantly, having the appropriate range of talents to support eBusiness growth. Yet, respondents do see that customer acceptance is driving the pace of eBusiness growth, as is the lower cost of Internet access. What seems to emerge is a picture of institutions who perceive the potential strength of the market, but who are deferring action.

First in the race, in the financial services industry, is not always first to the finish line, especially given the industry's uncertainties about eBusiness. Only 21% of the sample rated early adopters of eBusiness from among local financial institutions as the leaders in five years' time. Instead, respondents favored the fortunes of the larger, global players – many of whom have yet to create substantial eBusiness operations. A disjointed picture emerges between the real and immediate progress of eBusiness within the financial services industry and the willingness of management to relate this to their own strategic and investment choices. Global financial institutions are seen as the future leaders, perhaps because of the reduction of restrictive regulatory barriers that stimulate globalization.

Management does not make the fundamental connection between the real and immediate progress of eBusiness within the financial services industry and their willingness to relate this to their own strategic and investment choices.

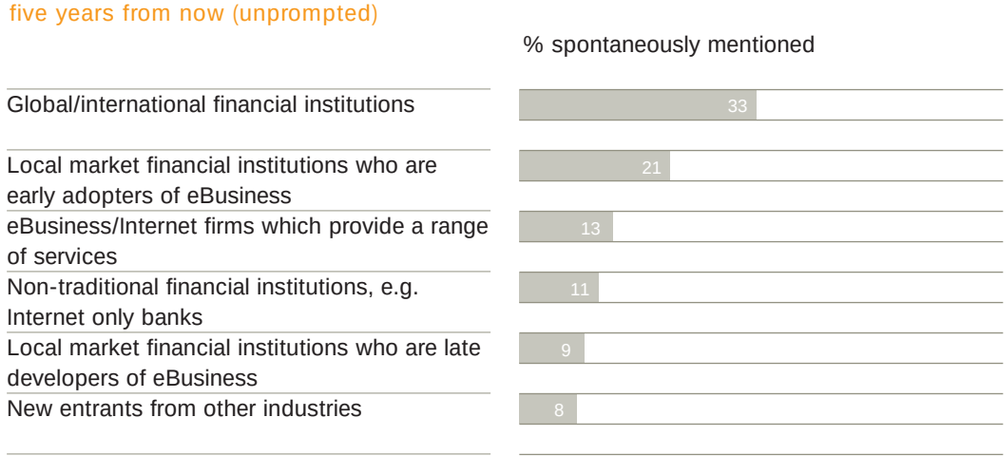
### Financial services eBusiness leaders – five years from now (unprompted) (chart 3)

Financial institutions may put off investing because they do not see the current size of the Internet customer base as being a large proportion of their existing customer base. This underlines the view of many respondents that eBusiness is only one more channel in an essentially 'business as usual' approach. Rather than looking to an expansive potential market, they are focusing still on their existing marketplace. In some cases, such as in insurance, this belief is underwritten by the current small share of Internet penetration in client or even target audiences. The 'end game' may not be visible yet in most sectors; therefore, it is not deemed important to act right now. So decisions are being driven by current customer demand, to which institutions cautiously respond without undergoing the transformation required by an eBusiness strategy focused on the future Internet market.

### 'Chips-and-Clicks' vs. 'Bricks-and-Mortar'

In line with the findings of our earlier asset management survey, respondents recognize that the development of eBusiness will alter their existing distribution channels and alliances, with over half the sample seeing eBusiness having a direct impact on existing distribution channels. Despite this, respondents placed a number of more traditional channels and distribution strategies higher in importance to future business growth than eBusiness. This included the maintenance of multiple delivery channels and strategic partnerships, both of which were ranked twice as important as eBusiness in their strategic priorities.

3
Financial services eBusiness leaders – five years from now (unprompted)



A challenge for established players is the need to balance the level of integration of existing distribution channels within an eBusiness environment. The solutions adopted range from the maintenance of a portfolio of channels, from physical branches to Internet services to the creation of entirely separate Internet operations. Financial services institutions are also wrestling with the issue of how best to meet customer service requirements in a 'virtual' world and how those services should be priced – both to protect and expand their customer base. Many institutions are handicapped by management structures which value internal process and organizational hierarchy over the customer interaction. The new economy favors flatter organizational structures which are shaped around the need to meet – and indeed anticipate – customer demand. Building this platform creates 'customer intimacy' and further enhances an organization's ability to continuously develop the relationship between suppliers and consumers.

For commoditized products, such as mortgages and non-life insurance products, the message is clear. Market competition from new entrants has made the economic realities of eBusiness imperative to future survival. In just five years, Direct Line, a UK-based motor insurer, transformed that sector by offering its products by phone. The impact of these new entities is going beyond their domestic markets; online mortgage brokers E-Loan and Mortgage.com are promising to reshape the credit market in the US, Asia and Europe. In just three years, E*Trade and Charles Schwab revolutionized the brokerage industry and slashed dealing costs by 90%. The creation of the first wholly Internet-based investment bank was announced in November. The clear victim of these trends are intermediaries, which have seen their commissions eroded by more than 50% in all key geographies.[3]

Despite these recent, and radical, restructurings of the marketplace, the industry is still divided over the right approach to its future on the Internet. There is no right approach. There are only best practices. There is a persistent, if largely intuitive, belief that customers will continue to require certain kinds of advisory services, particularly in the asset management and long-term savings sectors. Defining the potential size and scope of this market for advisory services is a more difficult exercise, as the provision of information and analysis over the Internet becomes more generally available to consumers across the income spectrum. For the industry, defining the right approach to the provision of these services may involve a mixture of online and traditional resources, echoing trends seen in some online retailers.

## Cannibals and Conquerors

Established institutions have made a considerable investment over the past decade in developing their branch and distribution network, as well as in the organizational, procedural and technical infrastructure to support that network. This outlay represents a heavy cultural as well as physical investment, as both the management structure and career path within many of these organizations have been driven from models which predate the rise of eBusiness.

Respondents are sensitive to the fact that eBusiness will change many aspects of current reality in a number of areas – none more sensitive than the potential impact on existing channels and structures. Economist Joseph Schumpeter, looking at the first electronic revolution of the Twentieth Century, noted that a great shock to industry – such as the introduction of eBusiness – will be followed by a period of 'creative destruction' as established players are replaced by innovative outsiders and newcomers.

Respondents recognize that the development of eBusiness will alter their existing distribution channels and alliances.

The new economy favors flatter organizational structures which are shaped around the need to meet customer demand.

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[3] OECD, page 68.

Perhaps the only choice established companies have is to act as the innovators themselves. Companies such as Charles Schwab set the pace by taking the decision early on to allow e.Schwab to 'eat' into the market share of the company's traditional brokerage business. This decision resulted in a tough hit on earnings ($125 million, accompanied by a deep dive in stock price), which clearly was short-term, and which has left the company offering a blended mix of online and advisory services. Most recently, Merrill Lynch has acknowledged the eBusiness imperative by reshaping its own channels.

Despite the fact that web-based transactions cost less, setting up a new channel or an entirely new business can be an expensive proposition, as the established players cannot 'turn off' existing channels.

If there is no alternative to cannibalization for established players who want to be serious about eBusiness, there remain some options on how to tackle this issue. Schwab and Merrill Lynch have chosen to spread their brand across very different distribution channels. This can work, but has usually been more successful for retail brands with greater market stretch, such as Virgin and Carrefour. For this reason, an alternative approach is to mute overt cannibalization by creating a newly branded entity, such as Egg or Wingspan (the Internet banking offshoot of US retail banking giant Bank One). This strategy effectively seeks to separate potentially competitive offerings within the market, and was used to this end in the early 1990s by the former Midland Bank (now HSBC) when it launched FirstDirect, the first mass market telephone bank in the UK.

Of course, both of these alternatives come with a cost – what can initially be a very heavy investment. Despite the fact that web-based transactions cost less, setting up a new channel or an entirely new business can be an expensive prospect, as the established players cannot 'turn off' existing channels. At the same time, they must compete in a market that spends upwards of $500 in advertising and/or acquisition costs for every new customer.[4]

## Risky business

Survey participants made several references to the impact of tax, legal and regulatory issues on the development of eBusiness domestically and internationally. This reflects growing concern among governments on the revenue implications of electronic international financial businesses as well as their potential to circumvent existing restrictions. The legal status of Internet-based transactions remains unclear in several major jurisdictions. The sensitivity in this area clearly derives from the non-physical nature of financial services in contrast, for example, with the more easily applied restrictions on the shipment of physical commodities, which already exist in some jurisdictions.

eBanks of course must comply with their local country tax and legal regulations regarding anti-money laundering provisions, deductions of tax from interest or evidence of eligibility for exemption, and reporting of customer details as well as the thorny issue of customer privacy. While institutions based in onshore tax jurisdictions address these issues, the highly competitive offshore sector sees eBusiness as a natural extension of existing efforts to serve as hubs for the cross-border distribution of financial products.

Certain jurisdictions are already taking up the potential for more liberal operating environments. Indeed, web institutions can set up virtual offshore holding companies over the net. For example, companies wanting to carry out eBusiness from Bermuda are now able to do so without forming a Bermuda company, registering with the Bermuda government, or paying any Bermuda taxes. A new service enables Hong Kong businesses to access the online registration networks in Anguilla. This is likely to be affected by moves from 'onshore' governments to push their offshore dependencies to re-examine the tax and regulatory framework.

[4] The Online Brokerage Battle, Joseph Kahn, New York Times, 10/04/99, page C1.

The global trend towards deregulation and increased cross-border transactions may act as a catalyst for eBusiness. However, regulations at the national and intergovernmental level may have the opposite effect. For example, the European Union regimes on data protection and consumer protection may have the effect of prohibiting significant data flows on individuals between the EU and US, and may also mandate increased regulation as increased disclosure rules are brought into play at the retail end. This leads to speculation and uncertainty as to what level of government will ultimately address eBusiness regulation and taxation. In the largest Internet market, the United States, state tax regimes on the treatment of eBusiness are being hotly debated. A potential solution at the multilateral level, for example the World Trade Organization, seems some distance away.

## Tomorrow's successes are happening now

eBusiness is a reality, but for many financial services companies, eBusiness strategy remains locked within old models. It is clear from the way the market has grown that tomorrow's successful eBusiness players within financial services are already staking their ground. Our survey results suggest that many in the industry are still poised, rather than prepared, for action.

The brand value of established players does constitute a first line of defense. eBusiness transactions which are based on financial rather than physical commodities are by their nature operating at two layers away from the consumer. A trusted name can provide assurance to consumers as to the security or reliability of the eBusiness provider, but this must be balanced against potential brand dilution/cannibalization of existing business.

eBusiness is rewriting the role of information and knowledge in business. By unlocking the monopoly of information formerly held by producers and putting it in the hands of consumers, it has subverted the information advantage that underwrote the classic models of financial services market interaction. Successful eBusinesses, such as E*Trade and E-Loan, have used the concept of open access to formerly restricted information as a key element in their marketing platform. For example, E*Trade advertises that 90% of the site information available to their clients is also available to non-fee generating members. That knowledge is power has been proven. In the new paradigm, sharing knowledge and information hands power to consumers.

This erosion of the classic business model has an impact on the way products are priced as well as how they are sold. Price transparency has strengthened the consumer's hand in the electronic marketplace. Power is being transferred to the customer and consequently the providers' pricing power is diminishing. Price transparency further pressures producers in this marketplace. It enables consumers to disaggregate their financial product purchases on the basis of cost as well as service factors, which was outside the options available to them until today. For this reason, today's successful eBusinesses structure their operations on a seamless transaction flow from front-to-back-office, to ensure that the customer relationship and the transaction are managed as efficiently as possible on both a service and cost basis.

Indeed, the need to understand the market and the customer has never been more important. This may be the most immediate and important requirement of eBusiness. Many of the marketing disciplines that have supported the growth of traditional companies remain true, but Internet technologies now allow companies to be more sophisticated and broad-based in managing the customer relationship. This, more than any other factor, underlines the imperative for companies to move from viewing the Internet as a marketing platform into using the Internet as a transactional platform.

Unless eBusiness becomes real in a meaningful way to the financial services industry, the opportunities it presents will remain untapped. Transformation of existing perceptions must be driven by an understanding that the revolution in the industry is underway now.

eBusiness is a reality, but for many financial services companies, eBusiness strategy remains locked within old models.

The fact that knowledge is power has been proven. In the new paradigm, sharing knowledge and information hands incredible power to customers.

## Growth

On average, respondents saw retail eBusiness growth near 90% over the next two years, with banking achieving the lowest (69%) and asset management the highest (158%).

## Strategies

Only 18% of respondents viewed eBusiness as more important than consolidating, cost reduction and streamlining, while only 20% saw it as more important than multiple delivery platforms.

## Winners

33% of respondents see global financial institutions as the eBusiness winners five years from now. 21% believe the leaders will be those who adopted eBusiness early, while only 8% see new entrants from other industries as future leaders.

## Drivers

Customer acceptance, reduced costs of Internet access, increased security and cross-border deregulation were among respondents' top five spontaneously mentioned drivers and potential advantages in using eBusiness for financial transactions.

## Barriers

Top five issues that hinder the use of eBusiness were transaction security issues, the cost of making wrong decisions, the ability of their organizations to support eStrategy, the difficulty of projecting return on investment on eBusiness and the lack of Internet infrastructure accessible to customers.

## Partnerships

Less than 30% of respondents envisioned their institution as being part of a network mobilized around another organization as opposed to 42% who envisioned acting as the center of a web of partnerships.

## Marketing

54% of respondents believe their eBusiness customer target groups are well-defined. 51% state they have a customer retention strategy in place. 48% cite that they have a customer acquisition strategy in place.

# Key findings

In this section, we highlight and summarize key findings. For further analysis, we have created an appendix that outlines our survey methodology and sample as well as supporting data in a series of graphs. Key findings cover:

- Current strategic challenges
- Drivers of, and barriers to, adoption of eBusiness
- Marketing approaches to eStrategy
- Outsourcing
- Organization of eBusiness
- Taxation and regulation
- Future eBusiness directions

## Current strategic challenges

One of the most surprising findings of the survey was respondents' persistent ranking of a number of core strategic issues as being more important than eStrategy. This reveals a contradiction in thinking as to how to achieve the integration of eBusiness into their organizations. Asked to rank the importance of eBusiness compared to other business strategies, respondents consistently rated the better known and understood issues as more important. These included:

- Consolidation, cost reduction and streamlining
- Diversification of products and markets
- Strategic partnerships
- Multiple delivery platforms
- Globalization of operations and brands
- Disintermediation

The weighting given to these factors indicates that respondents did not see any innate linkage between eBusiness and its capacity to support strategic change in the areas outlined. Within sectors, some differences emerge. Insurers, for example, generally ranked eBusiness more strongly against these categories than other segments of the industry.

## Drivers of, and barriers to, the adoption of eBusiness

Respondents' perception of the drivers and potential advantages of using eBusiness for financial transactions implies that eBusiness strategies are not being integrated as part of a comprehensive platform, although there does appear to be a reasonable level of sensitivity about customer-driven growth. This is reflected in the 48% of spontaneous responses of customer acceptance as a driver in using eBusiness for financial transactions. This, however, far exceeded the next two categories of spontaneous responses of reduced access costs (25%) and increased transaction security (24%). Disappointingly, only 9% saw increased dialog with customers and improving customer service as a potential advantage of the system. This does suggest respondents have yet to buy fully into the interactive nature of eBusiness.

Two areas were identified as hindering financial services organizations' move to eBusiness. The issue of transaction security, as perceived by customers, was of critical concern to participants. Nearly half (43%) of respondents polled saw security as a vital factor for eBusiness success. Of almost equal weight is companies' fear of making the wrong decisions, and the cost this could bring (40% viewed it of critical concern and 32% viewed it with some concern). These findings suggest that management perceptions on security are lagging those of customers. Other barriers appearing on the radar screens include recruitment and retention of appropriate personnel and the difficulty of projecting return on investment. Interestingly, despite the steep growth of access to the Internet, respondents still see lack of Internet access as a key barrier to the use of eBusiness.

Asked to rank the importance of eBusiness compared to other business strategies, respondents consistently rated the better known and understood issues as more important.

Respondents' perception of the drivers and potential advantages of using eBusiness for financial transactions implies that eBusiness strategies are not being integrated as part of a comprehensive platform.

Certain regulatory and compliance issues are perceived as hampering eBusiness growth. These include potential restrictions on certain types of products or transactions and on cross-border activity, as well as increased tax regulation – or rather over-regulation – of eBusiness (see Taxation and regulation below). Respondents also lack confidence that eBusiness will provide a sustainable source of custom, i.e. that its novelty will not translate into ongoing and longterm business. This may reflect that horizon developments in areas such as digital TV and wireless commerce are on their minds, but may more simply reflect respondents' uncertainty about the eBusiness phenomenon more generally.

Our experience shows that organizations developing an eBusiness initiative often either sorely lack a marketing perspective or have an improperly aligned marketing strategy.

69% of respondents favored acting as suppliers of their own financial products, yet experience bears out that successful organizations are on the broker/distributor side.

## Marketing approaches to eStrategy

Despite all the concerns expressed about the acceptability and sustainability of eBusiness from a strategic or operational perspective, the majority of our respondents stated they had eBusiness customer targeting and customer management strategies in place, and nearly two-thirds believe they have an effective technical infrastructure to support it. This has not been the experience of our consultants to date in working with clients in a number of key economies and may well reflect some unwarranted optimism on the part of respondents. In fact, our experience shows that organizations developing an eBusiness initiative often either sorely lack a marketing perspective or have an improperly aligned marketing strategy.

Survey participants gave a wide range of priorities for developing eBusiness. These include:

- Extending the range of services, meeting customer demand for eBusiness
- Better communication with customers, support services
- Growing/improving market share
- Attracting new customers, exploiting eBusiness market potential
- Keeping up to date with new technology
- Maintaining current position/retention of customers

69% of respondents favored acting as suppliers of their own financial products, rather than as brokers and suppliers of other organizations' financial services, yet experience bears out that successful organizations are on the broker/distributor side. The participants further confirm this pattern, however. When asked about the most appropriate Internet distribution strategy, 42% plan to offer their own products with hyperlinks to other companies products (not necessarily in the financial services industry) and a third of the sample plans to offer only their own products. Remarkably, only 13% plan to integrate their offerings into other online services, perhaps reflecting the fact that the better-established ISPs, such as Yahoo, already have a substantial suite of financial services offerings.

Some differentiation among sectors occurs, however, between asset managers and other segments. Asset managers expressed stronger preference toward delivery of individual products and services, and toward operating independently in delivering those services to the marketplace. On the other hand, both banks and insurers saw themselves focusing on the development of networks of strategic partners.

In this area, banking institutions also viewed themselves as being providers of infrastructure or services to support eBusiness, which was ranked lower by asset managers and insurers. One of the more interesting outlayers in this area was insurance. Respondents from that industry tend to see themselves as 'going it alone'. The longer-term impact of the eBusiness phenomenon may well be to force existing institutions to choose between being manufacturers or distributors of financial products to best exploit their core competencies.

More interestingly, the majority of respondents (54%) claimed to have their eCustomer target groups well defined in terms of demographics and behavior and to have both customer retention (51%) and acquisition (48%) strategies in place. Again, this is not in line with other findings, nor with our own experience of clients in the financial services marketplace. It may again signal that respondents view eBusiness more as a marketing platform than as a transactional platform. Clearly there is a sound basis for this opinion. One may merely look at the successes of eBusiness leaders such as Amazon.com, who have barely begun to turn a profit, yet through sheer marketing prowess – and spending – have amassed a market cap to rival many traditional, long-profitable businesses.

Looking ahead, respondents showed a strong market-facing approach to prioritizing their eBusiness activities. Asked to rank these, survey participants spontaneously mentioned extending the range of customer services, enhanced communication, growth of market share and attracting new customers. Of these, the customer communication finding is interesting when contrasted with respondents' earlier rather low ranking (9%) of increased dialog with the customer as a driver or potential advantage of eBusiness. Surprisingly, respondents do not mention the potential advantages of the customer dialog eliciting more information on the customer to support the sales process and overall relationship management.

## Outsourcing

Despite respondents' confidence in the capacity of their current IT infrastructure to support eBusiness, a significant number saw total (21%) or partial (51%) outsourcing in this area. This might reflect survey participants' expressed concern about potentially making the wrong decision with regard to the eBusiness approach. It may also signal the trend to use application service providers (ASPs) as a proactive strategy, recognizing that to compete in a market that is growing exponentially, only the larger scale ASPs will be able to deal with scalability issues and process transactions in the most cost efficient manner. It is creating a new business model of collaboration and interaction across the entire supply chain (e.g. Egg's recent selection of enCommerce to provide Internet-scale infrastructure).

## Organization of eBusiness

In line with respondents' belief that they have an effective marketing strategy for eBusiness, the survey sample was robust on the ability of their current infrastructure to support an eBusiness operation. 69% said their organization has a front-to-back-office IT system in place capable of supporting eBusiness. This does not ring true with the experience of our consultants in working with eBusinesses. 72% of respondents rated current management and strategic planning skills as either "very" or "fairly" effective. Similarly, 62% saw current processing capacity as "very" or "fairly" effective, although the per cent rating processing as "very effective" was much smaller than for either management or IT. These findings contrast with the importance given by respondents to consolidation, cost reduction and streamlining as being significantly more important than eBusiness as a strategic issue and reflects a certain disconnect in seeing the clear linkage between enhancing eBusiness operations and achieving such cost reductions.

The high ranking given by respondents to their existing infrastructure may explain why 63% of the survey saw eBusiness as being incorporated into their existing operations. However, a fifth of the sample saw eBusiness operating as a stand-alone function and a smaller group (10%) saw eBusiness as becoming a replacement platform for all of their business. This points to the caution of respondents in buying into eBusiness fully and further implies that they see it as a means of improving, but not necessarily transforming, their business.

The picture that emerges is of considerable hesitancy as to how business operations should regard this new phenomenon and reflects the spread of answers as to the function of eBusiness in terms of customer communication, acquisition and maintenance. The findings are remarkable, given the success of businesses that have cast themselves in a wholly 'e-incarnation'.

Respondents view eBusiness more as a marketing platform than a transactional platform.

Respondents do not mention the potential advantages of the customer dialog eliciting more information on the customer to support the sales process and overall management.

Despite their caution, respondents do see the Internet generating significant levels of growth in the coming years.

The fortunes of non-traditional financial institutions, such as Internet insurers, were more positively predicted by European and North American participants than those of Asia-Pacific.

### Taxation and regulation

Overall, respondents were uncertain as to the indirect or direct tax advantages of offering products electronically. The majority of respondents see certain jurisdictions taking up eBusiness to capitalize on their favorable tax treatment. There was strong support (50%) for the potentially positive impact of the establishment of 'eBusiness havens' to boost eBusiness on a regional basis. Respondents were divided as to whether financial institutions would move their eBusinesses to such havens.

Cross-border deregulation and increased Internet access are again widely tipped to fuel eBusiness growth. But there is also some concern that certain types of products and certain areas of regulation will continue to impede growth of this channel.

### Future eBusiness directions

Despite their caution, respondents do see the Internet generating significant levels of growth in the coming years. Within asset management, eBusiness is expected to increase a prodigious 158% in the retail sector over the next two years. Contrasting retail and wholesale, respondents expected to see an overall 88% increase in retail business in the next two years and a 62% increase in wholesale business over the same period. For asset management, wholesale growth is expected at almost twice the combined level of other financial services sectors.

On a regional basis, European participants were extremely buoyant about growth prospects in the retail sector, predicting a 103% increase in revenues. This is in line with expected increases in eBusiness activity as Europe catches up with North America in terms of Internet penetration.

Looking ahead, 54% of the sample agreed that channel conflict and cannibalization would occur. The greatest impact would be on traditional outlets (35%) and intermediaries (19%). The survey participants strongly favored the fortunes of the large global financial institutions, which they rated as having the greatest chance of success in this marketplace. Regional variations were more marked in this area, with European respondents being most positive. North America saw local financial institutions that are early adopters of eBusiness more positively, particularly insurers and asset managers.

The fortunes of non-traditional financial institutions, such as Internet insurers, were more positively predicted by European participants than those of North America and Asia-Pacific. Finally, eBusiness/Internet firms who provided a range of services were perceived as winners by a large margin among North American and Asia-Pacific institutions over their European counterparts. Asia-Pacific institutions gave no support to the future of local market financial institutions that are late developers of eBusiness, whereas Europe and North America were a little more optimistic. However, the Asia-Pacific respondents showed stronger support for new entrants from outside the financial services industry than the European and North American participants.

# Appendix

# Methodology and sample

The global eBusiness survey asked organizations offering financial services as part of their overall product offering about their perceptions on the factors supporting the growth of eBusiness and some areas which are potential roadblocks. The sample included established financial services companies as well as new entrants. The survey sought to identify what is causing the gap between the industry's appreciation of the potential of eBusiness and the reluctance to translate that appreciation into investment. Work done by Arthur Andersen, as well as other industry analysts, has identified a persistent disconnect between appreciation and investment. The factors we looked at include:

- Importance of eStrategy relative to other strategic company issues
- Direction of eBusiness operations
- Marketing approach being taken
- Drivers and advantages of using eBusiness
- Issues hindering the use of eBusiness
- Taxation of eBusiness

Respondents were also asked to identify:

- Main priorities in developing eBusiness
- Existing infrastructural supports for eBusiness
- Appetite for outsourcing areas of eBusiness activity
- Most appropriate Internet distribution strategies
- Anticipated growth of eBusiness within the next two years

The results highlight areas of management concern with regard to eBusiness as part of their overall strategic development and reveal some primary areas for management action over the coming year.

Arthur Andersen's Global Financial Services Industry practice has undertaken this survey to understand more fully the factors influencing management thinking on eBusiness and to assess the attitude of participants about the future direction of eBusiness within financial services. Our research was conducted in conjunction with Research International, an independent London-based market research agency which is part of WPP's information consultancy portfolio. This research is part of an ongoing series of surveys and thought pieces which Arthur Andersen publishes as part of our commitment to contributing to industry debate on future strategy and current tactics. It also provides a body of globally gathered data to inform discussion within the industry and provide a basis for our ongoing dialog with industry leaders on how best to maximize competitive advantage in the global financial services market.

The research methodology employed in this survey is quantitative and based on 200 interviews conducted between September and November 1999. Of that total, 88% were conducted with established financial services companies, where respondents included chief executive officers, chief information officers and senior executives with some responsibility for their company's eBusiness strategy.

The first chart shows regional distribution of respondents. The second shows the sectoral distribution.[5]

Participants were presented with a series of statements in individual interviews covering a broad range of topics relevant to eBusiness in their industry. They were asked the direction of their eBusiness strategies, the importance of eBusiness vis-à-vis other components of their overall strategy and their perception of the eBusiness development in their own company and the global marketplace in general. Participants were asked to identify spontaneously the factors driving adoption of eBusiness and which factors would have the greatest impact on the growth of the industry going forward, either positively or negatively. They were then asked to identify, from among a list of factors driving change, which factors hinder adoption of eBusiness. They were also asked their opinion on the likely percentage increase in revenues from eBusiness operations in the different sectors over the next two years, and who the leading players would be as eBusiness develops.

### 200 interviews achieved were geographically distributed as follows:

| Total Americas | 74 |
|---|---|
| North America | 60 |
| USA | 52 |
| Canada | 6 |
| Other | 2 |
| South-central | 14 |
| Mexico | 8 |
| Argentina | 5 |
| Paraguay | 1 |

| Total Europe | 90 |
|---|---|
| UK | 26 |
| Germany | 15 |
| Switzerland | 15 |
| Luxembourg | 13 |
| France | 6 |
| Spain | 5 |
| Italy | 3 |
| Other | 7 |

| Total Asia-Pacific | 36 |
|---|---|
| Japan | 23 |
| Singapore | 6 |
| Hong Kong | 7 |

### Total sample classified by principal activity %

| | |
|---|---|
| Financial services | 87 |
| Manufacturing | 4 |
| Retail | 2 |
| Energy/Utilities | 1 |
| Wholesale distribution | 1 |
| IT/Telecom | 1 |
| Construction | 1 |
| Other services | 2 |
| Others | 1 |

### Classification of financial services organizations %

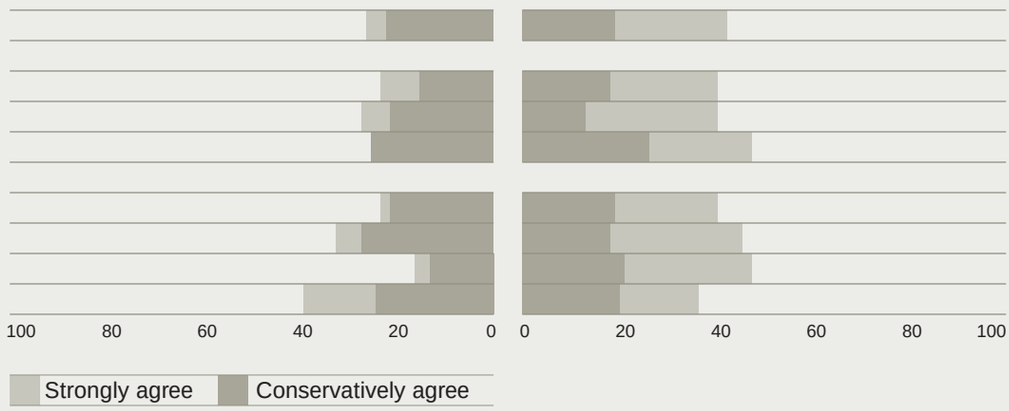
| | |
|---|---|
| Banking | 62 |
| Asset management | 19 |
| Insurance | 14 |
| Custodian banking | 2 |
| Other | 4 |

Note: figures in all bar charts have been rounded to the nearest integer, so may not total 100%.

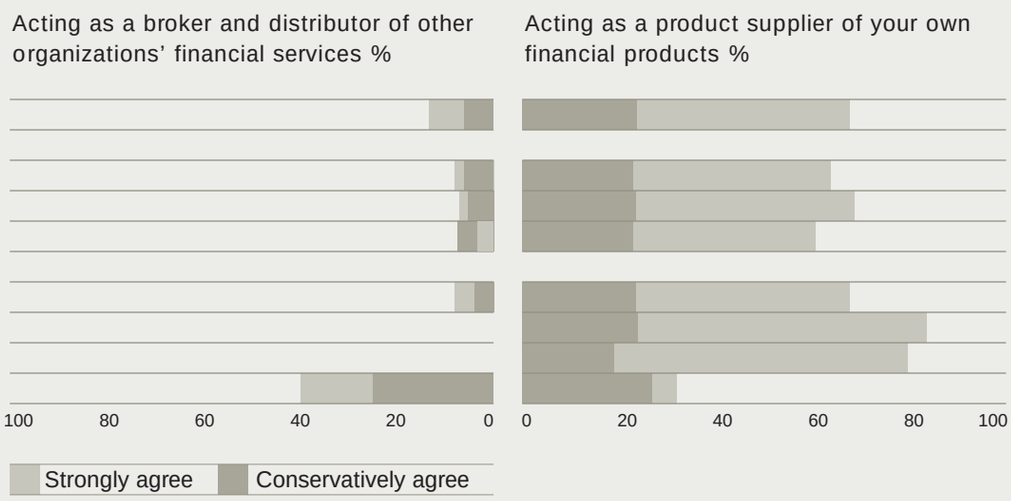
[5] Note that this survey did not address brokerages to a large extent, because we felt that this area has already received a large amount of attention. We will revisit this sector in our next eBusiness survey which will focus on the wholesale sector.

# Direction of eBusiness operations

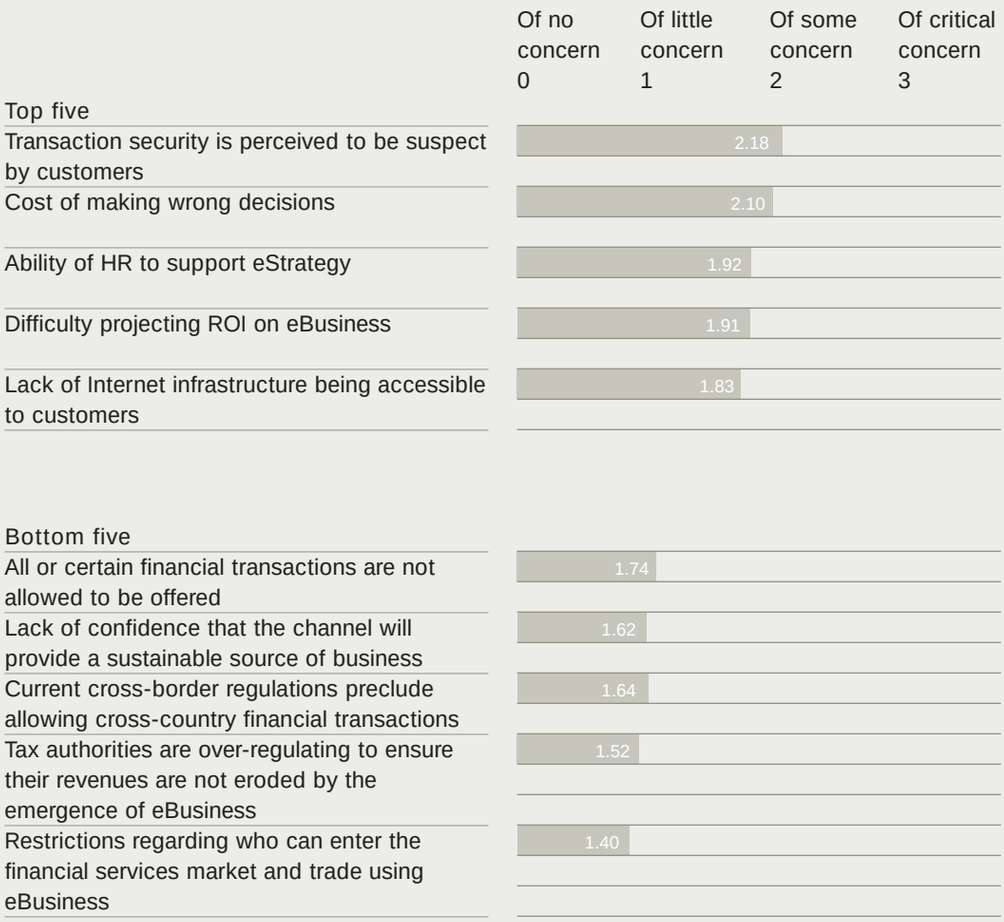
| | Neither % |
|---|---|
| Total sample | 20 |
| Europe | 24 |
| North America | 23 |
| Asia-Pacific | 8 |
| Banking | 20 |
| Asset management | 15 |
| Insurance | 25 |
| Other | 12 |



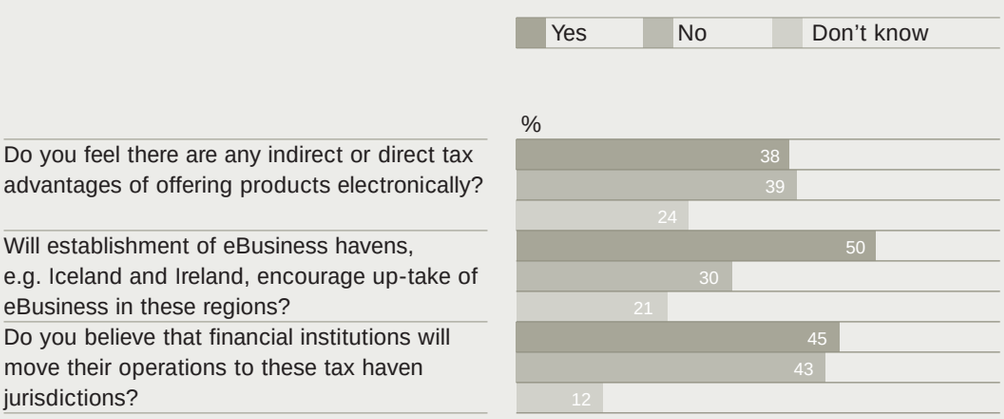

| | Neither % |
|---|---|
| Total sample | 17 |
| Europe | 19 |
| North America | 15 |
| Asia-Pacific | 22 |
| Banking | 18 |
| Asset management | 15 |
| Insurance | 4 |
| Other | 28 |



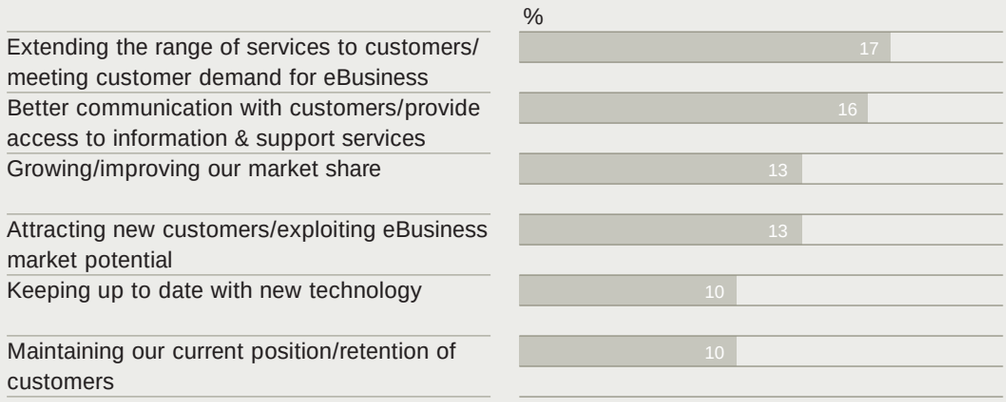
# Issues that hinder use of eBusiness



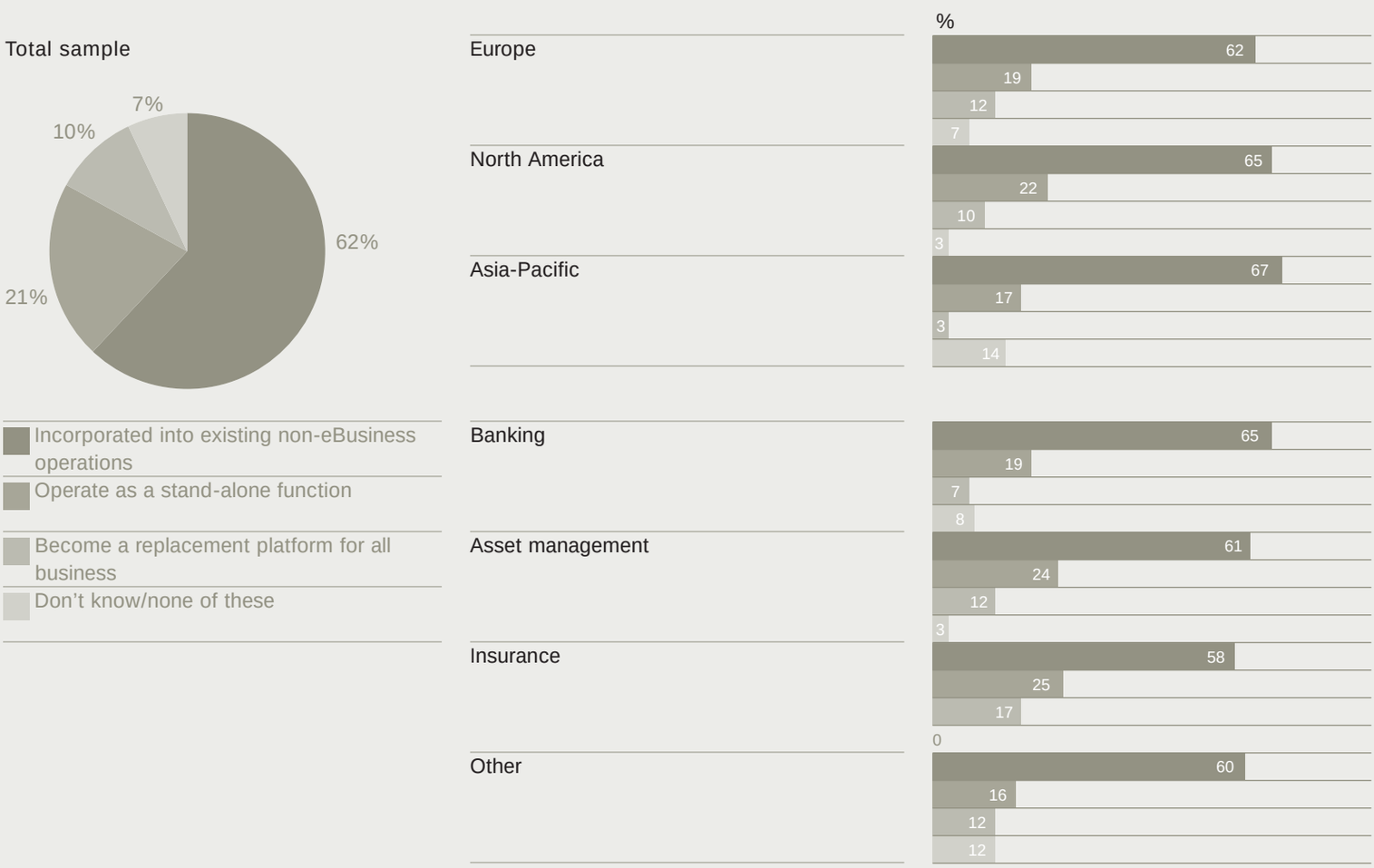

# eBusiness taxation issues



# Main priority in developing eBusiness activity (spontaneous)

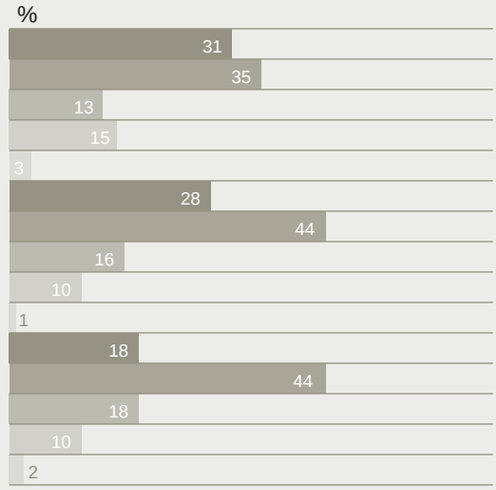



# eBusiness operations strategy



# Support for eBusiness

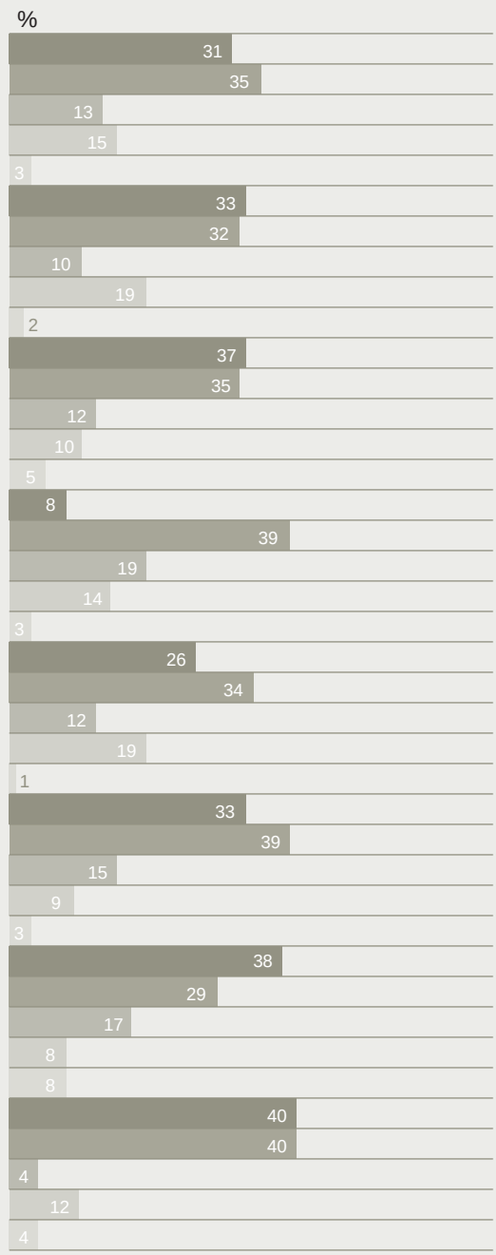
## From existing infrastructure




- Very effective
- Fairly effective
- Neither
- Not effective
- Not at all effective

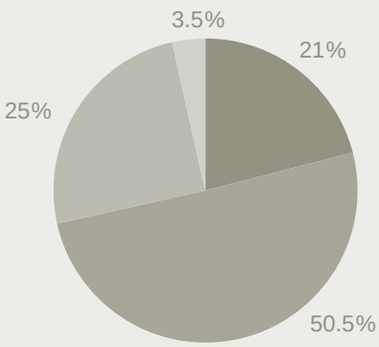
Some respondents replied ‘don’t know’ but are not represented on the chart.

## From IT



# Control of eBusiness development – internal vs. external

Total sample



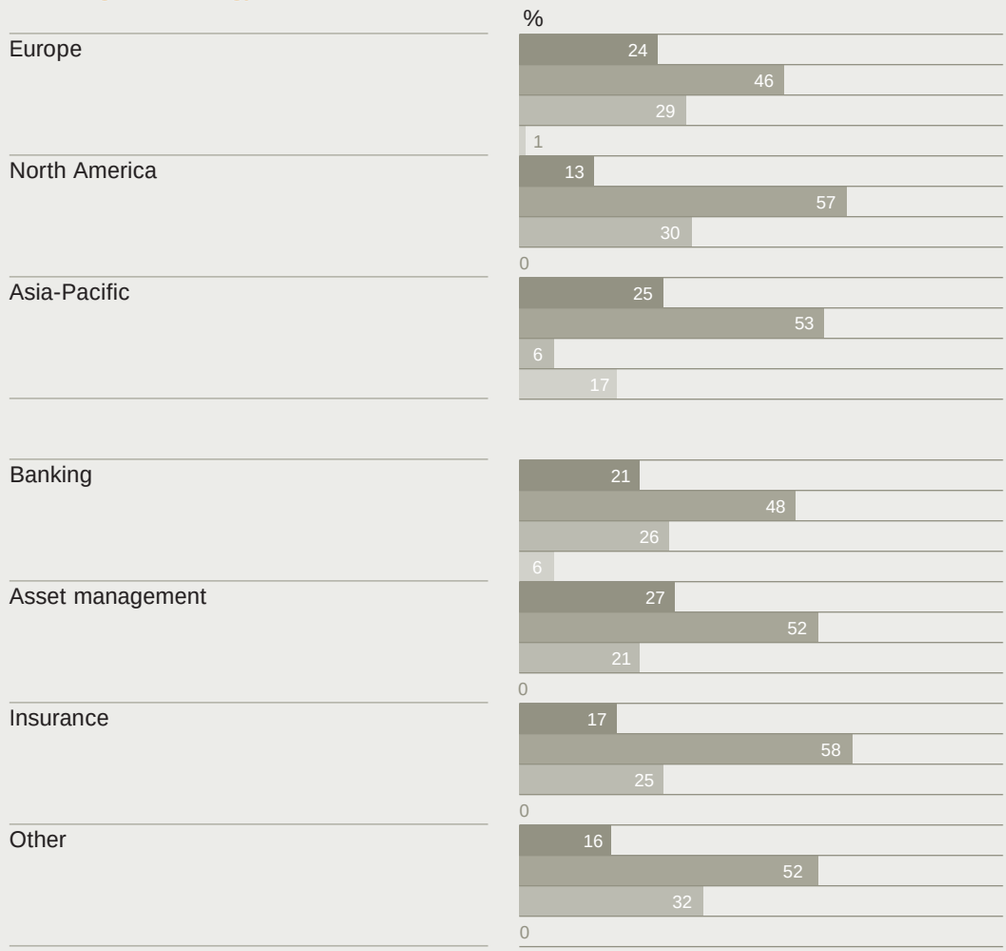

Outsourced

Partly outsourced

Internally controlled

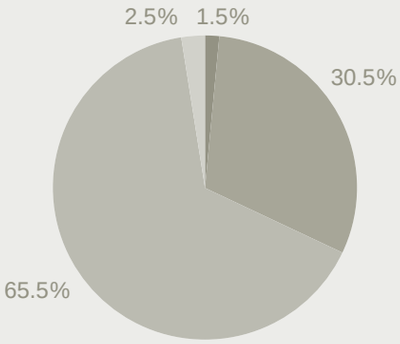
Don't know

Providing eTechnology

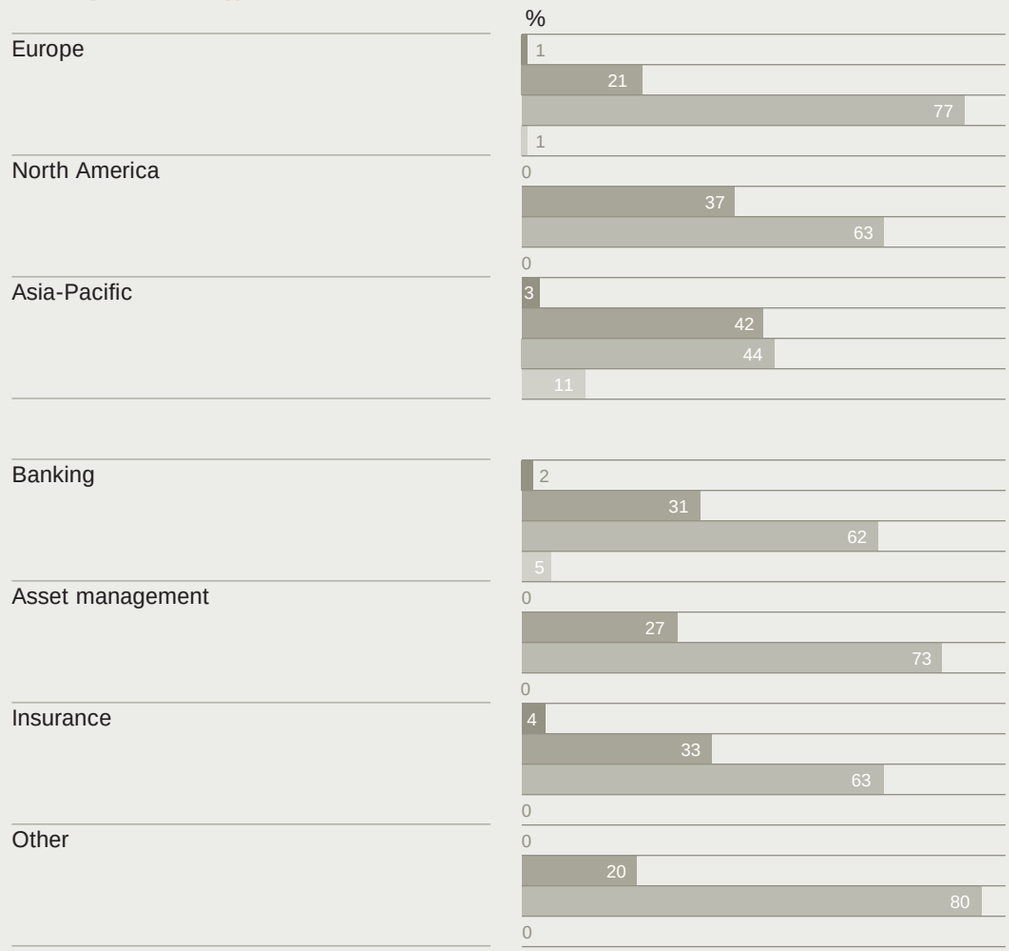


## Forming an eStrategy

Total sample

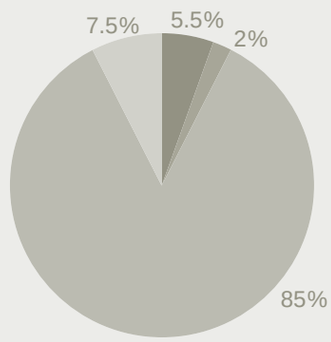



- Outsourced
- Partly outsourced
- Internally controlled
- Don't know

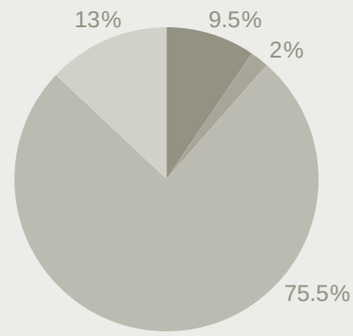


# Perception of change in eBusiness generated revenues over the next two years

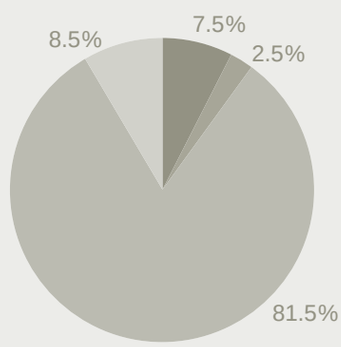
Retail



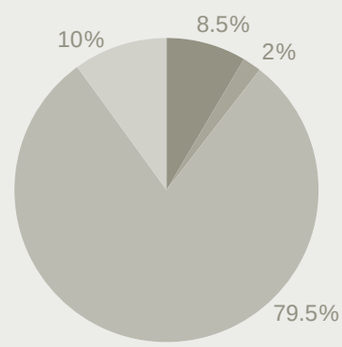

Insurance




Wholesale




Asset management




- No change
- Decrease
- Increase
- Don’t know

## Perception of change in eBusiness generated revenues over the next two years – retail

| % | % |
|---|---|
| 200+ | 14 |
| 100 to 199 | 7 |
| 50 to 99 | 9 |
| 30 to 49 | 10 |
| 21 to 29 | 19 |
| 10 to 19 | 14 |
| 1 to 9 | 11 |
| Don't know | 15 |

| | % |
|---|---|
| Overall mean | 88 |
| | |
| Europe | 103 |
| North America | 94 |
| Asia-Pacific | 50 |
| | |
| Banking | 69 |
| Asset management | 158 |
| Insurance | 80 |
| Other | 78 |

## Perception of change in eBusiness generated revenues over the next two years – wholesale

| % | % |
|---|---|
| 200+ | 9 |
| 100 to 199 | 6 |
| 50 to 99 | 16 |
| 30 to 49 | 12 |
| 21 to 29 | 14 |
| 10 to 19 | 17 |
| 1 to 9 | 10 |
| Don't know | 17 |

| | % |
|---|---|
| Overall mean | 62 |
| | |
| Europe | 44 |
| North America | 96 |
| Asia-Pacific | 39 |
| | |
| Banking | 58 |
| Asset management | 69 |
| Insurance | 82 |
| Other | 51 |

# Will increase/decrease in overall revenues cause channel conflict and/or cannibalization

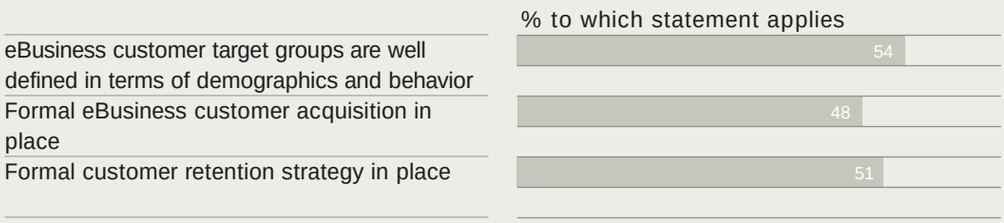
54% of sample agreed that channel conflict and/or cannibalization would occur

| In what way would cannibalization occur? | % |
|---|---|
| Decline of traditional outlets | 35 |
| Intermediaries affected | 19 |
| Direct marketing – increase | 13 |
| Internet use – increase | 12 |
| Increased price competitiveness | 12 |
| All channels affected | 11 |
| Inter-industry conflict | 8 |
| Changed marketing strategy | 7 |
| Increased labour force mobility | 6 |
| Affect retail banking operations | 5 |
| Other | 11 |
| Don't know | 10 |

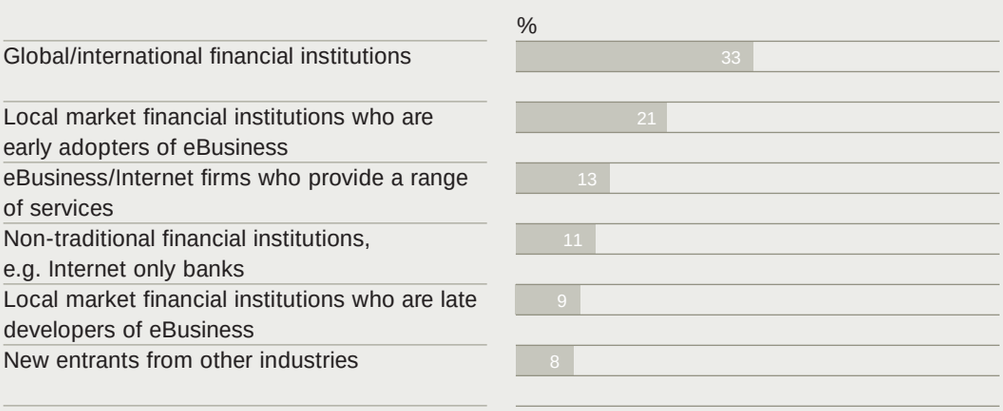
# Most appropriate Internet distribution strategy

| | % |
|---|---|
| Offering your own products with hyperlinks to other companies' products | 42 |
| Offering own products only | 34 |
| Integrating your offerings into the on-line services provided by others | 13 |
| Bundling other companies' products only | 7 |
| Don't know | 5 |

# Marketing approach to eStrategy




# Champions in five years



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